

15 April 2013
PLEN/2013/55

Implementing the FSB Key Attributes of Effective Resolution Regimes – how far have we come?

Report to the G20 Finance Ministers and Central Bank Governors on
progress in reforming resolution regimes and resolution planning for globally
systemically important financial institutions (G-SIFIs)

1. Introduction

At their February meeting this year, the G20 Finance Ministers and Central Bank Governors reiterated their commitment to ensure that all global systemically important financial institutions (G-SIFIs) are resolvable, and requested a report on progress.

Authorities have made continued efforts to develop resolution strategies and operational plans for all G-SIFIs and to introduce resolution powers and tools consistent with the *Key Attributes of Effective Resolution Regimes for Financial Institutions* (“*Key Attributes*”) endorsed by the G20 at Cannes. As shown by the FSB’s recent peer review, substantial headway was made in the US with the adoption of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd Frank Act”) and there have been refinements to resolution regimes in other FSB jurisdictions, including in Australia, Germany, France, Netherlands, Spain, Switzerland and the UK.¹ Further legislative measures are necessary to implement the *Key Attributes* fully and to put in place the powers and arrangements for cross-border cooperation and recognition of resolution measures needed to make resolution strategies and plans operational. The adoption and implementation of the EU’s Recovery and Resolution Directive will be a significant step in this direction since the EU is home to a number of G-SIFIs. It is important that both home and host countries to G-SIFIs have the necessary resolution tools and the capacity to cooperate across borders to resolve these institutions without systemic disruption and without exposing taxpayers to loss.

2. Recovery and Resolution Planning – addressing remaining challenges

In November 2010, FSB Members undertook to develop resolution strategies, operational resolution plans and firm-specific cross-border co-operation agreements (COAGs) that set out a process for cooperation and information sharing for all G-SIFIs. Some progress has been made with respect to the institutions that were designated as G-SIFIs in November 2011.² However, progress has been relatively slow both because the issue is complex and because in many jurisdictions the powers necessary for implementing a preferred resolution strategy have not yet been provided.

Cross-border Crisis Management Groups (CMGs) have been established for all G-SIFIs,³ though two of them are still ‘domestic’, i.e., none of the members are host authorities. Most home authorities of G-SIFIs report that they have developed high-level resolution strategies and discussed and shared these with host authorities participating in the CMGs. They are also developing operational resolution plans that build on these high-level strategies. However, completion of these plans hinges on the finalisation of legal and regulatory reforms and on the agreement of a cooperation framework set out in COAGs that supports their cross-border implementation. While work on COAGs is progressing, none has yet been agreed and, in some cases, the institution-specific contents of the agreements are not yet being negotiated.

¹ See Thematic Review on Resolution Regimes, Peer Review Report, April 2013, Annex A, http://www.financialstabilityboard.org/publications/r_130411a.pdf

² http://www.financialstabilityboard.org/publications/r_111104bb.pdf

³ http://www.financialstabilityboard.org/publications/r_121031ac.pdf

Resolution planning by CMGs has coalesced around two stylised approaches:

- a **“single point of entry” (SPE) strategy**, which involves the application of resolution powers at the top holding or parent company level by a single resolution authority, with the assets and operations of subsidiaries being preserved on a going concern basis and the restructured parent or successor to the parent serving as “source of strength” by recapitalising subsidiaries and down-streaming liquidity, as necessary; and
- a **“multiple point of entry” (MPE) strategy**, which involves the application of resolution powers by two or more resolution authorities to multiple parts of the group, and break-up of the group into two or more separate parts along national, regional or functional lines, or some combination of each.

Some strategies draw on elements of both the SPE and MPE strategies. The FSB is undertaking further work on the preconditions for the effective implementation of these strategies, including in particular

- adequate loss absorbing capacity at the right location and effective mechanisms through which losses can be absorbed
- the enforceability of the write down or conversion of debt by the resolution authority when the debt is issued in a foreign jurisdiction;
- the sources of funding for resolution in a cross-border context;
- appropriate legal, operational and financial structures that support effective resolution and are aligned with the resolution strategy; and
- the treatment of financial contracts in a manner that supports the effective implementation of the resolution strategy and avoids contagion through large-scale early termination of financial contracts when an entity enters into resolution.

A successful implementation of both strategies will require the effective coordination of the different resolution actions undertaken by home and host authorities. Firm-specific cooperation agreements therefore need to set out general expectations as regards action by home and host authorities participating in a CMG in implementing the resolution strategies.

To support the recovery and resolution planning work, the FSB issued a consultative document in November 2012.⁴ It provides (i) guidance on triggers for recovery actions and stress scenarios that should be used in G-SIFI recovery plans; (ii) guidance to help identify the functions that make a firm systemically relevant and assist the CMG resolution planning process; and (iii) guidance on the development of resolution strategies and plans. The guidance will be finalised in the course of 2013.

