FINANCIAL MARKETS LAW COMMITTEE

28 November 2014

Secretariat to the Financial Stability Board (the "FSB")
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

By email to: fsb@bis.org

Dear Sirs

Recovery and Resolution

Cross-border recognition of resolution action – Consultative Document – 29 September 2014

The role of the Financial Markets Law Committee (the "FMLC" or the "Committee") is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks, and to consider how such issues should be addressed.

The FMLC welcomes proposals in the consultative document ("CD") aimed at enhancing legal certainty in the resolution of systemically important financial institutions ("SIFIs") within a cross-border context. As the CD observes, measures in this area are required, in part, because many jurisdictions currently do not have statutory powers to recognise and enforce foreign resolution measures. Such powers were identified as critical to an effective cross-border resolution process by the Financial Stability Board's Key Attributes of Effective Resolution Regimes for Financial Institutions ("Key Attributes") but there has been considerable disparity in national approaches to the implementation of the Key Attributes.

The CD proposes (i) a set of elements to be incorporated in Member States' statutory cross-border recognition frameworks, and (ii) the use of contractual mechanisms in the interim to achieve cross-border recognition in two areas: temporary restrictions or stays on early termination rights in financial contracts, and "bail-in" of debt instruments governed by the laws of a jurisdiction other than that of the issuing entity. The CD envisages the continued use of contractual mechanisms for reinforcing the legal certainty and predictability of recognition under the statutory frameworks once adopted.

The interaction between the laws of a resolution forum and the applicable foreign laws governing the contracts, liabilities or assets of a financial institution undergoing resolution proceedings, is a major source of legal uncertainty. The FMLC drew attention to this issue in a discussion paper published in February 2013 ("2013 Paper") which highlighted the issues of legal uncertainty arising from the then proposed European Commission's Recovery and Resolution Directive.[1] Regarding the enforcement of temporary stays on termination rights in financial contracts, the 2013 Paper states

T +44 (0)20 7601 4286
contact@fmlc.org

8 Lothbury
London EC2R 7HH
www.fmlc.org

1 Recovery and Resolution - Discussion of certain legal uncertainties arising from the proposal for a Recovery and Resolution Directive - Report, available at www.fmlc.org

> *...the most challenging area of legal uncertainty generated by the application of the RRD to derivatives transactions is likely to be the interaction of the law of the resolution forum and the applicable law of the contract, particularly where the applicable law is the law of a third country outside the EU. The fact that the resolution forum will have implemented the RRD's provisions on the exclusion and suspension of termination rights may have no effect whatsoever if the counterparty is in a position to claim under the terms of the contract, applying the law of a third country, in a third country jurisdiction against assets in that jurisdiction of the institution under resolution.*

The Bank Recovery and Resolution Directive ("BRRD")[2] subsequently adopted by the European Parliament in April 2014 provides a framework for relations with third countries.[3] With regard to the recognition of third country resolution proceedings, the decision whether or not to recognise third country resolution measures is taken by the European resolution colleges comprising two or more resolution authorities of EU Member States. Where the European resolution college is unable to reach a joint decision or in the absence of a European resolution college, national resolution authorities shall make their own decisions on whether or not to recognise and enforce third country resolution measures. These provisions however, are voluntary, not mandatory; leaving the uncertainty on the conflict of laws unresolved.

As stated in the CD, the implementation of statutory regimes consistent with the Key Attributes is the preferred means by which the mutual recognition and enforcement of resolution measures may be achieved. Harmonised statutory regimes would provide a determinate, publicly ascertainable and predictable process for giving effect to resolution measures across jurisdictions and, in consequence, would provide the greatest degree of legal certainty. Acknowledging, however, the challenges involved in crafting legislation and the considerable length of time required to enact and implement new statutes, the CD proposes the use of contractual mechanisms as a temporary solution for achieving the consistent cross-border application of resolution measures. The CD goes on to say that such contractual mechanisms should be retained even where statutory frameworks are adopted, as a means of reinforcing the legal certainty and predictability of recognition under the statutory frameworks already in place.

The CD recognises two important areas where the use of contractual mechanisms is likely to be most helpful: temporary restrictions or stays on early termination rights in financial contracts, and "bail-in" of debt instruments governed by the laws of a jurisdiction other than that of the issuing entity.

Concerning the enforcement of temporary restrictions or stays on early termination rights, the International Swap and Derivatives Association ("ISDA") has developed the ISDA Resolution Stay Protocol ("Protocol") as an industry initiative. The Protocol relates to over-the-counter ("OTC") bilateral derivatives traded under the ISDA Master Agreement (1992 and 2002 versions). The Protocol enables adhering counterparties to opt into certain overseas resolution regimes by agreeing a change to their ISDA derivatives contracts. The first wave of voluntary adoption of the Protocol in early November 2014

---

2 Directive 2014/59/EU.
3 Title VI of the BRRD.

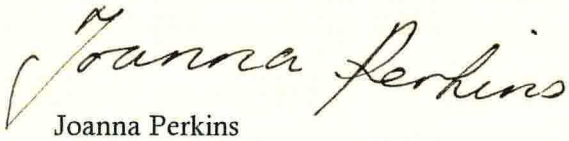
includes eighteen major banks and certain of their affiliates. This may be extended to other banks and institutions in due course. Asset management firms stipulate, however, that since the opt-in provisions entail the giving up of certain advantageous contractual rights on close-out, they are unable to adopt the Protocol voluntarily owing to their fiduciary obligations.

FINANCIAL MARKETS LAW COMMITTEE

While the Protocol is a welcome step forward of very great significance, a contractual approach alone is not broad enough to cover all industry participants and, as a consequence, leaves a considerable area of legal uncertainty in relation to the enforcement of stays on termination rights. The FMLC is therefore of the view, in line with the position set out in its 2013 Paper, that a statutory framework for cross-border recognition remains an important global regulatory objective. The Committee would add that, in order to widen the market coverage of the Protocol in the interim period, it may be beneficial for jurisdictions to require banks to include enabling provisions for the opt-in directly in new derivative contracts; as such requirement may in turn indirectly cover non-banks that wish to be counterparties to such banks.[4]

I and Members of the Committee would be delighted to meet you to discuss the issues raised in this letter. Please do not hesitate to contact me to arrange such a meeting or should you require further information or assistance.

Yours sincerely,



Joanna Perkins

FMLC Chief Executive

---

4 The CD refers to this option on page 13:

> *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 . . .*

The FMLC would welcome further consideration of this alternative.