

**Application of the Key Attributes of Effective Resolution Regimes  
to Non-Bank Financial Institutions**

**Consultative Document**

12 August 2013



The Financial Stability Board (FSB) is seeking comments on its Consultative Document on the Application of the *Key Attributes of Effective Resolution Regimes for Financial Institutions* ('the *Key Attributes*')<sup>1</sup> to non-bank financial institutions. This Consultative Document proposes draft guidance, developed by the FSB in conjunction with relevant standard setters, on how the *Key Attributes* should be implemented with respect to non-bank financial institutions that could be systemically significant or critical in failure.

The guidance should be incorporated into the *Key Attributes* as additional Annexes and covers the following:

### **I. Resolution of financial market infrastructure (FMI) and resolution of systemically important FMI participants (Appendix I)**

Part I of this draft Annex to the *Key Attributes* provides guidance on the implementation of the *Key Attributes* in relation to resolution regimes for FMIs. Part II deals with the failure of FMI participants. FMIs play an important role in the resolution of any of their participants and should endeavour to minimise disruption to critical functions that are provided by the FMI.

### **II. Resolution of insurers (Appendix II)**

This draft Annex to the *Key Attributes* provides guidance on the implementation of the *Key Attributes* in relation to resolution regimes for insurers. It supplements the *Key Attributes* by indicating how particular KAs, or elements of particular KAs, should be interpreted when applying to resolution regimes for insurance companies, insurance groups and insurance conglomerates, including reinsurance companies and reinsurance groups, that could be systemically significant or critical if they fail.

### **III. Client asset protection in resolution (Appendix III)**

This draft Annex to the *Key Attributes* provides guidance on the interpretation and implementation of the *Key Attributes* in relation to elements in resolution regimes that are necessary to shield client assets from the failure of the firm and, to the extent possible, of any third party custodian or sub-custodian.

**The FSB invites comments on the guidance notes and the specific questions set out in this consultative document by 15 October 2013. Responses should be sent to [fsb@bis.org](mailto:fsb@bis.org). Responses will be published on the FSB's website unless respondents expressly request otherwise.**

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<sup>1</sup> [http://www.financialstabilityboard.org/publications/r\\_111104cc.pdf](http://www.financialstabilityboard.org/publications/r_111104cc.pdf)



## Introduction

At the Cannes Summit in November 2011, the G20 Leaders endorsed the *Key Attributes of Effective Resolution Regimes for Financial Institutions* ('the *Key Attributes*') as the international standard for resolution regimes.<sup>2</sup> The *Key Attributes* set out the core elements considered to be necessary to make feasible the resolution of financial institutions without severe systemic disruption and without exposing taxpayers to loss, while protecting vital economic functions through mechanisms that make it possible for shareholders and unsecured and uninsured creditors to absorb losses in a manner that respects the hierarchy of claims.<sup>3</sup> They constitute an 'umbrella' standard for resolution regimes for all types of financial institutions that are potentially systemically significant or critical in failure. This design was a strategic choice, motivated by the fact that resolution regimes need to be capable of managing the failure of different types of financial institutions, including mixed activity financial groups. Resolution tools should therefore be compatible across sectors, and resolution plans and resolvability assessment should encompass different sectoral entities within the same group.

Sector-specific resolution regimes should be consistent with the objectives and relevant requirements of the *Key Attributes*. However, not all resolution powers and features of resolution regimes set out in the *Key Attributes* are relevant for all sectors. Different types of financial firms - even within a particular sector - have distinctive features that need to be taken into account in the way that the *Key Attributes* are applied. For example, resolution regimes for financial market infrastructure (FMI) need to give particular priority to maintaining continuity of the critical functions that FMI perform in financial markets and take account of the loss allocation arrangements under the rules of certain kinds of FMI; resolution regimes for insurers need to protect policyholder interests; and resolution regimes need to interact effectively with client asset protection rules, so that client assets can be rapidly transferred or returned in the resolution of a firm with holdings of client assets.

The objective of the proposed guidance, which is published for consultation, is to assist jurisdictions and authorities in implementing the *Key Attributes* with respect to resolution regimes for FMI, insurers and firms with holdings of client assets. The guidance complements and should be read in conjunction with the *Key Attributes*.

Once finalised, the three guidance notes will be submitted to the FSB for adoption as new Annexes to the *Key Attributes*.

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<sup>2</sup> The *Key Attributes* are published at: [http://www.financialstabilityboard.org/publications/r\\_111104cc.pdf](http://www.financialstabilityboard.org/publications/r_111104cc.pdf)

<sup>3</sup> See the Preamble to the *Key Attributes*.

## **I. Resolution of Financial Market Infrastructure (FMI) and Resolution of Systemically Important FMI Participants (Appendix I)**

The proposed guidance that is published for consultation covers the resolution of all type of systemically important FMI and the resolution of FMI participants.

### ***Resolution of Financial Market Infrastructure***

Part I of the draft Annex (“Resolution of Financial Market Infrastructure”) provides guidance on the implementation of the *Key Attributes* in relation to resolution regimes for FMIs. The *Key Attributes* state that FMIs – defined to include payment systems, central securities depositories (CSDs), securities settlement systems (SSSs), central counterparties (CCPs) and trade repositories (TRs) – should be subject to resolution regimes that apply the objectives and provisions of the *Key Attributes* in a manner appropriate to FMIs and their critical role in financial markets (KA 1.2). The guidance supplements the *Key Attributes* – which apply generally to resolution regimes for all financial institutions, including FMIs (other than those owned and operated by central banks) that are systemically important - by indicating how particular KAs, or elements of particular KAs, should be interpreted when applying to resolution regimes for FMIs or specific classes of FMI. Where relevant, it sets out specific features of resolution regimes needed for different types of FMI.

### ***Resolution of systemically important FMI participants***

Part II of the draft Annex (“Resolution of Systemically Important FMI Participants”) deals with the failure of FMI participants. FMIs play an important role in the resolution of any of their participants and should endeavour to minimise disruption to critical functions that are provided by the FMI. To resolve a failing firm in a manner that maintains continuity of the firms’ critical functions, it is necessary that the firm in resolution (or a successor firm) can continue to rely on services provided by FMIs in which it participates, as long as it promptly performs its margin, collateral or settlement obligations that arise under a financial contract or as a result of its membership of the FMI. It is important that FMIs’ rules and procedures adequately address circumstances where FMI participants enter resolution and that the resolution plans for FMI participants are compatible with the rules and procedures of the FMIs in which they participate. The guidance sets out certain expectations as regards resolution planning for FMI participants and FMI rules and procedures to ensure consistency with and support for actions by a resolution authority to manage the failure of a participant that could be systemically significant or critical if it fails.

## **Draft Implementation Guidance: Resolution of Financial Market Infrastructure (FMI) and Resolution of Systemically Important FMI Participants**

### **Questions for consultation**

#### Part I of the Draft Guidance: Resolution of Financial Market Infrastructure

1. *Does the draft guidance adequately cover the principal considerations that are relevant to the resolution of each class of FMI (CCPs, CSDs, SSS, PS and TRs)? Would it be helpful if the guidance distinguished more between different classes of FMI? If so, please explain.*
2. *Should any further distinction be made in the draft guidance, for the purposes of applying the Key Attributes, between types of FMI that assume credit risk through exposures to participants and those that do not? If so, for which provisions is that distinction relevant?*
3. *Are the additional statutory objectives for the resolution of FMI (paragraph 1.1) appropriate? What additional objectives (if any) should the draft guidance include, relating either to FMIs generally or specific classes of FMI?*
4. *Is it appropriate to exclude FMIs that are owned and operated by central banks from the scope of application of the Key Attributes and this guidance (paragraph 2.1)?*
5. *Should resolution authorities have a power to write down initial margin of direct or (where appropriate) indirect participants of an FMI in resolution (paragraph 4.8)? If so, should the power be restricted to initial margin that is not 'bankruptcy remote' and may be used to cover the obligations of participants other than the participant that posted it? What are the implications of such a power for FMIs and participants? Are any further conditions appropriate in addition to those specified in paragraph 4.9?*
6. *Should the Annex explicitly restrict resolution authorities from interfering with the netting rights of FMI participants (for example, by splitting a netting set through partial transfer of positions in a CCP or partial 'tear up' of contracts)? What is the possible impact on participants' risk management, accounting reporting or regulatory capital requirements if netting rights can be interfered with in resolution, and how might any such impact be mitigated?*
7. *Does the draft guidance (paragraphs 4.1 and 4.2) adequately address the specific considerations in the choice of the resolution powers set out in KA 3.2 to FMIs? What additional considerations (if any) regarding the choice of resolution powers set out in KA 3.2 that should be addressed in this guidance?*
8. *Are the conditions for entry into resolution of FMI (paragraph 4.3) suitable for all classes of FMI? What additional conditions (if any) would be relevant for specific classes of FMI?*
9. *Does the draft guidance (and paragraphs 4.4, 4.8 and 4.9 in particular) deal appropriately with the interaction between the contractual loss-allocation arrangements under the rules of certain classes of FMI and the exercise of statutory resolution powers?*
10. *Should contractual porting arrangements be recognised in the draft guidance on the transfer of critical functions (paragraphs 4.11 and 4.12)?*
11. *Are there any other FMI-specific considerations regarding the application of any of the*

*resolution powers set out KA 3.2 that should be covered in this guidance?*

- 12. Does the draft guidance (paragraphs 5.1 and 5.2) deal appropriately with the considerations that are relevant to the decision whether to stay the exercise of early termination and set-off rights by FMI participants on the entry into resolution of the FMI? Should the guidance distinguish between different classes of FMI in this regard?*
- 13. Are loss-allocation arrangements under FMI rules reflected appropriately in the application of the “no creditor worse off” safeguard in FMI resolution (paragraph 6.1)?*
- 14. What additional factors or considerations (if any) are relevant to the resolvability of FMIs, or particular classes of FMI (paragraphs 10.3 and 10.4)?*
- 15. Are there additional matters that should be covered by resolution plans for FMIs or particular classes of FMI (paragraphs 11.6 and 11.7)? If yes, please elaborate.*
- 16. Are the proposed classes of information that FMIs should be capable of producing (paragraph 12.1) feasible? Are any of the proposed classes of information unnecessary, duplicative or redundant? What additional classes of information (if any) should FMIs be capable of producing for the purposes of planning, preparing for or carrying out resolution?*
- 17. Are there any other issues in relation to the application of the Key Attributes to FMIs or particular classes of FMI that it would be helpful for the FSB to clarify in this guidance? If yes, please elaborate.*

*Part II of the Draft Guidance: Resolution of Systemically Important FMI participants*

- 18. Does the draft guidance achieve an appropriate balance between the orderly resolution of FMI participants and the FMI’s ability to manage its risks effectively?*
- 19. What actions of the FMI in relation to failing participants could hamper its orderly resolution? How could the impact of such actions on orderly resolution be mitigated or managed?*
- 20. Are the safeguards set out in the guidance (paragraph 1.3) adequate as regards the conditions and requirements for maintaining access of a firm in resolution or admitting as a new member an entity to which that firm’s activities have been transferred? If not, what additional safeguards should be included in the guidance?*
- 21. Are there any other issues in relation to the handling of the failure of FMI participants that it would be helpful for the FSB to clarify in this guidance? If yes, please elaborate.*



## II. Resolution of Insurers (Appendix II)

The assumption is that traditional insurance activities and even some non-traditional insurance activities that are no longer viable will typically be resolved through run-off and portfolio transfer procedures. It may not, however, be possible to rely on those tools in all circumstances, and particularly in those cases in which the business model, booking model or shared services model of a firm is complex. Run-off and portfolio transfer tools may not be sufficient to mitigate the systemic impact of a sudden deterioration in the viability of a larger, complex insurance group engaging in other non-traditional insurance and non-insurance activities that may involve some degree of bank-like leverage and maturity transformation, or where continuity of insurance cover is critical to the economy or confidence in the financial system and the business cannot be rapidly transferred or replaced. Insurance companies, insurance groups and insurance conglomerates, including reinsurance companies and reinsurance groups (hereinafter “insurers”), that could be systemically significant or critical if they fail therefore should therefore be subject to resolution regimes that meet the standard set out in the *Key Attributes*.

