FSB FINANCIAL STABILITY BOARD

Cross-border recognition of resolution action

Consultative Document

29 September 2014

The Financial Stability Board (FSB) is seeking comments on its Consultative Document on Cross-border recognition of resolution action ('consultative document').

The FSB's September 2013 report on *Progress and Next Steps Towards "Ending Too Big To Fail" (TBTF Report)*[1] identified uncertainties about the cross-border effectiveness of resolution measures as an important impediment to cross-border resolution. Unless resolution actions can be given prompt effect in relation to assets that are located in, or liabilities or contracts that are governed by the law of a foreign jurisdiction, authorities are likely to face obstacles in implementing group-wide resolution plans effectively for cross-border groups.

Accordingly, in the *TBTF Report* FSB made a commitment to "develop policy proposals on how legal certainty in cross-border resolution can be further enhanced" by the time of the Brisbane Summit. This consultative document responds to that commitment and proposes a package of policy measures and guidance consisting of:

(i) a set of elements that jurisdictions should consider including in their statutory cross-border recognition frameworks in order to enable effective cross-border resolution as required by the FSB *Key Attributes of Effective Resolution Regimes*;[2] and

(ii) contractual approaches to cross-border recognition that focus on two particular cases where achieving cross-border recognition is a critical prerequisite for orderly resolution: temporary restrictions or stays on early termination rights in financial contracts; and 'bail-in' of debt instruments that are governed by the laws of a jurisdiction other than that of the issuing entity.

The FSB invites comments on the consultative document and the following specific questions:

1. Are the elements of cross-border recognition frameworks identified in the report appropriate? What additional elements, if any, should jurisdictions consider including in their legal frameworks?
2. Do you agree that foreign resolution actions can be given effect in different ways, either through recognition procedures or by way of supportive measures taken by domestic authority under its domestic resolution regime? Do you agree with the report's analysis of these approaches?
3. Do you agree that achieving cross-border enforceability of (i) temporary restrictions or stays on early termination rights in financial contracts and (ii) 'bail-in' of debt instruments that are governed by the laws of a jurisdiction other than that of the issuing entity is a critical prerequisite for the effective implementation of resolution strategies for global systemically important financial institutions (G-SIFIs)? Is the effective cross-border implementation of any other resolution actions sufficiently relevant for the resolvability of firms that the FSB should specifically consider ways of achieving their cross-border enforceability?
4. Do you agree that contractual approaches can both fill the gap where no statutory recognition framework is in place and reinforce the legal certainty and predictability of recognition under the statutory frameworks once adopted?
5. Are the key principles for recognition clauses in debt instruments set out in the report appropriate? What other principles **or** provisions do you consider necessary to support the exercise of 'bail-in' powers in a cross-border context?

Responses to this consultative document should be sent to fsb@bis.org by 1 December 2014. Responses will be published on the FSB's website unless respondents expressly request otherwise.

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1 See http://www.financialstabilityboard.org/publications/r_130902.htm

2 See http://www.financialstabilityboard.org/publications/r_111104cc.pdf

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Executive Summary

1. At the St. Petersburg G20 Summit in 2013 the FSB made a commitment to "develop policy proposals on how legal certainty in cross-border resolution can be further enhanced" by the time of the Brisbane Summit. This consultative document responds to that commitment and proposes a package of policy measures and guidance consisting of some elements that jurisdictions should consider including in their statutory cross-border recognition frameworks in order to enable effective cross-border resolution as required by the FSB *Key Attributes of Effective Resolution Regimes* (the '*Key Attributes*' and, individually, 'KA' or KAs); and contractual approaches to cross-border recognition that the FSB agreed to support and promote pending widespread adoption of comprehensive statutory frameworks.

2. Unless resolution measures can be given prompt effect in relation to assets that are located in, or liabilities or contracts that are governed by the law of, other jurisdictions, authorities are likely to face obstacles in implementing effective group-wide resolution plans. Effective statutory cross-border recognition processes consistent with the *Key Attributes* are the preferred goal. However, until comprehensive statutory regimes have been adopted in all relevant jurisdictions, contractual arrangements, if properly crafted and widely adopted, offer a workable interim solution. Under a contractual approach, counterparties would agree contractually to be bound by specified resolution actions taken by a foreign resolution authority, possibly under identified resolution regimes. Even with statutory recognition regimes in place, such contractual provisions would help reinforce the legal certainty and predictability of cross-border recognition of resolution actions.

3. Statutory processes for giving effect to foreign resolution measures in a manner consistent with the *Key Attributes* may take the form of a recognition procedure or the taking of measures by the host authority under the domestic resolution regime that support and are consistent with the resolution measures taken by the foreign home resolution authority. Whatever form the statutory processes take, jurisdictions should consider including in them the elements set out in this report. Those elements are not intended to be comprehensive, and each jurisdiction will need to consider what is required in the context of its own legal environment for such a recognition framework to be effective.

4. FSB Members agreed to pursue the rapid implementation of contractual solutions in regard to two particular cases where achieving cross-border recognition is a critical prerequisite for orderly resolution: (i) temporary restrictions or stays on early termination rights (including with respect to cross-defaults) in financial contracts; and (ii) write-down, cancellation or conversion of debt instruments in resolution ('bail-in') where the instruments are governed by the laws of a jurisdiction other than that of the issuing entity.

5. To make a contractual approach effective with respect to derivatives contracts governed by the ISDA Master Agreement, ISDA, in consultation with regulators and the FSB, has developed a protocol that, if adopted by both counterparties to an ISDA

Master Agreement, would support the cross-border enforcement of a temporary stay of early termination rights in relation to resolution-based defaults.

