FINANCIAL
STABILITY
BOARD

Consultative Document

Effective Resolution of Systemically Important Financial Institutions

Recommendations and Timelines

19 July 2011

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Effective Resolution of Systemically Important Financial Institutions

The Financial Stability Board (FSB) is seeking comments on its Consultative Document on Effective Resolution of Systemically Important Financial Institutions. This Consultative Document contains a comprehensive package of proposed policy measures to improve the capacity of authorities to resolve systemically important financial institutions (SIFIs) without systemic disruption and without exposing the taxpayer to the risk of loss, and a time line for their implementation. The Consultative Document consists of a cover note and eight closely interrelated annexes. Annexes 1-6 comprise proposed recommendations as set out below, while Annexes 7-8 comprise discussion notes reflecting preliminary FSB views:

Resolution powers and tools

1. **Key Attributes of Effective Resolution Regimes.** This sets out the powers and tools that all jurisdictions' regimes for resolution of financial institutions should have to be effective, including for resolution of cross-border SIFIs.
2. **Bail-in within Resolution.** This sets out proposed essential elements of a bail-in regime to enable creditor-financed recapitalisation of financial institutions.

Cross-border arrangements

3. **Institution-specific Cross-border Cooperation Agreements.** This sets out proposed minimum common elements of institution-specific cooperation agreements amongst relevant resolution authorities to facilitate resolution of a cross-border firm.

Planning for resolution

4. **Resolvability Assessments.** This sets out a proposed framework to be used for assessing the resolvability of a SIFI, taking into account the structure of the firm and the resolution regimes of the jurisdictions within which it operates, and which will inform Recovery and Resolution Plans.
5. **Recovery and Resolution Plans (RRPs).** This sets out a proposed framework and contents of RRPs, which will be mandatory for global SIFIs (G-SIFIs).

Removing obstacles to resolvability

6. **Measures to Improve Resolvability.** This seeks comment on actions to remove obstacles to resolution arising from complex firm structures and business practices, in particular obstacles that arise from fragmented information systems, intra-group transactions, reliance on service providers and global payment operations.

Discussion notes

To help inform its final recommendations, the FSB is also seeking comment on the two following notes for discussion. These two notes reflect the preliminary views of the FSB and are being published as part of the Consultative Document to facilitate public discussion of the issues:

7. **Creditor hierarchy, depositor preference and depositor protection in resolution.** This sets out the policy issues surrounding whether or not greater convergence across jurisdictions in the ranking of creditors' claims, in particular in the treatment of deposit claims, is desirable.

8. **Conditions for imposing temporary stays**. This note discusses the possible conditions under which a temporary suspension of contractual early termination rights should apply to support implementation of certain resolution tools.

The FSB invites comment on all above documents and the questions raised in the Consultative Document by Friday, 2 September 2011. Responses should be sent to the following e-mail address: fsb@bis.org. Responses will be published on the FSB's website unless respondents expressly request otherwise.

The FSB will revise the documents, including taking into account comments received, and will submit them, as part of its overall recommendations to address moral hazard posed by SIFIs, to the G20 Leaders Summit in Cannes on 3-4 November 2011.

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Overview

The disorderly collapse of Lehman Brothers in September 2008 provided a sharp and painful lesson of the costs to the financial system and the global economy of the absence of powers and tools for dealing with the failure of a SIFI. Lehman Brothers was the last SIFI allowed to fail during the last financial crisis. All other SIFIs at risk were supported by public capital injections, asset or liability guarantees, or exceptional liquidity measures undertaken by central banks. While this was necessary for economic and financial stability reasons, public bail-outs placed taxpayer funds at unacceptable risks and has increased moral hazard in a very significant way. A recent stock-take undertaken by the Basel Committee on Banking Supervision (BCBS) of progress in implementing its Recommendations on Cross-border Bank Resolution of March 2010 [1] shows that while some jurisdictions have enacted or are considering legislative changes, many jurisdictions continue to lack important resolution tools. The report underlines the need to accelerate reforms of domestic resolution regimes and tools and of frameworks for cross-border enforcement of resolution actions.

At their Summits in Pittsburgh, Toronto and Seoul, the G20 Leaders asked the FSB to set out more effective arrangements for resolution of SIFIs. The Annexes to this document set out the proposed policy recommendations, which are described in the following pages. They comprise four key building blocks:

- **Strengthened national resolution regimes** that give a designated resolution authority a broad range of powers and tools to resolve a financial institution that is no longer viable and there is no reasonable prospect of it becoming so.
- **Cross-border cooperation arrangements** in the form of bilateral or multilateral institution-specific cooperation agreements, underpinned by national law, that will enable resolution authorities to act collectively to resolve cross-border firms in a more orderly, less costly way.
- **Improved resolution planning by firms and authorities** based on *ex ante* resolvability assessments that should inform the preparation of RRPs and that may, if necessary, require changes to individual firm structures and business practices to make them more effectively resolvable.
- **Measures to remove obstacles to resolution** arising from fragmented information systems, intra-group transactions, reliance on service providers and the provision of global payment services.

Legislation or regulatory changes will be required in many jurisdictions to implement these recommended measures. Moreover, ensuring that financial institutions are resolvable under the current resolution regimes will require a reorientation of the supervision of SIFIs.

The FSB is also publishing two discussion notes for public comment on the pros and cons of greater convergence in creditors' hierarchy, depositor preference and depositor protection in

1 Basel Committee on Banking Supervision, *Resolution policies and frameworks – progress so far*, July 2011, available at http://www.bis.org/publ/bcbs200.htm.

resolution and on the possible introduction of a brief stay on contractual early termination rights upon entry into resolution to support the implementation of resolution measures.

The measures to improve resolution regimes and tools set out in this consultative document represent a "bookend" to the FSB's policy framework[2] for addressing the systemic and moral hazard risks associated with SIFIs that are "too-big, too-complex and too-interconnected-to-fail". The other "bookend" of the FSB's policy framework is a requirement that global SIFIs (G-SIFIs) hold additional loss absorption capacity, as set out for banks in a separate consultative document from the BCBS released today. The framework also comprises requirements for more intensive and effective supervisory oversight of SIFIs, as set out in the FSB's November 2010 report[3], and improvements to financial market infrastructures (FMIs) both to strengthen their robustness and reduce counterparty exposures, so as to reduce systemic contagion from a SIFI failure[4].

Many countries entered this crisis without a proper resolution regime, and no country had a regime that could cope with failing SIFIs. Where effective resolution tools existed, these did not address the cross border dimension or obstacles stemming from within firms themselves. This meant that proper market discipline was not in place in the years preceding the crisis and made the handling of the crisis more difficult. The G20 called on the FSB to propose actions to address these challenges. These proposed policy recommendation are offered for public consultation ahead of finalising the recommendations for the G20 Leaders in November. Their effective implementation would entail changes in laws and regulation, supervisory practice and cross-border cooperation as well as within firms.

I. Proposed policy recommendations

Effective resolution regimes

A national resolution regime should provide the authorities with the tools to intervene safely and quickly to ensure the continued performance of the firm's systemically important functions. It should ensure prompt payout or transfer of insured deposits and prompt access to transactions accounts as well as to segregated client funds, wherever they are located. It should enable the transfer or sale of viable portions of the firm while apportioning losses, including to unsecured and uninsured creditors, in a manner that is fair and predictable and so avoids panic or destabilisation of financial markets.

Need for a special national resolution regime for financial institutions

Corporate liquidation procedures are not well suited to deal with the failure of major banks and other financial institutions. Such procedures freeze an institution's balance sheet,

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2 *Reducing the moral hazard posed by systemically important financial institutions*, 20 October 2010, available at http://www.financialstabilityboard.org/publications/r_101111a.pdf.

3 *Intensity and effectiveness of SIFI supervision*, 2 November 2010, available at http://www.financialstabilityboard.org/publications/r_101101.pdf.

4 The Committee on Payment and Settlement Systems and the International Organization of Securities Commissions published in March 2011 a consultative report on *Principles for financial market infrastructures*, containing new and more demanding international standards for payment, clearing and settlement systems.

typically in multiple jurisdictions, preventing access to the funds needed to manage its positions and to the assets and funds to which counterparties have claims. This rapidly destroys the value of the SIFI's balance sheet assets, including from fire sales, the tying up of liquidity and multiple, prolonged legal proceedings. A resolution regime is therefore needed that is better tailored to the problems posed by the balance sheets and activities of major financial institutions than are corporate liquidation procedures.

An effective national resolution regime should provide a broad range of options to resolve a financial institution that is no longer viable. It needs a designated administrative authority with a statutory mandate to promote financial stability in the exercise of its resolution powers. This resolution authority should have the expertise, resources, capacity and operational independence consistent with their statutory responsibilities to exercise those powers, including for large and complex institutions such as SIFIs. And just as is the case for supervisors, the law should provide for legal protection against lawsuits for actions or omission made while discharging their duties in good faith.[5]

It should be able to act with the necessary speed. In those jurisdictions where a court order is required, it should consider any possible delay in its resolution planning process. If more than one authority has responsibilities in the domestic resolution process, their respective powers and cooperation mechanism should be clear, and a lead authority should be identified to coordinate the resolution process of a group with multiple entities in the jurisdiction.

Statutory financial stability objectives

A resolution authority should have the powers and tools to meet the following key objectives:

- to preserve those of the SIFI's operations that provide vital services to the financial system and the wider economy, which would cause system-wide damage if lost;
- to avoid unnecessary loss in value of financial assets and contagion (direct and indirect) to other parts of the financial system; and
- to ensure that losses are borne by those with whom the risks properly reside – first shareholders, and unsecured and uninsured creditors - rather than taxpayers.

A resolution regime needs to credibly be able to achieve these objectives if financial stability is to be protected and market discipline and incentives are to operate effectively. Any resolution involves the distribution of losses but these losses are generally much smaller under orderly resolution than under disorderly liquidation.

Resolution tools

Resolution tools to preserve the viability of a firm's systemically important functions basically fall into three types:

- sale of the entire firm (or at least of all its viable activities) as an ongoing business to a new owner;
- separation and eventual sale of functions that are systemically important or have franchise value as a separate operation while the residual parts of the firm are wound

[5] Basel Core Principle 1 (5).

down (or alternatively carving out and transferring the bad assets to a separate asset management vehicle);

- recapitalisation of the firm by restructuring its liabilities.

Resolving a firm in a sustainable way is likely to take time, particularly given the complexities of the businesses of SIFIs. An interim solution, such as a 'bridge bank' (or a 'bridge company' more generally for non-banks)[6], may therefore be needed to maintain systemically important operations, including the funding for them, while a more permanent resolution is being sought. Meanwhile, the bad assets in the financial institution's balance sheet will need to be run down, while avoiding a destructive fire sale.

Any mechanism for addressing a firm's assets and the associated allocation of losses while it is resolved will need to:

- allow authorities to take control of the firm within resolution, replacing management and directors if necessary;
- facilitate the continuity of essential financial functions by allowing for their transfer of the underlying financial contracts that support them to a sound third party or a bridge company;
- give the resolution authority all powers necessary to operate and resolve the firm, including powers to terminate contracts, continue or assign contracts, purchase or sell assets, and take other actions necessary to restructure or wind down the firm's operations; and
- respect the hierarchy of claims that would apply in a liquidation, and ensure that no creditors are worse off than they would be in liquidation, so as to preserve creditors' legal rights.

Legal capacity to enable cross-border coordination of resolution

Cross-border resolution is impeded by major differences in national resolution regimes, absence of mutual recognition to give effect to resolution measures across borders, and lack of planning for handling stress and resolution. The complexity and integrated nature of many firms' group structures and operations, with multiple legal entities spanning national borders and business lines, make rapid and orderly resolutions of these institutions under current regimes virtually impossible. Legislative changes are likely to be needed in many jurisdictions to ensure that resolution authorities have resolution powers with regard to all financial institutions operating in their jurisdictions, including the local branch operations of foreign institutions. Cross-border cooperation and effective pre-planning of resolution will be difficult if not impossible if the authority over failed institutions, including foreign bank branches, resides with the courts. As part of its statutory objectives, the resolution authority should duly consider the potential impact of its resolution actions on financial stability in other jurisdictions. It should have the legal capacity to cooperate and coordinate effectively with foreign resolution authorities, to exchange information in normal times and in crisis, and to draw up and implement RRPs and cooperation agreements on an institution-specific basis.

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6 'Bridge bank' or 'bridge company" is a term used for a temporary institution that is established to take over and continue certain critical and viable operations of a failed firm during the resolution process.

An international standard for effective resolution regimes

The ***Key Attributes of Effective Resolution Regimes*** are intended to address these failings. They set out the features that all resolution regimes should have in order adequately to mitigate the disruption from the failure of a financial institution and reduce moral hazard. These include the features necessary for cross-border cooperation and the requirements to improve authorities' and firms' readiness for resolution.

In the FSB's view, in order to raise the effectiveness of resolution around the world in a consistent way, the ***Key Attributes*** should form an international standard. This will entail that jurisdictions' implementation of the ***Key Attributes*** standard will be subject to assessments under the IMF/WB Financial Sector Assessment Program. Any further sector-specific operational guidance by individual standard-setting bodies should be consistent with this overall framework.

Scope of application

The objectives set out in the Preamble of the ***Key Attributes***, as well as many of the attributes themselves, apply to financial institutions of all sizes that could be systemically significant or critical in particular circumstances; any ailing financial institution that can cause contagion and disruptive effects on financial markets therefore should be subject to the type of resolution regime set out here. Yet, the crisis response needs to be tailored to the specific nature of the firm's activities and to sectoral differences. It is important that resolution regimes provide a wide range of tools and the flexibility to apply them on a case-by-case basis to achieve an effective resolution. Not all resolution powers set out in the ***Key Attributes*** are suitable for all sectors and all circumstances. For example, to the extent that insurers conduct activities which are bank-like, the application of banking sector resolution tools to such activities rather than to the insurer as a whole or to its core traditional insurance business may be appropriate. The FSB will be working with the CPSS, IAIS, and IOSCO to develop sector-specific guidance for the application of its framework to non-bank SIFIs, including insurance companies, financial infrastructures and other financial institutions.

Questions for public consultation

1. *Comment is invited on whether* **Annex 1: Key Attributes of Effective Resolution Regimes** *appropriately covers the attributes that all jurisdictions' resolution regimes and the tools available under those regimes should have.*
2. *Is the overarching framework provided by* **Annex 1: Key Attributes of Effective Resolution** *specific enough, yet flexible enough to cover the differing circumstances of different types of jurisdictions and financial institutions?*

Bail-in powers

The paper on ***Bail-in within Resolution*** sets out the essential elements of statutory powers within a special resolution procedure and possible contractual provisions to achieve a creditor-financed recapitalisation of systemically vital functions of an ailing financial institution. Such powers enable the resolution authority to write-down or convert into equity unsecured and uninsured claims, with a view to maintaining continuity of systemically vital functions, by either recapitalising the entity providing these functions, or, alternatively, capitalising a newly established entity or bridge institution to which these vital functions have been transferred following closure of the residual firm. Resolution authorities should have bail-in powers within resolution to implement at least one of the above mechanisms.

The existence of statutory bail-in within resolution tools does not prevent firms from issuing instruments that write-off or convert contractually, nor do they prevent national authorities from requiring them. It may create incentives for firm to issue such contractual instruments which might reinforce the capacity of firms to recover from distress without going into resolution. Where, at the point of entry into resolution, an institution has contractual instruments with write-off or conversion features outstanding, a contractual instrument that had not been previously written-off or converted will be written-off or converted according to the contractual terms and conditions of the instrument upon entry into resolution but before the application of bail-in within resolution or other powers by the resolution authority. A contractual instrument that, prior to entry into resolution, has already been written-off or converted upon activation of a contractual trigger would be subject to a subsequent application of bail-in powers upon entry into resolution.