The systemic impact of an insurance failure can materialise in various ways, including through contagion (where policyholders or markets consider that similar problems may exist in similar products from other insurers) and financial links (for example, in the derivatives markets), and may have an impact on the broader economy through a failure to make good on promises to policyholders or to engage in new transactions that would foster economic activity.

The proposed implementation guidance, which is published for consultation, provides guidance on the implementation of the *Key Attributes* in relation to resolution regimes for insurers. It supplements the *Key Attributes* by indicating how particular KAs, or elements of particular KAs, should be interpreted when applied to resolution regimes for insurers. The guidance on individual KAs should be read in conjunction with the KA to which it relates. It reflects input from the International Association of Insurance Supervisors (IAIS) drawing on their work on the resolution and resolvability of Global Systemically Important Insurers (G-SIIs)<sup>4</sup> and the different issues that arise in relation to traditional and non-traditional insurance activities.

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<sup>4</sup> IAIS policy measures on G-SIIs, including recovery and resolution planning requirements, were published on 18 July 2013: [http://www.financialstabilityboard.org/press/pr\\_130718.pdf](http://www.financialstabilityboard.org/press/pr_130718.pdf)

## **Draft Implementation Guidance: Resolution of Insurers**

### **Questions for consultation**

22. *Are the general resolution powers specified in KA 3.2, as elaborated in this draft guidance, together with the insurance-specific powers of portfolio transfer and run-off, as specified in KA 3.7, sufficient for the effective resolution of all insurers that might be systemically important or critical in failure, irrespective of size and the kind of insurance activities (traditional and 'non-traditional, non-insurance' (NTNI)) that they carry out? What additional powers (if any) might be required?*
23. *Should the draft guidance distinguish between traditional insurers and those that carry out NTNI activities? If yes, please explain where such a distinction would be appropriate (for example, in relation to powers, resolution planning and resolvability assessments) and the implications of that distinction.*
24. *Are the additional statutory objectives for the resolution of an insurer (section 1) appropriate? What additional objectives (if any) should be included?*
25. *Is the scope of application to insurers appropriately defined (section 2), having regard to the recognition set out in the preamble to the draft guidance that procedures under ordinary insolvency law may be suitable in many insurance failures and resolution tools are likely to be required less frequently for insurers than for other kinds of financial institution (such as banks)?*
26. *Does the draft guidance (section 4) adequately address the specific considerations in the application to insurers of the resolution powers set out in KA 3.2? What additional considerations regarding the application of other powers set out in KA 3.2 should be addressed in this guidance?*
27. *Does the draft guidance deal appropriately with the application of powers to write down and restructure liabilities of insurers (paragraphs 4.4 to 4.6)? What additional considerations regarding the application of 'bail-in' to insurers (if any) should be addressed in the draft guidance?*
28. *Is it necessary or desirable for resolution authorities to have the power to temporarily restrict or suspend the exercise of rights by policyholders to withdraw from or change their insurance contracts in order to achieve an effective resolution (paragraph 4.9)?*
29. *Are there any additional considerations or safeguards that are relevant to the treatment of reinsurers of a failing insurer or reinsurer, in particular to:*
  - (i) *the power to transfer reinsurance cover associated with a portfolio transfer (paragraphs 4.7 and 4.8); and*
  - (ii) *the power to stay rights of reinsurers to terminate cover (paragraph 4.10)?*
30. *What additional factors or considerations (if any) are relevant to the resolvability of insurers or insurers that carry out particular kinds of business (section 8)?*
31. *What additional matters (if any) should be covered by recovery plans or resolution plans for insurers or insurers that carry out particular kinds of business (section 9)?*

- 32. Are the proposed classes of information that insurers should be capable of producing (section 10) feasible? What additional classes of information (if any) should insurers be capable of producing for the purposes of planning, preparing for or carrying out resolution?*
- 33. Does this draft Annex meet the overall objective of providing sector-specific details for the implementation of the Key Attributes in relation to resolution regimes for insurers? Are there any other issues in relation to the resolution of insurers that it would be helpful for the FSB to clarify in this guidance?*

### III. Client Asset Protection in Resolution (Appendix III)

The proposed guidance that is published for consultation addresses the elements of resolution regimes that are necessary to resolve a financial firm with holdings of client assets (hereinafter “client assets”). The *Key Attributes* state that the legal framework governing the segregation of client assets should be clear, transparent and enforceable during a crisis or resolution of firms and should not hamper the effective implementation of resolution measures (KA 4.1). Effective resolution regimes should allow for the rapid return of segregated client assets (Preamble to the *Key Attributes*).

Client assets are held by different types of firms in the course of different financial activities and services, including safeguarding, administration and custody, investment services and brokerage, prime brokerage and collateral taking in connection with other financial transactions. The legal and contractual arrangements by which client assets are held and the permissible use, if any, of those assets by the firm or third parties may also differ depending on the activities in question. For example, in some jurisdictions prime brokers have and exercise the contractual right to use (and re-hypothecate) some of the client assets that they hold (for example, a portion of margin securities<sup>5</sup>). By contrast, custodians generally hold and safeguard securities on behalf of clients.

Given the significant variations in national regimes for client asset protection, the draft guidance is intended to specify outcomes rather than prescribe methods or mandatory rules by which those outcomes should be achieved. Whatever national arrangements apply, client assets should be shielded - in a manner appropriate to those arrangements - from the failure of the firm and, to the extent possible, of any third party custodian.<sup>6</sup> The legal status of client assets and the clients’ entitlement to them should not be affected by entry into resolution of the firm.<sup>7</sup>

The Technical Committee of IOSCO has issued a number of reports pertaining to client asset protection: namely the Report on Client Asset Protection (August 1996);<sup>8</sup> the Final Report on Survey of Regimes for the Protection, Distribution and/or Transfer of Client Assets (March 2011);<sup>9</sup> and the Consultation Report on Recommendations Regarding the Protection of Client Assets (February 2013).<sup>10</sup> The Recommendations Regarding the Protection of Client Assets support the guidance proposed by the FSB. They specify in further detail how requirements relating to the safeguarding and identification of client assets, use of assets and transparency to clients should be met.

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<sup>5</sup> That is, securities purchased by the client where the purchase is facilitated by a loan from the firm.

<sup>6</sup> Although it is generally possible to ensure that client assets placed with a third party are shielded from the failure of the third party, this is not always the case: for example, client money deposited in a bank could be affected by the failure of that bank.

<sup>7</sup> In some jurisdictions, the fact that assets are held through and in the name of a financial intermediary does not alter the client’s ownership interest.

<sup>8</sup> <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD57.pdf>

<sup>9</sup> <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD351.pdf>

<sup>10</sup> <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD401.pdf>

## **Draft Implementation Guidance: Client Asset Protection in Resolution**

### **Questions for consultation**

34. *Are the distinct but complementary roles of the draft FSB guidance and the IOSCO Recommendations Regarding the Protection of Client Assets sufficiently clear?*
35. *Does the draft guidance deal adequately with the different types of firms and the range of their activities in the course of which they hold client assets, including investment business, prime brokerage and custody services? If not, what additional types of firms or activities should be covered?*
36. *Are the additional statutory objectives for the resolution a firm with holdings of client assets (paragraph 1.1) appropriate? What additional objectives should be included?*
37. *Is the proposed definition of 'client assets' (paragraph 2.1) sufficiently comprehensive? Are there any other classes of assets (in addition to those specified in paragraph 2.2) that should be excluded from the scope of this guidance?*
38. *Does the draft guidance (paragraphs 3.1 to 3.5) cover all relevant issues concerning the exercise of transfer powers in relation to client assets? If not, please explain what additional issues should be covered.*
39. *Is the interaction between transfer powers and contractual porting arrangements or other arrangements under the rules of CCPs, exchanges or trading platforms (paragraph 3.3) sufficiently clear? If not, please explain what aspects might usefully be clarified.*
40. *Should the guidance be more prescriptive in relation to arrangements for the identification and safeguarding of client assets, including segregation, that are necessary to enable resolution authorities and administrators quickly to identify client assets and ascertain the nature of claims to those assets (paragraph 4.1)? If so, how?*
41. *Are there arrangements other than segregation that are capable of achieving the outcome described in paragraph 4.1? If so, please explain what other arrangements are currently used.*
42. *Are the requirements for firms to maintain adequate records in relation to securities lending (paragraph 4.3(i)) and re-hypothecation (paragraph 4.3 (ii)) sufficiently clear and specific as to the standard that is required? Are they sufficient to enable a resolution authority or administrator to act swiftly and with certainty? If not, please elaborate.*
43. *Is the requirement regarding adequate disclosure by firms to clients of the effects of asset lending, rights of use or re-hypothecation (where permitted) on the protection of client assets in resolution (paragraph 4.4) sufficiently clear and specific as to the standard that is required? What additional disclosure or information requirements relating to re-hypothecation (if any) should be included in the guidance?*
44. *Is the draft guidance regarding re-hypothecation consistent with the recommendations of other FSB workstreams, such as Recommendations 9 and 10 in the FSB, Consultative Document, Strengthening Oversight and Regulation of Shadow Banking, A Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos (18*

*November 2012)? Please explain any inconsistencies.*

- 45. Are there any other requirements in relation to securities lending and re-hypothecation that would support clarity as to clients' rights in resolution in relation to assets that have been lent or re-hypothecated? If yes, please elaborate.*
- 46. Does the draft guidance (paragraphs 6.1 and 6.2) adequately cover the challenges for resolution authorities or administrators in dealing with client assets that held in a different jurisdiction to the firm in resolution? Please outline any additional aspects that might usefully be covered by the guidance in this regard.*
- 47. Does the draft guidance (paragraph 7.1) set out the principal matters that should be considered and addressed in resolution planning for firms with holdings of client assets? What additional considerations (if any) are relevant for all such firms, or firms that carry out particular activities involving the holding of client assets?*
- 48. Are the classes of information that firms should be able to provide promptly in order to facilitate the rapid transfer or return of client assets (paragraph 8.1) feasible? What additional classes of information (if any) should firms be capable of producing for those purposes?*
- 49. How far should information requirements also extend to CCPs, exchanges and trading platforms?*
- 50. Are there any other issues in relation to protection of custody and client assets in resolution that it would be helpful for the FSB to clarify in this guidance?*

## **Annex to the Key Attributes:**

### **Financial Market Infrastructure (FMI): Resolution of FMIs and Resolution of Systemically Important FMI Participants**

Part I of this Annex (“Resolution of Financial Market Infrastructure”) provides guidance on the implementation of the *Key Attributes of Effective Resolution Regimes for Financial Institutions* (the ‘Key Attributes’, KAs) in relation to resolution regimes for systemically important FMI.

