afme/ Finance for Europe

Association for Financial Markets in Europe

Moratorium tools in the Risk Reduction Measures package

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Executive Summary

- There are a number of significant concerns with regards to the proposed new moratorium tools in the Risk Reduction Measures package.
- The two tools, one for use prior to resolution, the other during resolution, have not had their impacts adequately assessed.
- We are concerned that the tools will undermine the objectives of the resolution framework, are inconsistent with the internationally agreed standards, endanger financial stability, and increase the risk of contagion.
- We do not believe that the proposed new tools are necessary or appropriate and therefore should be deleted.

Introduction

As set out in our position paper[1], AFME[2] does not believe that the introduction of the new powers is necessary or appropriate, and gives rise to a number of significant concerns. This paper provides additional detail on the concerns and potential impacts of the proposals which we believe have not been fully assessed.

Moratorium powers, i.e. the ability to freeze the flow of payments for a period of time, can have significant impacts on the orderly functioning of financial markets due to their interference with the rights of counterparties and the incentives they create. This is true in the event of their use but also by virtue of their existence, and as such any proposal that introduces new or extended powers must be considered very carefully with the impact fully assessed. This note highlights our significant concerns with the Commission's proposed new moratorium power which can be exercised prior to resolution, along with our other concerns regarding the proposed power that can be exercised in resolution.

Background

The BRRD introduced, under Article 69, a power that enables resolution authorities to suspend any payment or delivery obligations pursuant to any contract to which an institution under resolution is a party. This power enables such moratoria to last no more than two business days, but does not include within its scope eligible deposits[3], obligations owed to payment and settlement systems, central counterparties, central banks, or

[1] **AFME** – See https://www.afme.eu/en/reports/publications/afme-views-on-the-resolution-aspects-of-the-eu-risk-reduction-measures-package/

[2] The Association for Financial Markets in Europe (AFME) represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society. AFME is listed on the EU Transparency Register, registration number 65110063986-76.

[3] Eligible deposits are defined under the Deposit Guarantee Scheme Directive, 2014/49/EU, Article 2 (1) (4)

eligible claims under investor-compensation schemes. This is accompanied by further powers to place restrictions on the enforcement of security interests (Article 70) and on the temporary suspension of termination rights (Article 71). These powers implement, and are consistent with, the international standards on resolution stays established in the FSB Key Attributes of Effective Resolution Regimes for Financial Institutions ("Key Attributes")[4] (see annex for extracts). All these powers are only exercisable in resolution, and only for a limited time period, i.e. not exceeding two business days. The industry has supported the cross-border effectiveness of these stays through contractual recognition of key contracts such as through the ISDA Resolution Stay Protocols. This has involved a very significant exercise by the industry whose efforts have been acknowledged and welcomed by the FSB[5].

On 23 November 2016, the Commission made a legislative proposal to amend the BRRD to implement Total Loss-Absorbing Capacity (TLAC) and amend the Minimum Requirement for own funds and Eligible Liabilities (MREL). However, in addition to making changes to the framework for loss absorbing and recapitalisation capacity, the proposals also introduce two new broad moratorium powers through the introduction of Article 29a and amendments to Article 63(1) of the BRRD.

Pre-resolution moratorium power

Under Article 29a the proposal would provide supervisory authorities with a power to suspend payment and delivery obligations for a maximum of five business days, prior to resolution. This power could be exercised where it is deemed necessary to make the determination of whether the firm is failing or likely to fail (although as drafted it would appear that this tool can only be used once that determination has been made). Its scope is similar to that of the existing two-day resolution moratorium under Article 69, however this tool will only be exercisable prior to resolution, and it excludes only covered deposits as opposed to eligible deposits.

Where Member States have designated the resolution authority as the competent authority to make the assessment of whether a firm is failing or likely to fail, this power would be made available to them. Due to the interaction with the existing Article 68(3), this power would be deemed an "early intervention measure" and a "crisis prevention measure". This proposed power is referred to as the pre-resolution moratorium tool, and has been justified by the Commission as providing authorities more time to undertake a "failing or likely to fail" assessment.