The objective of bail-in is to reduce the loss of value and the economic disruption associated with insolvency proceedings for financial institutions, yet ensure that the costs of resolution are borne by the financial institutions' shareholders and unsecured creditors.

The FSB proposes that authorities put in place statutory bail-in powers within their resolution regimes as a complement to other resolution tools. Bail-in powers could be activated alone but most likely would be used in combination with other resolution tools. The capacity to bail-in creditors would enhance resolution options and foster market discipline by countering the expectation that public funds will be used to support failing financial institutions. Resolution authorities should have the statutory power, but not the obligation, to apply a bail-in within resolution.

The legislation giving the resolution authority statutory bail-in powers should provide clarity and certainty as regards the authority triggering entry into resolution; the process and the threshold conditions under which bail-in, and other resolution tools, could be used; the relevant consequences for capital providers and creditors; and the scope of liabilities covered by the bail-in powers. It is desirable that divergence is limited across countries.

In acting quickly and seeking to ensure sufficient resources for either restoration to viability, or orderly resolution, authorities may impose haircuts or write-downs that turn out to be greater than needed. To address these situations, authorities therefore should have in place mechanisms for compensating the holders of bailed-in claims, or written-off equity when the amount of actual losses is finally determined, e.g., by the issuance of warrants.

As a general principle, bail-in within resolution should be initiated by the home authority with respect to debt issued by the parent firm in resolution (and/or subsidiaries in resolution in the jurisdiction of the parent). Where subsidiaries issue bail-in instruments, host authorities should be able to exercise bail-in at the subsidiary level. Recognizing that the exercise of bail-in powers could result in a change of the ownership structure, host authorities should consult with the home authorities and, to the extent possible, in the CMG, and satisfy themselves that the subsidiary is not viable, that support from the group is not available and that no alternative group-wide solution would achieve a more favourable outcome from a domestic and cross-border financial stability perspective.

Authorities should regularly monitor whether firms' balance sheets contain a sufficient quantum of liabilities covered by bail-in powers within resolution to facilitate orderly resolution.

Questions for public consultation

3. *Are the elements identified in* ***Annex 2: Bail-in within Resolution: Elements for inclusion in the Key Attributes*** *sufficiently specific to ensure that a bail-in regime is comprehensive, transparent and effective, while sufficiently general to be adaptable to the specific needs and legal frameworks of different jurisdictions?*
4. *Is it desirable that the scope of liabilities covered by statutory bail-in powers is as broad as possible, and that this scope is largely similarly defined across countries?*
5. *What classes of debt or liabilities should be within the scope of statutory bail-in powers?*
6. *What classes of debt or liabilities should be outside the scope of statutory bail-in powers?*
7. *Will it be necessary that authorities monitor whether firms' balance sheet contain at all times a sufficient amount of liabilities covered by bail-in powers and that, if that is not the case, they consider requiring minimum level of bail-in debt ? If so, how should the minimum amount be calibrated and what form should such a requirement take, e.g.,:*

   (i) a certain percentage of risk-weighted assets in bail-inable liabilities, or

   (ii) a limit on the degree of asset encumbrance (e.g., through use as collateral)?
8. *What consequences for banks' funding and credit supply to the economy would you expect from the introduction of any such required minimum amount of bail-inable liabilities?*

Cross-border cooperation

The recent crisis was made considerably worse by obstacles to the ability of home and host authorities to cooperate in the resolution of SIFIs. Some of these obstacles are legal barriers, and a legally binding international treaty would be a comprehensive means of addressing this for the global good. Although an internationally agreed model law exists that addresses cross-border cooperation in corporate insolvencies [7], there is no immediate prospect of an equivalently formal multilateral agreement addressing the set of issues raised in the resolution of financial institutions. In its absence, bilateral or multilateral cooperation agreements are

7 The United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency, available at http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model.html.

needed, setting out how those jurisdictions most affected will cooperate over the resolution of individual firms, both in the planning phase and during a crisis itself.

Lack of adequate tools for cross-border resolution

Resolution regimes and tools need to be able to cope with the international reach of SIFIs' operations, and of their assets and liabilities, and to set out how resolution authorities in home and host jurisdictions interact with each other. Resolution measures in a home jurisdiction, such as for instance the transfer of assets or liabilities to a bridge bank, will not have automatic effect in host jurisdictions unless there is an internationally binding arrangement to this effect. Although there are some existing legal mechanisms under which foreign jurisdictions might give effect to transfers to a bridge bank or to a private sector purchaser, most of these involve court proceedings that may not be sufficiently predictable or timely to contribute to effective resolution. They often rely on doctrines applicable to insolvencies generally, do not adequately take into account considerations of financial stability, and may not provide authorities with the necessary powers to implement the transfer unless the consent of the relevant counterparties is obtained.

The cross-border effectiveness of resolution measures would be improved if both home and host authorities had the requisite powers and regimes, applying not only to domestically-incorporated banks but to domestic branches of foreign banks, and to assets, liabilities and contracts of foreign banks located within a jurisdiction. These should empower authorities to cooperate in the application of a range of special resolution tools to local operations, including the power to transfer assets, liabilities and contracts of the bank to a foreign bridge bank or private sector purchaser without the consent of the counterparties.

Statutory mandates to foster cross-border cooperation

Cooperation and trust among resolution authorities should be built up. The mandates of resolution authorities should be framed so that they have to duly consider the potential impact of their resolution actions on financial stability in other jurisdictions. In applying resolution powers to individual components of a financial group, the resolution authority should have to take into account the overall impact on the group as a whole and the impact on financial stability in other jurisdictions concerned and undertake best efforts to avoid taking actions that could reasonably be expected to trigger instability elsewhere in the group or in the financial system.

There should be a strong encouragement of cross-border cooperation supported by robust abilities to cooperate. However, the statutory framework for cross-border cooperation would not be so prescriptive as to deprive jurisdictions of the flexibility to act when necessary to achieve domestic stability in the absence of effective cross-border cooperation and information sharing,[8] or in the event of inaction or inappropriate action by the home authority.

Provisions that hamper fair cross-border resolution need to be removed. More specifically, jurisdictions should ensure that no legal, regulatory or policy impediments exist that hinder the appropriate exchange of information, including firm-specific information, between

8 This should not apply where jurisdictions are subject to a binding obligation to respect resolution of financial institutions under the authority of the home jurisdiction (e.g., the EU Winding up and Reorganisation Directives).

supervisory authorities, central banks, resolution authorities, finance ministries and the public authorities responsible for insurance guarantee schemes.

The sharing of all information relevant for recovery and resolution planning and in resolution should be possible in normal times and in crisis at a domestic and a cross-border level. The modalities for the sharing of information relating to a G-SIFI should be set out in institution-specific cooperation agreements. They should, in particular, provide for holding at least annual meetings including top officials of the home and relevant host authorities to ensure that they are effectively involved in and informed of status of the work on recovery and resolution plans and that they provide the needed leadership to the process. Where appropriate and necessary to respect the sensitive nature of information, information sharing may be restricted, but should be possible among the top officials of the relevant home and host authorities.

National laws and regulations should not discriminate against creditors based on nationality or location of their claim, or the jurisdiction where it is payable. Where any such provisions exist, they should be transparent and properly disclosed.

Institution-specific cooperation agreements

Home and host authorities need to consult and cooperate on actions that may affect each other's jurisdiction. A policy framework for cross-border cooperation between resolution authorities is needed to enable advance planning and to avoid dealing with cross-border issues through the courts. In the near term, it may be easiest and most flexible for authorities to reach cross-border cooperation agreements on resolution on an institution-specific basis. The FSB report on *Reducing the moral hazard posed by systemically important financial institutions* endorsed by the G20 in November 2010 (SIFI Recommendations) called for institution-specific cooperation agreements for all G-SIFIs.

The document on ***Essential elements of institution-specific cooperation agreements*** proposes essential elements that such agreements between home and host authorities should have, covering both crisis planning and actions during resolution, with an emphasis on the latter. Cooperation agreements should build upon the principles the Financial Stability Forum set out in April 2009.[9] The agreements should cover institution-specific crisis management planning and cooperation amongst relevant authorities in the event of the institution's resolution. The agreements should contain provisions that authorities wished had been in place to facilitate cooperation with respect to failing firms during the most recent crisis. They should provide an appropriate level of detail with regard to the cooperation procedures in place both in the "pre-crisis" (i.e. recovery and resolution planning) phase as well as "in crisis". To do so they will need to be firm-specific and also lay out how national legal regimes interact. They should also set out the framework under which the home and key host authorities cooperate in the elaboration of RRPs and the conduct of resolvability assessments.

Firm-specific agreements are needed among all members of a firm's Crisis Management Group (CMG), which should include the home and all key host jurisdictions. Bi-national agreements between authorities of the home and a host jurisdiction, and firm-specific

9 FSF Principles for Cross-Border Cooperation on Crisis Management, 2 April 2009, available at http://www.financialstabilityboard.org/publications/r_0904c.pdf

multinational agreements among authorities of the home and all key host jurisdictions may complement each other.

Questions for public consultation

9. *How should a statutory duty to cooperate with home and host authorities be framed? What criteria should be relevant to the duty to cooperate?*
10. *Does **Annex 3: Institution-specific Cross-border Cooperation Agreements** cover all the critical elements of institution-specific cross-border agreements and, if implemented, will the proposed agreements be sufficiently reliable to ensure effective cross-border cooperation? How can their effectiveness be enhanced?*
11. *Who (i.e., which authorities) will need to be parties to these agreements for them to be most effective?*

Resolvability assessments

At present, few if any SIFIs could be effectively resolved in an orderly and speedy fashion, given the existing powers available to authorities, the lack of legal capacity for national authorities to cooperate, and the complex structures and activities of the firms. To identify the changes needed to regimes, legal powers and individual firms, resolvability assessments need to be made at the level of each individual SIFI. ***Annex 4: Resolvability Assessments*** proposes in detail the process and elements of such an assessment. Authorities need to make a candid assessment of the current resolvability of SIFIs, and the obstacles that exist, in order to determine what changes authorities and firms need to make. A separate assessment is needed for each individual SIFI, as firms differ greatly in their corporate structure and mix of activities, and each presents its own technical complexities to be addressed in the event of crisis.

Annex 4 also defines a framework for assessing the feasibility of existing resolution tools and regimes and the credibility of resolution strategies in the light of the systemic impact of their application to a SIFI. These assessments will help focus authorities and firms on the implications of the current status quo, and the steps that need to be taken, by firms, by national regimes and globally, to reduce the current systemic threat from the lack of adequate resolution procedures.

Questions for public consultation

12. *Does* ***Annex 4*****:** ***Resolvability*** **Assessments** *appropriately cover the determinants of a firm's resolvability? Are there any additional factors to be considered in determining the resolvability of a firm?*
13. *Does **Annex 4** identify the appropriate process to be followed by home and host authorities?*

Recovery and resolution plans

During the recent crisis, efforts to cope with the failure of Lehman Brothers were greatly complicated by a lack of preparation. Basic information was missing about organisational structures and relationships between subsidiaries. This made it difficult to act quickly, to anticipate the effects of different actions in different jurisdictions, and to resolve conflicts between subsidiaries and jurisdictions. Much economic value was lost as a result. When a firm falls into distress, the authorities and the firm need detailed contingency plans to implement rapid, well-planned measures to ensure that the firm can continue to perform critical functions, or wind them down if necessary, without spillovers that damage the wider system. An adequate, credible RRP should be required for any firm which is assessed by its home authority to have a potential impact on financial stability, in the event of liquidation of that firm. The SIFI Recommendations call for RRPs to be put in place for all G-SIFIs.

Authorities and SIFIs are currently working together to create RRPs for each firm. RRPs should set out in advance the measures, in the event of a crisis, that a firm could take to recover as a going concern or else that the authorities could take to resolve it in an orderly way. RRPs and resolvability assessment complement each other: RRPs should use as a base the conclusions of the resolvability assessments discussed above; indeed, an important benefit of the process of developing a plan is to identify actions that firms need to take to make themselves resolvable.

RRPs of G-SIFIs will be reviewed, subject to adequate confidentiality agreements, within the institution's CMG at least annually. To ensure the involvement of the key decision makers and keep them informed, the adequacy of RRPs of G-SIFIs should also be the subject of a formal review, at least on annual basis, by top officials of home and relevant host supervisory and resolution authorities, where appropriate, with the firm's CEO.

Questions for public consultation

14. *Does* ***Annex 5: Recovery and Resolution Plans*** *cover all critical elements of a recovery and resolution plan? What additional elements should be included? Are there elements that should not be included?*
15. *Does* ***Annex 5*** *appropriately cover the conditions under which RRPs should be prepared at subsidiary level?*

Improving resolvability

Complex organisational structures and business models, with economic functions and business lines spanning multiple legal entities with a web of intra-group exposures, make resolution more difficult. The FSB has focused in detail on some particular areas arising from the complexities of SIFIs' operations that can create practical obstacles to resolution:

- the need for *information systems* that can provide rapid, comprehensive data on the position of each of the firm's legal entities when a crisis hits;

- *the reliance on service providers*, which may help firms capitalise on economies of scale and increase efficiency in normal times, but may pose obstacles to effective resolution and threaten the continued performance of *systemically important operations*;
- *intra-group transactions*, which may be a source of strength for a firm in normal times but can impede actions to deal separately with individual business units of a group during a crisis; and
- challenges in recovery and resolution of the essential services that a firm's *global payment operations* provide to customers.

Proposals to help address these issues, including for the powers of supervisory and resolution authorities to require firms to reduce unnecessary organisational complexities and intra-group exposures, are included in ***Annex 6: Measures to improve resolvability.***

Questions for public consultation

16. *Are there other major potential business obstacles to effective resolution that need to be addressed that are not covered in **Annex 6**?*
17. *Are the proposed steps to address the obstacles to effective resolution appropriate? What other alternative actions could be taken?*
18. *What are the alternatives to existing guarantee / internal risk-transfer structures?*
19. *How should the proposals set out in **Annex 6**in these areas best be incorporated within the overall policy framework? What would be required to put those in place?*

Timelines for implementation of G-SIFI related recommendations

The gap between the arrangements necessary for effective resolution of firms and the arrangements that are currently in place is wide. The proposals in this paper need much detailed follow-up work, including on planning for individual firms and on bilateral and multilateral cooperation between authorities. Authorities need to be accountable to each other and to the public for taking the steps needed to achieve the objectives of the proposals.

The SIFI Recommendations call for RRPs and firm-specific cooperation agreements to be put in place for all G-SIFIs. In this respect, the time line and key milestones that authorities should work towards in their immediate tasks of developing RRPs and conducting resolvability assessments for G-SIFIs; and enhancing cross-border cooperation among home and key host authorities of G-SIFIs are set out below.

Cross-border Cooperation Agreements

- Before the end of 2011, home authorities of G-SIFIs should have begun engaging with key host authorities as regards institution-specific cooperation agreements.
- By June 2012, the modalities for information sharing within the CMGs and the first drafts of the cooperation agreements should be completed.

- By December 2012, home authorities of G-SIFIs should have entered into cooperation agreements with the key host authorities.

Recovery and Resolution Plans

- By December 2011, the first drafts of the recovery plans should be completed.
- By June 2012, the first drafts of the resolution plans should be completed.
- By December 2012, both the recovery plans and the resolution plans should be completed.