Part II of this Annex (“Resolution of Systemically Important FMI Participants”) deals with the failure of FMI participants that could be systemically significant or critical in the event of failure.

#### **I. Resolution of Financial Market Infrastructure**

The *Key Attributes* state that FMIs – defined to include payment systems, central securities depositories (CSDs), securities settlement systems (SSSs), central counterparties (CCPs) and trade repositories (TRs) – should be subject to resolution regimes that apply the objectives and provisions of the *Key Attributes* in a manner appropriate to FMIs and their critical role in financial markets (KA 1.2).

This guidance supplements the *Key Attributes* – which apply generally to resolution regimes for all systemically significant or critical financial institutions, including FMIs (other than FMIs owned and operated by central banks) - by indicating how particular KAs, or elements of particular KAs, should be interpreted when applying to resolution regimes for FMIs or specific classes of FMI. The presumption is that all FMIs are systemically important or critical, at least in the jurisdiction where they are located, typically because of their critical roles in the markets they serve. However, an authority may determine that an FMI in its jurisdiction is not systemically important or critical and, therefore, not subject to the *Key Attributes*.

Where relevant, this guidance sets out specific features of resolution regimes appropriate for different types of FMIs. The guidance on individual KAs should be considered in conjunction with the KA to which it relates.

##### **1. Objectives (KA Preamble)**

**1.1** An effective resolution regime for FMIs should pursue financial stability and allow

for the continuity of critical FMI functions without exposing taxpayers to loss from solvency support. From the point at which an FMI enters resolution pending the restoration of the ability of the FMI to perform those functions as a going concern, their performance by a successor to the FMI or their performance through an alternative mechanism, the use of resolution powers should aim to achieve continuity of critical FMI functions, including, as applicable:

- (i) continuity and timely completion of critical payment, clearing, settlement and recording functions;
- (ii) timely settlement of obligations due to participants and any linked FMI (subject to the use of any applicable loss allocation powers (see paragraph 4.8)) and the continued application of relevant finality rules;
- (iii) continuous access of participants to securities or cash accounts provided by the FMI and (securities or cash) collateral posted to and held by the FMI that is owed to such participants (subject to the use of statutory loss allocation powers);
- (iv) no disruption in the operation of links between the FMI in resolution and other FMIs; and
- (v) adequate safeguarding, preservation and continuous processing of, and access to, data stored in a TR.

## **2. Scope of resolution regimes for FMIs (KA 1)**

### ***Application to all systemically important FMIs (other than those owned and operated by central banks)***

**2.1** All FMIs that are systemically important, other than FMIs owned and operated by central banks, should, in the event of failure, be subject to a resolution regime that applies the *Key Attributes* in a manner appropriate to the specific characteristics of the type of FMI in question and its critical role in financial markets. All such FMIs, irrespective of their licensing status (for example, FMIs licensed as banks) should be subject to a resolution regime that includes the elements and delivers the objectives set out in this Annex.

### ***Systemic importance***

**2.2** Authorities should have regard to the presumptions set out in paragraph 1.20 of the CPSS-IOSCO *Principles for Financial Market Infrastructures*<sup>1</sup> regarding the systemic importance of FMIs.

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<sup>1</sup> <http://www.bis.org/publ/cpss101a.pdf>



### **3. Resolution authority<sup>2</sup> for FMIs (KA 2)**

#### *Statutory objectives*

- 3.1** As part of its statutory objectives and functions, an authority responsible for the resolution of FMIs should be guided in the exercise of its resolution powers by the specific objectives of pursuing financial stability and allowing for the continuity of the critical functions of an FMI in resolution without losses for taxpayers (see KA 2.3 (i) and paragraph 1.1), in addition to the other relevant general objectives set out in KA 2.3.

#### *Appointment of an administrator, conservator or other official*

- 3.2** The resolution of an FMI may be carried out by the resolution authority directly or through a special administrator, conservator, receiver or other official with similar functions. A special administrator, conservator, receiver or other official should be guided by the objectives specified in paragraphs 1.1 and 3.1 (including those set out in KA 2.3) when carrying out resolution.

#### *Consultation and cooperation with the central bank*

- 3.3** Where the central bank is not also the resolution authority, supervisory or oversight authority of an FMI that settles through, or is otherwise linked to, systems operated by the central bank, the resolution authority or appointed administrator should consult and cooperate with the central bank when planning or carrying out the resolution of that FMI.
- 3.4** The resolution authority or appointed administrator should consult any market regulator or other relevant authority that is not also the resolution authority, supervisory or oversight authority of an FMI where the services of the FMI are material for the adequate functioning of the capital markets that are overseen by that regulator or other authority.

### **4. Resolution powers for FMIs (KA 3)**

#### *Choice of resolution powers*

- 4.1** The choice of resolution powers that are applied to an FMI should take into account the type of critical functions that the FMI provides and its capital structure, available assets, default resources and loss allocation arrangements, together with:
- (i) the risk profile of the FMI, including its exposure to credit, liquidity and general business risks and, in particular, whether it takes credit risk through exposures to its participants as principal; and

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<sup>2</sup> Consistent with KA 2.1, references to “resolution authority” include references to more than one authority where two or more authorities are responsible for exercising resolution powers under the resolution regime.

(ii) any recovery measures taken by the FMI.

**4.2** The choice of resolution powers should take into account the expected impact of those powers on the participants of the FMI, any linked FMIs and other stakeholders, regardless of where they are located, and the expected impact on financial markets more widely.

### ***Entry into resolution (KA 3.1)***

**4.3** Entry into resolution should be possible when an FMI is no longer viable or likely to be no longer viable (before balance-sheet insolvency), and has no reasonable prospect of returning to viability within a reasonable timeframe through other actions taken by the FMI (that do not themselves compromise financial stability). Entry into resolution should be possible, in particular, if:

- (i) recovery measures taken by the FMI, including use of its available assets and default resources and application of any loss allocation rules, have failed to return the FMI to viability or have not been implemented in a timely manner; or
- (ii) the relevant oversight, supervisory or resolution authority determines that recovery measures will not be sufficient to return the FMI to viability or would otherwise compromise financial stability.

### ***Implementation of loss allocation rules and procedures prior to entry into resolution***

**4.4** Where the FMI has rules and procedures for loss mutualisation or allocation, those rules and procedures should generally be exhausted prior to the entry into resolution of the FMI (unless it is necessary or appropriate to initiate resolution before those rules and procedures have been exhausted). Where any such rules and procedures have not been exhausted prior to entry into resolution, the resolution authority should have the power to enforce implementation of those rules and procedures (see paragraph 4.8(a)).

### ***Continuity upon entry into resolution***

**4.5** Any licenses, authorisations, recognitions and legal designations of a (domestic or foreign) FMI necessary for the continued performance of the FMI's critical functions in resolution, including its recognition for the purposes of the application of relevant settlement finality rules, should not be revoked automatically solely as a result of entry into resolution under either domestic or foreign law and should remain effective to the extent necessary to allow for continuity of the critical functions of the FMI in resolution.

**4.6** The entry into resolution of an FMI should not lead to the automatic restriction, suspension or termination of its participation in, or link with, other FMIs (wherever located).

### ***Temporary administration***

**4.7** The resolution authority or an appointed administrator, conservator, receiver or similar official should have the power and the capacity to ensure the continued provision of the critical functions of an FMI in resolution and to fulfil the FMI's payment and settlement obligations on time, including on the day that the FMI enters into resolution, until the FMI is restored to viability or those functions transferred, replaced by another provider or wound down in an orderly manner.

### ***Powers to allocate losses and terminate contracts (KA 3.2 (iii), KA 3.5)***

**4.8** Resolution authorities should have the powers, subject to the relevant safeguards set out in paragraph 4.9 and in KA 5 (as elaborated in paragraph 6.1), to:

- (i) enforce any existing and outstanding contractual obligations of the FMI's participants to meet cash calls or make further contributions to a guarantee or default fund, or any other rules and procedures of the FMI for loss allocation where they have not been already applied exhaustively by the FMI prior to the entry of the FMI into resolution;
- (ii) write down (fully or partially) equity in the FMI;
- (iii) write down or convert to equity ("bail in") any outstanding debt of the FMI;
- (iv) reduce the value of any variation margin payable by the FMI to participants;
- (v) where consistent with the legal framework and the rules of the FMI,<sup>3</sup> write down initial margin of direct and, where permitted, indirect participants to the extent that, under the legal framework and the rules of the FMI, the margin covers the obligations of participants other than the participant that posted it; and
- (vi) terminate ("tear up") or close out contracts and settle in cash.

**4.9** Any power to allocate losses to participants of the FMI by reducing the value of variation margin payable to such participants or initial margin consistent with paragraph 4.8 (v), should be subject to the following conditions:

- (i) the FMI's available resources have been exhausted and other mechanisms under its rules to cover losses and restore viability have either been unsuccessful or have not been implemented (because the resolution authorities determine that their implementation would compromise financial stability or would not be successful having regard to the circumstances, or for any other reason);

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<sup>3</sup> In principle, initial margin is only available to cover obligations of the participant that posted it. In addition, in many jurisdictions the regulatory framework requires initial margin to be bankruptcy remote.

- (ii) the loss allocation respects the rules of the FMI (where applicable) and the creditor hierarchy: in particular, the equity of the FMI has been written down before any reduction of the value of margin of a non-defaulting participant; and
- (iii) the loss allocation applies only to collateral and margin to the extent that they would bear losses other than those related to the obligations of the participant that posted them under the loss allocation rules of the FMI or if the FMI entered into insolvency.

These conditions do not preclude the use of initial margin that serves as collateral for a participant's payment obligations to the FMI associated with any loss allocation under the rules of the FMI where the participant has not fulfilled those obligations prior to the entry into resolution of the FMI.

***Termination (“tear up”) or close out of contracts***

**4.10** When considering whether to terminate the outstanding contracts of a CCP, the resolution authority should take into account, among other things, the impact of that action on:

- (i) the risk management of the CCP's participants (including, for example, the impact of any splitting of netting sets caused by the contemplated termination, where such splitting is permitted by law); and
- (ii) financial stability.

***Transfer of critical functions to a solvent third party or bridge institution (KAs 3.2 (vi) and (vii), 3.3 and 3.4)***

**4.11** Resolution authorities should have the power to transfer to a third party purchaser or bridge institution the ownership of an FMI or all or part of an FMI's critical operations (for example, clearing in one specific product), including all associated rights and obligations and necessary service-level agreements. Any such power should be exercisable notwithstanding any requirements for consent or novation that would otherwise apply.