6. FSB Members have agreed to act in a concerted manner to promote, to the extent possible, broad adoption of the contractual approach to making temporary stays of early termination rights (including with respect to cross-defaults) in financial contracts effective in a cross-border context. In particular, contractual approaches in relation to financial contracts generally (including the 1992 and 2002 ISDA Master Agreement and standardised market documentation adopted by other trade bodies) should, as far as possible, be supported by official sector action either in the form of regulation or other enforceable measures that could be implemented by resolution authorities, supervisors or other regulators.

7. The inclusion of contractual recognition clauses in debt instruments governed by the laws of a jurisdiction other than the home jurisdiction of the issuing entity can help support the cross-border enforceability of bail-in and other resolution actions of the home resolution authority in relation to the issuing entity. The FSB has proposed high-level principles that would guide the drafting of such contractual clauses in debt instruments.

8. In relation to contractual recognition clauses in debt instruments, the proposals in this paper complement the FSB work on the development of proposals on the adequacy of global systemically important financial institutions' loss-absorbing capacity when they fail. Authorities must have confidence that the exercise of resolution powers will be legally enforceable in relation to a firm's loss absorbing resources in resolution. Where instruments are governed by a foreign law, an acceptable level of confidence can be achieved only where there are legal frameworks in place by which the write down or conversion of the instruments under the issuer's home resolution regime can be recognised promptly and with an adequate degree of predictability and certainty in other relevant jurisdictions, or where the instruments include legally enforceable contractual provisions recognising the application of resolution tools by the relevant resolution authority.

Introduction

The FSB Report to the G20 on *Progress and Next Steps Towards Ending "Too-Big-To-Fail" (TBTF)*[1] ('the TBTF Report') identified legal uncertainties about the cross-border effectiveness of resolution measures as one of the main obstacles to the resolution of systemically important financial institutions (SIFIs) that operate across borders. Unless resolution actions can be given prompt effect in relation to assets that are located in, or liabilities or contracts that are governed by the law of, host jurisdictions, authorities are likely to face obstacles in implementing effective group-wide resolution plans for cross-border groups.

Although powers to take regulatory or administrative action to support resolution by another jurisdiction are available in some jurisdictions, most jurisdictions do not currently have statutory powers to recognise, enforce or give legal effect to foreign resolution measures consistent with KA 7.5.[2] In most jurisdictions, existing procedures for recognition involve a court-based process that relies on the court's discretionary and inherent jurisdiction to grant relief, rather than an explicit statutory regime.[3] Those judicial recognition procedures were typically designed for corporate insolvency proceedings and are largely untested for actions taken by foreign resolution authorities with respect to financial institutions, particularly where those resolution actions do not involve court orders or other core features of a corporate insolvency proceeding.

Particular challenges from the lack of processes to give prompt effect to foreign resolution measures arise in respect of stays on early termination rights under financial contracts and the write-down and conversion of debt instruments governed by foreign law.

Stays on early termination rights

The *Key Attributes* (KAs 4.2 and 4.3) specify that counterparties should be restricted from exercising early termination rights that arise only by reason of or in connection with a firm's entry into resolution[4] and, where such rights exist, for example in financial contracts, resolution authorities should have the power to stay counterparties temporarily from exercising them. Given that financial institutions enter into large volumes of financial contracts with counterparties in different jurisdictions and in such cases those contracts will by definition have, as their governing law, a foreign law for at least one of the counterparties, it is very important that the restrictions on contractual rights can be enforced across borders. Under the current frameworks, national courts may not be able to enforce a restriction or temporary stay on the exercise of early termination rights imposed under a foreign resolution

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1 http://www.financialstabilityboard.org/publications/r_130902.pdf

2 KA 7.5 provides:" Jurisdictions should provide for transparent and expedited processes to give effect to foreign resolution measures, either by way of a mutual recognition process or by taking measures under the domestic resolution regime that support and are consistent with the resolution measures taken by the foreign home resolution authority. Such recognition or support measures would enable a foreign home resolution authority to gain rapid control over the firm (branch or shares in a subsidiary) or its assets that are located in the host jurisdiction, as appropriate, in cases where the firm is being resolved under the law of the foreign home jurisdiction. Recognition or support of foreign measures should be provisional on the equitable treatment of creditors in the foreign resolution proceeding."

3 http://www.financialstabilityboard.org/publications/r_130411a.htm

4 This would be broad enough to include early termination rights based on the direct default of the institution under resolution, cross default provisions, default of a specified reference entity and defaults based on credit support.

regime, where the contract or instrument in question is governed by the law of the court's jurisdiction, or would be unlikely to do so sufficiently promptly to meet the needs of effective resolution.

Write-down and conversion of debt ("bail-in") and transfers of assets and liabilities

Similarly, the effectiveness of the bail-in power may be uncertain where instruments are governed by foreign law since the write down or conversion might not be recognised and enforced by courts outside the issuer's home jurisdiction.

The same is true for the transfer by a resolution authority of assets and liabilities that are located in or governed by the law of a foreign jurisdiction. A transfer of assets and liabilities ordered by a foreign resolution authority may not take effect unless formally recognised under the law of that foreign jurisdiction.

This consultative document sets out a package of considerations and policy measures to address the legal uncertainties about the cross-border effectiveness of resolution measures consisting of:

- **elements of statutory frameworks for cross-border recognition** that jurisdictions' should consider including in their frameworks in order to enhance the effectiveness of cross-border resolution, as required by the *Key Attributes* (KA 7.5) (Section 1); and
- **contractual approaches to cross-border recognition** that the FSB agreed to support pending the adoption of comprehensive statutory frameworks. The contractual approach is focused on making **temporary stays of early termination rights** in financial contracts and **write-downs or conversion of debt instruments** in resolution effective in a cross-border context (Section 2).