Resolvability Assessments

- By June 2012, home authorities of G-SIFIs should have entered into discussions with firms and members of their respective CMGs as regards the preliminary assessment of the firms' resolvability.
- By December 2012, the first resolvability assessments should be completed.

CMG Outreach

- By June 2012, CMGs should have identified the jurisdictions where the respective firms have a systemically important presence, but are not represented in the CMGs.
- By December 2012, the modalities for cooperation and information sharing between the home authorities and the host authorities of jurisdictions not represented in the CMG where the G-SIFIs have a systemically important presence, should be established.

Questions for public consultation

20. Comment is invited on the proposed milestones for G-SIFIs.

II. Discussion notes

The FSB is exploring the policy issues surrounding two specific additional measures to strengthen effective resolution. In particular, the FSB is assessing the pros and cons of greater convergence in creditors' hierarchy, depositor preference and depositor protection in resolution and of the possible introduction of a brief stay on contractual early termination rights upon entry into resolution in order to facilitate the implementation of resolution measures.

1. Discussion note on creditor hierarchy, depositor preference and depositor protection in resolution (Annex 7)

An important feature of effective resolution regimes is to "*make it possible for shareholders and unsecured and uninsured creditors to absorb losses in their order of seniority.*" [10] This should be achieved in an equitable manner and in a manner that keeps the risk of contagion to a minimum and obviates the need for bail-outs. Clarity and predictability as regards the order of seniority or statutory ranking of claims in insolvency is a necessary prerequisite for effective resolution. It determines the allocation of losses. It shapes the incentives of market participants and pricing of risk. It affects the ease with which certain resolution measures can be applied. Differences in ranking can complicate cross-border resolutions.

Effective protection of local depositors and assurance of financial stability will be crucial considerations in the determination by the host authorities of whether to cooperate. The FSB is seeking public comment on the issue of whether or not existing differences in statutory credit ranking represent an impediment to effective cross-border resolution and greater convergence in particular in, the treatment of deposit claims, could be pursued further at the international level.

Questions for public consultation

21. *Does the existence of differences in statutory creditor rankings impede effective cross-border resolutions? If so, which differences, in particular, impede effective cross-border resolutions?*
22. *Is a greater convergence of the statutory ranking of creditors across jurisdictions desirable and feasible? Should convergence be in the direction of depositor preference or should it be in the direction of an elimination of preferences? Is a harmonised definition of deposits and insured deposits desirable and feasible?*
23. *Is there a risk of arbitrage in giving a preference to all depositors or should a possible preference be restricted to certain categories of depositors, e.g., retail deposits? What should be the treatment of (a) deposits from large corporates; (b) deposits from other financial firms, including banks, assets managers and hedge banks, insurers and pension funds; (c) the (subrogated) claims of the deposit guarantee schemes*

10 See recommendation 12 of the SIFI recommendations.

(especially in jurisdictions where these schemes are financed by the banking industry)?

24. *What are the costs and benefits that emerge from the depositor preference? Do the benefits outweigh the costs? Or are risks and costs greater?*
25. *What other measures could be contemplated to mitigate the impediments to effective cross-border resolution if such impediments arise from differences in ranking across jurisdictions? How could the transparency and predictability of the treatment of creditor claims in a cross-border context be improved?*

2. Discussion note on conditions for a temporary stay on early termination rights (Annex 8)

Under standard market documentation for financial contracts, contractual acceleration, termination and other close-out rights (collectively, "early termination rights") in financial contracts may be triggered when the resolution authorities initiate resolution proceedings or take certain related resolution actions with respect to a financial institution. In the case of a SIFI, the termination of large volumes of financial contracts upon entry into resolution could result in a disorderly rush for the exits and frustrate the implementation of resolution measures, such as the transfer of critical operations to a bridge bank, or the implementation of bail-in within resolution, which are aimed at achieving continuity of critical financial functions and of the financial contracts that support them. The FSB is seeking public comments on the introduction of a possible statutory provision that would allow for a brief suspension of early termination rights pending the use of resolution tools, as well as the length and scope of such a stay, possible exemptions and its cross-border application.

Questions for public consultation

26. *Please give your views on the suggested stay on early termination rights. What could be the potential adverse outcomes on the failing firm and its counterparties of such a short stay? What measures could be implemented to mitigate these adverse outcomes? How is this affected by the length of the stay?*
27. *What specific event would be an appropriate starting point for the period of suspension? Should the stay apply automatically upon entry into resolution? Or should resolution authorities have the discretionary right to impose a stay?*
28. *What specific provisions in financial contracts should the suspension apply to? Are there any early terminations rights that the suspension should not apply to?*
29. *What should be an appropriate period of time during which the authorities could delay the immediate operation of contractual early termination rights?*
30. *What should be the scope of the temporary stay? Should it apply to all counterparties or should certain counterparties, e.g., Central Counterparties (CCPs) and FMIs, be exempted?*

31. *Do you agree with the proposed conditions for a stay on early termination rights? What additional safeguards or assurances would be necessary, if any?*
32. *With respect to the cross-border issues for the stay and transfer, what are the most appropriate mechanisms for ensuring cross-border effectiveness?*
33. *In relation to the contractual approach to cross-border issues, are there additional or alternative considerations other than those described above that should be covered by the contractual provision in order to ensure its effectiveness?*
34. *Where there is no physical presence of a financial institution in question in a jurisdiction but there are contracts that are subject to the law of that jurisdiction as the governing law, what kind of mechanism could be considered to give effect to the stay?*

Annex 1

Key attributes of effective resolution regimes for financial institutions

At Seoul in November 2010, the G20 Leaders asked the FSB to set out *Key Attributes of Effective Resolution Regimes*, comprising frameworks and tools for the effective resolution of financial groups to help mitigate the systemic disruption of financial institution failures and reduce moral hazard.

The following *Key Attributes* set out the essential features that should be part of the resolution regimes of all jurisdictions. In many cases, legislation will be needed to put these features in place. Not all resolution powers set out in the *Key Attributes* are suitable for all sectors and all circumstances. Further sector-specific guidance would be provided as necessary for the application of this framework to insurance companies, financial market infrastructures (FMIs) and other financial institutions, including non-bank systemically important financial institutions (SIFIs).

Preamble

The objective of an effective resolution regime is to make feasible the resolution of any financial institution without severe systemic disruption and without exposing taxpayers to loss while protecting vital economic functions through mechanisms which make it possible for shareholders and unsecured and uninsured creditors to absorb losses in their order of seniority.

An effective resolution regime should:

- ensure continuity of systemically critical financial services and functions;
- protect insured depositors and insurance policy holders and ensure the rapid return of segregated client assets;
- allocate losses on firm owners (shareholders) and unsecured and uninsured creditors in their order of seniority;
- not rely on public solvency support and not create an *ex ante* expectation that such support will be available;
- avoid unnecessary destruction of value, and therefore minimise the overall costs of resolution in home and host jurisdictions;
- provide for speed and transparency and as much predictability as possible through legal and procedural clarity and advanced planning for orderly resolution;
- provide a mandate in law for cooperation, information exchange and co-ordination domestically and among relevant foreign resolution authorities before and during a resolution;
- ensure that non-viable financial institutions can exit the market in an orderly way; and
- be credible and thereby provide incentives for market-based solutions.

Jurisdictions should have in place a special resolution regime that provides the resolution authority with a broad range of powers and options to resolve a financial institution that is no longer viable and there is no reasonable prospect of it becoming so. The resolution regime should include:

- stabilisation options, which achieve continuity of systemically important functions by way of a sale or transfer of the shares in the firm or all or parts of the firm's business to a third party, either directly or through a bridge institution, and/or an officially mandated creditor-financed recapitalisation of the entity that continues providing the critical functions; and
- liquidation options, which provide for the orderly closure and wind-down of all or parts of the firm's business in a manner that protects insured depositors, policy holders and other retail customers.

1. Scope

1.1 The resolution framework should apply to any financial institution that could be systemically significant or critical in particular circumstances. It should extend to:

- holding companies;
- significant non-regulated operational entities within a financial group or conglomerate; and
- branches of foreign financial institutions (see Section 8.4 below)

The resolution regime should be clear and transparent as to the institutions within its scope.

2. Resolution authority

2.1 Each jurisdiction should have a designated administrative authority responsible for exercising the resolution powers over financial institutions within the scope of the resolution regime ("resolution authority"). Where there are multiple resolution authorities within a jurisdiction their respective mandates, roles and responsibilities should be clearly defined and coordinated.

2.2 Where different resolution authorities are in charge of resolving entities of the same group within a single jurisdiction the resolution regime of that jurisdiction should identify a lead authority ("group resolution authority") that coordinates the resolution of the legal entities within that jurisdiction.

2.3 As part of the statutory objectives, the resolution authority should pursue financial stability and the protection of insured depositors, policy holders and other retail customers, and duly consider the potential impact of its resolution actions on financial stability in other jurisdictions.

2.4 The resolution authority should have the authority to enter into agreements with resolution authorities of other jurisdictions.

2.5 The resolution authority should have operational independence consistent with their statutory responsibilities, transparent processes, sound governance and adequate resources and be subject to rigorous evaluation and accountability mechanisms to assess the effectiveness of any resolution measures. It should have the expertise, resources and the operational capacity to implement resolution measures with respect to large and complex financial institutions.

2.6 The resolution authority and its staff should be protected against law suits for actions taken and/or omissions made while discharging their duties in the exercise of resolution powers in good faith, including actions in support of foreign resolution proceedings.

2.7 The resolution authority should have unimpeded access to firms as necessary for purposes of resolution planning, and the preparation and implementation of resolution measures.

3. Entry into resolution

3.1 The resolution regime should provide for timely and early entry into resolution before a financial institution is balance-sheet insolvent, with clear standards for suitable indicators or threshold conditions for entry into resolution. Resolution should be initiated when a firm is no longer viable or likely to be no longer viable and other measures have proved insufficient to prevent failure.

4. Resolution powers

4.1 Resolution authorities should have specific legal powers that apply as appropriate across the complex structures of SIFIs, and also the operational capacity to implement orderly resolutions. These include powers to:

(i) Remove and replace the senior management, remove directors, and recover monies from responsible parties;

(ii) Appoint an administrator and take control of the affected firm with powers to actively manage the firm;

(iii) Operate and resolve the firm, including powers to terminate contracts, continue or assign contracts, purchase or sell assets, write down debt and take other actions necessary to restructure or wind down the firm's operations;

(iv) In the case of insurance firms, require portfolio transfers to a protection fund; run-off insurance business; hold underlying assets for derivatives;

(v) Require other companies in the same group to continue to provide essential services to the entity being resolved; and procure necessary services from unaffiliated third parties;

(vi) Override rights of shareholders of the firm subject to resolution, including the requirement for approval by shareholders, in order to permit a merger, acquisitions, sale of substantial business operations, recapitalisation or other measures to restructure and dispose of the firm's business and/or its liabilities and assets;

(vii) Transfer or sell assets and liabilities, legal rights and obligations, including deposit liabilities and ownership in shares, to a solvent third party, notwithstanding any otherwise applicable consent or novation requirements;

(viii) Establish a temporary bridge institution to take over and continue operating certain critical functions and viable operations of a failed firm;

(ix) Establish a separate asset management vehicle in order to run down bad assets and transfer non-performing loans or difficult to value assets to the vehicle (that asset management vehicle can take the form of a subsidiary of the distressed firm, a separate bank complete with separate charter, or a trust or asset management company);

(x) Carry out bail-in within resolution by either recapitalising the entity hitherto providing systemically important functions that is no longer viable, or, alternatively, capitalising a newly established entity or bridge institution to which these vital functions have been transferred following closure of the residual firm, by way of a write-down or conversion of unsecured and uninsured debt of the firm in resolution (see Annex 2, *"Bail-in within resolution"*);

(xi) Effect the closure and orderly liquidation of the whole or part of a failing firm that is not viable, with payout or transfer of insured deposits and prompt (e.g., within seven days) access to transactions accounts as well as to segregated client funds;

(xii) Impose a moratorium and suspend, for a short period of time, payments to unsecured creditors and customers (except for payments to central counterparties and those entered into the payment systems) and stay creditor actions to attach assets or otherwise collect money or property from the failing firm; and

(xiii) Impose a brief (e.g., two business days) stay on the exercise of contractual early termination and acceleration rights for financial market contracts in order to complete a transfer of such contracts to a performing third party (i.e., private sector purchaser or bridge institution), subject to adequate safeguards (see Annex 8, "*Conditions for a temporary stay on early termination rights*").

4.2 Resolution authorities should have the power to apply one or a combination of resolution powers, with resolution actions being either combined or applied sequentially.

4.3 Resolution authorities should be able to apply different types of resolution powers to different parts of the firm's business (e.g., retail and commercial banking, trading operations, insurance) and be able to initiate a wind-down for those operations that, in the particular circumstances, are judged by the authorities to be not critical to the economy.

4.4 In applying resolution powers to individual components of a financial group located in its jurisdiction, the resolution authority should have to take into account the overall impact on the group as a whole and the impact on financial stability in other jurisdictions concerned and undertake best efforts to avoid taking actions that could reasonably be expected to trigger instability elsewhere in the group or in the financial system.

5. Netting, collateralisation and segregation

5.1 The legal framework governing netting and collateralisation and the segregation of client positions should be clear, transparent and enforceable during a crisis or resolution of financial institutions, and should not hamper the effective implementation of resolution measures.

6. Funding of firms in resolution

6.1 Jurisdictions should have statutory or other policies in place so that authorities are not constrained to rely on public ownership or bail-out funds as a means of resolving financial institutions.

6.2 Where temporary sources of funding to maintain essential functions are needed to accomplish orderly resolution, the resolution authority or authority extending the temporary funding should make provisions to recover any losses incurred from shareholders and unsecured creditors subject to minimum recovery rights or, if necessary, the financial system more widely.

6.3 Jurisdictions should have in place privately-financed deposit insurance or resolution funds or a funding mechanism for *ex post* recovery from the industry of the costs of providing bridge financing to facilitate the resolution of the firm.

6.4 Any provision of temporary funding should be subject to strict conditions that minimize moral hazard risk, and should include the following:

(i) A determination that the provision of temporary funding is necessary to foster financial stability and will permit implementation of a resolution option that is best able to achieve the objectives of an orderly resolution, and that private sources have been exhausted or cannot achieve these objectives; and

(ii) The allocation of losses to equity holders and residual costs, as appropriate, to unsecured and uninsured creditors and the industry through ex-post assessments, insurance premium or other mechanisms.

6.5 Where resolution reconstitutes parts of a firm as a going concern, it may be eligible to have access to a central bank's liquidity facilities, at the discretion of the central bank.

6.6 As a last resort and for the overarching purpose of maintaining financial stability, some countries may decide to have a power to place the firm under temporary public ownership and control in order to continue critical operations, while seeking to arrange a permanent solution, such as a sale or merger with a commercial private sector purchaser. Where countries do equip themselves with such powers, they should make provision to recover any losses incurred by the state from unsecured creditors or, if necessary, the financial system more widely.

7. Speed, flexibility and adequate safeguards

7.1 Resolution authorities should have the ability to act in a coordinated manner and with the necessary speed, flexibility and legal certainty subject to adequate safeguards. Adequate safeguards include the assurance that creditors have a minimum recovery right or the right to compensation equal to what they would have received in an ordinary liquidation (bankruptcy) process.

7.2 Directors and officers of the firm in resolution should be protected in law (e.g., from suits by shareholders or creditors) for actions taken when complying with decisions of the resolution authority.

