

INTERNATIONAL MONETARY FUND

**The Key Attributes of Effective Resolution Regimes for Financial Institutions—
Progress to Date and Next Steps**

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Monetary and Capital Markets Department¹

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GLOSSARY

CMG	Crisis Management Group
FDIC	U.S. Federal Deposit Insurance Corporation
FSA	U.K. Financial Services Authority
FSB	Financial Stability Board
FSF	Financial Stability Forum
G-SIB	Global Systemically Important Bank
G-SIFI	Global Systemically-Important Financial Institution
IMFC	International Monetary and Financial Committee
ROSC	Report on the Observance of Standards and Codes
RRP	Recovery and Resolution Plan
SIFI	Systemically-Important Financial Institution
TBTF	Too-big-to-fail Institutions

EXECUTIVE SUMMARY

The financial crisis underscored the need to develop an effective international framework to resolve cross-border financial institutions and groups. The development of such a framework has been a priority for the international community. Many important milestones have been achieved—most notably the adoption by the Financial Stability Board (FSB) of the *Key Attributes of Effective Resolution Regimes for Financial Institutions* (the *Key Attributes*) which is emerging as a new (nonbinding) international standard. Fund staff have been heavily involved in their development.

The *Key Attributes* specify essential features that should be part of the resolution framework at both the national and international levels, with the key objective of making resolution feasible without severe systemic disruption and without exposing taxpayers to loss. These features include a comprehensive “toolkit” of resolution powers for national authorities, including powers to: (i) assume control of a financial institution from existing managers and owners; (ii) effect a resolution of the troubled institution through the sale or merger of the entity, the transfer of assets and liabilities of the institution to third parties, or through unilateral debt restructuring or “bail-in”; and (iii) support the resolution through a temporary stay on the execution of early termination rights under financial contracts.

The *Key Attributes* foster effective international cooperation. They call for national resolution frameworks to be designed in a manner that *enables* and *encourages* the resolution authorities to cooperate with their foreign counterparts in a cross-border resolution. For Global-Systemically Important Financial Institutions (G-SIFIs), the *Key Attributes* provide for an elaborate framework of crisis management groups, resolvability assessments, and recovery and resolution plans.

While the *Key Attributes* represent an important step forward, gaps in the framework remain. In particular, the *Key Attributes* do not articulate principles that would guide burden sharing between national authorities who might have to commit public funds to support a cross-border resolution. Moreover, challenges remain with the implementation of the framework. Progress in the completion of resolvability assessments and of resolution plans for G-SIFIs is uneven, while significant political commitment will be required for many countries to amend their legal frameworks to comply with the *Key Attributes*.

Fund staff are participating actively in the work of the FSB to implement the *Key Attributes*—in particular, in the development of a methodology to be used in assessing countries’ compliance with the new standard. This methodology is planned to be completed in late 2013, and the staffs of the Fund and the Bank expect to seek appropriate authorization under their respective governance frameworks for the *Key Attributes* to be used as a new standard under the Standards and Codes (ROSC) program.

I. INTRODUCTION

1. **The 2008 financial crisis underscored the need for the development of an effective international framework for the resolution of cross-border financial institutions and groups.** The absence of such a framework significantly hampered the efforts of national authorities to respond to the crisis and to the potential failure of large, systemically-important financial institutions (SIFIs). In most cases, national authorities were left with no realistic alternative other than to commit public resources to support the relevant institutions and the banking system more generally.
2. **Since the beginning of the financial crisis, the international community has devoted considerable attention to the development of a robust international framework for the resolution of cross-border financial institutions.** The International Monetary and Financial Committee (IMFC) and the G-20 leaders have both called for such a framework,² which—together with more intensive and effective supervision and enhanced requirements for loss-absorption capacity—would form a comprehensive set of policies aimed at addressing the moral hazard risks associated with SIFIs.
3. **Important milestones in the development of a resolution framework have been achieved.** Key work in this area includes: (i) the Report of the Cross-border Resolution Group of the Basel Committee on Banking Supervision;³ (ii) the 2010 Fund Board paper on the *Resolution of Cross-border Banks—A Proposed Framework*;⁴ and (iii) most recently, the Financial Stability Board’s *Key Attributes of Effective Resolution Regimes for Financial Institutions* (the *Key Attributes*).⁵
4. **The *Key Attributes* set out the core elements necessary for an effective resolution regime for financial institutions and groups.** They were endorsed as a new standard by the G-20 leaders at their summit in Cannes in November 2011.⁶ They draw on the work of the

² IMFC, *Communiqué of the Twenty-Fourth Meeting of the IMFC: Collective Action for Global Recovery*, at <http://www.imf.org/external/np/cm/2011/092411.htm>, and Communiqué of the G-20 Leaders Summit in Cannes, 2011, <http://www.g20-g8.com/g8-g20/g20/english/for-the-press/news-releases/g20-leaders-summit-final-communicue.1554.html>.

³ Basel Committee, *Report and Recommendations of the Cross-border Bank Resolution Group* (March 2010), <http://www.bis.org/publ/bcbs169.htm>.

⁴ www.imf.org/external/np/pp/eng/2010/061110.pdf.

⁵ FSB (2011), *Key Attributes of Effective Resolution Regimes for Financial Institutions*, November 2011, http://www.financialstabilityboard.org/publications/r_111104cc.pdf.

⁶ The Final Communiqué notes: “13. We have agreed on comprehensive measures so that no financial firm can be deemed “too big to fail” and to protect taxpayers from the costs of resolution... G-SIFIs will be submitted to strengthened supervision, a new international standard for regimes as well as, from 2016, additional capital requirements....”