1. Statutory frameworks for cross-border recognition

The *Key Attributes* (KA 7.5) require jurisdictions to establish transparent and expedited processes that would enable resolution measures taken by a foreign resolution authority to have cross-border effect provided that domestic creditors are treated equitably.[5] Three distinct scenarios highlight the importance of statutory frameworks to give effect to foreign resolution measures:

1. **a foreign bank undergoing resolution in its home jurisdiction operates a foreign branch.** Home resolution measures need to have effect throughout the whole legal entity, including the branches in host jurisdictions. In this scenario, the protection of the domestic creditors and local financial stability will generally be primary considerations for the host authorities;
2. **a foreign financial institution undergoing resolution in its home jurisdiction controls a subsidiary in another jurisdiction.** In order for home resolution measures to be effective, host jurisdictions may, in particular, need to provide a

[5] The *Key Attributes* aim to provide a comprehensive framework for resolution regimes for financial institutions. Accordingly, KA 7.5 should not be read in isolation. This section assumes that the regime of the relevant jurisdiction complies generally with other KAs that are relevant to the cross-border effectiveness of resolution measures.

process to allow the transfer of shares in the subsidiary to another institution or to require local subsidiaries to continue to provide essential services to the parent company or other group entities. Particular concerns of host authorities may relate to local financial stability given the potential spill-over between entities of the same group, and prudential matters (for example, 'fit and proper' test for the acquirer of the subsidiary); and

3. **assets, liabilities or contracts of a foreign firm in resolution are located or booked in, or subject to the law of, another jurisdiction in which the firm is not established.** In order for home resolution measures to be effective, the relevant jurisdiction would need to allow the implementation of the resolution measures adopted by a foreign authority.

1.1 Procedures to achieve cross-border recognition

Statutory processes for giving effect to foreign resolution measures in a manner consistent with KA 7.5 may take the form of (1) a recognition procedure or (2) the taking of measures under the domestic legal framework that support and are consistent with the resolution measures taken by the foreign home resolution authority.

1. **Recognition** implies that, at the request of a foreign party, a jurisdiction would accept the commencement of a foreign resolution proceeding domestically and thereby empower the relevant domestic authority (either a court or an administrative agency[6]) to enforce the foreign resolution measure or grant other forms of domestic relief, such as for example a stay on domestic creditor proceedings. Recognition proceedings typically occur outside of a resolution framework; accordingly, recognition would generally be possible irrespective of whether domestic resolution or insolvency proceedings have been commenced or the threshold conditions for such proceedings are met. Once recognition is granted, the measures adopted by the foreign home authority can have effect in the domestic jurisdiction regardless of the resolution powers under the domestic. However, although recognition is not dependent on the exercise of resolution powers in the local jurisdiction, it generally does not extend to the application of provisions of foreign law that are not part of the domestic framework.[7] Even where the firm in resolution has no operations in a jurisdiction, recognition may still be needed; for example, to give effect to a temporary stay on early termination rights in financial contracts governed by the law of the recognising jurisdiction.

2. **Supportive measures** involve the domestic resolution authority taking resolution measures, usually but not exclusively in the context of its own domestic resolution proceedings, that help implement and support resolution measures taken by the

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[6] The *Key Attributes* generally require that jurisdictions confer resolution powers on an administrative authority but allow for judicial involvement in resolution, provided that resolution measures can be implemented quickly and in a manner that is consistent with promoting financial stability. See KA 2.1 (administrative authorities) and KA 5.4 (judicial interventions).

[7] For example, it is a basic principle of the UNCITRAL Model Law on Cross-Border Insolvency (see Box 1) that recognition has its own effects under domestic law rather than importing the consequences of the foreign law into the insolvency system of the enacting State. (See paragraph 178 of the Commentary on the Model Law.)

foreign home resolution authority. In this regard, the domestic authority may act at the request of the foreign resolution authority or independently take resolution actions that are consistent with the foreign measures. The ability to take supportive measures is generally conditional on the commencement of domestic resolution proceedings and the resolution authority would be limited to the measures that are available under the domestic regime (see sub-section 1.2, point 4 below).

Jurisdictions could comply with KA 7.5 by establishing an administrative and/or judicial framework for recognition; an administrative and/or judicial framework for taking supportive measures; or a framework that combines recognition and supportive measures in an administrative and/or judicial form. Although broadly comparable outcomes may be achieved using both types of process, recognition and supportive measures complement each other and in some cases both may be required to achieve the desired outcome. Legal and procedural differences may mean that recognition procedures are more suitable for certain resolution actions or certain situations, while supportive measures may be the preferred approach for others. Further discussion of illustrative scenarios in which either recognition or supportive measures might achieve cross-border implementation of different resolution measures is set out in the Annex to this paper.

Existing cross-border recognition frameworks adopt a combination of approaches (see Box 1 for more detail).[8] However, no jurisdiction has experience applying an existing framework that is designed for financial institutions in the context of the resolution of a complex cross-border financial group.

[8] Reference to existing frameworks for cross-border recognition is not intended to set a standard or establish guidelines for future frameworks.

Box 1

Examples of Statutory Frameworks for Giving Effect to Foreign Resolution Actions

The **United Nations Commission on International Trade Law Model Law on Cross-Border Insolvency** is currently the only example of a global framework that addresses coordination and recognition of cross-border insolvency actions. At present, however, the Model Law is generally not applicable to financial firms and does not include specific rules regarding enterprise groups. The Model Law provides mechanisms for facilitating access to courts in other countries, recognition of foreign proceedings, and assistance and relief to the foreign court and foreign representative. Courts applying the Model Law retain discretion as to whether and how to grant relief with respect to foreign proceedings. However, the most critical relief (the stay) should be automatically granted upon recognition of a foreign proceeding as the main proceeding. There is no reciprocity requirement under the Model Law framework.