7.3 The resolution authority should have the capacity to exercise the resolution tools with the necessary speed. In those jurisdictions, where a court order is required to apply resolution measures, resolution authorities should take this into account in the resolution planning process so as to ensure that court proceedings will not affect the effective implementation of resolution actions.

7.4 Judicial review should be *ex post*, and not result in the reversal of measures taken by resolution authorities acting within their legal powers where doing so would affect financial stability and reduce value for creditors. Instead, redress may be provided by awarding compensation if justified.

7.5 In order to preserve market confidence, jurisdictions should provide for flexibility to allow temporary exemptions from disclosure requirements or a postponement of disclosures required, e.g., under market reporting; takeover provisions and listing rules etc. where the disclosure could affect the successful implementation of resolution measures.

8. Legal framework conditions for cross-border cooperation

8.1 In order to facilitate the coordinated resolution of financial institutions active in multiple countries, jurisdictions should seek convergence of their resolution regimes through the legislative changes needed to incorporate the tools and powers set out in these *Key Attributes* into their national regimes.

8.2 The statutory mandate of a resolution authority should empower and strongly encourage the authority wherever possible to act to achieve a cooperative solution with foreign resolution authorities.

8.3 National laws and regulations should not contain provisions that trigger automatic action in the domestic jurisdiction as a result of official intervention and/or the initiation of resolution or insolvency proceedings in another jurisdiction, while reserving the right of discretionary national action if necessary to achieve domestic stability in the absence of effective international cooperation and information sharing.

8.4 The resolution authority should have resolution powers over local branches of foreign financial institutions and the capacity to use their powers to either support a resolution carried out by a foreign home authority (e.g., by ordering a transfer of property to a bridge institution established by the foreign home authority) or, in exceptional cases, to take measures on their own initiative where the home jurisdiction is not taking action or acts in a manner that does not take sufficient account of the need to preserve the local jurisdiction's financial stability.[11]

8.5 National laws and regulations should not discriminate against creditors based on nationality or location of their claim, or the jurisdiction where it is payable. Where any such provisions exist, they should be transparent and properly disclosed.

8.6 Jurisdictions should provide for transparent and expedited processes to enable a foreign resolution authority to gain rapid control over assets (located in their jurisdiction) of a financial firm being resolved in the foreign jurisdiction, provided that doing so does not prejudice the local creditors and that they are treated equitably in the foreign resolution proceeding.

8.7 The resolution authority should have the capacity in law to share information, including Recovery and Resolution Plans (RRPs), pertaining to the group as a whole or to individual subsidiaries or branches, with foreign resolution authorities, where sharing is necessary for recovery and resolution planning or for implementing a coordinated resolution, subject to adequate confidentiality requirements and protections for sensitive data.

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11 This should not apply where jurisdictions are subject to a binding obligation to respect resolution of financial institutions under the authority of the home jurisdiction (e.g., the EU Winding up and Reorganisation Directives).

8.8 Jurisdictions should provide for confidentiality requirements and statutory safeguards for the protection of information received from foreign authorities.

9. Institution-specific cross-border cooperation agreements

9.1 For all global SIFIs (G-SIFIs), at a minimum, institution-specific cooperation agreements should be in place between the home and relevant host authorities that need to be involved in the pre-planning and crisis resolution stages. These agreements should, inter alia, :

(i) establish the objectives and processes for cooperation through Crisis Management Groups (CMGs);

(ii) define the roles and responsibilities of the authorities pre-crisis (i.e., in the recovery and resolution planning phases) and in a crisis;

(iii) set out the legal bases in the respective national laws and the process for information sharing pre-crisis and in crisis, including sharing with any host authorities that are not represented in the CMG;

(iv) set out the processes for coordination in the elaboration of the RRPs for the firm, including parent or holding company and significant subsidiaries, branches and affiliates that are within the scope of the agreement and engagement with the firm as part of this process;

(v) set out the processes for coordination in the conduct of resolvability assessments;

(vi) include agreed modalities for the home authority to inform and consult host authorities in a timely manner when there are material adverse developments affecting the firm and before taking any significant action or crisis measures;

(vii) provide an appropriate level of detail with regard to the cross-border implementation of specific resolution measures; and

(viii) provide for holding at least annual meetings including top officials of the home and relevant host authorities to assess the robustness of the G-SIFIs' RRPs (see Annex 5, "*Recovery and Resolution Plans*").

9.2 The agreements, at least their broad structure, should be made public.

10. Cross-border Crisis Management Groups

10.1 Home and key host authorities of all G-SIFIs should form CMGs with the objective to enhance preparedness for and facilitate the management and resolution of a cross-border financial crisis affecting the firm in line with *the FSF Principles on cross-border crisis management of April 2009*. CMGs should comprise the supervisory authorities, central banks, resolution authorities, finance ministries and the public authorities responsible for insurance guarantee schemes of jurisdictions that are home or host to entities of the group that are material to its resolution, and should cooperate closely with authorities in other jurisdictions where firms have a systemic presence.

10.2 CMGs should keep under active review, and report to the FSB on, the adequacy of institution-specific cross-border cooperation agreements for G-SIFIs and the recovery and resolution planning process under these agreements (see Annex 3, "*Essential Elements of institution-specific cross-border cooperation agreements*").

11. Recovery and resolution planning

11.1 Jurisdictions should put in place an ongoing recovery and resolution planning process, covering at a minimum the locally-incorporated financial institutions, to promote the resolvability of financial institutions as part of the overall supervisory process.

11.2 Jurisdictions should require that robust and credible RRPs, containing all elements set out in the paper on *Recovery and Resolution Plans* are in place for all G-SIFIs and for any other firm assessed by its home authority to have a potential impact on financial stability in the event of liquidation of that firm. The RRP should take account of the specific circumstances of the firm and reflect the nature, complexity, interconnectedness, level of substitutability and size of the financial institution. For G-SIFIs, the RRP should be informed by an assessment of the financial institution's resolvability (see Annex 4, *"Resolvability Assessment"*).

11.3 Supervisory and resolution authorities should ensure that the firms subject to a RRP requirement maintain a recovery plan that identifies options to recover financial strength and viability when a firm comes under severe stress. Recovery plans should include:

(i) credible options to cope with a range of scenarios including both idiosyncratic and market wide stress;

(ii) scenarios that address capital shortfalls and liquidity pressures; and

(iii) processes to ensure timely implementation of recovery options in a range of stress situations.

11.4 The resolution plan is intended to facilitate the effective use of the resolution authority's resolution powers with the aim to make the resolution of any financial institution feasible without severe systemic disruption and without exposing taxpayers to loss while protecting systemically important functions. It should, in particular, identify:

(i) financial and economic functions for which continuity is critical;

(ii) suitable resolution options to preserve them or wind them down in an orderly manner;

(iii) data requirements on the firm's business operations, structures, and systemically important functions;

(iv) potential barriers to effective resolution and actions to mitigate these; and

(v) actions to protect insured depositors and insurance policy holders and ensure the rapid return of segregated client assets.

11.5 Firms should be required to ensure that key Service Level Agreements (SLAs) can be maintained in crisis situations and in resolution and that the underlying contracts include provisions that prevent termination triggered by recovery or resolution events and facilitate transferability to a bridge-institution or a third party acquirer.

11.6 For G-SIFIs, the home resolution authority should lead the development of the group resolution plan in coordination with all members of the financial institution's CMG. Where they deem the group resolution plan insufficient, or otherwise with the agreement of the home authority, host resolution authorities may maintain their own, detailed resolution plans for parts of the firm that are active in their jurisdictions.

11.7 Supervisory and resolution authorities should be satisfied that senior management has taken responsibility for the preparation of the recovery and relevant components of the resolution plan.

11.8 Supervisory and resolution authorities should ensure that RRPs are updated regularly, at least annually or when there are material changes to a firm's business and/or structure, and subject to regular stress-tests and reviews within the financial institution's CMG, subject to adequate confidentiality agreements.

11.9 The adequacy of RRPs of G-SIFIs should be the subject of a formal review by top officials of home and relevant host supervisory and resolution authorities at least annually, where appropriate with the firm's CEO.

11.10 If a firm's resolution plan is unsatisfactory to the resolution authorities, the authorities should require appropriate measures to address the deficiencies. Relevant home and host authorities should provide for prior consultation on the actions contemplated.

11.11 To improve a firm's resolvability, supervisory authorities or resolution authorities should have powers to require, where necessary and appropriate, the adoption of measures, such as changes to a firm's business practices, structure or organisation, to reduce the complexity and costliness of resolution, duly taking into account the effect on the soundness and stability of ongoing business. To enable the continued operations of systemically important functions authorities should evaluate whether to require that these functions be lodged in legally and operationally independent entities that are shielded from group problems.

11.12 In order to restore market discipline and promote the efficient operation of financial markets, the resolution authorities should incorporate into their planning, clear options or principles for the exit from public intervention in a firm.

12. Access to information and information sharing

12.1 Jurisdictions should ensure that no legal, regulatory or policy impediments exist that hinder the appropriate exchange of information, including firm-specific information, between supervisory authorities, central banks, resolution authorities, finance ministries and the public authorities responsible for insurance guarantee schemes,. In particular:

(i) The sharing of all information relevant for recovery and resolution planning, and in resolution should be possible in normal times and in crisis at a domestic and a cross-border level;

(ii) The modalities for the sharing of information relating to a G-SIFI should be set out in institution-specific cooperation agreements (see Annex 3, "*Essential Elements of institution-specific cross-border cooperation agreements*"); and

(iii) Where appropriate and necessary to respect the sensitive nature of information, information sharing may be restricted, but should be possible among the top officials of the relevant home and host authorities.

12.2 Jurisdictions should require firms to have in place Management Information Systems (MIS) able to produce on a timely basis, in normal times for recovery and resolution planning as well as in resolution and under a separation scenario, information required at both the group and legal entity levels. Firms should be required to maintain a detailed inventory, including description and location of the key MIS used in their material legal entities, mapped to their essential and systemically important functions.

12.3 To facilitate the unwinding and/or transfers of intra-group guarantees and back-to-back trades when necessary, jurisdictions should require firms to maintain at the legal entity level, information on intra-group guarantees and intra-group trades booked on a back-to-back basis.

Annex 2

Bail-in within resolution: Elements for inclusion in the *Key Attributes*

The FSB SIFI Recommendations called on national authorities to consider "restructuring mechanisms to allow recapitalisation of a financial institution as a going concern by way of contractual and/or statutory (i.e., within-resolution) debt-equity conversion and write-down tools, as appropriate to their legal frameworks and market capacity." The FSB has examined the legal and operational aspects of bail-in based on contractual bail-in instruments as well as on statutory bail-in mechanisms.

The FSB has included statutory bail-in powers as a resolution tool in the *Key Attributes of Effective Resolution Regimes* (see Annex 1), which sets out a recommended statutory framework for resolution. Bail-in within resolution constitutes an additional resolution option that could be used in conjunction with other resolution tools. It should be part of a robust resolution regime that satisfies the *Key Attributes*. Resolution authorities should have the statutory power, but not the obligation, to apply a bail-in within resolution.

Statutory bail-in within resolution tools do not prevent firms from issuing instruments that write-down or convert contractually, nor do they prevent national authorities from requiring them. Where, at the point of entry into resolution, an institution has contractual instruments with write-off or conversion features outstanding, a contractual instrument that had not been previously written-off or converted will be written-off or converted according to the contractual terms and conditions of the instrument upon entry into resolution but before the application, within the resolution, of bail-in or other powers by the resolution authority. A contractual instrument that, prior to entry into resolution, has already been written-off or converted upon activation of a contractual trigger would be subject to a subsequent application of bail-in powers upon entry into resolution.

This notes focuses on the elements and legal framework conditions that jurisdictions need to incorporate in a manner consistent with their resolution regime for bail-in within resolution to be effective. The FSB is consulting on the details of how to apply bail-in as a resolution tool.

1. Objectives

1.1 Like other resolution tools, the objective of bail-in within resolution is to ensure that the costs of resolution are borne by the firm's owners (shareholders) and other unsecured and uninsured creditors, rather than by taxpayers, so as to reduce moral hazard and enhance market discipline while minimizing the losses of value and economic disruption associated with insolvency proceedings.

1.2 Bail-in within resolution refers to the exercise of statutory powers within a special resolution procedure. Bail-in within resolution will achieve or help achieve continuity of systemically important functions by either recapitalising the entity hitherto providing these functions that is no longer viable, or, alternatively, capitalising a newly established entity or bridge institution to which these systemically important functions have been transferred following closure of the residual firm. Resolution authorities should have the statutory power to apply bail-in powers via at least one of the above mechanisms.

1.3 Under both alternatives, capitalisation, complemented by other recapitalisation measures, where appropriate, should be to levels of capital deemed adequate to preserve financial stability and restore market confidence.

2. Statutory framework

2.1 Bail-in powers need to be embedded in an effective statutory resolution regime that meets the FSB *Key Attributes of Effective Resolution Regimes*.

2.2 The resolution regime and legal framework for bail-in should provide clarity and certainty as regards:

(i) the authority triggering entry into resolution;

(ii) the conditions under which bail-in, and other resolution tools, could be used and the authority with responsibility for exercising the power;

(iii) the scope of the bail-in power in terms of the range of liabilities covered and hierarchy according to which bail-in powers may be applied;

(iv) the process for triggering bail-in (e.g., publication of a decree or instrument pursuant to which the write-down takes effect); and

(v) the consequences for owners (shareholders) and creditors upon their activation and available legal remedies and compensation mechanisms.

2.3 Where necessary, the authorities may require firms to include specified bail-in terms in certain debt contracts in order to help ensure application of statutory bail-in to debt issued outside the home country of firm being resolved and to help ensure enforceability of the authorities' statutory bail-in actions more generally.

3. Bail-in powers

3.1 Bail-in powers within resolution should enable resolution authorities to do all of the following as necessary to absorb losses and either recapitalise the vital or viable parts of the business of the firm, or capitalise a newly formed entity to which the vital and viable parts of the business have been transferred:

(i) undertake write-off of equity or other instruments of ownership of the firm;

(ii) write-off up to all of subordinated claims;

(iii) write-off up to all of the subordinated or senior unsecured and uninsured creditor claims against the firm; and

(iv) convert into equity or other instruments of ownership of the institution under resolution (or any successor in resolution or the parent company), all or parts of subordinated or senior unsecured and uninsured creditor claims (including any contractual bail-in instruments, on a post-write-down/conversion basis, see Section 5.3 below) .

3.2 To give effect to the bail-in and conversion into newly issued shares, the resolution regime should provide for the requisite authority, as necessary and consistent with their legal framework, to:

(i) issue new shares on an expedited basis without the need for shareholder consent;

(ii) override pre-emption rights of existing shareholders of the firm being resolved;

(iii) issue warrants to otherwise fully-written-off equity or subordinated debt holders (so as to adjust the distribution of shares based on a further valuation at a later stage);

(iv) cancel share capital (unrepresented by available assets); and

(v) make provision for the suspension of shares and other relevant securities from listing and trading and prohibit dealings in the shares for a temporary period as necessary to support the effective implementation of the bail-in.

3.3 The resolution authority should have the power to apply the bail-in tools in combination with other resolution tools and regulatory measures as necessary to restore confidence and facilitate resolution, such as the power to remove boards and management.

3.4 The resolution authority should have the capacity to exercise bail-in powers with the necessary speed. In those jurisdictions where a court order is required to apply bail-in, resolution authorities should take this into account in the resolution planning process to ensure that court proceedings will not affect the effective implementation of the bail-in.

3.5 Bail-in powers should be available for firms of any legal form of incorporation.

4. Triggers

4.1 Bail-in powers within the context of a resolution regime should be available for use by authorities where they determine that the firm has met the conditions to enter the resolution regime.