**4.12** Where functions of an FMI are transferred to a third party purchaser or bridge institution, the resolution authority should aim to ensure continuity of the FMI's legal and technical arrangements, such as delivery-versus-payments arrangements, domestic or cross-border links with other FMIs or other critical service providers and relevant contractual arrangements. This may require advance agreement by other FMIs and relevant service providers.

**4.13** Where functions are transferred to a bridge institution, any licenses, authorisations, recognitions and legal designations of the FMI necessary for the continued performance of those functions in resolution, including its recognition for the purposes of the application of relevant settlement finality rules, should be transferred or otherwise applied to the bridge institution (or institutions).

- 4.14** The transfer powers of resolution authorities should enable the authority, in cases where the FMI in resolution holds client assets in a capacity as custodian, to transfer those assets to another institution for custody without affecting the ownership rights or entitlements of the relevant clients to those assets.

***Moratorium (KA 3.2(xi))***

- 4.15** A resolution authority should not impose a moratorium on payments due by the FMI to its participants or to any linked FMI if that would affect the ordinary flow of payments, settlements and deliveries being processed by the FMI in the course of its core functions (subject to the use of any loss allocation powers referred to in paragraph 4.8 in relation to such payments and deliveries) and be inconsistent with the resolution objective of ensuring continuity of critical functions. This should not prevent a resolution authority from imposing a moratorium on payments to general creditors (that is, creditors whose claims on the FMI are not the result of the use of the FMI's critical functions).

**5. Set-off, netting, collateralisation, segregation of client assets (KA 4)**

***Temporary stay on early termination rights (KA 4)***

- 5.1** In accordance with KA 4 and Annex IV, early termination rights should not be exercisable by any participant in an FMI or other counterparties under a financial contract solely by virtue of the entry into resolution of, or the exercise of any resolution power in relation to, an FMI. Such rights should remain exercisable where the FMI (or the authority, administrator, receiver or other person exercising control over the FMI in resolution) fails to meet payment or delivery obligations, including collateral transfers, when due in accordance with its rules, but subject to any application of loss allocation to margin or collateral under the rules of the FMI or through the exercise of statutory loss allocation powers.
- 5.2** In accordance with KA 4 and Annex IV, the resolution authority should have the power to stay temporarily any early termination rights exercisable by FMI participants and other relevant counterparties, and, where appropriate, regarding the objectives of the resolution procedure, by the FMI itself. When considering whether to impose a temporary stay consistent with KA 4 and Annex IV on the exercise by FMI participants and other relevant counterparties of early termination rights and set-off rights triggered by entry into resolution of the FMI, the resolution authority should take into account the impact on the financial markets and on the safe and orderly operations of the FMI and any linked FMI.

## **6. Safeguards (KA 5)**

### *“No creditor worse off” principle (KA 5.3)*

**6.1** Any determination of whether a participant is worse off as a result of resolution measures than in liquidation (application of the “no creditor worse off safeguard” set out in KA 5.3) should as far as practicable be based on the losses incurred (or that would be incurred) and recovery made (or that would be made) by the participant after the full application of the FMI’s rules and procedures for loss allocation.

## **7. Funding of FMI resolution (KA 6)**

**7.1** Jurisdictions should have in place appropriate arrangements and powers to provide temporary funding to facilitate resolution and to recover any losses incurred by the State as a result of providing such funding from shareholders, unsecured creditors (including FMI participants) or, if necessary, participants in the financial system more widely (see KA 6.2 and 6.4).

**7.2** Where jurisdictions provide for the power to place an FMI under temporary public ownership and control in order to ensure continuity of its critical functions, they should make provision to recover any losses incurred by the State from shareholders, unsecured creditors (including FMI participants) or, if necessary, participants in the financial system more widely (see KA 6.5).

## **8. Cross-border cooperation (KA 7)**

**8.1** The legal framework should not provide for the automatic revocation of any licenses, authorisations, recognitions and legal designations of an FMI necessary for the continued performance of the FMI’s critical functions in resolution, including its recognition for the purposes of the application of relevant settlement finality rules, or automatically restrict, suspend or terminate its participation in or links with other FMIs, as a result of official intervention or its entry into resolution in another jurisdiction.

## **9. Cooperation, coordination and information sharing (KA 8, 9, 12)**

**9.1** Crisis Management Groups (CMGs) or other arrangements based on the cooperative arrangements maintained under Responsibility E<sup>4</sup> that achieve an equivalent outcome, should be maintained for all FMIs that are systemically important in more than one jurisdiction, as determined by the oversight or supervisory authorities and resolution authorities in those jurisdictions.

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<sup>4</sup> Responsibility E of the Responsibilities of central banks, market regulators and other relevant authorities for financial market infrastructure, CPSS-IOSCO *Principles for Financial Market Infrastructures*, section 4: <http://www.bis.org/publ/cpss101a.pdf>

**9.2** CMGs for FMIs (or equivalent arrangements) should include the authorities that participate in the cooperation arrangements adopted in accordance with Responsibility E, resolution authorities, and other relevant authorities of the jurisdictions where the FMI has operations that are material to its resolution.

**9.3** The requirement for institution-specific cross-border cooperation agreements (KA 9) may be met by crisis coordination and communication agreements, protocols or MoUs adopted in accordance with Responsibility E, provided that those arrangements are adapted, amended or supplemented where necessary to support the cooperation, coordination and information sharing needed to carry out the functions relating to recovery and resolution that are specified by the *Key Attributes*. In particular, they should:

- (i) provide for the resolution authority and other authorities that do not participate in the arrangements adopted under Responsibility E (for the purposes of regulation, supervision or oversight of the FMI) to participate in planning, preparing for and carrying out resolution of the FMI;
- (ii) define the roles and responsibilities of the authorities involved in planning, preparing for and carrying out resolution;
- (iii) include arrangements and procedures for sharing information necessary for the purposes of planning, preparing for and carrying out resolution; and
- (iv) include institution-specific details regarding the implementation of the resolution measures set out in the resolution plan for the FMI.

## **10. Resolvability assessments of FMIs (KA 10)**

**10.1** FMIs that are systemically important (other than those owned and operated by central banks) should be subject to regular resolvability assessments that are conducted in accordance with KA 10 and Annex II.

**10.2** In the case of an FMI that is systemically important in more than one jurisdiction, the resolvability assessment should be carried out within the FMI's CMG or under an equivalent arrangement.

**10.3** When conducting a resolvability assessment of an FMI, authorities should assess the feasibility and credibility of implementing the resolution strategy and operational resolution plan developed for the FMI, by assessing in particular:

- (i) technical and legal barriers to the transfer of the critical functions of the FMI to another entity, including those arising from the bespoke nature of the risk management and technical processes of individual FMIs;
- (ii) the ability of the entity to which functions would be transferred to assume and operate the critical functions, take over links and gain access to other

infrastructure, including the robustness of any arrangements already in place to facilitate that;

- (iii) the impact of resolution strategies and measures set out in the operational resolution plan on FMI participants and on any linked FMIs, including the ability of participants and those linked FMIs to retain continuous access to the FMI's critical functions during the resolution process;
- (iv) the ability of the FMI in resolution to maintain access to the services of any linked FMIs and other service providers during the resolution process;
- (v) the rights and obligations of linked FMIs in the event of the failure of one of those FMIs that could affect the conduct of resolution, including any loss-sharing arrangements of linked FMIs and the ability to maintain enforcement rights over collateral; and
- (vi) any interoperability agreements and any cross-margining or loss-sharing arrangements with other FMIs.

**10.4** The oversight, supervisory and resolution authorities for FMIs should have powers to require an FMI to adopt measures to improve the resolvability of the FMI including, where necessary and appropriate, changes to the terms or operation of its links with other FMIs and changes to delivery, segregation or portability arrangements of participants' positions or related collateral. Any such requirements should take due account of the changes on the soundness of operations of the FMI, including its risk management.

## **11. Recovery and resolution planning for FMIs (KA 11)**

**11.1** FMIs that are systemically important (other than those owned and operated by central banks) should be subject to a requirement for ongoing recovery and resolution planning.

**11.2** Recovery and resolution plans need to be tailored to the specific risks and systemic implications that a particular type of FMI may be exposed to or create.

### ***Recovery plans***

**11.3** FMI recovery plans should be consistent with the CPSS-IOSCO *Principles for Financial Market Infrastructures* (including Principle 3, key consideration 4) and take into account the CPSS-IOSCO *Guidance on Recovery Plans for FMIs*.<sup>5</sup>

### ***Resolution strategies and plans***

**11.4** Resolution authorities for an FMI should, in cooperation with the FMI's oversight or

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<sup>5</sup> Link to be added when final guidance is published.



supervisory authorities (where distinct from the resolution authority), develop resolution strategies and operational plans to facilitate the effective resolution of the FMI in a way that ensures continuity of the critical functions carried out by the FMI.

**11.5** In the case of an FMI that is systemically important in more than one jurisdiction, the resolution strategy and plan should be developed in coordination with all authorities participating in the FMI's CMG or equivalent arrangements.

**11.6** Resolution plans for FMIs should:

- (i) contemplate scenarios where some or all existing loss allocation arrangements between participants under the FMI rules have been fully or partially put into effect or not implemented;
- (ii) contemplate scenarios where there may be no existing alternative provider to which the critical functions of an FMI can be transferred in the short term;<sup>6</sup>
- (iii) consider and address the potential technical and legal barriers to a transfer of FMI functions;<sup>7</sup>
- (iv) take into account the legal mechanism by which collateral is provided, including whether collateral is provided as a security interest or pledge or by way of title transfer, the status of that collateral in insolvency (that is, whether it is 'bankruptcy remote), and the implications of that status for the extent to which losses can be imposed under loss allocation rules of the FMI and the exercise of statutory powers; and
- (v) take into account the impact on direct and indirect participants.

**11.7** Resolution plans for FMIs should contain the essential elements set out in Annex III to the *Key Attributes* and include in addition, as appropriate to the type and specific characteristics of each FMI and its critical functions, the following elements in particular:

- (i) draft transition agreements that would allow the FMI to continue to provide uninterrupted critical services on behalf of a purchaser or bridge institution using existing staff and infrastructure; and
- (ii) a purchaser's pack that includes key information on the critical operations, IT procedures, creditors and list of key staff and service providers to facilitate

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<sup>6</sup> For many FMIs there will, in the short term, be no alternative providers of its critical functions to which operations can be transferred.

<sup>7</sup> Practical challenges (such as IT incompatibility) may make a transfer difficult unless the alternative provider is willing and able to take over the failing FMI's operations in their entirety and run them separately until they can be integrated. Where an alternative provider exists, FMIs and resolution authorities should therefore consider in advance the potential technical and legal barriers to the transfer of activities and seek to address them.

transfer of operations to another FMI or bridge institution.