Swiss legislation allows the Swiss Financial Market Supervisory Authority (FINMA) to recognise foreign bank insolvency proceedings or measures provided certain conditions are met, including that the proceeding or measure is not manifestly incompatible with Swiss public policy and that the foreign decree or insolvency measure has been ordered in the country where the bank is incorporated or where its headquarters is located. The effect of recognition is that FINMA may commence concurrent, local insolvency proceedings against the bank. Alternatively, FINMA may subject local assets directly to the foreign insolvency proceeding, if: (i) the foreign insolvency proceedings treat the claims of collateralised and privileged creditors domiciled in Switzerland equally; and (ii) the foreign insolvency proceedings adequately take into account the other claims of creditors domiciled in Switzerland. The recognition proceedings generally take about two months, but may take longer depending on the complexity of the case and the speed with which the necessary documents are provided to FINMA. The affected bank's governing body, but not its owners or creditors, may file an appeal against FINMA's recognition decision.

Under the **Monetary Authority of Singapore (MAS) Act**, MAS has powers to transfer the business or shares of a financial institution or to restructure or require issuance of shares, in support of a foreign resolution action. The exercise of the powers is subject to Ministerial approval and there is no need to go to Court. In exercising the powers, MAS must consider whether the failure of the institution would have a widespread adverse effect on the financial system in Singapore or the economy of Singapore, whether it is in the public interest to do so and whether the interests of the depositors of the transferor institution are granted depositor priority in accordance with the law. MAS should also be satisfied that the relevant action is appropriate, having regard to the stability of the financial system in Singapore.

The **European Union Bank Recovery and Resolution Directive (BRRD)** and related amendments to the Winding-Up Directive provide a framework for recognition and enforcement of resolution decisions within the EU and between EU Member States and third countries. Within the EU, resolution measures taken by a resolution authority in respect of an institution within its jurisdiction and resolution measures agreed in resolution colleges in the case of groups are immediately recognised and enforced by resolution authorities of other Member States. With respect to non-EU countries, decisions regarding the recognition of such a country's resolution proceedings that concern groups may be taken either jointly by the EU resolution college (if established); or, in its absence or where the proceeding concerns an institution that is not part of a group, by each EU resolution authority individually. As regards both group resolution measures and decisions from non-EU countries in relation to institutions located in their territories, the BRRD provides that resolution authorities may only refuse recognition on specified grounds, including that: the non-EU resolution proceedings would have adverse effects on financial stability in the Member State or in another Member State; creditors located or payable in a Member State would not receive the same treatment as creditors of the non-EU country; the recognition or enforcement of the non-EU resolution proceedings would have material fiscal implications for the Member State; or the effects of recognition or enforcement would be contrary to national law.

1.2 Elements of cross-border recognition frameworks

While further work in this area is needed, a review of existing procedures for cross-border recognition in some jurisdictions has identified a set of elements that jurisdictions should consider including in legal frameworks to enable prompt effect to be given to foreign resolution actions. These elements are neutral as regards the type of procedure and apply equally to both recognition procedures and supportive measures, as explained below.

1. **The legal framework should confer to a domestic authority or authorities legal capacity to give effect to foreign resolution measures and clearly establish which actions may be taken by these authorities.**

   For *recognition procedures* - domestic law should explicitly empower the relevant authority, which could be the supervisory or resolution authority or a court, to recognise and enforce foreign resolution measures at the request of a foreign authority, subject to clearly specified conditions relating, for example, to equitable treatment of domestic creditors and protection of local financial stability (see point 4 below).[9] The legal framework should also provide a foreign resolution authority with legal standing to request recognition and enforcement.[10]

   For *support mechanisms* - a resolution authority's legal capacity to act would derive from the domestic resolution framework or general legal framework, including its authority to cooperate with foreign authorities as required by KA 7[11] (see point 3 below). Such action may be taken either at the request of the foreign authority or at the domestic resolution authority's own initiative. For support mechanisms to be effective, jurisdictions should have implemented the *Key Attributes* and provided their resolution authorities with the full range of resolution powers that the *Key Attributes* envisage. Differences between the resolution powers available in the home and host jurisdictions could give rise to inconsistencies between the outcome desired by the foreign home authority and the outcome the host authority may achieve. Such inconsistency may be minimised if home and host jurisdictions fully implement the *Key Attributes*.

2. **The legal framework should clearly establish the process and conditions for giving effect to foreign resolution actions and provide clarity about the extent to which the effect is automatic or subject to a discretionary decision by an authority.**

   For *recognition procedures* - certain foreign actions might have automatic effect domestically if these foreign actions meet certain conditions, for example, the imposition of a stay on domestic creditor proceedings. Recognition of some actions may involve the exercise of discretion in accordance with considerations and specific national protections set out in statute (see point 4 below). Measures for which

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[9] As noted above, recognition of a foreign proceeding generally entails attaching to the foreign measure the consequences envisaged under local law.

[10] As noted below, enforcement or the grant of other relief may be automatic upon recognition or may entail an exercise of discretion.

[11] In particular: KA 7.1 (empowerment to achieve a cooperative solution), KA 7.2 (no automatic action) and KA 7.3 (powers over foreign branches to support foreign resolution measures).

recognition might be subject to discretion might include enforcing a foreign transfer of assets from a firm in resolution to a third party purchaser or bridge institution.

For *support mechanisms* - relevant actions would derive from powers contained in the domestic framework. There should be clarity about the actions that can be taken by the relevant domestic authorities in support of a foreign resolution, the circumstances in which those actions can be taken (see point 5) and the extent to which the decision to take supportive action is at the discretion of the local resolution authority or required by the regime where specified conditions are met.

3. The legal framework should clearly identify the grounds for granting recognition of foreign resolution proceedings or adopting measures to support foreign resolution actions.