5. Scope

5.1 The scope of a statutory bail-in regime, in terms of the range of liabilities covered, should be as wide as possible.

5.2 Write-off/conversion powers should, as far as possible, be applied in a manner consistent with the hierarchy of the capital structure of the institution, and respect the rights of secured creditors and the statutory ranking of senior creditors that would apply in a liquidation.

5.3 Where an institution has instruments outstanding on entry into resolution that as a matter of contract could be written-down or converted into equity, then that write-down and/or conversion shall be triggered. Bail-in within resolution shall then apply to the instruments resulting from that contractual write-down and/or conversion, *pari passu* with instruments of the same type. This means that:

(i) A contractual bail-in instrument that has not been previously written-off or converted will be written-off or converted according to the contractual terms and conditions of the instrument upon entry into resolution, but before the application, within the resolution, of bail-in or other powers by the resolution authority; and

(ii) A contractual instrument that, prior to entry into resolution, has already been written-off or converted upon activation of a contractual trigger may be subject to a subsequent application of bail-in powers upon entry into resolution. As a result, an equity instrument that was created, either prior to or upon entry into resolution, from the conversion of a contractual bail-in instrument would absorb losses, alongside other equity, prior to write-down and/or conversion into equity of other senior debt through the application of statutory bail-in within resolution by the resolution authority.

6. Respect for statutory order of priorities

6.1 The exercise of statutory write-off or conversion powers within resolution should respect the *pari passu* treatment of creditors and the statutory ranking and order of priorities of the affected debt that would otherwise exist in insolvency, except to the extent necessary to achieve the objectives of the resolution regime as set out in statute. Any exception should be clearly stipulated in law or regulations and respect the principle of "no creditor worse-off than in liquidation." This principle need not be observed in the case of those instruments where investors have agreed to contractual write-off or conversion terms *ex ante* at the time of their initial investment.

7. Safeguards and judicial review

7.1 Adequate safeguards (see Section 7 of the *Key Attributes*) and the principle of non-discrimination between creditors along national lines should apply in the same manner as in the case of application of other statutory resolution tools.

7.2 Authorities should apply a consistent approach to the treatment of creditors and compensation rights across bail-in within resolution and the application of other resolution tools and respect any statutory priority or subordination of holders of contractual bail-in instruments where resolution measures other than bail-in powers are employed.

7.3 In acting quickly and seeking to ensure sufficient resources for either restoration to viability, or orderly resolution, authorities may impose haircuts or write-downs that turn out to be greater than needed. To address these situations, authorities therefore should have in place mechanisms for compensating the holders of bailed-in claims, or written-off equity when the amount of actual losses is finally determined, e.g., by the issuance of warrants.

7.4 Judicial review should be *ex post* and not result in the reversal of the bail-in measures taken by resolution authorities acting within their legal powers. Instead, redress may be provided by awarding compensation (see Section 7.4 of the *Key Attributes*).

8. Impact on financial contracts

8.1 As with other resolution tools, such as transfers of contracts to a newly established entity or bridge bank, the exercise of bail-in powers within resolution should not constitute an event of default that permits the exercise of early termination and close-out rights in respect of financial contracts, or a brief stay on the exercise of early termination and close-out rights should be imposed.

9. Group and cross-border issues

9.1 As a general principle, bail-in within resolution should be initiated by the home authority with respect to debt issued by the parent firm in resolution (and/or subsidiaries in resolution in the jurisdiction of the parent).

9.2 Where host authorities have bail-in within resolution powers embedded in their resolution framework, they should be able to exercise these powers at subsidiary level, which could lead to a transfer of ownership to new shareholders. Prior to exercising these powers host authorities should have satisfied themselves following consultation with the home authority and, to the extent possible, with the Crisis Management Group (CMG) that (i) the subsidiary is not viable and should enter into resolution and that (ii) the group would not support the subsidiary and no alternative group-wide solution would achieve a more favourable outcome from a host country perspective and from a cross-border financial stability perspective.

9.3 As part of their recovery and resolution planning work within CMGs, home and host authorities should discuss and agree in advance on processes to coordinate resolution actions that involve bail-in measures within resolution.

9.4 To help ensure that bail-in powers within resolution are effective in a cross-border context, home authorities should require that institutions incorporated in their jurisdiction include in debt contracts provisions whereby the creditor recognizes the home authority's bail-in powers to write-down creditor claims or convert them into equity claims whether or not the contract itself is governed by the law of the home jurisdiction or of a host jurisdiction.

10. Quantum of bail-in debt

10.1 Authorities should regularly monitor whether firms' balance sheets contain a sufficient quantum of liabilities covered by bail-in powers within resolution.

11. Liquidity needs

11.1 As with other resolution tools that seek to promote continuity, the liquidity needs of a bailed-in entity will need to be met to provide confidence to counterparties and the markets. Giving super-senior status to funds provided to an institution in resolution may help ensure access to funding, though the effects of altering the creditor hierarchy in this way would need to be carefully considered.

12. Transitional period

12.1 Bail-in powers within resolution should be applicable to the relevant liabilities to all existing and new non-exempted liabilities as from the time the powers are enacted, in the same manner as the enactment of other resolution powers and subject to the appropriate safeguards. Jurisdictions may consider the introduction of an appropriate transitional period before bail-in powers are exercisable in order to ensure that firms can adequately adjust to the statutory bail-in regime.

Annex 3

Essential elements of institution-specific cross-border cooperation agreements

The SIFI Recommendations called for institution-specific cooperation agreements for all global systemically important financial institutions (G-SIFIs).

Cross-border cooperation agreements should help facilitate institution-specific crisis management planning and cooperation amongst relevant authorities, with a presumption in favour of cooperation in the event of the institution's resolution and build upon the FSF's *Principles for cross-border cooperation in crisis management* as endorsed by the G20 Leaders Summit in London in April 2009. They should support the preparation of Recovery and Resolution Plans (RRPs) and the effective implementation of resolution measures in a crisis by providing a framework for possible solutions to legal or other impediments that may exist. This will require firm-specific agreements among all members of a firm's cross-border Crisis Management Group (CMG), including the relevant authorities from the home and all key host jurisdictions. Bi-national agreements, i.e., agreement between the relevant authorities of the home and a host jurisdiction that set out how national legal and resolution regimes would interact given a firm's business, and firm-specific multinational agreements among home and all key host jurisdictions, may complement each other.

The effectiveness of institution-specific cooperation agreements hinges on the home and host authorities having the necessary resolution powers in relation to the firm's operations, including the branch operation of a foreign financial institution (see Annex 1*, "Key Attributes of Effective Resolution Regimes",* Section 8.4).

The institution-specific cooperation agreement establishes a framework for the development of RRPs, based on the conduct of pre-crisis resolvability assessments, and for cooperation and coordination in crisis in line with the agreed RRPs. Both RRPs and cooperation agreements are expected to be regularly updated and evolve over time. Institution-specific cross-border cooperation agreements should, at a minimum, include the following elements.

1. Objectives, nature and scope of the agreement

1.1 A declarative statement of its objectives and scope (e.g., "we, as home and host authorities for the [firm], have signed this cooperation agreement setting out how we will work together with a view to facilitating institution-specific crisis management planning and cooperation amongst relevant authorities, with an emphasis on cooperation in the event of the [firm's] resolution....The objective is to minimise the impact of the failure of the [firm] in each of the jurisdictions represented by the Parties to the Agreements").

1.2 The home and host authorities that sign the agreement ("the Parties").

1.3 Description of the firm, parent or holding company and significant subsidiaries, branches and affiliates that are within the scope of the agreement.

1.4 The legal nature of agreement (i.e., whether and to what extent the agreement is binding).

1.5 Rules on public disclosure (e.g., whether and to what extent its content or its existence should be disclosed to the public).

2. General framework for cooperation

2.1 The roles, responsibilities and powers of the Parties "pre-crisis" (i.e., in the recovery and resolution planning process) and "in crisis" with respect to the firm, including the parent or holding company and significant subsidiaries, branches and affiliates that are within the scope of the agreement.

2.2 Reference to the Parties' relevant elements of the RRP for the firm, parent or holding company and significant subsidiaries, branches and affiliates that relate to the preparation and execution of resolution measures in a cross-border context (recognising that the plan is regularly reviewed and updated).

3. Commitments to cooperate

3.1 The Parties' agreement that the FSF's *Principles set out in April 2009*, and the *Key Attributes of Effective Resolution Regimes* should guide their actions in any crisis management and resolution measures adopted in respect of the firm.

3.2 The Parties' commitments to implement resolution options that are aimed at pursuing financial stability, the protection of insured depositors, policy holders and other retail customers, and duly considering the potential impact of their resolution actions on financial stability of other jurisdictions.

3.3 The Parties' commitments to coordinate in the recovery and resolution planning process and share all relevant information, including RRPs pertaining to the group as a whole or to individual subsidiaries, where plans of subsidiaries exist in order to ensure that the plans are consistent and help prepare for a coordinated resolution of the whole firm.

3.4 The Parties' commitment, through the CMG process, to engage in periodic table top or other scenario analyses or simulation exercises in order to ensure that the plans are viable and to help prepare for a coordinated resolution.

3.5 The Parties' commitment to conduct an assessment of the financial institution's resolvability, using the note *on Resolvability Assessments* set out in Annex 4, including the financial institution's demonstrated ability, as part of the recovery and resolution planning process, to produce the essential information needed to implement such plans in a timely fashion in a crisis; to share the results of the assessment and use them to inform the resolution planning process with respect to the implementation of cross-border resolution measures.

3.6 The agreed frequency of review and sharing of full RRPs (at least annually).

3.7 The Parties' commitment to inform and consult each other in a timely manner when taking any crisis management or resolution measures (with precise definition of crisis management or resolution measures).

3.8 The Parties' commitment to promptly inform each other of material changes to their crisis management and resolution frameworks.

3.9 The Parties' commitment to share information at both senior and technical levels as appropriate, subject to appropriate confidentiality arrangements (see Section 6.6 below). Where appropriate and necessary to respect the sensitive nature of information, information sharing may be restricted, but should be possible among the top officials of the relevant home and host authorities.

4. Home authority's commitments

4.1 The home (resolution or supervisory) authority's commitment to:

(i) Coordinate in the CMG, with the benefit of the active participation of the other Parties, the assessment of the firm's resolvability in line with the *Resolvability Assessments* and identification of actions that home or host authorities or the firm may need to take to ensure its resolvability;

(ii) Facilitate and chair meetings of the CMG and lead the review of the firm's RRP within the CMG, with the active participation of the other Parties and in line with the key elements of *Recovery and Resolution Plans* (see Annex 5);

(iii) Alert other Parties without delay, so as to allow practical cooperation, if the firm encounters difficulties or if it becomes apparent that it is likely to enter the home authority's resolution regime;

(iv) Take into account the overall effect on the group as a whole and on financial stability in other jurisdictions concerned and undertake best efforts to avoid taking actions that could reasonably be expected to trigger instability elsewhere in the group or in the financial system; and

(v) Where possible and feasible, coordinate a resolution of the firm as a whole, with the aim of maintaining financial stability, protecting depositors, policy holders, and other retail customers in all relevant jurisdictions.

5. Host authorities' commitments

5.1 The host authorities' commitment to:

(i) Alert other Parties without delay if a local branch or locally-incorporated part of the firm encounters difficulties or if it becomes apparent that it is likely to enter the host authority's resolution regime;

(ii) Work with the other Parties towards the coordinated resolution of the firm as a whole, with the aim of maintaining financial stability and protecting depositors, insurance policy holders, and retail investors in all relevant jurisdictions;

(iii) Not to pre-empt resolution actions by home authorities while reserving the right to act on their own initiative if necessary to achieve domestic stability in the absence of effective cooperation and information sharing; and

(iv) Participate at the level of top officials in the formal annual review of the firm's RRP, and to contribute through representation on the CMG at an appropriately senior level to the development and maintenance of the firm's group-wide resolution plan. The adequacy of RRPs of G-SIFIs should be the subject of a formal review by top officials of home and relevant host supervisory and resolution authorities at least annually, where appropriate with the firm's CEO.

6. Cooperation mechanisms and information sharing framework

6.1 Modalities of regular meetings amongst Parties to the Agreement (e.g., number of meetings per year; level of participants, ad hoc meetings in emergency situations and meetings upon request by parties to the Agreement), including the relationship with existing cooperative structures (CMG, supervisory college).

6.2 The statutory and contractual bases for prompt information sharing, including sharing with any host authorities that are not represented in the CMG, existing constraints and how these could be addressed.

6.3 The level of detail in regard to information sharing; whether and how it would change "pre-crisis and "in crisis".

6.4 Modalities for information sharing at both senior and technical levels, tools of information exchange (e.g., use of secured website).

6.5 Commitment to maintain up to date contact lists with contact details for key senior and working-level staff, that cover multiple means of communication.

6.6 Commitment to maintain confidentiality of shared information and measures to ensure confidentiality (e.g., limiting the personnel to access the data; confidentiality agreement signed by each personnel; procedure and responsibility were confidentiality to be breached).

7. Cross-border implementation of resolution measures

7.1 Process for the evaluation of the application of available resolution options and processes to the firm, including the parent or holding company and significant subsidiaries, branches and affiliates that are within the scope of the agreement.

7.2 Commitments to address the legal and operational impediments to cross-border implementation and specification of particular framework conditions for resolution strategies and necessary processes and host country requirements for implementation. For example:

(i) Procedural requirements and conditions for recognition, including any applicable court procedures, of the transfer of (a) assets and liabilities from the failing financial institution to a bridge bank or third party purchaser with respect to branches in the host jurisdiction, and (b) shares of majority or wholly owned subsidiaries in the host jurisdiction to a bridge or third party purchaser;

(ii) Identification of types of financial contracts and assets that cannot be transferred with legal certainty (e.g., contracts governed by the law of a third jurisdiction where the firm does not have a physical presence) and implications for the successful implementation of the resolution tool;

(iii) Availability of funding arrangements in home and host jurisdictions to support the implementation of the resolution measure and restore market confidence; and

(iv) Application of insurance schemes (for depositors, policy holders, other retail customers) and of applicable segregation and customer asset protection rules.

Annex 4

Resolvability assessments

1. Defining resolvability

A systemically important financial institution (SIFI) is "resolvable" if it is feasible and credible for the resolution authorities to resolve it without severe systemic disruption and without taxpayer exposure to loss, while protecting systemically important functions. For resolution to be feasible, the authorities should have the necessary legal powers - and the practical capacity to apply them - to ensure the continuity of functions critical to the economy. For resolution to be credible, the application of those resolution tools should not itself give rise to unacceptably adverse broader consequences for the financial system and the real economy.

2. Objectives of resolvability assessments

The objectives of resolvability assessments are to:

(i) make authorities and financial institutions more aware of the implications of resolution for systemic risk both nationally and globally;

(ii) identify factors and conditions affecting the effective implementation of resolution actions, both endogenous (firm structure) and exogenous (resolution regime and cross-border cooperation framework), in relation to subject financial institutions, and the degree of contingency preparedness (adequacy of Recovery and Resolution Plans (RRPs); and

(iii) help determine the specific actions necessary to achieve greater resolvability without severe systemic disruption and without taxpayer exposure to loss from solvency support, while protecting systemically important functions.

3. Process for assessing resolvability

Resolvability assessments are necessarily qualitative and are not binary. Resolvability assessments should be led by the home authority and coordinated with key host authorities according to the process established in institution-specific cross-border cooperation agreements (see Annex 3, "*Essential Elements of Institution Specific Cross-border Co-operation Agreements*") and in line with the "*Recovery and Resolution Plans*" (see Annex 5). The results of the resolvability assessment should inform the recovery and resolution planning process.