In-resolution moratorium power

Through amendments to Article 63(1), the proposal also seeks to introduce a further power to suspend payment and delivery obligations where it is deemed necessary for the effective application of one or more resolution tools, or for the purposes of valuation. This tool also has a maximum duration of five 'working' days and shares the same scope as the tool proposed under Article 29a. This power would be deemed as a "resolution power", a "resolution action", and a "crisis management measure", and is referred to as the in-resolution moratorium tool.

[4] **FSB –** see http://www.fsb.org/wp-content/uploads/r_141015.pdf, Annex IV, page 43

[5] See http://www.fsb.org/wp-content/uploads/20151111-Contractual-stays-press-release.pdf

The key justification set out by the Commission for proposing the new in-resolution moratorium power is the perceived need to harmonise existing moratorium powers available to authorities in the EU, due to the different ways the existing moratorium power provided under Article 69 has been implemented in Member States[6]. However, the proposal does not include amendments providing any clarity as to what should apply in Member States under that moratorium power, as per the concerns of the Commission as to the perceived need for harmonisation.

It is understood that a broadening of the scope of both tools is desired by some parties, potentially including all deposits. If the scope of these powers is extended further to all deposits, it is not clear how this would be consistent with the determination of the unavailability of deposits under the Deposit Guarantee Scheme Directive (2014/49/EU), and the respective trigger of the obligation for the applicable Deposit Guarantee Scheme to make the repayment amount available.

Below we set out our concerns with regards to these proposals, the potential impacts both in their existence and use, and why co-legislators should have a heightened concern around the implementation of these powers because of the implications they may have on financial stability, the day-to-day operation of financial markets, and the increased likelihood of contagion and resolution occurring.

Impacts of the new moratoria powers

We do not believe that it is necessary or appropriate to introduce new moratoria powers, and are very concerned with the substantial risks to financial stability (and minimal benefits, if any) of any additional moratorium powers, especially prior to resolution. We have significant concerns regarding: (i) the compatibility of the powers with an effective recovery and resolution framework and the resolution objectives; (ii) the impact on incentives, contagion and financial stability; (iii) the capital required to be held by counterparties; and (iv) global consistency and the interaction with the progress made in ensuring contractual recognition of resolution stays.

(i) Compatibility with an effective framework and resolution objectives

Resolution is predicated on the objective of ensuring that the critical economic functions of the bank continue prior to and throughout resolution. This is key to ensuring the success of resolution in minimising the impact on financial stability.

The proposed moratoria would run directly contrary to the stated objectives of ensuring the continuity of critical functions (such as cash payments and transfers) and avoiding significant adverse effects on the financial system[7]. The broad scope of the moratoria includes a number of critical economic functions of banks which are intended to be maintained prior to and throughout resolution, including uninsured deposits and other critical economic functions. As such the moratorium tool (either pre-resolution or in resolution) could undermine the resolution objectives, signalling to creditors and the market that a particular bank is in distress, and create financial instability by incentivising runs ahead of a possible moratorium being implemented, and through the possible increase in contagion.

[6] European Commission Impact Assessment on RRM package, see - http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CONSIL:ST_14778_2016_ADD_1_REV_1&from=EN

[7] As set out in article 31(2)(a),(b) BRRD

Further to this, the lack of transparency on exactly when such moratorium tools, in particular the pre-resolution tool, would be applied creates additional uncertainty that counterparties will take into consideration at the earliest signs of financial distress.

The additional powers are also inconsistent with the international standard agreed by the G20 in the Key Attributes. The Key Attributes emphasised the importance of stays being strictly time limited (for example, for a period not exceeding two business days), and only arising for reasons of entry into resolution or in connection with the use of resolution powers (See Key Attribute 4.3).

We view the existing moratoria under the BRRD as sufficient to enable the authorities to conduct an effective resolution and as consistent with the Key Attributes.

As discussed below, we are also concerned that the new powers, in particular the pre-resolution power, and the prospect of counterparties not being paid for a significant period of time, will incentivise such counterparties to run and/or cease further business with the bank at an earlier stage, increasing the possibility of contagion effects. This could make recovery from stressed situations less likely and increase the likelihood of the bank failing and the speed of its deterioration. This would also clearly be contrary to the objectives of increasing resilience in financial institutions.