## **12. Access to Information and information sharing (KA 12)**

**12.1** In order to facilitate the implementation of resolution measures, FMIs should be required to maintain information systems and controls that can promptly produce, both in normal times and during resolution, the relevant data and information needed for the purposes of timely resolution planning and resolution, in particular, on the following:

- (i) FMI rules, default fund and other loss allocation arrangements;
- (ii) stakeholders, including the FMI's direct and indirect participants, owners, settlement agents, liquidity providers, linked FMIs, custodians and other service providers;
- (iii) data and information needed for effective and timely risk control during resolution, including gross and net exposures between the FMI and each participant;
- (iv) the status of obligations of FMI participants (for example, the extent to which FMI participants have fulfilled their obligations to make default fund contributions);
- (v) links and interoperability arrangements with other FMIs;
- (vi) the location of participant collateral, the arrangements under which it is held and any rights of use or rehypothecation that have been exercised in relation to collateral; and
- (vii) netting arrangements (so that authorities can assess the impact of possible transfers of part of the business of an FMI on participants' netting rights).

**12.2** Oversight, supervisory and resolution authorities should take into account the impact of any contractual agreement between an FMI, its direct participants and, where relevant, its indirect participants on the information available on the positions or flows of indirect participants.

## **II. Resolution of Systemically Important FMI participants**

The Preamble to the *Key Attributes* states that an effective resolution regime should ensure continuity of systemically important financial services and payment, clearing and settlement functions. FMIs play an important role in the resolution of any of their participants and should endeavour to minimise disruption caused by the failure of a participant to any such functions that are provided by the FMI. To resolve a failing firm in a manner that maintains continuity of its critical functions, it is necessary that the firm in resolution (or a successor firm) can continue to rely on services provided by FMIs in which it participates, as long as it promptly performs its margin, collateral or settlement obligations that arise under a financial contract or as a result of its participation in the FMI. It is important that FMIs' rules and procedures adequately address circumstances where FMI participants enter resolution, and that the resolution plans for FMI participants are compatible with the rules and procedures of the FMIs in which they participate.

This guidance sets out certain objectives as regards resolution planning for FMI participants and FMI rules and procedures to ensure consistency with and support for actions by a resolution authority to manage the failure of a participant that could be systemically significant or critical if it fails.

### **1. Rules and procedures governing a participant's default**

- 1.1** Jurisdictions should ensure that the participation requirements and rules and procedures of an FMI governing a participant's default (see Principle 13 of CPSS-IOSCO *Principles for Financial Market Infrastructures*) (hereinafter "FMI rules") are not likely to hamper unnecessarily the orderly resolution of participants in the FMI.
- 1.2** The entry into resolution of an FMI participant should not lead to an automatic termination of its participation in the FMI. FMI rules should provide the FMI with sufficient flexibility to cooperate with the resolution authorities in preparing for and implementing an orderly resolution of a participant in a way that does not increase risk to the FMI, its risk management or its safe and orderly operations.
- 1.3** To support the continuity of critical functions of a participant in resolution, FMI rules should:
  - (i) allow for a firm to maintain its participation as it undergoes a resolution process, subject to adequate safeguards to protect the continued safe and orderly operations of the FMI, including the condition that the firm continues to meet payment and delivery obligations and comply with any other obligations of participants under the rules of the FMI;
  - (ii) facilitate, for example, through a fast-track application process, the participation of a third party successor or bridge institution that assumes particular functions or positions of the failing firm, subject to the maintenance of adequate risk control standards;

- (iii) facilitate the transfer of positions of a participant in resolution to other participants of the FMI.

## **2. Resolvability assessments of FMI participants (engagement of resolution authorities with FMIs)**

**2.1** As part of resolution planning and resolvability assessments for firms that are FMI participants, resolution authorities should engage regularly with the FMIs in which those firms are participants in order to have a clear understanding of:

- (i) the implication of the application of resolution tools on the firm's FMI membership (including circumstances where resolution leads to a change of control of the participant);
- (ii) the conditions that the firm needs to meet to maintain its participation in the FMI, such as requirements to contribute to default funds, liquidity commitments, payment and settlement obligations (including collateral and margin);
- (iii) the implication for the risk management of the FMI and for its other participants of continued participation in the FMI of a participant in resolution;
- (iv) the conditions for a bridge entity or another firm to which functions of the firm in resolution would be transferred to participate in the FMI and the time any application process would take;
- (v) the technological changes needed to implement the resolution measures, for example, transfer or integration of IT systems, and the preparations needed to facilitate the rapid execution of such transfer or integration;
- (vi) the FMI's segregation and portability regime, where relevant;
- (vii) the process for and consequences of termination of membership and its impact on other participants, any linked FMIs and the operations of the FMI;
- (viii) the FMI's internal governance policies and policies for communication in a crisis;
- (ix) the FMI's procedures for evaluating the financial health of its participants; and
- (x) the FMI's risk management protocols with respect to a participant that it determines to be in danger of default.

**2.2** FMIs should be required as part of their contingency arrangements to test the effectiveness of their procedures if a major participant were to enter into resolution, including the conditions and requirements for the continuing participation of that participant or admitting as a new participant in the FMI an entity to which that participants' activities have been transferred.

### **3. Potential impediments to resolvability**

- 3.1** Resolution authorities should inform FMIs and the relevant authorities responsible for oversight or supervision of FMIs of any impediments arising from FMI rules and procedures that could affect the effective implementation of a resolution of an FMI participant. The oversight, supervisory and resolution authorities should consider whether rule changes (for example, introduction of carve-outs or exemptions in FMI rules or fast-track application processes) or other actions can be taken to address those reported impediments without compromising the risk management and safe operation of the FMI.



## **Annex to the Key Attributes:**

### **Resolution of Insurers**

The *Key Attributes of Effective Resolution Regimes for Financial Institutions* (the ‘*Key Attributes*’, KAs) state that any financial institution that could be systemically significant or critical if it fails should be subject to a resolution regime consistent with the *Key Attributes*.

The systemic impact of an insurance failure can materialise in various ways, including through contagion (where policyholders or markets consider that similar problems may exist in similar products from other insurers) and financial links (for example, in the derivatives markets), and may have an impact on the broader economy through a failure to make good on promises to policyholders or to engage in new transactions that would foster economic activity.

The general assumption is that traditional insurance activities and even some non-traditional insurance activities that are no longer viable will typically be resolved through run-off and portfolio transfer procedures. It may not be possible, however, to rely on these tools in all circumstances, and particularly in those cases in which the business model, booking model or shared services model of a firm is complex. Run-off and portfolio transfer tools may not, for example, be sufficient to mitigate the systemic impact of a sudden deterioration in the viability of a larger, complex insurance group engaging in other non-traditional insurance and non-insurance activities that may involve some degree of bank-like leverage and maturity transformation. Insurance companies, insurance groups and insurance conglomerates, including reinsurance companies and reinsurance groups, (hereinafter “insurers”), that could be systemically significant or critical if they fail therefore should therefore be subject to resolution regimes that meet the standard set out in the *Key Attributes*.

This Annex provides guidance on the implementation of the *Key Attributes* in relation to resolution regimes for insurers. It supplements the *Key Attributes* by indicating how particular KAs, or elements of particular KAs, should be interpreted when applied to resolution regimes for insurers. The guidance on individual KAs should be read in conjunction with the KA to which it relates.

#### **1. Objectives**

- 1.1** A resolution regime for insurers should meet the general objectives set out in the *Key Attributes* (Preamble and KA 2.3). It should make it feasible to resolve an insurer without severe systemic disruption or exposing taxpayers to loss, while protecting vital economic functions through mechanisms which make it possible for

shareholders and unsecured creditors to absorb losses in a manner that respects the hierarchy of claims in liquidation. Additionally the resolution regime should have as a statutory objective the protection of insurance policyholders, especially retail policyholders who are dependent on insurance benefit payments.

- 1.2 Functions provided by insurers that may constitute vital economic functions include risk transfer, risk pooling and the pooling of savings. The protection of these functions should include securing appropriate continuity of insurance coverage and payments.

## 2. Scope of resolution regimes

- 2.1 Any insurer that could be systemically significant or critical if it fails and, in particular, all insurers designated as Globally Systemically Important Insurers<sup>1</sup> (“G-SIIs”), should be subject to a resolution regime consistent with the *Key Attributes*.

## 3. Resolution authority<sup>2</sup>

- 3.1 As part of its statutory objectives and functions, the authority responsible for the resolution of insurers should exercise its resolution functions in a way that meets the relevant general objectives set out in the Preamble and KA 2.3 and the specific objective of protecting policyholders (see Section 1).
- 3.2 To achieve its objectives, the resolution authority may need to interact with applicable schemes for the protection of insurance policyholders (‘policyholder protection schemes’). The respective mandates, roles and responsibilities of the resolution authority and policyholder protection schemes should be clearly defined and coordinated.
- 3.3 The resolution powers may be exercised by the resolution authority directly or through a special administrator, receiver, conservator or other official subject to the same objectives as the resolution authority.

## 4. Resolution powers

### *Entry into resolution (KA 3.1)*

- 4.1 The resolution regime should set out clear standards or suitable indicators of non-viability to guide the decision as to whether an insurer meets the conditions for entry

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<sup>1</sup> An initial list of G-SIIs was published by the FSB on 18 July 2013: [http://www.financialstabilityboard.org/publications/r\\_130718.pdf](http://www.financialstabilityboard.org/publications/r_130718.pdf).

The group of G-SIIs will be updated annually and published by the FSB each November, starting from November 2014.

<sup>2</sup> Consistent with KA 2.1 reference to “resolution authority” include reference to more than one authority where multiple authorities are responsible for exercising resolution powers under the resolution regime.



into resolution. Such standards or indicators should allow for timely and early entry into resolution before an insurer is balance-sheet insolvent. They may include a determination by the supervisory authority, in consultation with the resolution authority (where the supervisory authority is not also the resolution authority) that:

- (i) there is an unacceptably low probability that policyholders will receive payments as they fall due;
- (ii) there is an unacceptably low probability that policyholders receive payments of the total amount owed;
- (iii) (recovery measures have failed to return the insurer to sustainable viability or have not been implemented in a timely manner;
- (iv) proposed recovery measures will not be sufficient to return the insurer to viability or cannot be implemented in a timely manner; and
- (v) the resolution objectives (see Section 1) cannot be achieved through ordinary insolvency, run-off or portfolio transfer procedures alone.

#### ***Choice of resolution powers***

**4.2** Resolution authorities should have at their disposal a broad range of resolution powers, but should in each case only use those powers that are suitable and necessary to meet the resolution objectives. The choice and application of the resolution powers provided for in KA 3 should take into account insurance specificities and, in particular, the types of business the insurer engages in and the nature of its assets and liabilities.

#### ***Control, manage and operate the insurer or bridge institution (KA 3.2 (ii, iii and iv))***

**4.3** Resolution authorities should have the power to carry on some or all of the insurance business, either within the existing entity or using a bridge institution, with a view to maximising value for policyholders as a whole and providing continuity of insurance coverage, including the power to:

- (i) continue to fulfil in whole or in part existing obligations under contracts of insurance;
- (ii) permit the exercise of options under existing contracts of insurance, including the surrender or withdrawal of contract cash value;
- (iii) enter into new contracts of insurance and reinsurance; and
- (iv) buy reinsurance (or retrocession) coverage.

In each case, the costs of those obligations should be met either from the existing estate, the collection of premiums due, the collection of recurring premiums, the collection of new premiums or the support of the policyholder protection scheme.