Effective information sharing is essential for planning and carrying out resolution. Further supporting guidance is planned therefore this year on information sharing, both between authorities that participate in CMGs and as regards procedures for cooperation and information sharing with host authorities for which a G-SIFI’s operations are locally systemic but that are not represented on its CMG.

⁴ See http://www.financialstabilityboard.org/publications/r_121102.pdf

CMGs are expected to undertake a first review of the feasibility and credibility of putting the G-SIFI resolution plans into operation in the second half of 2013. Thereafter, the FSB will launch its Resolvability Assessment Process (RAP) which will assess the resolvability of each G-SIFI by a group of high-level policymakers from home and key host authorities of the G-SIFI.

3. Advancing reforms of resolution regimes

Timely and consistent implementation of the *Key Attributes* is an essential part of the reforms needed to end “too big to fail”. As noted, legislative action to reform resolution regimes is required in many jurisdictions before identified resolution strategies and plans for G-SIFIs can be implemented effectively. Reforms to resolution regimes are therefore a priority area under the FSB Coordination Framework for Implementation Monitoring,⁵ under which the implementation of the *Key Attributes* by FSB member jurisdictions will undergo intensive monitoring and detailed reporting. A first thematic peer review of national resolution regimes using the *Key Attributes* as a benchmark was completed this year.⁶

3.1 Findings from the first thematic peer review of national resolution regimes

While major legislative reforms have been undertaken by some FSB jurisdictions (particularly those directly affected by the financial crisis), the peer review identified the following areas in need of legislative or other action in FSB Members’ jurisdictions:

- (1) **Completing the resolution toolbox for banks** - It is critical that authorities have a broad range of powers at their disposal when faced with a crisis. This is not the case in all FSB jurisdictions. In many jurisdictions, resolution authorities still lack the powers set out in the *Key Attributes* to achieve rapid transfer of assets and liabilities and to write down debt of a failing institution or convert it into equity (“bail-in”), although legislation is in train in some jurisdictions (including Australia, Brazil, the EU, France, Germany, Indonesia, Singapore and South Africa) to align national regimes fully with the *Key Attributes*.⁷
- (2) **Extending resolution powers and tools to non-bank financial institutions** - Resolution regimes are most advanced for banks and progressively less so in certain jurisdictions for insurers, securities and investment firms and financial market infrastructures (FMIs). Further reforms are necessary to ensure that jurisdictions have the authorities and powers to resolve all types of financial institutions that could be systemic upon failure.
- (3) **Framework and powers to resolve financial groups and conglomerates** - The effective implementation of group-wide resolution strategies requires authorities to have appropriate powers to intervene at the level of financial holding companies and

⁵ See http://www.financialstabilityboard.org/publications/r_111017.pdf.

⁶ See <http://www.financialstabilityboard.org>

⁷ See Thematic Review on Resolution Regimes, Peer Review Report, April 2013, Annex C, http://www.financialstabilityboard.org/publications/r_130411a.pdf

ensure continuation of services by non-regulated operational entities that are significant to the systemic functions carried out within the group. These powers are not currently available in many jurisdictions.

- (4) **Cross-border cooperation** - A functional and workable resolution strategy depends on an effective framework for cross-border cooperation. The lack in most FSB jurisdictions of transparent and expedited procedures for giving effect to foreign resolution actions is a significant weakness that can undermine the effective implementation of group-wide resolution strategies. Few authorities have the authority to exercise their resolution powers over local operations of foreign institutions to support a foreign resolution authority in implementing a group-wide resolution strategy. In the absence of such powers, authorities may not be able to agree on effective cooperation agreements.
- (5) **Information sharing** - Effective resolution and resolution planning requires up-to-date information. Unless home and host authorities have the capacity to share relevant information, it is unrealistic to expect that they will share and discuss resolution strategies and plans and cooperate effectively in a crisis. Few FSB jurisdictions have clear and dedicated statutory provisions for domestic authorities to share confidential information for resolution purposes with foreign authorities. While most jurisdictions rely on existing powers to disclose non-public information for supervisory purposes, these powers may not be sufficiently broad to allow such information to be shared with all relevant domestic and foreign authorities that are not supervisors but have a responsibility for planning or carrying out resolution. Hence, in a number of jurisdictions the legal framework for sharing information for resolution purposes and applicable safeguards needs to be clarified.
- (6) **Treatment of financial contracts in resolution** - The termination of large volumes of financial contracts upon entry into resolution of a SIFI could result in further market instability and frustrate the implementation of resolution measures aimed at achieving continuity. Resolution authorities in most jurisdictions either lack powers to temporarily stay the exercise of contractual acceleration or early termination rights in financial contracts that arise by reason only of entry into resolution or, where the power exists, its exercise is not subject to suitable safeguards that minimise disruption to the contractual rights of counterparties.
- (7) **Funding of resolution** - Most jurisdictions rely on privately-sourced funds (including depositor, policy holder or investor protection funds and, in a few cases, restructuring funds), but it is not clear whether such arrangements are adequate or appropriate in scale or scope. Temporary public financial support therefore remains an important component of resolution funding arrangements for SIFIs. Mechanisms for the recovery of public funds are not well developed; conditions on their use, as specified in the *Key Attributes*, are largely absent.
- (8) **Recovery and resolution planning and actions to improve resolvability** - The *Key Attributes* call for a resolution planning requirement for all domestically incorporated firms that could be systemically critical if they fail. In most jurisdictions, there is no such explicit legal or regulatory requirement. Home jurisdictions of G-SIFIs without an explicit requirement generally derive such requirement from their general supervisory