(ii) Impact on the stability of financial markets

We are concerned about the impact that the proposed new powers would have on the ability of banks to recover in stressed situations and the market impact. In particular, customers and counterparties would be incentivised to run at an earlier stage making recovery more challenging and potentially increasing the likelihood of failure in a stressed situation. The possibility of a stay could increase concern in markets prior to their application, and increase contagion both through market reaction and also due to the impact that a stay would have on counterparties if utilised, which include other financial institutions that may be reliant on the income to meet their own obligations. For example, once a pre-resolution stay is enforced, it signals to the market that an institution is extremely vulnerable to collapse. If it is lifted following the 5-day period without the authorities putting the institution into resolution, at best it will weaken the institution (e.g. through greater cost of funding, risk of deposit flight, and franchise damage), and at worst destabilise the institution and tip it into resolution. Additionally, there is the contagion impact of such an action, and increased wariness in the market from lenders to institutions in a similar position.

We are also very concerned about the potential reaction that counterparties would have to the new moratoria. This may for example consist of demands for higher pricing for lending to European institutions during times of stress, which reflects a competitive disadvantage that could be destabilising in such periods. We believe that the potential adverse impact of a pre-resolution moratorium power has not been sufficiently assessed.

The existence of the tool, even if not exercised, could itself create uncertainty in the market and incentivise counterparties, including uninsured depositors (but also potentially insured depositors who are unwilling to rely on deposit insurance) to run at an earlier stage than they otherwise would. The trigger for early intervention is vague and therefore markets could react at the first sign or rumour of difficulties. Further to this, the triggers for the use of the pre-resolution tool as an "early intervention measure" are neither sufficient nor appropriate given the far-reaching effect and impact the tool may have.

This could be counterproductive and make recovery actions less likely to succeed. As drafted, it appears that the moratoria could apply successively such that a counterparty could be subject to a stay for 12 business days (five days for each tool in addition to the two days already provided for in the BRRD), which is a long period in what could be a volatile and stressed market. The possibility of repeated use is also not excluded.

We firmly believe that the likely adverse consequences of a pre-resolution moratorium tool far outweigh the mere benefit of granting the authorities more time to make their assessment. Given the far-reaching and counterproductive implications, it would be difficult for these tools to be justified on these grounds. Where the pre-resolution tool is utilised to make an assessment as to whether the firm is failing or likely to fail, we would challenge whether the use of the tool is necessary given the information already available to supervisors that should enable them to make this assessment. Where the tool is used to provide time for a resolution authority to make an assessment of whether the firm is failing or for the purposes of valuation, we would highlight that the value of an institution is not static during a moratorium, and that the use of such a tool would be counterproductive to maintaining value in the institution in question. Further to this, under Article 36 (2) and (9) of the BRRD, there is scope for a provisional valuation in cases where there is no time for a full assessment to be undertaken. As such, this scenario is already considered and the pre-resolution tool is not necessary or indeed sufficient to perform a final valuation.

Where the tool is utilised to stem liquidity outflows, we would highlight that liquidity concerns can be addressed through existing liquidity planning and central bank access in accordance with FSB guidelines on temporary funding to support the orderly resolution of a G-SIB[8]. Much to the contrary, if the pre-resolution moratorium does not result in putting the institution into resolution, it will most likely lead to a substantial deterioration in its liquidity position once the pre-resolution moratorium is lifted.

(iii) Capital impact

Given the significantly longer duration to which the proposed set of moratoria can be implemented compared to the existing two-day tool, there is a greater period of risk of non-payment to counterparties should the powers be fully utilised. As such, there remains the potential that there could be an impact on the regulatory capital position of counterparties due to this increased margin period of risk. Further, the significantly longer proposed moratoria may prevent counterparties under certain implementations of the Basel III framework, including the U.S. capital rules, from treating exposure to European banks on a net basis. Being forced to hold capital against exposure with European Banks on a gross basis would make current netting arrangements prohibitively expensive potentially locking European banks out of critical global markets. We believe these impacts should be fully assessed.