Fund (*Box 1*) and the Basel Committee, and Fund staff have been heavily involved in their development.

5. **This paper provides an overview of the *Key Attributes*.** It first describes the principal features of the *Key Attributes*. It then discusses three important issues that the *Key Attributes* address: (i) the resolution toolkit; (ii) mechanisms for cross-border cooperation; and (iii) the recovery and resolution planning process. It ends with a brief conclusion and describes the process for the implementation of the *Key Attributes* and the Executive Board’s involvement in this process.

6. **The paper does not propose decisions for the Executive Board’s adoption at this stage.** Rather, it is intended to familiarize Executive Directors with the purposes and principal features of the *Key Attributes* and with Fund staff’s recent work in this area.

Box 1. The 2010 Fund Paper

The Fund Board paper advocated a pragmatic framework for enhanced coordination among national authorities. Based on four principal elements that would be set out in a non-binding memorandum of understanding between relevant countries and, where appropriate, incorporated into domestic law:

- Countries amend their **domestic legal frameworks to require coordination of resolution efforts** with their counterparts in other jurisdictions to the maximum extent consistent with the interests of creditors and domestic financial stability. National authorities would retain the discretion to act independently, if they were to judge such action to be more consistent with these objectives.
- The enhanced coordination framework would only apply to countries that have in place “**core-coordination standards**” relating to the design and application of resolution systems. These relate to the harmonization of national resolution rules (nondiscrimination against foreign creditors, effective intervention tools, appropriate creditor safeguards, and robust and harmonized rules on priority), robust supervision, and institutional capacity to implement an international solution.
- Recognizing that there may be cases where public funding is needed, at least on a temporary basis, the framework also contemplated the development of principles that would guide the **burden-sharing process among cooperating authorities**.
- Countries would agree to **coordination procedures** that enable resolution actions to be taken as quickly as possible and to have cross-border effect. Such procedures would identify who would play the lead role, the level of communication (including consulting on key decisions to consider the impact of the decision on other jurisdictions), and provisions and procedures in national legal frameworks to give effect to foreign resolution actions.

International Monetary Fund, 2010, “*Resolution of Cross-Border Banks—A Proposed Framework for Enhanced Coordination*” <http://www.imf.org/external/np/pp/eng/2010/061110.pdf>.

II. OVERVIEW OF THE KEY ATTRIBUTES

7. **The *Key Attributes* specify essential features that should be part of resolution regimes at both the national and international levels.** The objective of such regime is to make resolution feasible without severe systemic disruption and without exposing taxpayers to loss, while protecting vital economic functions through mechanisms that make it possible for private stakeholders to absorb losses. The framework envisaged in the *Key Attributes* consists of four principal elements (Box 2): (i) strengthened national resolution regimes; (ii) arrangements for international cooperation; (iii) improved recovery and resolution planning; and (iv) the elimination of practical barriers to cooperation.⁷

Box 2. The Key Attributes—A Summary

The *Key Attributes* set out 12 features considered essential for an effective resolution regime:

- ***Scope:*** The regime should cover any financial institution that could be systemically significant.
- ***Resolution authorities:*** should be independent and have clear mandates, roles, and responsibilities.
- ***Toolkit:*** Resolution authorities should have broad resolution powers, as described in part III.
- ***Set-off, netting, collateralization, segregation of client assets:*** These arrangements should be preserved, although the authorities should also be able to suspend their operation, subject to adequate safeguards.
- ***Legal Safeguards:*** While resolution authorities may depart from the hierarchy of claims, they may have to offer compensation to creditors, and their decisions must be subject to judicial review.
- ***Funding of firms in resolution:*** Authorities should minimize the use of public funds to resolve firms.
- ***Framework for cross-border cooperation:*** Resolution authorities should be empowered and encouraged to achieve cooperative solutions with foreign resolution authorities.
- ***Crisis Management Groups:*** Home and key host authorities should maintain CMGs that actively review and report on resolvability and on the recovery and resolution planning process for G-SIFIs.
- ***Institution-specific cross-border cooperation agreements:*** should be in place among relevant authorities to manage the sharing of information and specify responsibilities in respect of all G-SIFIs.
- ***Resolvability assessments:*** Resolution authorities should regularly undertake resolvability assessments for all G-SIFIs, and should be able to require changes to business practices, structure or organization.
- ***Recovery and resolution planning:*** Jurisdictions must require planning for the recovery and resolution of firms that could be systemically significant.
- ***Information sharing:*** Jurisdictions should eliminate impediments to the domestic and cross-border exchange of information among authorities, both in normal times and during a crisis.

⁷ The fourth of these elements focuses on practical impediments to cross-border cooperation such as fragmented information systems, intra-group transactions, and reliance on service providers and is not discussed in detail in this paper.

8. **The *Key Attributes* are not an international treaty and do not give rise to binding legal obligations for countries.** Rather, the *Key Attributes* establish a nonbinding standard that countries—in particular, members of the Financial Stability Board (FSB)—will be encouraged to implement. The *Key Attributes* recognize that the conclusion of an international treaty governing cross-border resolution is not currently feasible and that countries are not prepared to surrender, to any significant degree, sovereignty over this area. Nonetheless, regional arrangements are being put in place building on the *Key Attributes*. The European Commission has recently proposed a European Union-wide framework for the recovery and resolution of financial institutions⁸ that would implement key features of the *Key Attributes*.

9. **The *Key Attributes* are broad in scope.** They seek to ensure that a country’s resolution framework applies to any type of financial institution that could be systemically important, including banks, nonbank financial institutions, insurers and financial market infrastructures.⁹ Although not explicitly called for by the standard, many of the *Key Attributes*’ provisions (e.g., resolution powers) could usefully be applied to any financial institution regardless of its systemic importance, albeit in a proportional manner.