### ***Restructuring of liabilities (KA 3.2 (iii))***

**4.4** The resolution authority should have the power to restructure or limit liabilities, including insurance and reinsurance liabilities, and allocate losses to creditors and policyholders in a way consistent with the statutory creditor hierarchy, subject to the safeguards set out in KA 5. Examples of a restructuring of liabilities include, but are not limited to, the following:

- (i) reducing future (or contingent) benefits, such as the sum assured or the annuity provided, in a manner that allocates losses as appropriate to policyholders whilst maintaining continuity of insurance coverage and payments falling due;
- (ii) reducing the value of contracts upon surrender, where insurance contracts have a surrender value to enable losses to be imposed as appropriate on policyholders that seek to surrender their contracts;
- (iii) reducing or terminating guarantees, such as the guaranteed sum assured or annuity rate provided by a with-profits policy, to enable losses to be imposed on policyholders that participate in the profits and losses of the insurer (or a fund) as appropriate and remove uncertainty about the future value of such guarantees;
- (iv) terminating or restructuring options provided to policyholders, for example as part of a deferred or variable annuity contract (including to help facilitate a transfer);
- (v) converting an annuity into a lump sum payment that can be used to fund the issuance of a new annuity contract or be paid out to the policyholder in circumstances where continuity is not achievable;
- (vi) settling crystallised and contingent insurance obligations<sup>3</sup> by payment of an amount calculated as a proportion of estimated present and future claims, to provide a more rapid and cost-effective resolution where future claims are uncertain and run-off is not feasible or there is not time to carry out a detailed actuarial valuation;
- (vii) converting insurance liabilities from one type of insurance liability into another (for instance ‘with profits’ into ‘unit linked’) in order to facilitate a sale of business or ensure its continuity;
- (viii) reducing the value of inwards reinsurance contracts or restructuring inwards reinsurance contracts, for example by imposing limits on a policy, to allow losses to be imposed on cedants, as appropriate and where this does not compromise financial stability.

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<sup>3</sup> This includes obligations under inwards reinsurance contracts.

Where a restructuring of insurance liabilities takes place and the values of insurance contracts are reduced, that restructuring may provide for the values of insurance contracts to be increased later in relation to the performance of the business following resolution so that creditors (including policyholders) benefit from any upside in a way that respects the creditor hierarchy.

- 4.5** The resolution authority should be able to exercise powers of conversion or commutation, subject to the safeguards set out in KA 5, without being required to identify every creditor or potential creditor or to provide notice to each one.
- 4.6** The powers should allow resolution actions to be taken effectively and in a way that binds unknown creditors where:
- (i) claims have not yet arisen;
  - (ii) claims have arisen but have not yet been notified;
  - (iii) claims have not yet been estimated; or
  - (iv) the identity of policyholders, claimants or beneficiaries is not known (for example because cover has been written by third parties and the claim investigation has not progressed to the point whereby all relevant parties have been identified).

***Portfolio Transfer (KA 3.2(vi) and 3.7(i))***

- 4.7** Resolution authorities should have the power to transfer contracts of insurance and reinsurance, including the power to vary or reduce the value of those contracts transferred. Where the value of the contract of insurance or reinsurance is uncertain or requires considerable time to evaluate, the power should provide for a pre-agreed mechanism to adjust the value of the contract after the transfer has been effected.
- 4.8** Resolution authorities should have the power to transfer any reinsurance associated with the transferred policies without the consent of the reinsurer.

***Power to suspend insurance policyholders' surrender rights***

- 4.9** In order to achieve an effective resolution, the power of the resolution authority to suspend creditor rights in resolution should extend to the ability to temporarily restrict or suspend the rights of insurance policyholders to withdraw from or change their insurance contracts with an insurer. The exercise of the power and duration of the stay should be appropriate to the nature of the insurance product (for example, the distinction between life and non-life insurance).
- 4.10** The resolution authority should have the power to stay rights of reinsurers of the firm to terminate coverage for periods relating to, or policies incepting, after the commencement of resolution. The resolution authority should also have the power to stay any right to no longer reinstate reinsurance cover upon payment of a premium; however, that power should be accompanied by an arbitration or compensation

mechanism to determine a fair value of reinsurance premium to be paid in relation to the continued period of reinsurance coverage.

## **5. Safeguards**

### ***Respect of creditor hierarchy and creditor status of policyholders***

**5.1** The hierarchy of claims in liquidation should give a high priority to policyholder claims so that shareholders and unsecured creditors, such as debt holders, absorb losses before policyholders.

### ***Pari passu principle***

**5.2** The flexibility for the resolution authority to depart from the general principle of equal (*pari passu*) treatment of creditors of the same class may extend to the treatment of classes of policyholders if this is necessary to contain the potential impact of a firm's failure, maximise the value for creditors as a whole (including for policyholders) or to otherwise meet the objectives of resolution, subject to the "no creditor worse off safeguard" (KA 5.2). A resolution authority may define sub-classes of policyholders (for example, policyholders with the same insurance product or those covered by a policyholder protection scheme) and treat those sub-classes of policyholders differently in resolution. However, there should be no differential treatment of policyholders within the same sub-class (for example, same insurance product or policies).

### ***No creditor worse off safeguard***

**5.3** Any determination of whether any class or sub-class of policyholders is worse off as a result of resolution measures than in liquidation should take into account the applicable legal regime and the contractual terms and conditions under the insurance policies.

**5.4** Authorities should clarify ex ante the method and as-of date by which claims in foreign currencies would be converted into the reporting currency of the failed entity.

## **6. Funding resolution**

**6.1** Jurisdictions should have in place privately-financed policyholder protection schemes that can assist in:

- (i) securing continuity of insurance coverage and payments by the transfer of insurance policies to a bridge insurer or third party or use of any other resolution powers; and
- (ii) compensating policyholders or beneficiaries for their losses in the event of a wind-up or liquidation.

## **7. Cross-border effectiveness**

- 7.1** Where contracts are written under a governing law other than that of the jurisdiction where the insurer is located, authorities should be satisfied that the terms of transfer and liability restructuring conducted by the resolution authority will be effective, for example by including recognition clauses in the insurance contracts.

## **8. Crisis Management Groups (CMGs) and Cooperation Agreements (COAGs)**

- 8.1** Crisis Management Groups (CMGs) and institution-specific cooperation agreements (COAGs) should be maintained or developed at least for G-SIIs. They should build upon existing supervisory colleges and cooperation agreements.

## **9. Resolvability assessments**

- 9.1** All insurers that could be systemically significant or critical upon failure in a domestic or cross-border context, at a minimum all G-SIIs, should be subject to regular resolvability assessments that are conducted in accordance with KA 10 and Annex II.

- 9.2** In undertaking a resolvability assessment to evaluate the feasibility and credibility of implementing the resolution strategy and operational resolution plan developed for the insurer, resolution authorities, in coordination with other relevant authorities, should assess in particular whether the chosen resolution strategy ensures the continuity of critical functions, including the continuity of coverage and payment for critical insurance contracts, and can be implemented without severe systemic disruption and without exposing taxpayers to loss.

- 9.3** The assessment of the feasibility of the resolution strategy should cover as appropriate:

- (i) the likely availability of a transferee or purchaser for any insurance business that is to be sold as part of the resolution strategy, taking into consideration the ability to use a bridge institution to operate the business on a temporary basis;
- (ii) the time needed to evaluate policyholder liabilities and the assets supporting, backing or to be transferred as consideration for assuming the liabilities, and for a potential buyer to carry out due diligence;
- (iii) the capacity of the policyholder protection scheme to fund its share of any transfer where there are insufficient assets to resolve all insurance liabilities in a timely manner;
- (iv) if the resolution strategy consists of or includes a solvent run-off, the risk that policyholders with later maturing policies may not receive their benefits in full

and are ‘time-subordinated’ to those with earlier-maturing policies and short-term non-policyholder creditors;

- (v) the quality of management information systems and the documentation of insurance contracts, including the capacity of the firm to deliver detailed, accurate and timely information about the types of insurance business it undertakes, the number and type of policyholders, the benefits due to each policyholder, the reinsurance in place and information about assets, especially assets backing the insurance liabilities;
- (vi) the extent to which corporate structures and business units are aligned with legal entities to ensure that the sale, transfer or wind down of different business units can be accomplished through control of a single corporation or closely related group of corporations;
- (vii) the extent to which corporate capital structures would permit a bail-in within resolution in accordance with KAs 3.5 and 3.6;
- (viii) the legal, operational and financial separateness of traditional insurance business from non-traditional insurance and non-insurance business;
- (ix) intercompany service agreements to ensure continuity of services;
- (x) the effect of intra-group transactions (for example, reinsurance transactions, loans or letters of credit, collateral upgrades or other liquidity support provided to banking entities, guarantees or letters of support, cost sharing or profit and loss-sharing agreements among affiliates) in resolution;
- (xi) the extent to which any interconnections or interdependencies between group entities or with third-parties affect the implementation of the resolution strategy;
- (xii) how contractual termination events (including cross-default) in financial contracts with insurers are defined, including whether rating down-grades, restructuring or (solvent or insolvent) run-off, in particular if occurring in a single legal entity within an insurance group, could trigger early termination of contracts of the relevant legal entity or its affiliates; and
- (xiii) whether surplus assets in other jurisdiction may be ring fenced in resolution.

**9.4** When assessing the credibility and overall impact of implementing the resolution strategy, consideration should be given to its effects on third parties and financial stability as a whole, including whether the resolution of the insurer would cause:

- (i) a material adverse impact on economic activity as a result of any disruption to continuity of insurance cover and payment, which will be greatest when insurance is a pre-requisite to day-to-day economic activity (for example, employers’ liability, trade credit and transport liability insurance); where a

disruption in insurance claims and benefit payments is likely to cause significant and widespread financial hardship to households and businesses; or where the insurer has a significant share of the market;

- (ii) a lack of confidence in other insurers triggering a policyholder run, particularly where other insurers provide insurance that resembles on-demand savings products;
- (iii) an adverse impact on the resolvability of insurance or other financial operations undertaken elsewhere in the group;
- (iv) large investment losses for other financial institutions that could affect their capital resources;
- (v) the termination of securities lending and reverse repo operations that could affect funding and liquidity for other parts of the financial system; and
- (vi) an amplification of financial market disruption owing to the termination of financial guarantees or credit default swaps.

## **10. Recovery and resolution planning**

**10.1** All insurers that could be systemically significant or critical upon failure, at a minimum all G-SIIs, should be subject to a requirement for an ongoing process of recovery and resolution planning.

**10.2** Recovery and resolution plans (RRPs) need to be tailored to the specific risks and systemic implications that each insurer may be exposed to or create and take into account the types of business the insurer engages in, its derivatives booking, intercompany guarantees, inter-affiliate support arrangements, risk pooling, shared services and risk management model and the nature of its assets and liabilities.