For *recognition procedures* - while recognising that jurisdictions will, to some degree, design their recognition procedures on the basis of their own national legal traditions, the ability to refuse the recognition of foreign resolution measures should generally be limited to cases where the foreign resolution measures in question:

- would have adverse effects on local financial stability (for example, they would affect the continuity of economic functions that are critical to the local financial system or would be inconsistent with or undermine the implementation of local resolution action undertaken by the host authority);
- contravene local public policy, in particular when the effects of the foreign resolution measure result in inequitable treatment of domestic creditors as compared to third-country creditors with similar legal rights (see above); or
- would have material fiscal implications (for example, by exposing local public authorities or taxpayers to loss).

Recognition of foreign resolution proceedings should in principle not be contingent on reciprocity since such a condition could unnecessarily constrain the circumstances in which recognition can be granted, even if it is in the jurisdiction's interests to do so. Where the legal framework does include a condition of reciprocity, that condition should not be absolute, and in particular should not prevent recognition without reciprocity where such recognition it is in the interests of the jurisdiction, for example, by contributing to financial stability.

For *support mechanisms* – the grounds for taking supportive measures will be based on the provisions of the domestic resolution framework that more generally permits the authorities to take resolution action. Specifically, for the domestic resolution authority to take supportive measures, it would typically be necessary for a domestic resolution proceeding to have commenced and for the domestic resolution authority to decide that cooperation with the home authority was consistent with the objectives of the resolution framework. While it is theoretically possible that legal frameworks could provide for supportive measures to be taken even where domestic resolution proceedings have not commenced, further work is needed to determine whether and under what circumstances such an approach would be appropriate.

4. The process for giving effect to foreign resolution measures should be guided by the principle of equitable treatment of creditors.

KA 7.5 expressly makes giving effect to foreign resolution measures conditional on the equitable treatment of creditors but does not expand on how this principle should be implemented. Equitable treatment could encompass non-discrimination between creditors based on their nationality or the location of their claim. As such, similarly situated creditors of the same legal entity, whether located in the home or host resolution proceeding, should be treated according to the same rules or standards. However, the principle of equitable treatment could also be understood as an equivalence standard that seeks to ensure that the claims of creditors in the host jurisdiction are treated as advantageously under the foreign proceeding as they would have been treated under a domestic proceeding. This latter interpretation could give rise to obstacles to recognition since, due to variations between legal arrangements—for example, the power to depart from equal treatment of creditors of the same class—the application of the same resolution powers in different jurisdictions may not result in the same treatment of similarly situated creditors. In addition, there could be differences in due process or other pertinent rights between jurisdictions. Finally, it is also unclear whether equitable treatment should be limited to creditors of the same legal entity (head office and foreign branch), or whether it should also consider the treatment of creditors of different legal entities of the same firm. These issues are complex and further consideration will be needed.[12]

5. In giving effect to foreign resolution actions, national authorities should take account of the need for speed in resolution.

To the extent possible and as part of resolution planning, authorities should engage with the relevant foreign authorities in advance to make sure that the process for giving effect to foreign resolution actions by way of recognition procedures or supportive measures can be carried out with the necessary speed and predictability.

6. The capacity to give effect to foreign resolution actions should be complemented by the necessary legal protections for authorities and their officials and other measures such as limitations on actions that could constrain or reverse resolution decisions to give effect to foreign resolution actions.

As specified in KA 2.6, the protection from liability for resolution authorities and their staff should also apply to actions taken in good faith to support foreign resolution authorities. Similarly, legislation should not provide for judicial action that could constrain the implementation of, or result in a reversal of, measures taken by resolution authorities acting within their legal powers and in good faith to recognise or support foreign resolution actions (and should instead, in accordance with KA 5.5, provide for financial remedies).

7. Authorities should require firms, or provide incentives for firms, to adopt contractual approaches, where appropriate, to reinforce the legal certainty and predictability of recognition under the statutory frameworks already in place

[12] Further consideration may also be needed about which country's framework should apply for the purposes of the 'no creditor worse off' safeguard to determine and, if relevant, quantify creditors' right to compensation where they do not receive at minimum what they would have received in liquidation of the troubled firm.

and to fill the gap for statutory approaches until these have been fully implemented.

Contractual approaches to cross-border recognition should be considered in relation to (i) temporary restrictions or stays on early termination rights (including as a result of cross-defaults) in financial contracts; and (ii) write-down, cancellation or conversion of debt instruments in resolution ('bail-in') where the instruments are governed by the laws of a jurisdiction other than that of the issuing entity (see Section 2 below). Such approaches may also support statutory regimes once they are in place, for example by helping to address any inconsistencies in the scope of the statutory regime.

2. Contractual approaches to cross-border recognition

Statutory frameworks of the kind detailed in section 1 are the preferred longer term solution to the cross-border recognition of resolution actions. However, very few jurisdictions currently have such frameworks in place. Given the time required to implement the necessary statutory changes, which are likely to be complex, the FSB agreed to develop contractual solutions in regard to two particular cases where achieving cross-border recognition is a critical prerequisite for orderly resolution:

1. temporary restrictions or stays on early termination rights (including as a result of cross-defaults) in financial contracts; and
2. write-down, cancellation or conversion of debt instruments in resolution ('bail-in') where the instruments are governed by the laws of a jurisdiction other than that of the issuing entity.

However, while there are advantages to pursuing contractual solutions to cross-border enforceability, contractual solutions have limitations and therefore may not be considered a substitute for statutory regimes in the longer term. Legal certainty about the effect of the contractual terms and the enforceability of a particular resolution action will necessarily have to be considered in relation to specific jurisdictions, and a contractual approach in isolation may not achieve the level of legal certainty that would be conferred by widespread adoption of statutory frameworks consistent with KA 7.5. For example, the enforceability of such contractual recognition provisions has yet to be tested in the courts and limitations on their enforceability (for example, on public policy grounds) may not always be clear. Furthermore, where the contractual drafting differs from statutory provisions, foreign counterparties may not be subject to precisely the same standards as domestic counterparties.