10. **The implementation of the framework envisaged in the *Key Attributes* will benefit both advanced and emerging countries.** Countries may wish to implement the *Key Attributes* in a manner that recognizes the level of development of their financial system and their institutional capacity. At the same time, the rapid growth of cross-border banking may prove to be a potent driver for countries to fully implement the *Key Attributes* and the framework they set out to address cross-border coordination challenges.

11. **While the *Key Attributes* represent an important step forward, gaps in the framework remain.** Principal among these is the failure of the *Key Attributes* to articulate principles that would govern public sector burden-sharing between national authorities involved in the resolution of a cross-border financial institution. Notwithstanding the many improvements that are being made to national resolution frameworks, there are likely to be circumstances in the future where public funds will have to be committed to support the resolution of a large cross-border institution. For an international framework to work effectively, principles that will govern such burden-sharing between jurisdictions will be essential. These principles form an important part of the framework outlined in the 2010

⁸ Draft Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms to be approved by the European Council and Parliament, http://ec.europa.eu/internal_market/bank/crisis_management/index_en.htm#framework2012.

⁹ In particular, the framework is applicable to all G-SIFIs designated by the FSB: for these institutions, the *Key Attributes* set out an elaborate framework of institution-specific cooperation agreements, crisis management groups, resolution planning, and resolvability assessments. It is recognized that some aspects of the *Key Attributes* may not be appropriate for certain types of financial institutions and that the provisions of the *Key Attributes* would need to be applied to such institutions with appropriate modifications.

Fund Board paper, but are absent from the *Key Attributes*. Fund staff continue to view the development of such principles as an important area for future work.

12. **The next three sections discuss elements of the *Key Attributes* that are of particular importance to the Fund:** (i) the resolution toolkit; (ii) cross-border cooperation; and (iii) recovery and resolution planning.

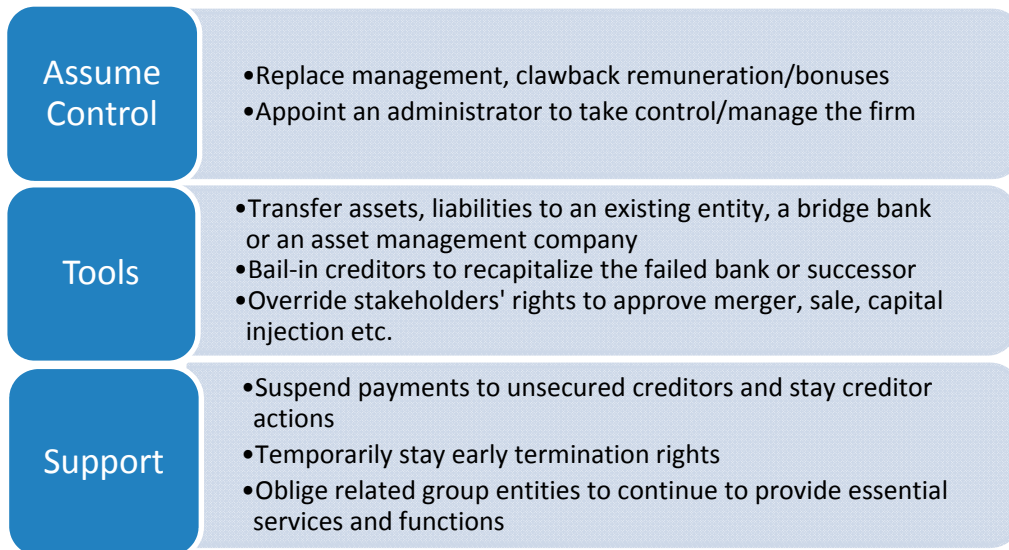
III. THE RESOLUTION TOOLKIT

13. **The *Key Attributes* call for the resolution authorities to have a broad range of powers to deal with a failing financial institution, without recourse to public funds.** In most countries, such powers are exercised in the context of resolution proceedings, which may be administrative or judicial in nature and generally take the form of official administration or liquidation.¹⁰ The *Key Attributes* provide that resolution powers should be exercised by a designated “resolution authority” (or authorities) that should be able to intervene at an early stage of an institution’s difficulties—when it is no longer viable or likely to be no longer viable, and has no reasonable prospect of becoming so again (i.e., before the bank is actually balance sheet insolvent).

14. **The *Key Attributes* recognize that there is no “one size fits all” approach to resolution** and that different approaches need to be taken, depending on the institution and its circumstances. Liquidation, when combined with a quick deposit insurance payout, may efficiently resolve a small bank. But when a failing bank is systemic, the authorities may seek to resolve the institution in a manner that preserves its systemic activities as a going concern. The resolution toolkit therefore needs to be comprehensive, and the authorities need to be able to act with the necessary speed and flexibility, subject to appropriate legal safeguards and due process.

15. **The resolution powers envisaged under the *Key Attributes* can be broadly grouped into three categories:** (i) powers to intervene quickly (prior to insolvency) and assume control from existing owners and managers; (ii) powers to effect a resolution; and (iii) powers to support the resolution, for example, by suspending third party actions that could otherwise undermine it (Figure 1).

¹⁰ In some countries, what is meant by official administration may be referred to by terms such as temporary administration, special administration or temporary management.