**10.3** A key component of RRP is a strategic analysis that identifies the firm's essential and systemically important functions and sets out the key steps to maintaining them in both recovery and resolution scenarios. Elements of such analysis should include identification of essential and systemically important functions, mapped to the legal entities in which they are conducted. Such essential functions could include, but are not limited to:

- (i) the provision of critical types of insurance policies, the continuity of which is a priority in resolution for reasons of policyholder protection or financial stability;
- (ii) the provision of services (actuarial, claims handling, policy administration, benefit payment etc.) that are necessary for the continuation of the critical insurance business;

- (iii) essential hedging activities that are necessary to the continuation of the insurance business (for example, hedging for variable annuities with complex embedded options and guarantees, or hedging to closely match annuity cash flows);
- (iv) liquidity or other funding support provided to other financial institutions, the sudden withdrawal of which could have adverse effects on financial stability;
- (v) intra-group transactions, for example, reinsurance (including captive reinsurance arrangements), funding, liquidity and intra-group support and guarantees, that are essential to the continuation of critical functions elsewhere in a group structure or that could otherwise significantly affect resolution or recovery if they are disrupted or suspended; and
- (vi) credit or financial guarantee insurance, or non-insurance (for example, CDS), the withdrawal of which could have adverse effects on financial stability or the broader economy.

### ***Recovery plans***

- 10.4** Recovery plans should be developed on the basis of severe stress scenarios that combine adverse systemic and idiosyncratic conditions. They need to take into account insurance specificities such as the longer pay-out duration and the liquidity profile of insurers.
- 10.5** The insurer's direct supervisory authority, the policyholder protection scheme and relevant resolution authorities should cooperate in the review of the insurer's recovery plan.
- 10.6** In the case of G-SIIs, the review of the recovery plan should be carried out within the insurer's CMG.
- 10.7** Firms should identify possible recovery measures and the necessary steps and time needed to implement such measures and assess the associated risks of implementation. The range of possible recovery measures could include:
- (i) actions to strengthen the capital situation, for example, recapitalisations after extraordinary losses, capital conservation measures such as suspension of dividends and payments of variable remuneration;
  - (ii) triggering of contingent capital instruments;
  - (iii) possible sales of subsidiaries, portfolios of insurance contracts, renewal rights and spin-off of business units;
  - (iv) changes to the reinsurance programme;
  - (v) changes to the investment strategy and hedging programme;



- (vi) changes to business mix, sales volumes and product designs, including options to close books of business to new underwriting;
- (vii) changes to underwriting and claims handling practices; and
- (viii) modifications to contract terms and conditions, the level of charges, fees and surrender payments, the amount and timing of any discretionary benefits and the operation of discretionary incentives to renew contracts (such as ‘no-claims discounts’ or contract renewals without new underwriting).

**10.8** A firm in solvent run-off should have a scheme of operations plan that sets out how all liabilities to policyholders will be met in full as they fall due and should include, for example, details on how expenses can be reduced as business volumes fall.

***Resolution strategies and plans***

**10.9** In the case of G-SIIs, the resolution strategies and plans should be developed within the insurer’s CMG.

**10.10** Resolution plans for insurers should contain the essential elements set out in Annex III and also include, as appropriate to the type of the insurer, the following:

- (i) identification of policyholders that protected by a policyholder protection scheme and policyholders that are not eligible for benefits from such schemes;
- (ii) the actuarial assumptions used for calculating insurance liabilities and an independent exit value actuarial valuation of the technical provisions (policyholder liabilities);
- (iii) review of asset quality and concentration issues;
- (iv) preparation of insurance portfolio transfers, including a determination of the acceptability of assets to be transferred to any insurer assuming liabilities in a portfolio transfer;
- (v) sources of funding, including those from a policyholder protection scheme;
- (vi) provision for continuity or an orderly winding down of any derivatives portfolio;
- (vii) details on the allocation of ceded reinsurance among the various legal entities and impact on the recovery levels;
- (viii) an estimate of the outcome for each class of policyholder upon winding up (the counter-factual to the resolution plan and the basis for ‘no creditor worse off’ considerations); and
- (ix) practical arrangements for ensuring continuity of coverage and payment under certain types of insurance policies.

## **11. Access to information and information sharing**

**11.1** In order to facilitate the implementation of resolution measures, insurers that could be systemically significant or critical upon failure, including all G-SIIs, should be required to maintain information systems and controls that can promptly produce, both in normal times and during resolution, the relevant data and information needed for the purposes of timely resolution planning and resolution, for example in particular, on the following:

- (i) insurance activities where continuity of coverage and payment need to be maintained in resolution;
- (ii) details of eligibility for protection under policyholder protection schemes and scope of protection for eligible policyholders; and
- (iii) deposit-like products and other financial products that could be prone to runs.

## **Annex to the Key Attributes:**

### **Client Asset Protection in Resolution**

This Annex provides guidance on the interpretation and implementation of the *Key Attributes of Effective Resolution Regimes for Financial Institutions* (the ‘Key Attributes’, KAs) relating to elements in resolution regimes that are necessary to resolve a financial firm with holdings of client assets (hereafter “firm”). The *Key Attributes* state that the legal framework governing the segregation of client assets should be clear, transparent and enforceable during a crisis or resolution of firms and should not hamper the effective implementation of resolution measures (KA 4.1). Effective resolution regimes should allow for the rapid return of segregated client assets or the transfer to a performing third party or bridge institution of the client asset holdings.

This Annex supplements, and should be read in conjunction with, the *Key Attributes* in relation to any financial firm that directly or indirectly holds client assets and that could be systemically critical or important in the event of failure.

National regimes for client asset protection vary significantly in the methods by which client assets are protected because such protection depends on the particularities of the laws defining property rights and resolution and insolvency regimes in each jurisdiction. Client asset protection regimes fall into a number of broad categories which have been classified by IOSCO as ‘custodial regimes’, ‘trust regimes’ and ‘agency regimes’,<sup>1</sup> based on the legal nature of the relationship between the firm and its clients with respect to client assets. Those differences are likely to affect the legal nature of the client’s rights to its assets, the way in which those rights are protected by the regime and the treatment in insolvency. Moreover, the definition of a ‘client asset’ that is subject to a particular form of protection and rights for the client varies across jurisdictions.

Client assets are held by different types of firms in the course of different financial activities and services, including safeguarding, administration and custody, investment services and brokerage, prime brokerage and collateral taking in connection with other financial transactions. The legal and contractual arrangements by which client assets are held and the permissible use, if any, of those assets by the firm or third parties may also differ depending on the activities in question. For example, in some jurisdictions prime brokers have and exercise the contractual right to use (and re-hypothecate) some of the client assets that they

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<sup>1</sup> Introduction to the Final Report of the IOSCO Technical Committee on Survey of Regimes for the Protection, Distribution and/or Transfer of Client Assets (March 2011) <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD351.pdf>

hold (for example, a portion of margin securities<sup>2</sup>). By contrast, custodians generally hold, administer and safeguard securities on behalf of clients.

The Technical Committee of IOSCO has issued a number of reports pertaining to client asset protection: namely the Report on Client Asset Protection (August 1996);<sup>3</sup> the Final Report on Survey of Regimes for the Protection, Distribution and/or Transfer of Client Assets (March 2011);<sup>4</sup> and the Consultation Report on Recommendations Regarding the Protection of Client Assets (February 2013).<sup>5</sup> The recommendations and principles regarding standards of client asset protection, including those relating to safeguarding, administration, management, and the deposit of client assets in a foreign jurisdiction, waivers of client asset protection, rights of use and disclosure to clients are relevant to and support the guidance set out in this draft Annex. This draft Annex relies upon those IOSCO standards to specify in further detail how the principles in the Annex relating to the safeguarding and identification of client assets, use of assets and transparency to clients should be met.

Given the significant variations in national regimes for client asset protection, the draft guidance is intended to specify outcomes rather than prescribe methods or mandatory rules by which those outcomes should be achieved. Whatever national arrangements apply, client assets should be shielded - in a manner appropriate to those arrangements - from the failure of the firm and, to the extent possible, of any third party custodian.<sup>6</sup> The legal status of client assets and the clients' entitlement to them should not be affected by entry into resolution of the firm.<sup>7</sup>

## **1. Objectives (Preamble and KA 2.3)**

**1.1** The resolution authority or an administrator in charge of the resolution of a firm with holdings of client assets should, in the exercise of its resolution powers, be guided by the following specific objectives related to the protection of those assets (in addition to the general objectives set out in KA 2.3):

- (i) ensuring prompt access for the firm's clients to their assets through the continued functioning of the firm following stabilisation in resolution, the rapid return to the client of identifiable and segregated client assets or the transfer of the client asset holdings of that firm to a performing third party or bridge institution; and

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<sup>2</sup> That is, securities purchased by the client where the purchase is facilitated by a loan from the firm.

<sup>3</sup> <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD57.pdf>

<sup>4</sup> <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD351.pdf>

<sup>5</sup> <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD401.pdf>

<sup>6</sup> Although it is generally possible to ensure that client assets placed with a third party are shielded from the failure of the third party, this is not always the case: for example, client money deposited in a bank could be affected by the failure of that bank.

<sup>7</sup> In some jurisdictions, the fact that assets are held through and in the name of a financial intermediary does not alter the client's ownership interest.

- (ii) avoiding adverse impacts that might arise from lack of access for clients to their assets.

**1.2** The objectives related to protection of client assets should be reflected in the mandate and objectives of the resolution authority or of the administrator in charge of the resolution of the firm. They should be balanced with other objectives of the resolution authority or administrator, as appropriate in the circumstances of the specific case.

## **2. Definition of client assets**

**2.1** For the purposes of this guidance, client assets should be interpreted broadly to include all assets that are treated as client assets and subject to protection as such under applicable national law or regulation. Typically, they are assets held by a firm (whether or not through a custodian) for or on behalf of a client in the course of or in connection with services provided by the firm to the client, where the client has a proprietary or similar right to the return of the asset or its substitute. Client assets typically include:

- (i) money held on behalf of or owed to a client by a firm that is classified as client money under applicable national law;<sup>8</sup>
- (ii) financial instruments held for or on behalf of a client;
- (iii) client collateral, that is, assets received from a client and held by a firm for or on behalf of the client to secure an obligation of the client (other than under a title transfer transaction, see paragraph 2.2 (iii)); and
- (iv) assets arising from transactions entered into by a firm on behalf of a client.

**2.2** The provisions of this Annex do not apply to:

- (i) deposits held by banks (as ‘deposits’ are defined for the purposes of the regulation of the activity of taking deposits under applicable law), unless the deposits held by a firm with a bank constitute customer funds under the applicable legal framework and are labelled as such;
- (ii) assets held by an insurer or policyholder claims and rights in connection with insurance business; and
- (iii) assets delivered to a firm as ‘collateral’ in a title transfer transaction, such as repurchase or reverse repurchase agreements.<sup>9</sup>

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<sup>8</sup> The classification and treatment of money held on behalf of, or owed to, a client varies between jurisdictions. In some jurisdictions, clients may have a direct ownership interest in segregated cash balances, and in this case the money is treated as “client money”, and may be subject to specific forms of protection. In others, cash balances qualify as mere claims against a firm and as such would not be covered by this Annex.

- 2.3** The legal framework should include clear and transparent rules on how:
- (i) client assets are defined, including the classification of securities held for or on behalf of a client and (where applicable) client money; and
  - (ii) client assets are treated in the event of failure of the firm that holds the client assets either directly or indirectly (through one or more intermediaries or custodians).