The process for assessing resolvability consists of three stages:

Stage 1 - Feasibility of resolution strategies: Identify the set of resolution strategies which would be feasible, given the current resolution tools available, including RRPs, and the authorities' capacity to apply them at short notice to the specific SIFI in question.

Stage 2 - Systemic impact assessment: Determine the credibility of all feasible resolution strategies by capturing the likely impact of the SIFI's failure and resolution on global and national financial systems and real economies.

Stage 3 - Actions to improve resolvability: Conclude whether resolution is likely to be both feasible and credible and identify any changes necessary. Timelines for completing the requisite changes should be established. Progress should also be monitored.

Resolvability assessments, and the actions flowing from them, form a key part of the resolution planning process and are a **continuous** process consisting of:

(i) qualitative assessment by national authorities of the extent to which a firm is resolvable given the firm's structure and under the resolution regimes its operates;

(ii) assessment co-ordinated by the home authority within the firm's Crisis Management Group (CMG) drawing on shared national assessments, and identification of the issues to be addressed by the firm and / or by specific authorities(s);

(iii) presentation of issues to be addressed to the firm (or relevant regulatory authorities); and

(iv) remediation by the firm or relevant regulatory authorities, and re-assessment of resolvability co-ordinated by the home authority.

4. Assessing the feasibility of resolution strategies

Set out below are some of the questions that, at a minimum, would need to be explored in order to assess the feasibility of resolution strategies. In order to address these questions authorities should have collected, processed and verified the necessary information from the firm (see Section 5 of "*Recovery and Resolution Plans"*).

Firm structure and operations

4.1 **Firm's essential functions and systemically important functions.** Based on the firm's strategic analysis, what are the principal businesses and what are the services that are core to the firm's franchise value? What critical financial and economic functions does it perform for the global and national financial systems and the real economies?

4.2 **Mapping of essential functions and systemically important functions and corporate structures.** How do legal and corporate structures relate to principal business lines and critical and core functions?

4.3 **Intra-group exposures.** What is the extent of the use of intra-group guarantees, booking practices and cross-default clauses? Are intra-group transactions well documented? How strong is the relevant risk management? To what extent are these transactions conducted at arm's length? Could back-to-back trades be unwound (e.g., to facilitate a partial sale), if necessary? Do intra-group transactions result in material imbalances of value across legal entities?

4.4 **Continuity of Service Level Agreements.** What is the extent to which key operational functions such as payment operations, trade settlements and custody are outsourced to other group entities or third party service providers? How robust are the existing Service Level Agreements in ensuring that the key operational functions will continue to be provided to a bridge bank or surviving parts of a resolved firm when necessary?

4.5 **Assessment.** What are the obstacles to separating systemically important functions from the rest of the firm in a resolution and for ensuring their continuity, given the issues explored in 4.1 to 4.4 above?

Management information systems (MIS)

4.6 **Adequacy of MIS.** To what extent do the firm's MIS capabilities permit it to construct a complete and accurate view of its aggregate risk profile under rapidly changing conditions? Can the firm provide key information such as risk exposures, liquidity positions, interbank deposits and short-term exposures to/from major counterparties (including Central Counterparties (CCPs)) on a daily basis? Can the firm ensure the continuity of MIS for both the remaining and resulting entities if the firm or one or more component legal entities have entered into resolution or insolvency? Are the necessary MIS available at the legal entity level, including on intra-group transactions and collateral?

4.7 **Prompt provision of necessary information to relevant authorities.** How quickly could information (e.g., financial, credit exposure, legal entity specific and regulatory) be provided to the home supervisor, to functional supervisors, to resolution authorities and to host supervisors, as appropriate? What types of legal impediments preclude information sharing among authorities? Does the institution have processes and tools to provide authorities with the information necessary to allow the rapid identification of depositors and amounts protected by a deposit insurance scheme?

4.8 **Assessment.** In the authorities' view, to what extent is it likely that the firm could deliver sufficiently detailed, accurate and timely information to support an effective resolution?

Coordination of national resolution regimes and tools

4.9 **Domestic powers and tools to maintain continuity of systemically important functions.** Do the resolution regimes in the jurisdictions where the SIFI performs systemically important functions (or has subsidiaries which provide crucial services to those functions) provide for the resolution powers and tools set out in Section 4 of the *Key Attributes*?

4.10 **Cross-border resolution powers.** Do home and host country authorities have the requisite powers to act in a manner that supports implementation of a coordinated resolution, as set out in Section 8 of the *Key Attributes*? For example:

- What are the mechanisms in place to coordinate with a host authority the cross border operation/recognition of a bridge institution when the home authority has decided to use such a tool as part of a resolution procedure?
- Do resolution regimes provide for a differential treatment of creditor claims on the basis of the location of the claim, or the jurisdiction where it is payable?
- How would domestic actions triggered by resolution in foreign jurisdictions affect the resolution process? Is there a risk that they could automatically trigger action in other jurisdictions?

4.11 **Information sharing between home and host authorities.** Are there any legal impediments to information sharing? How willing and able are home and host authorities to share the information necessary to effect a co-ordinated resolution?

4.12 **Practical cross-border coordination.** Do existing cross-border cooperation agreements reflect the requirements set out in Section 9 of the *Key Attributes* and give authorities confidence that they have the practical, operational and legal capacity to coordinate effectively with their foreign counterparts?

4.13 **Assessment.** Are the authorities confident that they have the necessary legal tools and operational capacity to achieve an internationally co-ordinated resolution of the SIFI?

5. Assessing the systemic impact

A significant consideration in addressing the need to resolve one or more SIFIs is the set of expected adverse consequences for the financial system and the overall economy resulting from the failure. In the past, if these consequences were deemed too great, governments have felt pressed to provide public solvency support. A major goal of resolution planning is to identify and develop measures that mitigate the systemic impact of the firm's failure.

The ***residual*** systemic impact of the firm's failure reflects three sets of factors: (i) the inherent systemic risks in the firm's business profile; (ii) mitigating actions taken by the firm through sound business structures, governance, management practices and well-articulated resolution planning; and (iii) the robustness of the identified institution-specific resolution strategies. The criteria for evaluating the systemic impact of a firm's failure are still at a nascent stage and therefore the evaluation process is largely qualitative and judgemental. The core of the analysis, however, is assessing the residual systemic risks as they relate to the principal channels of systemic spillovers. Below are some suggested qualitative criteria to aid authorities' judgement of a given resolution strategy. The criteria should be assessed individually for each jurisdiction involved, and collectively for the firm as a whole.

5.1 **Impact on markets.** To what extent is the firm's resolution likely to cause disorder in domestic or international financial markets, for example because of lack of confidence or uncertainty effects?

5.2 **Impact on infrastructure.** What possible problems could the firm's resolution cause for or through financial market infrastructures (FMIs)? For example, could it lead to the triggering of default arrangements in FMIs, or leave other financial institutions without access to FMIs?

5.3 **Impact on funding conditions.** What are the likely impacts of the firm's resolution on other (similarly situated) financial firms in rolling over/raising funds?

5.4 **Impact on capital.** To what extent could the exposure of systemically important counterparties to the firm in resolution result in their capital, individually or in aggregate, falling to a dangerously low level?

5.5 **Impact on the economy.** To what extent could the firm's resolution and its consequences impact the economy and through which channels? Is there a potential for credit and capital flows to constrict? Are there important wealth effects?

Annex 5

Recovery and resolution plans

The FSB *Key Attributes of Effective Resolution Regimes* call on authorities to put in place an ongoing recovery and resolution planning process to promote resolvability as part of the overall supervisory process (*Key Attributes 11.1)*. An adequate, credible Recovery and Resolution Plan (RRP) is required for any firm which is assessed by its home authority to have a potential impact on financial stability, in the event of liquidation of that firm and payout under the deposit insurance scheme to that firm's insured depositors. This would include, at a minimum, all global systemically important financial institutions (G-SIFI) (*Key Attributes 11.2)*.

1. Objectives and governance of the RRP process

Recovery plan

1.1 The recovery plan (RCP) serves as a guide to the recovery of a distressed firm. In the recovery phase, the firm has not entered the resolution regime and therefore remains in principle under the control of its management, although the authorities may be able to order or enforce the implementation of recovery measures through ordinary supervisory powers. The RCP includes measures to decrease the risk profile of a firm and conserve capital, as well as strategic options such as the divestiture of business lines and restructuring of liabilities.

Resolution plan

1.2 The resolution plan (RSP) is intended to facilitate the effective use of the resolution authority's resolution powers with the aim to make feasible the resolution of any financial institution without severe systemic disruption and without exposing taxpayers to loss while protecting systemically important functions. It serves as a guide to the authorities for achieving an orderly resolution, in the event that recovery measures are not feasible or have proven ineffective.

Underlying assumptions

1.3 RRPs should be based on the specific characteristics of the firm and the tools available under the existing resolution regime. Stress scenarios should be sufficiently severe. Both firm-specific and system-wide stress scenarios should be considered taking into account the potential impact of cross-border contagion in crisis scenarios, as well as simultaneous stress situations in several significant markets. The options for recovery and resolution measures should be concrete and practical.

1.4 The RRP should make no assumption of exposures of taxpayers' funds to loss.

Responsibility for recovery plan

1.5 The responsibility for developing and maintaining, and where necessary, executing the RCP lies with the firm and, more specifically, the firm's senior management. Authorities should review the RCP, assessing its credibility and ability to be effectively implemented as part of the overall supervisory process.

1.6 Firms should update the RCP at regular intervals, and upon the occurrence of events that materially change the firm's structure or operations, its strategy or aggregated risk exposure. Firms should regularly review the exogenous and firm-specific assumptions an RRP is based upon and assess on an ongoing basis the relevance and applicability of the plans. If necessary, firms should adapt their RRPs accordingly and provide all relevant information to the authorities in a timely manner.

1.7 Firms should have in place a robust governance structure in support of the recovery and resolution planning process. This includes clear responsibilities of business units, senior managers, up to and including board members and identifying a senior level executive responsible for ensuring the firm is and remains in compliance with RRP requirements, and for ensuring that recovery and resolution planning is integrated into the firm's overall governance processes. The firm will need to ensure that sufficient resources are available to fulfil its responsibilities in connection with both the recovery and resolution phases of the RRP.

1.8 Firms should have in place systems to generate the information required to support the recovery and resolution planning process (see below Section 5), to enable both the firm and the authorities effectively to carry out recovery and resolution planning, and where necessary, implement the RRP.

1.9 Firms should upon request, engage in periodic table top or other scenario exercises with home and host regulatory authorities in order to ensure that the plans produced through the RRP process are viable.

Responsibility for resolution plan

1.10 The responsibility for developing and maintaining, and where necessary, executing the resolution strategies set out in RSPs lies with the authorities. However, firms are responsible for providing the authorities with the data and information, including strategy and scenario analysis, required for purposes of resolution planning on a timely basis.

1.11 Authorities should identify the specific information requirements and supervise that the firm has the capacity to provide them on a timely basis.

1.12 Authorities should establish a robust governance structure for the oversight of the recovery and resolution planning processes, including the ongoing review and updating of RRPs. Responsibilities for the development, review, approval and maintenance of RRPs should be clearly assigned. In those jurisdictions, where a court order is required to apply resolution measures, resolution authorities should take this into account in the resolution planning process, so as to ensure that court proceedings will not affect the effective implementation of resolution actions.

1.13 Recovery and resolution planning should become an integral part of authorities' ongoing supervision. They should ensure that sufficient resources and expertise are available to support the preparation and assessment of RRPs. Sufficient resources should also be dedicated to monitor the viability of RRPs on an ongoing basis, and define and communicate a clear process for interaction with the firms in recovery and resolution planning. This includes setting out a clear procedure, expectations placed on the firm and escalation process.

1.14 Authorities may discuss RSPs with the firms to the extent they believe is useful, and confidentiality is not necessary to preserve the effectiveness of the resolution plan or other public policy considerations. Authorities may decide not to disclose the RSP or parts of it to the firms.

Review

1.15 Authorities should put in place arrangements to monitor and where necessary direct the updating of RRPs on an ongoing basis, to take into account any changes in circumstances facing the firm or the financial system. There should be processes to review any changes in the underlying assumptions of the firm's RRP, and to incorporate any new information into the RRPs.

1.16 Authorities should review, and where necessary, direct changes to the stress scenarios underlying a firm's RRP. The stress scenarios should adequately consider all relevant endogenous and exogenous risk exposure that the firm faces, taking into account the firm's specific situation, strategy and positions. Authorities should seek to achieve a certain degree of consistency in the severity of stress scenarios used by different firms. However, the stress scenarios used need not be the same for each firm and they do not necessarily need to be highly specific.

1.17 Authorities should also assess the willingness of the bank's management to implement corrective measures, and where necessary, enforce the implementation of recovery measures. Authorities should be mindful that in situations of systemic crises, the effectiveness of certain measures may be undermined if those measures were implemented by several firms at the same time.

1.18 The top officials in the home and key host jurisdictions within supervisory colleges and CMGs should satisfy themselves that the RRPs are viable, taking into consideration the underlying scenarios, time frame needed to implement the measures and any challenge posed by cross-border operations.

Coordination among authorities at national level

1.19 At the national level, all relevant authorities involved in supervision, implementation of corrective actions as well as resolution should participate in the RRP process.

Cross-border coordination

1.20 On a national and cross-border level, relevant authorities should engage in periodic table top or other scenario exercises in order to ensure that the plans produced through the RRP process are viable, and to help prepare for a co-ordinated resolution. These exercises may include the subject firm. The outcomes of the exercises, including weaknesses noted and mitigating actions should be reported to the top officials of relevant host authorities.

1.21 As set out in the *Key Attributes* (Section 11.6), for G-SIFIs, the home resolution authority should lead the development of the group resolution plan in coordination with all members of the institution's CMG. Meetings involving top officials of the home and relevant host authorities to assess the robustness of the RRPs of G-SIFIs should be held at least on an annual basis, where appropriate with the CEO.

1.22 For all G-SIFIs, the home authorities should have a process to ascertain which jurisdictions not included in the CMG judge the local operations of the firm as systemically important to the local financial system, including the reasons for its importance. The home authorities should also establish a process for maintaining contact with such non-CMG jurisdictions.

2. General outline of RRPs

Structure of RRPs

2.1 To support rapid execution both recovery and resolution plans should include

(i) an executive summary;

(ii) a strategic analysis;

(iii) intervention conditions describing necessary and sufficient prerequisites for triggering the implementation of recovery or resolution actions;

(iv) concrete and practical options for recovery and resolution measures;

(v) preparation actions to ensure that the measures can be implemented effectively and in due time; and

(vi) responsibilities for executing preparatory actions, triggering the implementation of the plan and the actual measures.

Executive summary

2.2 RRPs should have a high-level executive summary, which includes an overview of key elements of the firm's strategy for recovery or resolution, an organisational chart of the firm's major operations, a description of the most important measures involved in implementing each phase of the RRP, potential impediments to their successful implementation and any material changes or actions taken since the firm's last RRP submission.