Figure 1. General Resolution Powers under the *Key Attributes*

i) Assumption of Control

16. **To ensure timely and effective resolution, the *Key Attributes* call for resolution authorities to be able to assume control of a firm.** In particular, the *Key Attributes* recognize the need for the authorities to be able to remove and replace the senior management and directors, appoint an administrator to take control of and manage the affected firm, ensure the continuity of its essential services, and recover monies from persons responsible for the firm's failure.

ii) Resolution Tools

17. **At the heart of the resolution “toolkit” are the principal powers needed to effect a resolution.** The *Key Attributes* recognize the need for the resolution authorities, where appropriate, to be able to transfer ownership of the entire financial institution in difficulty (i.e., the shares in the institution itself) to new owners or to merge it with another institution, but these approaches often fail because of a lack of private sector interest.¹¹ As an alternative, the *Key Attributes*, call for the authorities to be able to transfer unilaterally (i.e., without the consent of the counterparties) the institution's assets and liabilities to another entity. Where the institution in difficulty is a bank, this type of “purchase and assumption” transaction splits the institution's assets and liabilities into two parts:

¹¹ This is particularly the case if there is large negative equity, because an injection of new equity without first attributing losses to creditors would represent a wealth transfer from new shareholders to the creditors.

- One part, comprising marketable assets plus insured deposits and potentially other liabilities of the failed bank, is transferred to a healthy purchasing bank. In case the insured deposits exceed the value of the assets, the deposit guarantee scheme may be used to close the gap. If no private-sector buyer can be found, the assets and liabilities are transferred to a temporary state-owned vehicle (‘bridge bank’), which is set up specifically to manage the transferred business until it can be sold; and
- The other part comprising the remaining assets and liabilities is left in the residual bank and liquidated, imposing losses on the creditors. This removes any need for funds from the public purse or resolution fund to support the creditors left behind.¹²

18. **The *Key Attributes* also call for resolution authorities to be able to transfer assets out of troubled financial institutions into an asset management company.** This tool has been used in systemic crises to clean up bank balance sheets. By removing nonperforming assets and thereby reducing counterparty risk, this may help restore market access for troubled banks and afford some support and transparency to asset valuations in the market. Official funding is typically required to facilitate the purchase of the assets from the troubled banks.

19. **The *Key Attributes* call for resolution authorities to have the power to unilaterally restructure the debt of a financial institution or a successor entity through “bail-in” (Box 3).** Under this technique, the authorities unilaterally restructure the liabilities of the institution by writing them down and, in some cases, converting them into equity. The objective of this exercise is to return the financial institution to compliance with prudential requirements and restore its viability.¹³ Such a unilateral debt restructuring directly imposes losses on the private stakeholders of the ailing firm. In contrast to a purchase and assumption transaction (which, by definition, involves the transfer of assets and liabilities to another institution), a “bail-in” may be executed without making any transfers to other institutions.

¹² An important aim of this operation is to preserve the viable parts of the bank’s business encompassing the creditors and functions deemed critical. While this is a tried-and-tested tool, it has been used typically so far to deal only with relatively small, domestically focused institutions. These powers have been used for many years by the FDIC in the United States for generally small deposit takers where they are called a purchase and assumption (of assets and liabilities respectively). Deposit insurance funds are required to meet any shortfall between the assets and liabilities transferred. The operational challenges faced in splitting up a balance sheet in a short period (as is typically required in a resolution) increase exponentially with the size, complexity, and international outreach of a failing bank.

¹³ Though debt restructuring has not been a common resolution tool for financial institutions, it is not a completely new idea. Numerous frameworks for general corporate insolvency include provisions for debt restructuring as a method of addressing insolvency. Even before the global financial crisis, debt restructuring for financial institutions was available in several jurisdictions. In some cases, this was because financial institutions, as corporations, were subject to the general corporate insolvency framework, which included debt restructuring as a method of addressing insolvency. In other cases, jurisdictions had on their books a special framework of debt restructuring for financial institutions.

Box 3. Bail-in Within Resolution

Bail-in encompasses the power to write down equity and unsecured and uninsured creditor claims to absorb losses, convert unsecured and uninsured creditor claims into equity, and convert or write-down any outstanding contingent capital instruments that have not already been triggered according to their terms.

Bail-in must respect the hierarchy of claims in liquidation. Equity should absorb losses first, then subordinated debt (including all regulatory capital instruments), and, finally, senior unsecured debt. Creditors should have the right to compensation where they do not receive at least the amount they would have received in a liquidation of the ailing institution (the “no creditor worse off” principle).

There are several additional design elements that need to be addressed by the legal framework to make bail-in an effective resolution tool.

- **Triggers for bail-in:** Generally, the triggers should be consistent with those used for other resolution tools – for example, where a financial institution is no longer viable or is likely to be no longer viable and has no reasonable prospect of becoming so. This threshold should be met before the institution is balance-sheet insolvent and before all equity has been wiped out.
- **Scope of application:** Certain types of liabilities should not be subject to bail-in. While equity and subordinated debt should first absorb losses, the *Key Attributes* exclude secured creditor claims (up to the value of the security) and insured deposits, and leave open the possibility of excluding other liabilities that are of systemic or strategic importance (e.g., inter-bank and retail deposits, payment and settlement obligations, and trade-finance obligations).
- **Effect on financial contracts:** Bail-in should not trigger contractual rights of acceleration, termination, or set-off as long as the substantive obligations under the relevant contracts continue to be performed.
- **Safeguards and judicial review:** As is the case with other resolution powers and in the interests of financial stability, it would be preferable if, subject to a country’s own constitutional framework, bail-in could be exercised as part of an administrative (as opposed to judicial) process that is subject to ex-post judicial review to ensure that the authorities act within the scope of their legal powers.