**3. Transfer powers in relation to client assets (KA 3.2(vi) and (vii) and KA 3.3)<sup>10</sup>**

**3.1** The powers set out in KA 3.2 (vi) and (vii) and KA 3.3 (“transfer powers”) should extend to the transfer of client assets.

- (i) In the case of client assets held by the firm in resolution, the resolution authority or an appointed administrator should have the power to transfer the assets and corresponding client contracts to a sound financial institution or bridge institution that, in either case, is capable of providing similar services (a ‘qualified transferee’), as an alternative to returning the assets to the clients.
- (ii) In the case of client assets held by a domestic affiliate of the firm in resolution, a similar approach should be possible if the viability of the group or domestic sub-group is affected.
- (iii) In the case of client assets held by a third party custodian, the resolution authority should have the power to transfer the contractual rights and obligations between the custodian, the firm in resolution and its clients to the qualified transferee.

**3.2** The exercise of transfer powers should not require the consent of affected clients.

**3.3** Transfer powers should enable the resolution authority to transfer entire business lines and related client assets to a qualified transferee without that transfer being

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<sup>9</sup> This does not preclude jurisdictions from applying forms of client asset protection to such assets or client claims under national law. However, this Annex does not specifically address considerations relevant to the treatment of such assets or claims in resolution,

<sup>10</sup> The use of transfer powers may vary according to whether the assets are held by the firm in resolution or by an unaffiliated third party custodian. In the former case, transfer from the firm in resolution (or rapid return of the assets to clients) is likely to be the most appropriate action. However, where the client asset holdings of a firm in resolution are held by a third party custodian, transfer of the assets is not likely to be necessary. The resolution authority may instead transfer the contractual rights and obligations between the firm in resolution and its clients to the successor firm or bridge institution. Separate considerations may apply if the assets are held by a firm that is affiliated to the firm in resolution, if the viability of the group is affected.

prevented by contractual porting arrangements or the default rules of CCPs, exchanges or trading platforms. This should not prevent the operation of contractual porting arrangements or default rules where a default is declared by the relevant CCP, exchange or trading platform and transfer powers are not exercised.

**3.4** The exercise of transfer powers should be subject to the relevant safeguards set out in KA 5.

**3.5** The exercise of powers to transfer or achieve a rapid return of client assets should be supported, to the extent consistent with the national legal framework, by:

- (i) expedited court approvals, where these are necessary (consistent with KA 5.4 and 5.5);
- (ii) protection in law for resolution authorities, their employees or appointed administrators against liability for actions taken and omissions made while acting within their legal powers and discharging their duties in good faith;
- (iii) the availability of investor protection or similar industry backstop funds to support transfers of client assets or to make advance payments of client funds and delivery of securities;
- (iv) mechanisms for later adjustments to deal with disputed claims in relation to assets that have been transferred; and
- (v) the ability of the resolution authority or appointed administrator to adopt pragmatic approaches to the transfer or return of client assets (for example, advance distributions, piecemeal returns, returning substitute assets).

#### **4. Segregation of client assets, securities lending and rights of use (including “re-hypothecation”<sup>11</sup>) (KA 4.1)**

**4.1** Firms should be required to maintain adequate arrangements, including segregation, for the identification and safeguarding of client assets so that resolution authorities or administrators are able to identify quickly which assets are client assets and to ascertain the nature of claims and entitlements of individual clients to those assets, including with respect to client assets held in a holding chain.

**4.2** Clients should be adequately informed about the way their assets are held, including the type of segregation and the existence of any holding chain, and the applicable client asset protections. That information should include in particular the effects of pooling of client assets in omnibus client accounts in the event of the insolvency of the firm or any custodian, how any shortfall in pooled assets will be allocated; and, where relevant, the fact that the regime for client asset segregation and protection

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<sup>11</sup> Referring here to any use of collateral by a collateral holder.

may be different under foreign law, and that the client may not receive the same level of protection available under domestic law.

**4.3** Jurisdictions that permit securities lending by firms as agents for clients or re-hypothecation and use of client securities by the firm or third parties as principal should adopt clear frameworks governing those arrangements.

(i) Where a firm lends client securities as agent, it should keep adequate records of outstanding transactions, including counterparties, contract terms, legal documentation, collateral details and location of collateral. Those records should be sufficient to enable clients to unwind outstanding transactions to which they are principal or, in the event of resolution, to enable outstanding transactions to be transferred to a qualified transferee. Particular consideration should be given to ensuring that the firm holds adequate records of collateral allocation where securities collateral is held for multiple clients on a pooled basis and where cash collateral is reinvested on a pooled basis.

(ii) Where a firm re-hypothecates or otherwise uses client assets as principal, it should keep clear records of which client assets have been used. In particular, in order to facilitate resolution, it should be clear how the exercise of the right of use is recorded<sup>12</sup> and what quantity of assets can be used or re-hypothecated.

**4.4** Where the legal framework permits securities lending, rights of use, re-hypothecation or similar arrangements in respect of client assets, it should require adequate disclosure to clients of the effects of such transactions on the protection of their assets and the nature of their legal claims in resolution.

## **5. Shortfalls in client assets and use of protection funds (KA 6)**

**5.1** Jurisdictions should have in place clear rules on how losses are shared between clients in the event of shortfalls in a pool of client assets. Their application should not unduly delay or prejudice the objective of a rapid return or transfer of client assets.

**5.2** There should be clarity as regards the role of investor protection schemes and other guarantee schemes or funds supporting the transfer of client assets and addressing shortfalls.

**5.3** When an investor protection scheme may also be used in connection with resolution measures, there should be safeguards to avoid an excessive depletion of the protection scheme for the financing of resolution measures not directly aimed at the protection of client assets.

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<sup>12</sup> For example, by debiting the account of the client and crediting the account of the collateral taker, or by a form of notification on the client account.



## **6. Cross-border issues (KA 7)**

**6.1** Home and host resolution authorities should provide each other with the relevant information, including relevant legal analyses where available, on:

- (i) the operation of their domestic client asset protection regimes;
- (ii) the resolution measures and other actions that can be taken at national level in the event of a firm's failure and their impact on the ownership status and the clients' rights in relation to the assets; and
- (iii) available mechanisms to achieve a rapid return or transfer of client assets.

**6.2** Jurisdictions should develop:

- (i) cooperation arrangements that complement effective resolution strategies and plans and that facilitate a rapid return of clients assets held in their jurisdiction, including procedures for timely recognition of the appointment of an administrator to a foreign firm with holdings of client assets in their jurisdiction; and
- (ii) expedited mechanisms to give effect to transfers by a foreign resolution authority (acting directly or through a special administrator, receiver, conservator or other official) of client assets held in their jurisdiction, which may consist of the recognition of foreign transfers or the exercise of transfer powers by the local resolution authority or administrator to transfer such client assets or the contract between the foreign firm in resolution and a domestic intermediary that holds client assets on behalf of the foreign firm in resolution.

## **7. Resolution planning and actions to promote resolvability (KA 10 and KA 11)**

**7.1** Resolution planning for a firm holding client assets should consider the following:

- (i) arrangements in place within or involving the firm that ensure that the identity of clients and their assets can be established rapidly;
- (ii) the legal or procedural requirements for the transfer of client assets or of the contracts governing the holding of, or custody arrangements for, client assets;
- (iii) the type of segregation and its impact on rapid return or transfer of client assets;
- (iv) any rights of use and re-hypothecation that may be exercisable, and the impact of the exercise of such rights on the ability to transfer or recover and return assets;
- (v) the scale of lending of client assets by the firm as agent, including the following features:

- the maturity structure of the book and how quickly it could be unwound,
  - the liquidity of any cash collateral reinvestment and whether that could impede a rapid unwinding of the book,
  - how any cash collateral is reinvested (for example, whether on a pooled or segregated basis),
  - how any securities collateral is held (for example, whether on a pooled or segregated basis),
  - the quality of the firm’s records of outstanding securities lending transactions, particularly where collateral is held on a pooled basis, and
  - what information is provided to clients and how frequently;
- (vi) the effect of correlated failures on the resolvability of the firm, where a custodian, sub-custodian or other intermediary in the holding chain is an affiliate of the firm and is itself in resolution or insolvency;
- (vii) where client assets are held in another jurisdiction, the effect of foreign law on the nature of the protection of client assets and their treatment in insolvency, to the extent necessary for resolution;
- (viii) how shortfalls in client assets and resultant client claims are treated in the resolution and how losses to clients will be allocated;
- (ix) the role of investor protection schemes or other guarantee schemes or funds to support transfers of client assets or to make advance payments of client funds and delivery of securities; and
- (x) cooperation and information sharing arrangements with relevant foreign authorities to support the rapid return or transfer of client assets where those assets are held in a foreign jurisdiction.

**7.2** To support the effective exercise of transfer powers, resolution authorities should have the power to require changes to a firm’s business practices, information management systems and contractual arrangements relating to the holding and protection of client assets.

## **8. Information requirements and record keeping (KA 12.2)**

**8.1** In order to facilitate the rapid transfer or return of client assets, firms should be required to maintain information systems and controls that can promptly produce, both in normal times and during resolution, and in a format understandable by an

external party such as a resolution authority or an administrator, information on the following:<sup>13</sup>

- (i) the amount, nature and ownership status of client assets held directly or indirectly by the firm;
- (ii) the identity of the clients;
- (iii) the location of the client assets, how the assets are held (that is, by the firm, an affiliate or third party custodian or sub-custodian) and the identity of all relevant depositories;
- (iv) the terms and conditions on which the client assets are held, including contractual arrangements between the firm and the client and any third party holding the client assets;
- (v) the type of segregation (“omnibus” or “individual”), if applicable, at all levels of a holding chain and the effects of the segregation on the clients’ ownership rights;<sup>14</sup>
- (vi) the applicable client asset protections, in particular where client assets are held in a foreign jurisdiction and will be subject to the client asset protection and resolution or insolvency regime of that foreign jurisdiction, and any waiver, modification or opting out by the client of the client asset protection regime (where permitted by the applicable regime);
- (vii) the ownership rights of the clients and any potential limitations to those rights, including the existence of liens or other encumbrances that may affect the return of such assets or their value to clients, and the firm’s obligations with respect to the client assets;
- (viii) the existence and exercise of any rights of use by the firm, including details of the assets that have been re-hypothecated and the legal consequences of the exercise of those rights on the clients’ rights over those assets; and
- (ix) outstanding loans of client securities arranged by the firm as agent, including details of counterparties, contract terms and collateral received on behalf of the clients.

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<sup>13</sup> Record keeping requirements should be guided by the IOSCO Recommendations Regarding the Protection of Client Assets: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD401.pdf>

<sup>14</sup> In some jurisdictions, segregation of client assets from the firm’s proprietary assets may directly affect the clients’ rights to the assets. In others, segregation does not affect those rights, but facilitates identification and recovery of client assets.

## **9. Impediments to orderly resolution**

- 9.1** Resolution authorities should inform the relevant supervisory authorities if their resolvability assessments indicate that that client asset protection regime could impede orderly resolution and the rapid return or transfer of client assets. Supervisors should consider appropriate modifications to that regime or other actions to address the reported impediments.