I-Annex 5: Temporary stay on early termination rights[11]

1. Objectives

1.1 Under standard market documentation for financial contracts and absent any statutory or regulatory provisions to the contrary, contractual acceleration, termination and other close-out rights (collectively, "early termination rights") in financial contracts may be triggered upon entry of a firm into resolution or in connection with the use of resolution powers. In the case of a SIFI, the termination of large volumes of financial contracts upon entry into resolution could result in a disorderly rush for the exits that creates further market instability and frustrates the implementation of resolution measures aimed at achieving continuity.

1.2 The *Key Attributes* (see Key Attribute 4.3) stipulate that, subject to adequate safeguards, entry into resolution and the exercise of any resolution powers should not constitute an event that entitles the counterparty of the firm in resolution to exercise early termination rights provided the substantive obligations under the contract, including payment and delivery obligations, and provision of collateral, continue to be performed. Should early termination rights nevertheless be exercisable, the resolution authority should have the power to stay temporarily such rights where they arise by reason only of entry into resolution or in connection with the use of resolution powers and provided that the substantive obligations under the contract, including payment and delivery obligations, and provision of collateral, continue to be performed.

1.3 Limited in this way, the restrictions on early termination rights set out in paragraph 1.2 do not affect other rights of counterparties under a netting and collateralisation agreements and do not interfere with payment or delivery obligations to FMIs.[12] If a firm in resolution fails to meet any margin, collateral or settlement obligations that arise under a financial contract or as a result of the firm's membership or participation in an FMI, its counterparty or the FMI would have the immediate right to exercise an early termination right against the firm in resolution. The counterparty and the FMI could not terminate and close-out the contract based solely upon the entry into resolution or the exercise of resolution powers. They would have such right if the firm in resolution or the resolution authority failed to meet any margin,

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[11] Where components of this Annex have been deemed important for purposes of assessing compliance with the *Key Attributes*, those components are explicitly reflected in the Key Attributes Assessment Methodology.

[12] For the purposes of this document, the term "financial market infrastructure" is defined as "a multilateral system among participating financial institutions, including the operator of the system, used for the purposes of recording, clearing, or settling payments, securities, derivatives, or other financial transactions". It includes payment systems, central securities depositories (CSDs), securities settlement systems (SSSs), central counterparties (CCPs), and trade repositories (TRs). See CPSS-IOSCO report on *Principles for financial market infrastructures* - March 2012 (http://www.bis.org/cpmi/publ/d101.htm).

collateral or settlement obligations that arise under a financial contract or as a result of the firm's membership or participation in an FMI.

2. Conditions for a temporary stay

2.1 A temporary stay of the exercise of early termination rights should be subject to the following conditions:

(i) The stay only applies to early termination rights that arise for reasons only of entry into resolution or in connection with the use of resolution powers (including, for example, a change in control of the relevant firm or its business arising from such proceedings);

(ii) The stay is strictly limited in time (for example, for a period not exceeding two business days);

(iii) The resolution authority would only be permitted to transfer all of the eligible contracts with a particular counterparty to a new entity and would not be permitted to select for transfer individual contracts with the same counterparty and subject to the same netting agreement ("no cherry-picking" rule);

(iv) For contracts that are transferred to a third party or bridge institution, the acquiring entity would assume all the rights and obligations of the firm from which the contracts were transferred;

(v) The early termination rights of the counterparty are preserved against the firm in resolution in the case of any default occurring before, during or after the period of the stay that is not related to entry into resolution or the exercise of a resolution power (for example, a failure to make a payment or the failure to deliver or return collateral on a due date);

(vi) Following a transfer of financial contracts the early termination rights of the counterparty are preserved against the acquiring entity in the case of any subsequent independent default by the acquiring entity;

(vii) The counterparty can exercise the right to close out immediately against the firm in resolution on expiry of the stay or earlier if the authorities inform the firm that the relevant contracts will not be transferred; and

(viii) After the period of the stay, early termination rights could be exercised for those financial contracts that are not transferred to a sound firm, bridge institution or other public entity.

Operation of the stay

2.2 The stay may be discretionary (imposed by the resolution authority on a case-by-case basis) or automatic in its operation. In either case, jurisdictions should ensure that the counterparties to the firm in resolution have clarity as to the beginning and the end of the stay.

2.3 As part of the resolution planning process and resolvability assessments, authorities should consider the implications of a temporary stay on the exercise of early termination rights for FMIs and other counterparties of the firm (see I-Annex 3, 4.8; I-Annex 4, 4.1).