20. **The *Key Attributes* recognize the need for the authorities to be able to exercise this power in conjunction with other resolution tools (e.g., removal of problem assets, replacement of management) to ensure that the restructured firm, after bail-in, will be viable.**¹⁴ Moreover, it should be recognized that bail-in has not yet been tested, to any great degree, in practice. In addition, reliance on bail-in powers may lead to an increase in funding costs and to a change in the funding mix and liability structure, increasing firms’ reliance on short-term debt and secured borrowing. To the extent that bail-in were to be exercised in a systemic crisis, its potential contagion effects would need to be carefully managed.¹⁵

¹⁴ The authorities should also be able to convert or write-down any convertible or contractual bail-in instruments.

¹⁵ For further details on bail-in and a discussion of its scope, and its benefits and limitations see IMF (2012), “*From Bail-out to Bail-in: Mandatory Debt Restructuring of Systemic Financial Institutions*,” IMF Staff Discussion Note 12/03, April 24, 2012, <http://www.imf.org/external/pubs/ft/sdn/2012/sdn1203.pdf>.

21. **The *Key Attributes* provide that these various powers (i.e., sale, merger, purchase and assumption, bail-in) should be exercised without the need to obtain the consent of relevant stakeholders, including shareholders or creditors.** The rationale for this approach is clear: to protect financial stability, the authorities have to be able to move quickly and decisively. At the same time, the *Key Attributes* acknowledge that the exercise of these powers should be subject to appropriate safeguards to ensure that due process is respected and that the authorities act within the scope of their legal authority. In particular, the *Key Attributes* call for resolution powers to be exercised in a way that respects the hierarchy of claims between creditors while providing for flexibility to depart from the general principle of equal treatment, if necessary to contain the potential systemic impact of the institution's failure or to maximize the value for the benefit of all creditors as a whole. Moreover, the “no creditor worse-off” principle ensures that creditors have a right to compensation if they receive less than they would have received had the institution been liquidated. In circumstances where resolution powers are exercised through an administrative proceeding, the *Key Attributes* provide for judicial review of the authorities' actions, with redress in the form of compensation, rather than a reversal of the relevant measures.

iii) Support for the Resolution

22. **The *Key Attributes* recognize that the resolution of a failing financial institution will often need to be supported by other mechanisms—in particular, a temporary stay on the exercise of early termination rights in financial contracts.** It is normally the case that national insolvency frameworks provide for the imposition of stays or moratoria that prohibit certain creditors from enforcing their claims against the assets of the troubled entity. The purpose of these stays is to prevent creditors from rushing to seize the assets of a troubled institution, thereby undermining the institution's restructuring or its orderly liquidation. However, many countries have explicitly exempted financial contracts from these measures so that the parties to financial contracts with the troubled entity may immediately exercise their early termination rights. Most financial market transactions (e.g., derivatives, securities lending and repos) are executed under standard documentation that entitles the parties to manage counterparty exposures on a net, rather than a gross, basis, and accordingly to terminate and close-out outstanding trades following a defined trigger event such as the commencement of resolution proceedings.¹⁶ As close-outs potentially destroy the value of a financial institution that might otherwise be sold or transferred as a going-concern, the *Key Attributes* call for the resolution authorities to be able to stay temporarily the execution of these provisions in connection with the exercise of any resolution powers. Moreover, to facilitate a necessary restructuring during the period of the stay, the authorities should be able to transfer contracts from the failing institution to a solvent third party. The exercise of these powers must be subject to important safeguards. In particular, such exercise must be strictly limited in time and only apply to termination rights that would be triggered by the exercise of the resolution powers. Moreover, the resolution authority cannot “cherry-

¹⁶ In a close-out, the creditor appropriates to itself property representing assets that would otherwise be returned to the debtor, and pursues the debtor for any net amount by which assets exceed liabilities.

pick” the contracts that it transfers and, rather, must transfer all trades with a counterparty as a block, such that all related rights and obligations are treated together (Box 4).

Box 4. Stays on Early Termination Rights

The *Key Attributes* recognize that entry into resolution and the exercise of any resolution powers should not trigger statutory or contractual set-off rights, or constitute an event that entitles any counterparty to the firm in resolution to exercise contractual acceleration or early termination rights, provided the substantive obligations under the contract continue to be performed. Otherwise, the termination and close-out of these contracts would significantly undermine efforts to resolve the financial institution in an orderly manner.

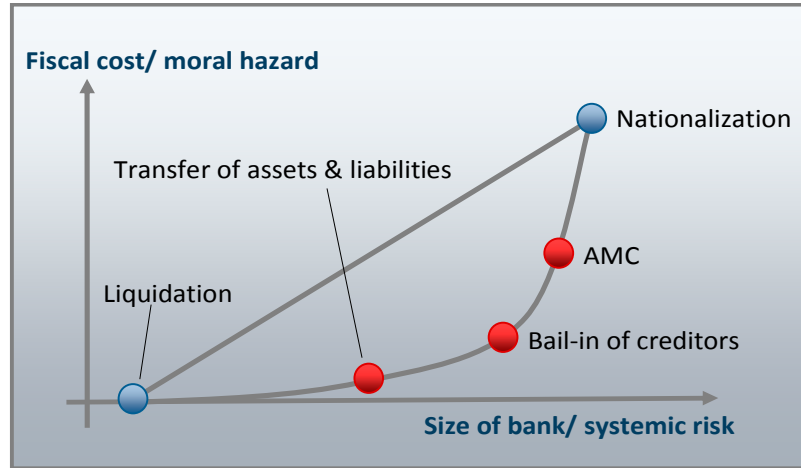
The *Key Attributes* therefore provide that, with respect to financial contracts, if contractual acceleration or early termination rights are nevertheless exercisable, the resolution authority should have the power to stay temporarily such rights where they arise by reason only of entry into resolution or in connection with the exercise of any resolution powers. The *Key Attributes* also seek to ensure that the exercise of this power is subject to appropriate safeguards. In particular, the stay should:

- be limited in time (for example, for a period not exceeding two business days);
- respect the integrity of financial contracts and provide certainty to counterparties; and
- not affect the exercise of early termination rights in the case of any event of default not related to entry into resolution (for example, failure to make a payment on a due date).