2.1 Temporary stays on early termination rights

There is a risk that national courts may not enforce a restriction or temporary stay on the exercise of early termination rights (including as a result of cross-defaults) imposed under a foreign resolution regime, where the contract is governed by their domestic law, or would be unlikely to do so sufficiently promptly to meet the needs of effective resolution, in the absence of appropriate contractual clauses. Effective stays on termination rights that arise only by reason of or in connection with a firm's entry into resolution are important to prevent

the close out of financial contracts in significant volumes. Contractual recognition clauses can help support the cross-border enforceability of such stays.

2.1.1 Development of an ISDA Protocol

The standardised documentation under which the majority of OTC bilateral derivatives are traded is the ISDA Master Agreement (1992 and 2002 versions). ISDA [has prepared], in consultation with G-SIB home authorities, a draft protocol to its Master Agreement which, if adopted by market participants, would support the cross-border enforcement of a temporary stay of early termination rights with respect to OTC derivatives governed by the Master Agreement between such adopting parties upon specified resolution actions with respect to certain counterparties, relevant group companies or their credit support providers.[13]

More specifically, the draft protocol provides for a number of mechanisms by which the effect of the stay provisions would be supported in different jurisdictions. The applicable mechanism for applying the stay will differ slightly depending on the jurisdiction of the counterparties, the governing law and the nature of the resolution or insolvency regime in question.

The protocol is formulated in a manner that is sufficiently generic to be adapted for use by other trade bodies (for example, SIFMA with respect to the MRA / GMRA) in protocols amending their standardised documentation for other types of financial contracts. It could also be used to amend financial contracts that do not use standardised documentation.

2.1.2 Adoption of the ISDA protocol

ISDA is expected to launch the protocol publicly in the near future, with an initial set of global systemically important banks (G-SIBs) and other large dealer banks to adhere to the protocol by November ahead of the meeting of the G20. The home authorities for these firms will monitor progress during this period through regular status meetings with these banks.

If those banks adopt the protocol, the protocol will then govern existing and new OTC derivatives contracts between the adopting banks from the beginning of 2015. The set of trades not covered through the initial voluntary adoption process would include OTC swaps between the adopting banks and non-adopting counterparties (that is, other banks, buy-side entities such as asset managers and non-financial corporates, or other non-bank entities, such as sovereigns). However, it is expected that measures discussed below will result in broader adoption by such entities.

2.1.3 Official measures to support adoption of contractual stay provisions

Any contractual solution binds only the parties that agree to it. This is particularly relevant in the context of contractual agreements to stay or limit the exercise of early termination rights since, in order to be effective, such contractual provisions would have to be adopted by both sides of the trade.

Measures for prudentially regulated firms and firms within the scope of resolution regimes

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[13] The protocol also provides for a stay that would apply in the context of a US Bankruptcy Code proceeding in relation to a financial holding company, whereby a recapitalisation occurs and the operating entities of the holding company remain viable going concerns

In many jurisdictions, banks, investment firms and other financial firms subject to prudential regulation could be required by prudential rules to adopt the necessary contractual language on stays in resolution with all their counterparties.

In addition, a number of jurisdictions have, or will have, the power to require firms to improve resolvability that could be used to require firms that are within the scope of resolution regimes and, in particular, those that are subject to requirements for resolution planning and resolvability assessments, in appropriate cases to improve their resolvability through the use of contractual stay provisions. However, such powers may be limited in the scope of firms to which they can be applied (which may be a subset of prudentially regulated firms) and, in particular, would not be available in relation to market participants that are not subject to requirements for resolution planning and resolvability assessments.

It is recommended thatG-SIBs and, where appropriate, other firms with significant derivatives exposures be subject to measures requiring the use of contractual language replicating statutory stays of early termination rights under derivatives and other similar financial contracts, particularly where they are trading with counterparts in jurisdictions that do not have statutory recognition regimes. While regulators should have discretion as to the means by which this is achieved, they should ensure that the requirement is enforceable.

Measures for non-prudentially regulated firms

Many counterparties of prudentially regulated firms, such as asset managers and non-financial corporates, are not subject to prudential regulation. The options for reaching such entities by regulatory or other official action are thus reduced to indirect means through requirements on firms that are subject to prudential regulation (which might have the effect of inducing counterparties to such firms to adhere to contractual stay provisions in order to be able to trade with prudentially regulated firms); or direct requirements through market-based regulation. In the majority of FSB jurisdictions, it is questionable whether national market regulators would have the authority to impose direct requirements on such firms based on their statutory objectives (although, in some cases, broad financial stability or public interest objectives may support such measures to improve resolvability). Even if legislation could confer the necessary competence where lacking (or impose the requirements), the time frame for its adoption would not be consistent with the use of contractual approaches as a short to medium term solution.

It is recommended that jurisdictions keep under review the indirect impact of requirements on prudentially regulated entities on their counterparties and consider whether further measures are required, including the imposition of requirements through market conduct regulation, to promote use of appropriate contractual language on stays by market participants that are not prudentially regulated.