Strategic analysis

2.3 A key component of RRPs is a strategic analysis that identifies the firm's essential functions and systemically important functions and sets out the key steps to maintain them in recovery as well as in resolution scenarios. Elements of such analysis should include:

(i) identification of essential, as well as systemically important functions, mapped to the legal entities under which they are conducted;

(ii) actions necessary for maintaining operations of, and funding for, these essential, as well as systemically important functions;

(iii) assessment of the viability of any business lines and legal entities which may be subject to separation in a recovery or resolution scenario, as well as the impact of such separation on the remaining group structure and its viability;

(iv) likely effectiveness and potential risks of each material aspect of the recovery and resolution actions, including impact on customers, counterparties and other market participants;

(v) estimate of the sequencing and the time needed to implement each material aspect of the plan;

(vi) underlying assumptions for the preparation of the RRPs;

(vii) potential material impediments to effective and timely execution of the plan; and

(viii) processes for determining the value and marketability of the material business lines, operations, and assets.

3. Essential elements of a recovery plan

3.1 In their recovery plan, firms should define clear backstops and escalation procedures, identifying the criteria (ideally both quantitative and qualitative) which would trigger the implementation of an RCP. Given that the firm is still in principle under the control of the management, the decision to trigger the implementation is the responsibility of the management, in consultation with the authorities. Such triggers should prevent undue delays in the implementation of recovery measures.

3.2 Firms should identify the necessary actions to strengthen their capital situation, e.g., recapitalisations after extraordinary losses, capital conservation measures such as suspension of dividend), and capital raising measures together with the necessary steps to implement them and the time horizon needed for their implementation.

3.3 Firms should identify possible restructuring of their business operations and liabilities structure, e.g., firms should assess: (i) possible sales of subsidiaries and spin-offs of business units, together with the pre-conditions and necessary steps to implement such a restructuring, and the associated risks (e.g., impact on market confidence); and (ii) a possible restructuring of liabilities through debt-for equity swaps.

3.4 Firms should assess their resilience to liquidity stress scenarios by identifying measures to secure sufficient funding, ensuring sufficient diversification of funding sources and adequate availability of collateral in terms of volume, location and quality. Proper consideration should also be given to possible transfers of liquidity and assets within the group.

3.5 Firms should ensure an organisational and operational set-up (e.g., functioning of internal processes, IT systems, uninterrupted access to clearing and settlement facilities, exchanges and trading platforms) is in place to enable them to continue to function in a recovery phase by assessing the potential impact of any change to the business operations.

3.6 Firms should develop a proper communication strategy with financial markets and other stakeholders, so as to limit doubts about their viability. They should also promptly provide home and host supervisors with the necessary data and information.

3.7 Firms should ensure effective preparation of the above measures by indicating the concrete steps they have implemented or will implement in due time if necessary in the light of the foreseen recovery measure, including the implementation of adequate governance and crisis management processes.

4. Essential elements of a resolution plan

4.1 Authorities should establish the regulatory and legal conditions that provide grounds for the initiation of official actions (e.g., early intervention thresholds, thresholds under national insolvency laws) and scope for authorities' discretion (e.g., the extent to which authorities can refrain from taking actions or not avoid acting under certain conditions).

4.2 Authorities should identify potential resolution strategies and the necessary preconditions that facilitate the implementation of the resolution strategies, using the tools set out in Section 4 of the *Key Attributes* and with regard to arrangements for cross-border co-ordination. The inclusion of a resolution strategy in a resolution plan does not in any way imply that the authorities would be obliged to implement it, or be prevented from implementing a different strategy in the event that the firm needs to be resolved.

4.3 For each resolution strategy, based on information and analysis from firms authorities should identify:

(i) the critical interdependencies and the impact of resolution actions on other business lines/legal entities (would other entities be able to continue to operate?); financial contracts (do authorities have powers to prevent, limit and/or delay termination / close-out rights?); markets and other firms with similar business lines; and include a comparative estimate of losses to be borne by creditors and any premium associated with various resolution strategies;

(ii) the range of sources available for resolution funding and the processes for ensuring effective operations by deposit insurance funds (e.g., by identifying insured and uninsured depositors);

(iii) the processes for preserving uninterrupted access to clearing and settlement facilities, exchanges and trading platforms;

(iv) the processes for ensuring (limited) continuity of internal process and market presence;

(v) modalities to implement proper communication strategies and ensure cross-border cooperation.

5. Information requirements for recovery and resolution planning

Firms should have the capacity to provide the essential information needed to implement the RRPs on a timely basis for purposes of recovery and resolution planning, as well as in crisis situations, including information on the following:

5.1 Intra-group inter-linkages, e.g., core business operations and interconnectedness by business and by legal entity/jurisdictional lines and information on intra-group exposures through intra-group guarantees and loans as well as trades booked on a back-to-back basis; dependencies of the firm's legal entities on other group entities for liquidity or capital support or other (e.g., operational) support.

5.2 Operational data, e.g., the extent of asset encumbrance, amount of liquid assets, off-balance sheet activities, etc.

5.3 Operational set-up that supports the execution of recovery and resolution measures, e.g., information on dealing room operations, including trade booking practices, hedging strategies, custody of assets etc; information on payment, clearing and settlement systems; and inventory of the key management information systems (MIS, including accounting, position keeping and risk systems) and applications used by the firm.

5.4 Key crisis-management roles and responsibilities, e.g., contact information, communication facilities for in-crisis communication, and modalities for accessing and sharing information with relevant home and host authorities, both in normal times and in-crisis.

5.5 Legal and regulatory framework in which the firm operates, e.g., the relevant home and host authorities and their roles, functions and responsibilities in financial crisis management; resolution regimes, including the key aspects of applicable corporate, commercial, insolvency, and securities laws and insolvency regimes affecting major portions of the group; liquidity sources, including both private and central bank sources.

Annex 6

Measures to improve resolvability

Complex organisational structures and business models, with economic functions and business lines spanning multiple legal entities with a web of intra-group exposures, complicate resolution. The FSB has identified four key areas arising from the complexities of systemically important financial institutions' (SIFIs') operations that may pose obstacles to resolution: (i) fragmented information systems; (ii) reliance on service providers; (iii) intra-group transactions; and (iv) global payment operations. Set out below are proposed recommendations for financial institutions aimed at improving their resolvability by overcoming the obstacles to resolution arising from the four identified areas. Although these proposals are aimed at improving resolvability, they should be designed to also enhance the effectiveness of firms' daily operations and risk management. As part of the consultation, the FSB seeks comments on the implications of the proposals on firms' operations and risk management in normal times.

1. Information systems

Timely and comprehensive information on a firm's risk and financial positions should be available to firms and regulatory authorities both in normal times and crisis situations.

In a resolution, the focus will naturally be more on individual legal entities. Firms therefore require legal entity-specific information to assess the extent of interconnectedness of the individual entities within a group, as well as impediments to separability. Regulatory authorities need such information to effectively plan for and implement a resolution.

In a resolution which involves transfers of some or all operations of, or the ownership of individual legal entities as a whole, to one or more bridge entities or third-party purchasers, management information systems (MIS) should continue to be available to the remaining group entities, to the new owners in the case of transferred entities, and to service providers supporting critical functions.

Legal entity-specific information on intra-group transactions is critical in the resolution process, e.g., for identifying and assessing the extent of inter-affiliate claims. The impact of complex booking practices may also be mitigated by MIS with the ability to track trades across multiple entities and facilitate positions and hedge adjustments. Comprehensive management information also helps reduce the ambiguity over the valuations and risk positions of individual entities (with each other and with third parties).

The lack of MIS with capabilities to provide both aggregated and legal entity-specific information, in both normal times as well as in crisis situations and resolution, would pose obstacles to resolution. The FSB has developed the following recommendations to address the above obstacles.

1.1 MIS should provide firms and regulatory authorities with comprehensive, pertinent information on a timely basis at both aggregate and legal entity level.

(i) Firms should maintain a detailed inventory, including description and location of the key MIS used in its material legal entities, mapped to their core services and critical functions;

(ii) Firms should identify and address exogenous legal constraints on the exchange of management information among the firms' constituent entities; and

(iii) Firms should demonstrate, as part of the recovery and resolution planning process, that they are able to produce the essential information needed to implement such plans within a short period of time (e.g., 24-hour).

2. Service level agreements (SLA)

In many firms, for reasons of efficiency and economies of scale, operational functions such as trade settlements, custody of securities, payment operations and information technology are outsourced. The service provider could be either a specialised unit, usually a separate legal entity within the firm, or a third-party. While outsourcing arrangements could bring about benefits in normal times, they may unnecessarily complicate resolution if the preconditions are not put in place to ensure continuity of the services in a resolution. To ensure that essential functions would continue in a resolution, e.g., for the parts of a firm transferred to a bridge-bank or surviving parts of a resolved firm, the FSB has developed the following recommendations.

2.1 Key service level agreements (SLAs) should be legally enforceable in crisis situations and in resolution.

(i) Firms should enter with the relevant parties into SLAs, as necessary, that are critical to the continuity of the firm as a whole and to its individual legal entities.

(ii) Firms should include provisions that prevent termination of SLAs triggered by recovery or resolution events and facilitate transferability to a bridge-bank or a third party acquirer.

3. Organisational complexity and intra-group transactions and exposures

Complexity in organisation structures, e.g., conduct of business through a complex web of separate legal entities makes resolution challenging. In normal times, these intra-group transactions and exposures may allow individual subsidiaries to benefit from the consolidated strength of the group, for example, through providing comfort to counterparties and creditors at the subsidiary level, and enabling economies of scale in risk management. The existence of intra-group transactions and exposures, including the use of intra-group guarantees (IGGs), back-to-back booking practices (BPs) and intra-group loan exposures and other funding increases interconnectedness and may impede separability of firms' transactions and legal entities.

In a resolution, the ability to quickly transfer assets from one entity to another is necessary for preserving the value of the good assets and the franchise value of the group as a whole. The existence of IGGs makes it challenging for a firm to transfer positions or portfolios from guaranteed entities to third parties as client consent would be required to not only transfer the trade but also to release the firm from the guarantee. Obtaining the release from the guarantee can add time and cost, e.g., price concessions or alternative credit support.

The use of IGGs also increases the likelihood that financially sound entities are caused to fail due to contagion. The insolvency of a guarantor, especially a parent, may hasten the insolvency of any guaranteed subsidiaries, thereby increasing the potential disruption to financial stability.

The use of back-to-back BPs can result in imbalances of value across legal entities, which may not be consequential in normal times, but can be problematic in a resolution. The individual legs of a trade can be caught in separate legal entities subject to different resolution regimes, making it very difficult to unwind or transfer the overall position. Any ring-fencing by local authorities can also trap value in one legal entity to the detriment of stakeholders of other legal entities, e.g., when collateral received is not passed through to the entity where the risk exposure resides. The FSB has developed the following recommendations to address the aforementioned challenges.

3.1 Intra-group transactions conducted at arm's length.

In structuring internal transactions, firms should adhere to the customary practices and requirements prescribed for dealing with external counterparties, such as standard documentation, netting and close-out arrangements, collateralisation, and margin maintenance on derivatives trades.

3.2 Ability to re-constitute, within a specified time, all separate legs of a transaction booked in separate intra-group entities.

Firms should:

(i) put in place preconditions that enable separate legs of a trade booked in different legal vehicles to be quickly collapsed, and re-constituted within a specified time in a single legal entity; and

(ii) limit imbalances between parent company and legal entities so as to avoid that the stability and the capital adequacy of the same legal entities is undermined when a crisis of the parent emerges.

3.3 Reducing unnecessary complexity in group structures, intra-group transactions and exposures.

Firms should:

(i) identify areas in their existing organisational structure where there is unnecessary complexity that creates difficulties in consolidated risk management and aggregation of the firm’s overall risk positions, thus impeding resolution, and take measures to reduce those complexities; and

(ii) identify existing IGGs, transactions and exposures that unnecessarily complicate resolution, and take measures to reduce those transactions and exposures.

3.4 Reducing inter-connectedness caused by terms of financial contracts

Firms should:

(i) consider eliminating or seek alternatives to cross-default clauses in Master agreements and other contractual rights counterparties have that can give rise to intra-group contagion in the event of distress or failure of a legal within a group; and

(ii) explore standardised valuation methodologies under ISDA for closing out derivatives contracts.

4. Global payment operations

The ability to continue operations of critical payment functions and carry out an orderly transfer of clients and business lines to a bridge institution or a private purchaser which is important for an orderly resolution in turn hinges on the firm’s ability to ensure continuity of access to financial market infrastructures (FMIs).

However, the existing entry and exit procedures (e.g., repercussions on membership due to credit rating downgrades) and modus operandi (e.g., requirements for higher collateral for weakened firm) of FMIs may pose obstacles to an orderly resolution as a firm’s access to FMIs may be impeded in a crisis. These issues are being addressed by the CPSS and IOSCO.

At the same time, it is important that firms develop and put in place contingency measures to ensure that they have continued access to FMIs to facilitate an orderly resolution when necessary. The challenges in transferring clients and business lines could also be mitigated if pertinent information that facilitates such transfers is readily available.

The FSB has developed the following recommendations to address these challenges in relation to global payment operations.

4.1 Contingency planning in respect of access to FMIs

Firms should:

(i) assess the additional requirements that they may potentially be subject to during crisis situations in order to maintain their FMI membership (e.g., pre-funding or collateralizing its positions); and

(ii) develop a range of options for addressing the additional requirements (e.g., plan for the sourcing of additional collateral, and assess potential constraints on the firm’s total payment flows).

4.2 Documentation and record-keeping requirements

Firms should:

(i) establish a centralised repository for all their FMI membership agreements to facilitate orderly transfers when necessary;

(ii) standardise documentation for payment services, covering issues including notice periods, termination provisions and continuing obligations, to facilitate orderly exits;

(iii) develop a draft Transitional Services Agreement as part of RRPs that, if needed, will allow the firm to continue to provide payments operations without a break (including access to FMIs) on behalf of the new purchaser, by using existing staff and infrastructure; and

(iv) develop a "purchaser's pack" that includes key information on the payment operations, credit exposures, lists of key staff, etc, to facilitate transfers of payments operations functions to a surviving entity, bridge institution or purchaser.

4.3 Alternative access to payments infrastructure for 2nd tier FMI members and clients

(i) Firms who are not direct FMI participants should have contingency arrangements to access the FMIs via more than one firm so that they can quickly switch if one direct participant fails; and

(ii) Firms providing FMI access for 2nd tier or lower firms should review their arrangements to ensure they are able to facilitate the switching of this access in the event of direct participant failure.

Annex 7

Discussion note on creditor hierarchy, depositor preference and depositor protection in resolution

1. An important feature of effective resolution regimes is to "*make it possible for shareholders and unsecured and uninsured creditors to absorb losses in their order of seniority.*" [12] This should be achieved in a manner that the risk of contagion is kept to a minimum and the need for bail-outs is absent. Clarity and predictability as regards the order of seniority or statutory ranking of claims in insolvency is a necessary prerequisite for effective resolution. It determines the allocation of losses. It shapes the incentives of market participants and pricing of risk. It affects the ease with which certain resolution measures can be applied. Differences in ranking can complicate cross-border resolutions. The FSB is therefore seeking public comments on the issue of whether or not greater convergence in the ranking of creditor claims across jurisdictions and in particular in, the treatment of deposit claims, could be pursued further at the international level.

I. The statutory hierarchy of claims in resolution

2. In insolvency, the liquidator or receiver distributes the proceeds according to a hierarchy of claims which is established by law. The highest-priority creditors are repaid first, and lower-priority ones are repaid only to the extent there are funds available. The typical classes consist in descending order of priority of: (i) secured creditors (up to the value of the collateral); (ii) those whose claims arise in the context of the administration of the liquidation or wind-down (e.g., fees of the liquidator and costs arising from continuing contract obligations that are essential for winding down the business); (iii) other preferred creditors; (iv) general unsecured creditors; (v) unsecured subordinated debt holders; and (vi) shareholders. The category of preferred creditors may be subdivided into several classes with differing priorities and typically includes: accrued payroll and wage claims; social security and claims of the fiscal and other public authorities; debtor in possession financing; and in some jurisdictions depositor claims. Further, the exercise of set-off and netting rights will also have the effect of providing a preference over other unsecured creditors.