The *Key Attributes* provide that, during the period of the stay, the resolution authority should be able to transfer eligible financial contracts with counterparties to other entities. However, the resolution authority should not be permitted to select for transfer individual contracts with the same counterparty (“no cherry-picking” rule). Moreover, 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.

23. **By providing for a wider range of resolution tools between liquidation (which may not preserve financial stability) and nationalization, the *Key Attributes* seek to improve the trade-off that authorities face between cost and risk (Figure 2).** If the powers discussed above were adopted and perceived by market counterparts to reduce the likelihood that the creditors of too-big-to-fail institutions (TBTF) will be bailed out, then the TBTF premium from which these firms currently benefit should decline.

Figure 2. Improving the Trade-Off Frontier between Cost and Risk in Bank Resolution



IV. CROSS-BORDER COOPERATION

24. **The provisions on international cooperation set out in the *Key Attributes* seek to address problems existing in many national legal frameworks that hinder effective international cooperation.** Foremost amongst these problems are the following:

- **Mandate of the supervisory/resolution authorities:** The existing legal frameworks in many countries establish objectives for national supervisory and resolution authorities that focus on the promotion of *domestic* (rather than international) financial stability and do not require the authorities to take into account the impact of their resolution actions on other jurisdictions.
- **Discrimination:** The legal frameworks of some countries include features that discriminate against foreign creditors, for example, through rules governing the distribution of proceeds that, either explicitly or implicitly, give priority to local depositors and creditors.
- **Support for foreign resolution proceedings:** National legal frameworks in some countries fail to make adequate provision for the local resolution authorities to support resolution actions taken by their foreign counterparts. In particular, these legal frameworks fail to provide an effective mechanism under which the authorities with respect to local branches of a foreign institution may give effect to the resolution actions taken by the authorities in the home jurisdiction.¹⁷

¹⁷In some countries, for example, the host resolution authorities have no power to deal with the insolvency of a branch of a foreign financial institution. Rather, the resolution of the branch will be left to the home authorities (e.g., through judicial proceeding), regardless of the potential effect of those actions on the financial stability of the host country. In other countries, the host resolution authorities may be required to liquidate the branch upon the occurrence of an external event (e.g., the initiation of resolution proceedings in the home jurisdiction). In

(continued...)

- **Restrictions on sharing information:** The legal frameworks governing the sharing of information, in some cases, effectively prevent national supervisory and resolution authorities from sharing information with their foreign counterparts, either before or as part of a resolution action.

25. **The *Key Attributes* seek to address these problems by calling on national authorities to ensure that their national resolution frameworks facilitate international cooperation in several important ways.** The *Key Attributes* establish several important principles that are to be enshrined in national resolution frameworks:

- **Statutory mandate:** The mandate of a resolution authority should empower and strongly encourage the authority, wherever possible, to act to achieve a cooperative solution with foreign resolution authorities. Moreover, several of the *Key Attributes* call on national resolution authorities to consider the impact of a resolution action on financial stability in other jurisdictions.
- **No discrimination:** National laws and regulations should not discriminate against creditors on the basis of nationality, the location of their claim, or the jurisdiction where it is payable.
- **Branches:** The host resolution authority should have resolution powers over local branches of foreign institutions and the capacity to use its powers either to support a resolution carried out by a foreign home authority or, exceptionally, to take measures on its own initiative where the home jurisdiction is not taking action or acts in a manner that does not take sufficient account of the need to preserve the local home jurisdiction’s financial stability.¹⁸
- **No automatic action:** Legislation in jurisdictions should not contain provisions that trigger automatic action in that jurisdiction as a result of official intervention or the initiation of resolution or insolvency proceedings in another jurisdiction. However, the *Key Attributes* recognize that resolution authorities should be able to take discretionary national action, when necessary, to achieve domestic stability in the absence of effective international cooperation and information sharing.
- **Recognition and effect:** Jurisdictions should provide for transparent and expedited processes to give effect to foreign resolution measures, either by way of a mutual

these circumstances, the branch will be liquidated as if it were a separate legal entity and its assets will be “ring-fenced” for the benefit of creditors of the branch. Such proceedings can significantly complicate efforts to implement a cooperative and coordinated resolution between jurisdictions.

¹⁸ Under the *Key Attributes*, a jurisdiction need not have such a power where it is subject to a binding obligation to respect the resolution of financial institutions under the authority of the home jurisdiction. In the European Union, such a system exists in order to organize a coordinated resolution.

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. Recognition or support of foreign measures should be provisional on equitable treatment of creditors in the foreign resolution proceeding.

- **Information sharing:** The resolution authority should have the capacity in law, subject to adequate confidentiality requirements and protections for sensitive data, to share information with relevant foreign authorities, where sharing is necessary for recovery and resolution planning or for implementing a coordinated resolution. Jurisdictions should provide for confidentiality requirements and statutory safeguards for the protection of information received from foreign authorities.¹⁹
- **Legal protection:** The *Key Attributes* provide for the protection for the resolution authority and its staff against liability for actions taken or omissions made in good faith not only domestically but also in relation to actions taken in support of foreign resolution proceedings.