2.2 Contractual recognition of bail-in

Where an entity has issued debt governed by the law of a foreign jurisdiction, there is a risk that the exercise of statutory bail-in powers, i.e., the write down or conversion of the debt by the resolution authority of the issuing entity, will not be recognised in the foreign jurisdictions. Contractual recognition clauses can help support the cross-border enforceability of such actions. A number of jurisdictions already require, or are in the process of adopting measures to require, firms to include contractual provisions of this nature in capital or debt

instruments governed by foreign law. In some cases, such a requirement is supplemented by an obligation for firms to demonstrate to the prudential or resolution authorities that any statutory bail-in of such instruments would be enforceable, including through the provision of an independent legal opinion, at or prior to the issue of the instrument. Drawing on existing and emerging practices, the FSB identified a set of key principles for recognition clauses in debt instruments that should support the exercise of bail-in powers in a cross-border context ("cross-border bail-in clauses").

2.2.1 Key principles for cross-border bail-in clauses

1. The contractual provisions should contain a clear agreement by the debt holder to be bound by the terms of the bail-in under the relevant resolution and a further agreement that, in the event of the application of such statutory powers, other terms and conditions governing the debt instrument will be overridden to give effect to the terms of the bail-in. The purpose of such agreement is to make the enforceability and effectiveness of the bail-in a matter of contract law, rather than relying on an argument that such write-down or conversion has extra-territorial effect under conflict of law rules. Although there cannot be complete certainty, courts will generally enforce contractual provisions properly entered into unless contrary to public policy.

2. The consequences of a bail-in should be disclosed prominently to debt holders in accordance with applicable disclosure requirements. Care should be taken to ensure that the offering documents and any statements comply with the disclosure requirements in the relevant jurisdictions. In particular, applicable securities regulation is likely to require clear disclosure about the contractual recognition clause and the potential effect a statutory bail-in under the home resolution regime on the value of the instrument and the claim of the debt-holder. Clear disclosure in accordance with applicable rules is necessary to reduce the likelihood of successful claims by investors alleging that they had been misled when purchasing the instruments. Liabilities or other remedies arising from such litigation could undermine the effectiveness of the recapitalisation of the firm achieved through bail-in.

3. Recognition provisions should be drafted in general terms so as to ensure that they do not conflict with how the statutory bail-in regime may be applied in practice. For example, the contractual provisions should make it clear that the terms of the bail-in will be determined by the relevant resolution authority, rather than any conversion set out in the debt documentation. Where an instrument also contains mechanisms for conversion or write-down (whether fully or partially) upon certain defined triggers outside of resolution (for example, where the firm's capital ratio falls below a particular level), the documentation should clearly establish and explain that this mechanism is separate and distinct from a statutory bail-in by the home resolution authority and that there may be circumstances where both could be applied consecutively.

4. As the enforceability and effectiveness of a bail-in of a debt instrument governed by foreign law will ultimately be determined by courts in accordance with that foreign law, firms should seek independent legal advice from the jurisdiction of the

governing law in order to ensure that the drafting of the contractual provisions fully takes account of any relevant legal issues under that law. For example, it may be necessary to include specific consents or waivers of legislative provisions under the foreign governing law (for example, provisions designed to prevent amendments to bond documentation without bondholder consent).

5. Firms should be required to demonstrate to the relevant authorities that any statutory bail-in of instruments governed by foreign law would be enforceable, including through the provision of a reasoned independent legal opinion prior to the issuance of the instrument. Those opinions should contain the following elements:

    a. The legal opinion should confirm the enforceability under the governing foreign law of the *specific* provisions of the particular capital or debt instrument. In order to provide resolution authorities with the necessary degree of assurance, the legal opinion should offer a positive confirmation of the enforceability of the specific contractual provisions under the specific governing law (rather than hypothetical language).

    b. Where the legal opinion includes qualifications or limitations (for example, on public policy grounds), the legal advisor should provide a reasoned assessment of the materiality of the limitation and the likelihood of its impact on the enforceability of any bail-in action.

2.2.2 Official measures to support use of contractual provisions in debt instruments

Prudential or resolution authorities should require entities issuing debt governed by the law of a foreign jurisdiction to include recognition clauses for statutory bail-in in those debt instruments. This is particularly important where the jurisdiction of the governing law does not provide for statutory recognition of write-down or conversion by the relevant resolution authority. Where firms are subject to requirements for resolution planning and resolvability assessments, this might be achieved through requirements for such firms to improve their resolvability.

The inclusion of appropriate language could also be a condition of a debt instrument's qualification to satisfy a requirement for loss-absorbing capacity in resolution where the laws of the jurisdiction governing the instrument do not provide for statutory recognition of write-down or conversion by the relevant resolution authority.

Since the legal framework and regulatory practice may vary from jurisdiction to jurisdiction, these measures may not be available to the authorities in every jurisdiction and their use would have to be considered in more detail. It should also be noted that any rule would only apply to new issuances. In addition to the timing for rule-making, there would be a period of some years as instruments issued prior to the rule coming into force (which would not include the required terms) matured or were replaced.

3. Next steps and timelines for implementation

The gap between the statutory frameworks necessary for effective recognition of foreign resolution actions and the arrangements that are currently in place remains wide. The proposals in this paper need much detailed follow-up work. However, significant progress can be made by adopting contractual approaches in the interim. The time line and key milestones that authorities and firms should work towards are set out below:

- By end October 2014, 14 G-SIBs and other large banks that engage in significant cross-border trading activities to commit to adopt the ISDA protocol or equivalent contractual clauses, to have effect from 2015.
- FSB to finalise guidance on key principles for recognition clauses by end-2015.
- FSB Members to take official action to promote widespread adoption of contractual clauses recognising stays on early termination rights and exercise of bail-in powers by end 2015.
- FSB to finalise guidance on core elements of statutory recognition frameworks by end 2015.

