I-Annex 3: Resolvability Assessments

1. Defining resolvability

A SIFI is "resolvable" if it is feasible and credible for the resolution authorities to resolve it in a way that protects systemically important functions without severe systemic disruption and without exposing taxpayers to loss. 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 firms 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 firms, and the degree of contingency preparedness (adequacy of RRPs); and

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

3. Process for assessing resolvability

Resolvability assessments are necessarily qualitative and are not binary. Group resolvability assessments of G-SIFIs should be conducted by the home authority and coordinated within the firm's CMG, taking into account national assessments by host authorities. The process for group resolvability assessment should be established in institution-specific cross-border cooperation agreements (see I-Annex 2). Host authorities that conduct resolvability assessments of local subsidiaries of foreign firms should coordinate as far as possible with the home authorities conducting the group resolvability assessment. The results of those resolvability assessments should inform the recovery and resolution planning for that firm.

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, the RRP for the firm, and the authorities' capacity to apply them at short notice to the firm in question.

Stage 2 - Systemic impact assessment: Determine the credibility of all feasible resolution strategies by capturing the likely impact of the firm'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 to the RRP or to the structure or operations of the firm to improve resolvability. 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 assessments by national authorities of the extent to which a firm is resolvable given its structure and the resolution regimes under which it operates;

(ii) assessments conducted by the home authority and coordinated within the firm's CMG drawing on shared national assessments of the resolvability of subsidiaries by members of the CMG, and identification of the issues to be addressed by the firm or by specific authorities;

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

(iv) remediation by the firm or relevant regulatory authorities; and

(v) re-assessment of resolvability coordinated 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.

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 non-financial sector?

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 **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 institution or surviving parts of a resolved firm when necessary?

4.4 **Assessment.** What are the obstacles to separating systemically critical functions from the rest of the firm in a resolution and for ensuring their continuity, given the issues referred to in paragraphs 4.1 to 4.3 above?

Internal interconnectedness

4.5 **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 (for example, to facilitate a partial sale), if necessary? Do firms maintain at the legal entity level information on intra-group guarantees and intra-group trades booked on a back-to-back basis?

4.6 **Assessment.** Do intra-group transactions result in material imbalances of value across legal entities that affect incentives for cooperation? How quickly could intra-group transactions be unwound?

Membership in FMIs[10]

4.7 **Continuity of membership in FMIs.** Can the firm being resolved retain membership of FMIs? Will a newly established bridge institution be able to access FMIs?

4.8 **Transfer of centrally cleared contracts to a bridge institution.** Can centrally cleared financial contracts of a failed institution be transferred to a bridge institution pending the bridge institution's access to the CCP?

4.9 **Transferability of payment operations.** Do firms have in place arrangements that facilitate the transfer of payment operations to a bridge institution or third party purchaser? In particular, is there:

(i) a centralised repository for all their FMI membership agreements;

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

(iii) a draft Transitional Services Agreement as part of RRPs that, if needed, will allow the firm to continue to provide uninterrupted payment services (including

[10] See Key Attributes, footnote 2.

access to FMIs) on behalf of the new purchaser, by using existing staff and infrastructure; and

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

4.10 **Second-tier firms.** Do firms that are not direct FMI participants have contingency arrangements to access FMIs via more than one firm? Can they quickly switch if one direct participant fails?

4.11 **Assessment.** Can critical payment functions continue? Can access to FMIs be maintained?

Management information systems (MIS)

4.12 **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 and of major counterparties (including CCPs) on a daily basis? Can the firm ensure the continuity of MIS for both the remaining and successor 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?

4.13 **Prompt provision of necessary information to relevant authorities.** How quickly could information (for example, 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 firm 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?

4.14 **Assessment.** 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

4.15 **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 set out Key Attribute 3?

4.16 **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 the *Key Attributes*? For example:

(i) What are the mechanisms in place to coordinate with a host authority the cross-border operation and recognition of a bridge institution when the home authority has decided to use such a tool as part of a resolution procedure;

(ii) 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; and

(iii) Could resolution measures in one foreign jurisdiction trigger action in other jurisdictions? How does this affect the resolution process and likelihood to achieve a coordinated solution?

4.17 **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 coordinated resolution?

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

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

5. Assessing the systemic impact

The assessment of the expected adverse consequences for the financial system and the overall economy resulting from the failure should help 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 judgmental. 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 financial markets.** To what extent is the firm's resolution likely to cause disruptions in domestic or international financial markets, for example, because of lack of confidence or uncertainty effects?

5.2 **Impact on FMI.** Could the firm's resolution cause contagion through FMIs, for example by triggering of default arrangements in FMIs, or leaving other firms without access to FMIs?

5.3 **Impact on funding conditions.** What are the likely impacts of the firm's resolution on other (similarly situated) firms in rolling over and 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 levels below the regulatory thresholds?

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