26. **The *Key Attributes* also call for relevant jurisdictions to put in place for G-SIFIs arrangements at the international level that will facilitate cross-border cooperation.** These arrangements include the establishment of Crisis Management Groups and the conclusion of institution-specific cooperation agreements.

- **Crisis management groups (CMGs):** Home and key host authorities of all G-SIFIs should put in place and maintain CMGs with the objective of enhancing preparedness for, and facilitating the management and resolution of, a crisis affecting the financial institution. Membership in a CMG is not open to all host authorities but only those that are host to entities of the group that are material to its resolution. However, CMGs should cooperate closely with authorities in other jurisdictions where the firm has a systemic presence.
- **Institution specific cross-border cooperation agreements:** Such agreements, which are to contain certain specified essential elements set out in the *Key Attributes*, are to be in place between home and relevant host authorities that need to be involved in planning and crisis-resolution. In particular, these agreements should establish the objectives and processes for cooperation through CMGs, define the roles and responsibilities of the authorities pre-crisis and during a crisis, and set out processes for information sharing and for coordination and consultation.

¹⁹ The *Key Attributes* specifically call on jurisdictions to ensure that there are no legal, regulatory, or policy impediments that hinder the exchange of information, both during normal times and during a crisis, at a domestic and a cross-border level.

V. RECOVERY AND RESOLUTION PLANNING

27. **Recovery and resolution planning has evolved into a key component for addressing the “too-big-to-fail” problem associated with systemically important financial institutions.** The concept of recovery and resolution plans (RRPs, also known as “living wills”) was first articulated in early-2009 by the FSB’s predecessor, the Financial Stability Forum (FSF). The FSF called for increased coordination between home and host authorities of financial institutions and encouraged firms to maintain, and regularly review, contingency plans and procedures to be followed in a wind-down situation.²⁰ More recently, various authorities, including the U.K. Financial Services Authority and the U.S. Federal Deposit Insurance Corporation (FDIC), together with the U.S. Federal Reserve Board, have issued detailed requirements and guidance in this area.

28. **For systemically important financial institutions (in particular, G-SIFIs), the *Key Attributes* establish a comprehensive procedural framework of resolvability assessments and recovery and resolution planning.**

- **Resolvability assessments:** These assessments are to be undertaken regularly for all G-SIFIs by the resolution authorities in relevant jurisdictions. They are designed to evaluate the feasibility of resolution strategies for the institution and their credibility in light of the likely impact of the firm’s failure on the financial system and overall economy.
- **Recovery and resolution planning (RRP):** RRP aims to guide the recovery of a distressed firm or, if this is no longer feasible, facilitate an orderly wind-down while minimizing the need for public money. A *Recovery Plan* is developed by the firm’s senior management and identifies options for restoring the firm’s financial strength and viability when faced with severe stress. Firms are expected to integrate their recovery plans into their governance and risk-control frameworks, and need to ensure that their plans cover sufficiently severe exogenous and firm-specific stress scenarios. In contrast, a *Resolution Plan* is prepared by the resolution authorities, based on information provided by the firm, and is intended to facilitate the effective use of resolution powers to protect systemically important functions, without severe disruption or exposing taxpayers to loss. For G-SIFIs, the home resolution authority leads the development of a group resolution plan in coordination with all members of the firm’s CMG.

²⁰ FSF *Principles for Cross-border Cooperation on Crisis Management*, issued in April 2009
http://www.financialstabilityboard.org/publications/r_0904c.pdf.

Figure 3. Key Decisions Underpinning Recovery and Resolution Planning



29. **The FSB has set out an ambitious timetable for the development of RRP**s (Figure 4). For all designated G-SIFIs, RRP are to be finalized by end-2012. The CMGs are then expected to conduct resolvability assessments for all G-SIFIs in the first quarter of 2013 and to develop basic resolution strategies. At the same time, institution-specific cooperation agreements (see paragraph 26 above) are to be developed for all G-SIFIs. The processes for recovery and resolution planning, the conduct of resolvability assessments, and the conclusion of cooperation agreements are iterative and will require further refinement and adjustment over time in light of experience.

30. **The implementation of the RRP framework is progressing, but challenges remain.** A survey conducted by the FSB indicates that for nearly all G-SIFIs, CMGs have been established and recovery plans have been reviewed by national supervisory bodies.²¹ However, progress in the completion of resolvability assessments and of resolution plans is

²¹ The Report of the Financial Stability Board to G20 Leaders, published in June 2012, indicated that, as of the second quarter of 2012, CMGs had been established for all but four of the 28 FSB designated G-SIFIs. Where a CMG is not yet established or active, substantive action has been planned. See http://www.financialstabilityboard.org/publications/r_120619a.pdf.

less advanced and uneven, as many jurisdictions lack the necessary statutory tools for resolution. Key issues highlighted in the FSB survey include a need for (i) greater severity in the stress scenarios and more exhaustive analysis of potential impediments to the implementation of recovery measures; (ii) intensified cross-border cooperation and information sharing; and (iii) further guidance on recovery and resolution triggers, critical functions, and stylized resolution strategies.²²

Figure 4. Key RRP Milestones



31. **Financial institutions are increasingly using RRP as an instrument to identify and address undue complexities in group structures.** Evidence from recent reports from the Financial Sector Assessment Program (FSAP) suggests that institutions that have gone through a detailed RRP process benefit from the opportunity to closely scrutinize their own structure and key processes in order to remove unnecessary complexities and better align the structure with the institution's business model.