(iv) Global consistency and interaction with the progress made in ensuring contractual recognition of resolution stays

The implications for the competitiveness of European markets and the interaction with requirements for contractual recognition of the existing moratoria also require very careful consideration. As discussed above, the proposed moratoria go beyond the global standard under the FSB Key Attributes of Effective Resolution Regimes, broadly implemented under the BRRD, which provide for a limited stay on termination rights in certain circumstances (see Key Attribute 4.3 and I-Annex 5); the consistent and effective application of which

[8] **FSB** – See http://www.fsb.org/wp-content/uploads/Guiding-principles-on-the-temporary-funding-needed-to-support-the-orderly-resolution-of-a-global-systemically-important-bank-%E2%80%9CG-SIB%E2%80%9D-Overview-of-Responses-to-the-Public-Consultation.pdf

has been supported by industry through the ISDA Resolution Stay Protocols. This could have an adverse impact on European banks which would be subject to additional uncertain powers prior to resolution which do not apply globally. Ensuring a level playing field is important in the global financial marketplace, and the proposed moratoria powers would disadvantage EU banks by making them less attractive as counterparties.

Additionally, a number of jurisdictions have introduced requirements for firms to amend certain contracts to give contractual recognition of resolution stays. If these requirements were expanded to address the proposed new moratoria this would create a significant burden on firms including the need to amend again contracts which have already been amended to recognise existing stays. Such an exercise would be burdensome and could create significant confusion in the market.

In addition, under the ISDA 2015 Resolution Stay Universal Protocol, which includes provisions by which parties opt-in to the resolution regimes of their counterparties in order to ensure the enforceability of stays on a cross-border basis, parties have the ability to opt-out of a special resolution regime if the length of the applicable stay is amended. Therefore, the proposed moratoria would risk numerous parties that have previously opted-in to BRRD-based special resolution regimes no longer contractually recognizing stays in such jurisdictions. This would undermine the significant advances in cross-border certainty and the reduction of systemic risk achieved by the ISDA Resolution Stay Universal Protocol.

We do not believe that these issues have been sufficiently considered or the impact assessed. We therefore oppose the proposed introduction of additional moratoria.

Existing moratoria

The key justification for putting forward proposals for the introduction of the new moratoria relates to the perceived need to harmonise existing moratoria tools that are available in various Member States. However, the proposals put forward by the Commission do not give effect to any form of harmonisation. Instead their proposals go far-beyond a harmonisation of the existing tool’s transposition. There is no strengthening of those provisions to ensure clarity on the exact scope, duration, and triggers for the tool provided for under Article 69, or to effect existing pre-liquidation tools. If this is a concern for the Commission we would recommend that they revisit the drafting of Article 69 such that differences in transposing that specific power is minimised without impacting on the substance of the provision as it exists today.

We have looked into a number of existing powers and it is clear that these were not developed with resolution in mind. Rather that they are pre-liquidation tools and we are unaware of any examples of a tool being used which has not resulted in the insolvency of the institution. Similarly, the tools have not been developed with a large internationally active bank in mind. These tools are not suited to the purpose that the Commission intends, and are mainly intended for use prior to and during the insolvency of small institutions. The resulting implications regarding the risks of contagion, financial instability, and the threat to the preservation of critical economic functions should be considered in the potential use of these tools on larger, cross-border banks that are more likely to be subject to a recapitalisation, rather than liquidation, resolution strategy.

Further to this, the intention to harmonise such tools is not fully provided for in the Commission’s proposals as there is no provision requiring the removal of any other tools provided at a national level for this purpose. The introduction of new powers alone does not harmonise the availability of these pre-insolvency tools that exist, and only act to provide a greater number of powers to authorities. These powers go beyond what is necessary and proportionate given the presence and support of the existing moratoria tool, and they introduce an unacceptable level of uncertainty that could give way to heightened incentives for counterparties to pre-empt their use. As discussed above, it is also necessary to foster global consistency and therefore we suggest the Key Attributes should be the starting point as opposed to pre-liquidation tools which are not suited to the resolution of significant banks.