II. Depositor preference

3. The ranking of claims in insolvency differs across jurisdictions. For example, in some countries depositors are treated as a class distinct from general unsecured creditors. This is referred to as "depositor preference" in insolvency. In the absence of depositor preference that subordinates the claims of other senior unsecured creditors to those of depositors, depositors have no greater claim on residual assets in the event of bankruptcy than senior

12 See Recommendation 12 of the SIFI recommendations.

unsecured creditors generally. Given that losses are imposed pro rata within each creditor class, depositors will bear the same losses, *pari passu* as senior unsecured creditors.

4. To the extent that depositors are insured by a deposit guarantee scheme, they will be compensated by the scheme. The existence of depositor preference is therefore only relevant for the uninsured portion of the depositor claim. It matters for recoveries by the deposit insurer. In most jurisdictions, the deposit insurer is subrogated to the rights of depositors against a failed institution. The concept of subrogation effectively allows the deposit insurance agency to “stand in the shoes” of the depositor when dealing with the liquidation of a deposit-taking institution and assume the claims of the depositor against the failed institution in order to recover its funds in the resolution process.

5. Certain jurisdictions provide for forms of depositor preference, including Australia, Argentina, China, Hong Kong, Switzerland and the United States. However, the scope of the preference differs. Some provide a broad preference, others, such as Hong Kong and Switzerland limit the preference to the insured amount. Broadly, the following approaches can be distinguished:

- **General depositor preference** gives preference to all deposit liabilities of a deposit-taking institution, irrespective of their deposit insurance eligibility, their covered status or the location where the deposits are booked or payable (whether in the local jurisdiction or at a foreign branch).
- **National depositor preference** gives preference to deposit liabilities booked and payable within the domestic jurisdiction and does not extend to deposits booked and payable at foreign branches.
- **Eligible depositor preference** gives preference to all deposits meeting the eligibility requirements for deposit insurance coverage (e.g., all classes of deposit covered by the scheme irrespective of limits).
- **Insured depositor preference** covers only insured depositors and no depositors outside the scope and limits of the deposit insurance system. The uninsured amount of a deposit will be treated as an unsecured senior creditor claim

III. The benefits and risks of depositor preference

6. The benefits and risks of depositor preference should be assessed in the light of the objectives of effective resolution regimes set out in the Preamble of the *Key Attributes* (see Annex 1).

7. On the one hand, there are arguments that a general depositor preference could offer additional protection and potentially higher recoveries to depositors (and where subrogation is present, deposit insurance agencies); reduce the incentive of uninsured depositors to run to the extent that they take comfort from the resolution regime’s capacity to sustain their position; augment the incentives of holders of non-deposit liabilities to exercise more effective discipline over risk-taking by banks through closer monitoring; facilitate the implementation of resolution options, such as partial transfers, statutory bail-in or good bank/bad bank splits; reduce the eventual costs of providing deposit insurance (where subrogation is present and the deposit insurer is subrogated to the rights of insured depositors against the failed institution);

and contribute to more effective cross-border resolutions if a more uniform treatment of depositors were adopted across jurisdictions.

8. If depositors and other general unsecured creditors had to be treated *pari passu* by statute, resolution options that distinguish among depositors and other categories of creditors could be more difficult to achieve in some jurisdictions. For instance, if a resolution authority were to carve out all deposits and transfer them to a bridge bank or third party in order to preserve the continued operation of the deposit taking function, but leaves in the receivership other general creditors it could possibly face legal challenges in jurisdictions that require that similarly situated creditors within the same class be treated equally, unless the creditors left behind are not in a lesser position. These challenges could be less likely to arise if all depositor claims were preferred. Similarly, if the resolution authority chose to apply its statutory bail-in powers and convert senior unsecured creditor claim into equity in order to recapitalise the failing bank or alternatively to capitalise a newly established entity or bridge institution to which the failing institution's vital functions have been transferred, the resolution authority could face similar challenges. Some jurisdictions have deposit protections arrangements under which the protection of depositors is so extensive that these issues do not arise.

9. On the other hand, the argument could be made that preferences increase the risks for financial stability. When depositors are given a higher ranking than other creditors, it increases the potential loss exposure of the lower ranking creditors, thereby increasing incentives for them to exercise more market discipline and run than would otherwise be the case. Non-deposit creditors can take actions to better protect themselves such as collateralizing their claims, shortening terms of maturity, or imposing additional charges. Depositor preference could also impair the incentives of uninsured depositors to monitor risks and encourage troubled banks to attract depositors through offering high-yield large-scale deposits; lower recoveries to non-depositors. When a deposit insurance fund that is funded by contributions from the financial sector is subrogated to the right of depositors, the financial sector may indirectly benefit from deposit preference at the detriment of other senior unsecured creditors, in particular when it is funded on an *ex post* basis.

10. As a general matter, any change in the statutory hierarchy of claims will have far reaching implication for the overall ranking of claims in insolvency. Its implementation in national resolution regimes would therefore require strong political support and its benefits would need to clearly outweigh its costs.

IV. Cross-border implications

11. Differences in the ranking of claims across jurisdictions will affect the willingness of national authorities to cooperate and achieve coordinated cross-border solutions. The effective protection of local creditors and depositors, in particular, is an important consideration in the determination by national authorities of whether to cooperate with their foreign counterparts. A host authority will be more willing to support a resolution led by the home country, and to give effect to home country actions in its own jurisdiction, if the home jurisdiction's laws provide for the fair and equitable treatment of host country creditors and do not prefer local creditors in the home jurisdiction over foreign creditors. By contrast, a preference for the home jurisdiction's depositors over the depositors of the failing firm's foreign branches is

likely to lead host authorities to act locally in order to protect their local depositors. Convergence in the statutory ranking of creditors and in particular the treatment of depositors (including retail and wholesale depositors) – whether or not in the direction of depositor preference - could promote cross-border cooperation and improve the predictability of outcomes of cross-border resolutions, though it inevitably raises the question of the scope of the coverage and definition of a deposit, which differs across jurisdictions.

V. Interaction with deposit guarantee schemes

12. Statutory deposit guarantee schemes are designed to protect small-scale depositors and to mitigate, in part, the impact of a bank failure on financial stability. The features of effective deposit guarantee schemes are reflected in the Core Principles for Effective Deposit Insurance Systems promulgated by the International Association of Deposit Insurers (IADI) and Basel Committee on Banking Supervision (BCBS)**.** Most mandatory deposit insurance arrangements are domestic in scope and provide protection for depositors of locally incorporated banks (whether foreign owned or not) and local branches of foreign banks. An exception is the deposit protection framework in the European Economic Area (EEA), where home country deposit insurance arrangements cover deposits in branches in other EEA countries. Coverage levels under deposit guarantee schemes differ across jurisdictions and are determined by a range of factors, including the average size of deposits in individual jurisdictions, the coverage levels of in the region.

13. It is generally recognized that deposit insurance is an effective means of protecting depositors of small and medium sized firms. However, some deposit insurance schemes may not have the capacity to effectively protect depositors of a large systemically important financial firm. Where this is the case, a system of depositor preference could provide an additional layer of protection and lower the costs of providing depositor protection by allowing depositors and the deposit insurer if it is subrogated to the rights of depositors to recover their claims in full before the remaining claimants are compensated. However, as discussed above, the individual firm's liability structure (and the changes it can undergo during times of financial stress) would ultimately determine the degree to which depositor preference could effectively lower an insurer's costs.

VI. Issues for discussion

14. Greater consistency in the statutory ranking of creditors, and in particular the treatment of depositors (including retail and wholesale depositors), could promote cross-border cooperation and facilitate the implementation of certain resolution measures, such as partial transfers. In this regard, if properly designed, convergence of the ranking of deposits in resolution could help address the objectives of protecting insured depositors and reducing any implicit government guarantee of deposits.

15. The FSB is therefore seeking comment on whether or not existing differences in statutory credit ranking represent an impediment to effective cross-border resolution and greater convergence in particular in, the treatment of deposit claims, should be pursued further at the international level (see ***Questions for public consultation*** in the Consultative Document Section II. 1.)

Annex 8

Discussion note on conditions for a temporary stay on early termination rights

1. Under standard market documentation for financial contracts, contractual acceleration, termination and other close-out rights (collectively, “early termination rights”) in financial contracts may be triggered when the resolution authorities initiate resolution proceedings or take certain related resolution actions with respect to a financial institution. In the case of a systemically important financial institution (SIFI), the termination of large volumes of financial contracts upon entry into resolution could result in a disorderly rush for the exits and frustrate the implementation of resolution measures, such as the transfer of critical operations to a bridge bank, or the implementation of bail-in within resolution, which are aimed at achieving continuity of systemically important functions and of the financial contracts that support them. The objective of this note is to seek public comments on conditions under which a brief stay on early termination right should be imposed following entry into resolution and pending the use of resolution tools, as well as the length and scope of such a stay, possible exemptions and its cross-border application.

I. Background - role of stays in resolution proceedings

2. Special resolution proceedings for financial institutions, as well as general corporate insolvency frameworks, provide for moratoria or stays on the rights of creditors and counterparties to enforce their claims on the (assets of the) troubled entity. They also typically prohibit counterparties from exercising their contract termination rights under so-called contractual “ipso facto clauses” that treat the initiation of insolvency or resolution proceedings as an event of default and permit the non-defaulting counterparty to terminate the contract. Many jurisdictions have explicitly exempted certain types of financial contracts from the scope of such a stay on the exercise of contract termination rights on financial stability grounds to avoid adverse contagion effects spreading from an insolvent firm to its solvent counterparties.[13] Such exemptions typically cover swap agreements, spot, future, forward agreements, repurchase agreements, and agreements to buy, sell, borrow or lend securities. The initiation of insolvency or resolution proceedings or the taking of resolution-related actions with respect to the financial institution generally constitute an event of default under these contracts and triggers early termination rights.

13 For example, the Collateral Directive requires European Union Member States to ensure that financial collateral arrangements and close-out netting provisions can take effect in accordance with their terms, “notwithstanding the commencement or continuation of winding up proceedings or reorganisation measures in respect of the collateral provider and/or the collateral taker”.

II. Discretionary versus automatic stays

3. The triggering of such early termination rights risks destabilising markets through, for example, the liquidation of collateral at fire-sale prices and the rush by counterparties to re-hedge their positions, particularly if the firm involved is large. It also complicates attempts to resolve the troubled financial institution and frustrate the implementation of resolution measures, such as the transfer of critical operations to a bridge bank, or the implementation of bail-in within resolution, aimed at achieving continuity of systemically important functions and of the financial contracts that support them. Preventing such close-out netting, termination, acceleration, or enforcement of security by any counterparty could be done in one of two ways:

(i) by providing the resolution authority with a discretionary power to impose, at its discretion, a temporary stay on close out rights upon the entry into resolution of the firm; or

(ii) by introducing a statutory provision that prevents the exercise of early termination clauses upon taking of certain resolution measures.

4. The stay would be aimed at achieving continuity of operations and therefore would not extend to all payment and delivery obligations and would not prevent close-out for reasons of failure to pay or deliver (so margin calls would still have to be met if due, or counterparties could close out, as at present). The starting point of the period of suspension would need to be clearly specified. Depending on the precise features of the jurisdiction's legal framework, it could be tied to the initiation of formal resolution proceedings or to a public announcement by the resolution authorities. A discretionary imposition of a temporary stay would in all cases require a public announcement.

III. Conditions and safeguards

5. In designing a legal framework that provides for a temporary stay of early termination rights, the following safeguards should be in place:

(i) The suspension should apply to provisions in financial contracts that trigger early termination rights by virtue of, or incidental to, the initiation of insolvency or resolution proceedings, or by virtue of a change in control of the relevant institution or its business arising from such proceedings;

(ii) The period of time during which the authorities could delay the immediate operation of such contractual early termination rights pending a transfer should be limited in duration (e.g., 24-48 hours or until the end of the next business day). It should provide authorities with sufficient time to decide on the resolution measures and to decide which assets or liabilities should be transferred and how to effect the transfer;

(iii) Counterparties' rights to terminate for "failure to pay" reasons (e.g., if a margin call is missed) should be preserved. After the period of the suspension, early termination rights could be exercised for those financial contracts that are not transferred to a sound financial institution, bridge financial institution or other public entity;

(iv) For contracts that are transferred to a third party or bridge bank, the acquiring entity would assume all the rights and obligations of the financial institution from which the contracts were transferred. In particular, the acquiring entity would assume all payment and margin requirements under all the transferred contracts;

(v) For contracts that are transferred, the exercise of early termination rights on the basis of the resolution of the troubled financial institution would continue to be precluded but any acceleration or termination rights based on a *subsequent* default by the acquiring entity should be preserved**;**

(vi) The authorities would only be permitted to transfer all of the contracts with a particular counterparty to a new entity and would not be permitted to select for transfer individual contracts with the same counterparty and subject to the same netting agreement ("cherry-picking");

(vii) In the case of a transfer to a bridge financial institution or other specialized entity that is not required to be capitalized under the applicable legal framework or that does not have a credit rating, some form of assurance may be needed. The availability of temporary liquidity funding through the resolution regime (without imposing costs on taxpayers) would generally provide sufficient assurances for counterparties. If the acquiring entity is a healthy institution that is fully capitalized and in compliance with prudential requirements, assurances of performance should not be necessary, especially since the counterparties' rights to terminate based upon a breach of the contract by the acquirer would be enforceable; and

(viii) Such legal authority would be implemented so as to avoid compromising the safe and orderly operations of regulated exchanges, Central Counterparties (CCPs) and financial market infrastructures (FMIs).

IV. Cross-border Issues

6. The imposition of a stay by a resolution authority in one jurisdiction does not have effect on contracts governed by the law of another jurisdiction. Conceptually, there would appear to be four different possible mechanisms ensure the cross-border effectiveness of a temporary suspension, some of which could be combined.

- **Contractual.** Authorities could require firms to incorporate provisions in their financial contracts whereby their counterparties recognize:

  (i) the right of the home jurisdiction to impose a temporary suspension of early termination rights as provided for under its resolution regime;

  (ii) the right of the home jurisdiction to transfer the relevant contracts; and

  (iii) that the transfer of such financial contracts to a third party, including bridge institutions, in and by itself does not constitute an event of default under the contract.

- **Administrative power given to host jurisdiction authorities.** Host jurisdiction authorities would be empowered to give effect in their jurisdiction, through an administrative act, to the suspension and the transfer implemented by the home jurisdiction. Such a power could most easily be established in jurisdictions where there are branches or regulated subsidiaries of the financial institution in resolution. Where there is no such physical presence but the financial institution in question has assets in the jurisdiction or has entered into contracts that are subject to the law of that jurisdiction as the governing law, other mechanisms for giving effect to the stay may need to be considered.
- **Courts.** Under existing legal mechanisms in many countries, the home jurisdiction authorities may apply to the courts in the relevant host jurisdiction for recognition of their resolution proceeding and seek a ruling giving effect to the suspension.
- **Automatic universality.** Some jurisdictions currently give automatic effect to the insolvency or reorganisation proceedings of other jurisdictions (e.g., within the EU), though this approach is not wide spread.

V. Issues for discussion

7. The FSB is seeking views on the suggested brief stay on early termination rights pending the implementation of certain resolution tools (see ***Questions for public consultation*** in the Consultative Document Section II. 2.)