32. **The resolution planning process may also help national authorities press for the simplification of group structures.** The Key Attributes provide that supervisory or resolution authorities should be empowered to require firms to change their structure, organization or business practices to reduce the complexity or costliness of resolution. This implies, in line with Fund staff advice in country-specific cases, that ex ante changes to group structures or business practices may, in some cases, be necessary to facilitate effective resolution. At the same time, any such change should take account of the specific circumstances at hand and avoid policy actions that may complicate capital and liquidity management at a global level.

33. **Greater inter-agency coordination and information sharing, particularly on a cross border basis, is paramount to the preparation of RRP.** While cross-border coordination and information sharing is improving—as evidenced by the establishment of CMGs—experience thus far suggests that obstacles remain. In particular, concerns have been expressed by firms subject to the RRP process over inconsistent rules governing the treatment of confidential information across jurisdictions. Moreover, as noted in the Fund's 2010 Board paper, national supervisory or resolution authorities may prove reluctant to cooperate with their foreign counterparts unless they have a high level of trust in their counterparts' ability to protect confidential information and to implement an international

²² The FSB's Cross-Border Crisis Management Group is preparing guidance notes on these topics.

resolution.²³ In addition, even within a single jurisdiction, inter-agency coordination may prove difficult.

34. **The resource implications of recovery and resolution planning should not be underestimated.** The initial experiences of firms indicate that the development of a credible recovery plan requires a significant effort on the part of supervised institutions, and the preparation of hundreds of pages of documentation. Moreover, the review of firms' recovery plans and the preparation of resolvability assessments and resolution plans will have significant resource implications for supervisory authorities, particularly those that are home to several G-SIFIs. While such exercises will certainly enhance supervisors' understanding of firms' structures, interdependencies and ability to deal effectively with a broad range of adverse scenarios, they are likely to strain further supervisors' limited resources.²⁴

VI. CONCLUSIONS AND NEXT STEPS

35. **The framework envisaged in the *Key Attributes* is forward-leaning and innovative.** It lays the foundation for more effective resolution regimes of financial firms both at the national and international level.

36. **Steps are underway to implement the *Key Attributes* and Fund staff remains closely engaged in this process:**

- Within the FSB, an assessment methodology and implementation guidelines are under preparation. Fund staff is participating in the methodology drafting group and is also co-chairing the FSB's Legal Advisory Panel, which is advising on legal issues that have arisen in the preparation of the methodology.²⁵
- FSB members have begun the first of an iterative series of thematic peer reviews on the implementation of the *Key Attributes*.²⁶ These peer reviews are expected to

²³ The FSB timeline foresees that authorities will commit to participate in a jointly agreed resolution process in the institution-specific cooperation agreements.

²⁴ See also the FSB's progress report on the *Intensity and Effectiveness of SIFI Supervision*, issued in November 2011, http://www.financialstabilityboard.org/publications/r_111104ee.pdf.

²⁵ The Legal Advisory Panel is a panel of lawyers and bank resolution experts from the public and private sectors, and academia, who advise the FSB's Resolution Steering Group on the legal issues arising from the *Key Attributes*. The draft methodology is being reviewed by the standard-setting bodies, whose representatives are also participating in the methodology drafting group to determine to what extent the methodology is suitable for different types of firms (e.g., financial market infrastructures, insurers and securities, and investment firms), and to what degree modifications may be necessary.

²⁶ The thematic peer review was launched on August 3, 2012. The FSB has published the peer review questionnaire and has invited financial institutions, industry associations and other stakeholders to provide comments (compared to the *Key Attributes*) of national resolution regimes in different FSB member jurisdictions. Comments have been requested by September 28, 2012. The questionnaire is available at http://www.financialstabilityboard.org/publications/r_120813.pdf. Fund staff are participating in this exercise and the report of the peer review team is expected to be published by end-2012.

provide a fuller picture of progress in implementing the new standard.

- Fund staff will participate, in early 2013, in a pilot of the draft methodology of two or more FSB members, at their request, in cooperation with the FSB and the World Bank.
- Subsequently, the draft methodology will be submitted for public consultation and will be revised and finalized by the FSB near the end of 2013.
- Once the methodology is finalized in a manner that is considered suitable to form the basis of a ROSC, staff of the Fund and the Bank expect to seek appropriate authorization under their respective governance frameworks to use the *Key Attributes* as a new standard under the ROSC program.²⁷ In the Fund's case, they will be presented to the Executive Board for endorsement. The resource implications arising from the Fund's endorsement would need to be reviewed in this context.

37. **The framework envisaged in the *Key Attributes* is, in many ways, aspirational.** Challenges will arise not only in implementing the standard and but also in assessing implementation. In particular, it will be difficult to distinguish formal *de jure* compliance (existence of an appropriate toolkit in the legal framework) from effective *de facto* compliance (ability and willingness to apply the framework in a crisis situation), in the absence of recent experience with respect to the failure of financial institutions.

38. **The *Key Attributes* are only the first step in a process that will require a long-term international commitment.** Some countries have taken steps to strengthen their resolution regimes since the crisis (e.g., Germany, Netherlands, United Kingdom, and United States). But, in many countries, significant further legislative reform will be needed. Implementation will require capacity building and significant resources in the resolution area, by both firms and competent authorities, as well as strengthened and more systematic cooperation among relevant authorities within and across borders. Through its continuous engagement with members, the Fund will play an important role in promoting timely implementation, while the newly developed methodology will, at the same time, serve as an effective mechanism for assessing progress in implementation.

²⁷It would form part of a new policy area on crisis resolution and deposit insurance, with the *Core Principles for Effective Deposit Insurance Systems*. See: *2011 Review of the Standards and Codes Initiative* <http://www.imf.org/external/np/pp/eng/2011/021611.pdf>.