Proposed Amendments

In light of our concerns with the proposals set out in Article 29a and amendments to Article 63(1) of the BRRD, we strongly recommend that the text introducing the new powers be removed (as set out in the attached annex).

Should it be felt that there is a need to harmonise the transposition of the existing tool provided for within Article 69 of the BRRD, we would encourage the Commission to consider further work to evaluate any observed differences in approaches, and in consultation with industry, seek to understand where any amendment to the existing text should be made, if at all.

Should any proposals be put forward, including those currently under consideration, these should be accompanied by a full quantitative and qualitative impact assessment. Very special care should be taken in evaluating the potential impact of any pre-resolution moratorium power in particular, as it is this type of moratorium tool that carries the greatest risks, and the smallest perceived benefits. To this end, as a minimum, we consider that any further discussion on introducing new moratorium powers should await a fuller assessment by the Commission on the potential impact of the proposed new tools. If necessary, a review clause could be inserted with this issue being considered further as part of the BRRD review in 2018.

ANNEX 1

Suggested amendments to the Commission's proposal amending Directive 2014/59/EU (BRRD)

Article 1: Amendment to Directive 2014/59/EU1; amending Article 27: Early intervention measures	
Original text: 18. In Article 27(1), the following point (i) is added: "(h) where the conditions laid down in Article 29a are complied with, suspend any payment or delivery obligation to which an institution or entity referred to in point (b), (c) or (d) of Article 1(1) is a party.".	Proposed amendment: ~~18. In Article 27(1), the following point (i) is added:~~ ~~"(h) where the conditions laid down in Article 29a are complied with, suspend any payment or delivery obligation to which an institution or entity referred to in point (b), (c) or (d) of Article 1(1) is a party.".~~
Justification See above	

Article 1: Amendment to Directive 2014/59/EU1; proposing new Article 29a: Power to suspend certain obligations	
Original text: 19. The following Article 29a is inserted: "Article 29a Power to suspend certain obligations. 1. Member States shall establish that their respective competent authority, after having consulted the resolution authority, can exercise the power referred to in point (i) of Article 27 (1) only where the exercise of the suspension power is necessary to carry out the assessment provided for in the first sentence of Article 27(1) or to make the determination provided for in point (a) of Article 32(1). 2. The suspension referred to in paragraph 1 shall not exceed the minimum period of time	Proposed amendment: ~~19. The following Article 29a is inserted:~~ ~~"Article 29a Power to suspend certain obligations.~~ ~~1. Member States shall establish that their respective competent authority, after having consulted the resolution authority, can exercise the power referred to in point (i) of Article 27 (1) only where the exercise of the suspension power is necessary to carry out the assessment provided for in the first sentence of Article 27(1) or to make the determination provided for in point (a) of Article 32(1).~~ ~~2. The suspension referred to in paragraph 1 shall not exceed the minimum period of time~~