Annex
Giving effect to foreign resolution measures – Illustrative statutory approaches

The stylised scenarios set out in this Annex aim to provide examples of how effect can be given to foreign resolution measures by recognition or support mechanisms, as consistent with KA 7.5. In practice, these scenarios may be implemented independently, in combination or in sequence, as part of an overall resolution strategy. The stylised scenarios are illustrative and are not intended to provide a comprehensive analysis, set a standard or establish guidelines. In particular, no financial stability, supervisory, prudential, competition or other public policy issues are considered.

Scenario 1: Appointment of an administrator

The home resolution authority appoints an administrator to a bank that has a branch abroad and requests the relevant authority in the host jurisdiction to give effect to this measure.

- The relevant authority in the host jurisdiction (e.g., a court or a resolution authority) could *recognise* the foreign resolution procedure and give effect to the appointment of the administrator by authorising, under domestic law, the foreign administrator to take control over the branch.
- As an alternative, assuming that the resolution triggers in the host jurisdiction have been met, the host resolution authority could *support* the foreign resolution proceeding by appointing a local administrator to the branch who could act in cooperation with the home resolution authority, in accordance with the local resolution framework.

Scenario 2: Temporary stay on financial contracts in jurisdictions where the firm in resolution has no physical presence

The home resolution authority declares a temporary stay on early termination rights under financial contracts entered into by a distressed bank. The financial contracts are governed by the law of a jurisdiction ("jurisdiction X") in which the bank does not have branches or subsidiaries and the collateral related to such contracts is also located in jurisdiction X. The home resolution authority requests the relevant authority in jurisdiction X to give effect to this measure.

- The relevant authority in jurisdiction X could recognise the foreign resolution proceeding and give effect to the stay; consequently, under the law of jurisdiction X, the counterparties to the financial contracts might be enjoined from exercising early termination rights under the contracts or taking any action in connection with the collateral.
- Given the lack of physical presence of the distressed bank in jurisdiction X, there would appear to be no basis to commence a domestic resolution proceeding and therefore a support measure is unlikely to be available.

Scenario 3: Transfer of assets and liabilities

The home resolution authority orders a transfer of assets and liabilities from a distressed bank to a healthy bank; both banks have branches in a host jurisdiction and the transfer applies to assets and liabilities booked in that jurisdiction. As a result of the transaction, the relevant assets and liabilities of the distressed bank that were previously recorded on the books of its branch in the host jurisdiction are to be transferred to the branch of the healthy bank in the host jurisdiction. To enhance the legal certainty of the transfer, the home resolution authority requests the relevant authority in the host jurisdiction to give effect to this measure.[14]

- The relevant authority in the host jurisdiction could recognise the foreign resolution proceeding and give effect to the transfer by allowing it to occur under domestic law and be reflected in the local books of the branches of the two banks. In addition, creditors in the host jurisdiction could be enjoined from taking any action that would undermine the transfer.
- Alternatively, assuming that the resolution triggers in the host jurisdiction have been met, the host resolution authority could support the resolution proceeding by ordering the transfer of assets and liabilities from the distressed bank's branch to the healthy bank in cooperation with the home jurisdiction.

Scenario 4a: Bail-in (Write-down of Liabilities)

The home resolution authority imposes losses on creditors by writing down their claims in a distressed bank that has a branch in another jurisdiction. The home resolution authority requests the relevant authority in the host jurisdiction to give effect to this measure.

- The relevant authority in the host jurisdiction could *recognise* the foreign resolution proceeding and give effect to the write-down by allowing it to occur under domestic law and be reflected in the local books of the branch. In addition, the relevant authority in the host jurisdiction could enjoin local creditors from obtaining repayment of the portion of liability that has been written down (e.g., through litigation in the host jurisdiction).
- Assuming that the host resolution authority has powers to write-down liabilities and that the resolution triggers under the domestic resolution regime have been met, a support measure could be used instead of recognition, although it is possible that this could give rise to different results, depending on the scope of the powers and any exclusions under the local regime. If write-down powers are not available under the domestic resolution regime, the host resolution authority would not be able to give effect to the foreign resolution measure using *support*.

Depending on the composition and allocation of assets and liabilities among the branch and the distressed bank, the extent of the write-down could differ between recognition versus support measures.

Scenario 4b: Bail-in (Conversion of Debt-to-Equity)

[14] It should be noted that in some cases the transfer could be given effect through normal corporate law or regulatory measures. The scenario considers circumstances where those cannot achieve the desired effect.

The home resolution authority implements a bail-in measure in a bank that has a branch in another jurisdiction by converting the claims of certain creditors into equity, including creditors in the host jurisdiction whose claims are reflected on the books of the branch. The home jurisdiction requests the relevant authority in the host jurisdiction to give effect to this measure.

- The relevant authority in the host jurisdiction could *recognise* the foreign resolution proceeding and give effect to the bail-in measure by enjoining domestic creditors from obtaining repayment of liabilities that have been converted into equity.
- Assuming that the resolution triggers in the host jurisdiction have been met and the powers to write-down liabilities are provided for in the domestic resolution regime, the host resolution authority could *support* the foreign resolution measures by ordering the write-down of liabilities. In addition, the relevant authority in the host jurisdiction could enjoin local creditors from obtaining repayment of the portion of liability that has been converted into equity. As the issuance of equity itself is conducted under the law of the jurisdiction in which the bank is incorporated, the conversion into equity (as opposed to the write-down) will be done entirely in the jurisdiction of incorporation.

Scenario 5: Sale of shares of a subsidiary

The home resolution authority sells a controlling stake in a foreign subsidiary of a distressed bank to a sound bank. The home jurisdiction requests the relevant authority in the host jurisdiction to give effect to this measure.

- The relevant authority in the host jurisdiction could *recognise* the foreign resolution proceeding and give effect to the sale by allowing it to occur under domestic law and be reflected in the local corporate registry. Assuming that the resolution triggers for the subsidiary in the host jurisdiction have not been met, no form of *support* measure would be available.