powers. Most jurisdictions, however, lack adequate powers to require firms to make changes to their organisational and financial structures in order to improve their resolvability.

- (9) **Operational capacity** - A resolution regime will not be effective unless the national authorities responsible for resolution have the operational capacity – including staff with the appropriate level and range of expertise, and adequate resources – to resolve complex financial groups and SIFIs. This critical aspect will need to be assessed in on-site IMF and World Bank financial sector assessments.

3.2 Resolution regimes for non-bank financial institutions

A priority focus of policy makers has been the reform of resolution regimes for banking institutions. As noted in point 2 above, authorities also need the necessary powers to resolve non-bank financial institutions that could be systemic upon failure. The FSB is working with the relevant standard setters to develop sector-specific implementation guidance that complements the *Key Attributes*.

- **Financial market infrastructure** - The *Key Attributes* require financial market infrastructure (“FMI”) to be subject to resolution regimes that apply the objectives and provisions of the *Key Attributes* in a manner appropriate to the different types of FMI and their critical roles in financial markets. Mandatory central clearing of standardised OTC derivatives called for by the G20 gives rise to concentration of counterparty risk and therefore necessitates effective resolution regimes that complement robust prudential requirements for CCPs and ex ante loss allocation rules. CPSS-IOSCO conducted a public consultation on FMI recovery and resolution in 2012, the results of which are informing further work by CPSS-IOSCO on FMI recovery, and work on FMI resolution and resolution planning by the FSB with support from CPSS-IOSCO.
- **Insurance groups and conglomerates** - To resolve a large complex insurance group or conglomerate with both traditional insurance business and non-traditional non-insurance business that is systemic in failure in an orderly manner, authorities require a broad range of powers as set out in the *Key Attributes*. The FSB, with IAIS, is developing further guidance on the specific features of resolution regimes for insurers consistent with the *Key Attributes*. Many jurisdictions already have special resolution tools for insurers which include run-off and portfolio transfer powers. However, in few jurisdictions are those regimes and policy holder protection arrangements robust enough to ensure continuity of policy holder protection and avoid contagion from non-traditional insurance or non-insurance activities if a larger insurer fails.
- **Client asset protection in resolution** - The *Key Attributes* call for clear and enforceable arrangements that promote prompt access to or transfer of client assets in resolution. Few regimes meet this objective. Uncertainty about the definition of client assets and rules governing the re-use of client assets together with lack of effective segregation and insufficient record keeping can cause uncertainties and delays in identifying and recovering client assets that complicate resolutions. The FSB is developing guidance on the elements that need to be in place to ensure both that transfer powers can be exercised effectively in relation to client assets in a resolution and that client assets can be returned as quickly as possible if the firm enters an

insolvency proceeding. The guidance is also intended to ensure that appropriate attention is paid to the issue in resolution planning and resolvability assessments for firms that hold a significant amount of client assets domestically or in other jurisdictions. This work complements IOSCO's "Recommendations Regarding the Protection of Client Assets" which was published for consultation earlier this year.⁸

3.3 FSB Key Attributes Assessment Methodology

With the involvement of experts from FSB member jurisdictions, and representatives of CPSS, IADI, IAIS, IOSCO, the IMF and World Bank, the FSB has been developing a single assessment methodology with the purpose of guiding the assessment of jurisdictions' compliance with the *Key Attributes* and ensuring that assessments are carried out in a consistent way. Once finalised, the assessment methodology will provide guidance to jurisdictions when adopting or amending national resolution regimes to implement those standards for all financial sectors, and will be relied on in peer reviews and IMF and World Bank assessments of that implementation. A recent draft of the methodology has been used as a reference document in preparing the thematic peer review of resolution regimes. The revised draft methodology will be published for consultation later this year. It will also be used in pilot assessments carried out jointly with the IMF and World Bank. The objective of the pilot assessments is to test the adequacy and suitability of the assessment criteria set out in the draft methodology for the *Key Attributes*.

⁸ <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD401.pdf>