that the competent authority considers necessary to carry out the assessment referred to in point (a) of Article 27(1) or to make the determination referred to in point (a) of Article 32(1) and shall in any event not exceed 5 working days. 3. Any suspension pursuant to paragraph 1 shall not apply to: (a) payment and delivery obligations owed to systems or operators of systems that have been designated in accordance with Directive 98/26/EC, CCPs and third country CCPs recognised by ESMA pursuant to Article 25 of Regulation (EU) No 648/2012 and to central banks; (b) eligible claims for the purpose of Directive 97/9/EC; (c) covered deposits. 4. When exercising a power under this Article, competent authorities shall have regard to the impact the exercise of that power might have on the orderly functioning of financial markets. 5. A payment or delivery obligation that would have been due during the suspension period shall be due immediately upon expiry of that period. 6. When payment or delivery obligations under a contract are suspended pursuant to paragraph 1, the payment or delivery obligations of the entity's counterparties under that contract shall be suspended for the same period of time. 7. Member States shall ensure that competent authorities notify the resolution authorities about the exercise of any power referred to in paragraph 1 without delay.	~~that the competent authority considers necessary to carry out the assessment referred to in point (a) of Article 27(1) or to make the determination referred to in point (a) of Article 32(1) and shall in any event not exceed 5 working days.~~ ~~3. Any suspension pursuant to paragraph 1 shall not apply to:~~ ~~(d) payment and delivery obligations owed to systems or operators of systems that have been designated in accordance with Directive 98/26/EC, CCPs and third country CCPs recognised by ESMA pursuant to Article 25 of Regulation (EU) No 648/2012 and to central banks;~~ ~~(e) eligible claims for the purpose of Directive 97/9/EC;~~ ~~(f) covered deposits.~~ ~~4. When exercising a power under this Article, competent authorities shall have regard to the impact the exercise of that power might have on the orderly functioning of financial markets.~~ ~~5. A payment or delivery obligation that would have been due during the suspension period shall be due immediately upon expiry of that period.~~ ~~6. When payment or delivery obligations under a contract are suspended pursuant to paragraph 1, the payment or delivery obligations of the entity's counterparties under that contract shall be suspended for the same period of time.~~ ~~7. Member States shall ensure that competent authorities notify the resolution authorities about the exercise of any power referred to in paragraph 1 without delay.~~

8. Member States that make use of the option laid down in Article 32 (2) shall ensure that the suspension power referred to in paragraph 1 of this Article can also be exercised by the resolution authority, after having consulted the competent authority, where the exercise of that suspension power is necessary to make the determination provided for in point (a) of Article 32(1)."	~~8. Member States that make use of the option laid down in Article 32 (2) shall ensure that the suspension power referred to in paragraph 1 of this Article can also be exercised by the resolution authority, after having consulted the competent authority, where the exercise of that suspension power is necessary to make the determination provided for in point (a) of Article 32(1)."~~
Justification See above	

Article 1: Amendment to Directive 2014/59/EU1; amending Article 63: General powers	
Original text: 25. In Article 63(1), the following point (n) is added: "(n) the power to suspend payment or delivery obligations to which the institution or entity referred to in paragraph 1 is party when the resolution authority, after having consulted the competent authority, decides that the exercise of the suspension power is necessary for the effective application of one or more resolution tools or for the purposes of the valuation pursuant to Article 36."	Proposed amendment: ~~25. In Article 63(1), the following point (n) is added:~~ ~~"(n) the power to suspend payment or delivery obligations to which the institution or entity referred to in paragraph 1 is party when the resolution authority, after having consulted the competent authority, decides that the exercise of the suspension power is necessary for the effective application of one or more resolution tools or for the purposes of the valuation pursuant to Article 36."~~
Justification See above	

ANNEX 2 – extracts from FSB Key Attributes

4.2. Subject to adequate safeguards, entry into resolution and the exercise of any resolution powers should not trigger statutory or contractual set-off rights, or constitute an event that entitles any counterparty of the firm in resolution to exercise contractual acceleration or early termination rights provided the substantive obligations under the contract continue to be performed.

4.3. Should contractual acceleration or early termination rights nevertheless be exercisable, the resolution authority should have the power to stay temporarily such rights where they arise by reason only of entry into resolution or in connection with the exercise of any resolution powers. The stay should:

(i) be strictly limited in time (for example, for a period not exceeding 2 business days);

(ii) be subject to adequate safeguards that protect the integrity of financial contracts and provide certainty to counterparties (see I-Annex 5 on Conditions for a temporary stay); and

(iii) not affect the exercise of early termination rights of a counterparty against the firm being resolved in the case of any event of default not related to entry into resolution or the exercise of the relevant resolution power occurring before, during or after the period of the stay (for example, failure to make a payment, deliver or return collateral on a due date). The stay may be discretionary (imposed by the resolution authority) or automatic in its operation. In either case, jurisdictions should ensure that there is clarity as to the beginning and the end of the stay.

I-Annex 5: Temporary stay on early termination rights

1 Objectives

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

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

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

2 Conditions for a temporary stay

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

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

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

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

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

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

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

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

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

Operation of the stay

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

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