

# CONSULTATION PAPER

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## Proposed Enhancements to Resolution Regime for Financial Institutions in Singapore

MAS

Monetary Authority of Singapore

## PREFACE

i. MAS proposes to enhance its resolution regime for financial institutions in Singapore by strengthening MAS' powers to resolve distressed financial institutions while maintaining continuity of their critical economic functions. These proposed enhancements take into account global developments, including the Key Attributes of Effective Resolution Regimes for Financial Institutions adopted by the Financial Stability Board.

ii. MAS invites interested parties to provide their views and comments on the proposed enhancements to Singapore's resolution regime. Electronic submission is encouraged. Please submit written comments by 22 July 2015 to –

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iii. Please note that all submissions may be made public unless confidentiality is specifically requested.

## 1 INTRODUCTION

1.1 The global financial crisis underscored the need to develop effective frameworks to resolve cross-border financial institutions. To this end, the Financial Stability Board (“FSB”) adopted the Key Attributes of Effective Resolution Regimes for Financial Institutions (“Key Attributes”) in October 2011<sup>1</sup>, setting out core elements that are necessary for an effective resolution regime.

1.2 Guided by the Key Attributes, MAS had in April 2013 strengthened its resolution regime for financial institutions and expanded its powers under the Monetary Authority of Singapore Act (“MAS Act”) for the resolution of financial institutions. We extended our resolution powers to cover a wider range of financial institutions<sup>2</sup> and enhanced our resolution toolkit. For example, MAS has powers to assume control of a financial institution, effect a compulsory transfer of business or shares of a financial institution in resolution, effect a compulsory restructuring of share capital of a financial institution in resolution, and set up a bridge financial institution<sup>3</sup>.

1.3 In view of global developments, MAS has further reviewed our resolution regime and proposes to strengthen our resolution regime for financial institutions in Singapore. MAS’ policy proposals in the areas of recovery and resolution planning, temporary stays and suspensions, statutory bail-in powers, cross-border recognition of resolution actions,

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<sup>1</sup> The Key Attributes (at [http://www.financialstabilityboard.org/wp-content/uploads/r\\_141015.pdf](http://www.financialstabilityboard.org/wp-content/uploads/r_141015.pdf)) were supplemented in October 2014 with new Annexes containing sector-specific guidance on how the Key Attributes should be applied for insurers, financial market infrastructures and the protection of client assets in resolution, and implementation guidance on information sharing for resolution purposes.

<sup>2</sup> MAS’ resolution powers were extended beyond banks and insurers, to apply to other financial institutions, including finance companies, merchant banks, operators and settlement institutions of designated payment systems, approved exchanges, recognised market operators, approved clearing houses, recognised clearing houses, licensed trade repositories, licensed foreign trade repositories, capital market services licensees and financial holding companies.

<sup>3</sup> Other enhancements included powers to issue directions to a non-regulated entity in Singapore which belongs to a group of companies of which a financial institution regulated by MAS is a part of and where the entity is significant to the business of such a group; to apply to the Court to claw back the salary, remuneration or benefits given to a director or executive officer under certain circumstances; and to share information with a foreign resolution authority if the information is necessary in the resolution of a financial institution.

creditor safeguards and resolution funding are elaborated in the following sections of the consultation paper –

- Section 2: Recovery and resolution plans
- Section 3: Temporary stays on early termination rights on financial contracts
- Section 4: Temporary suspensions and stays on insurance contracts
- Section 5: Ensuring continuity of essential services and functions
- Section 6: Statutory bail-in regime
- Section 7: Cross-border recognition of resolution actions
- Section 8: Creditor safeguards
- Section 9: Resolution funding

1.4 The proposed policy changes will be effected primarily through amendments to the MAS Act, supported by necessary Regulations. MAS also intends to amend the Insurance Act for provisions relating to the resolution regime for insurers. MAS will consult on the legislative amendments, after considering the feedback on the policy proposals in this consultation.

## 2 RECOVERY AND RESOLUTION PLANS (“RRPs”)

2.1 Robust and credible RRP s serve to reduce the risks posed by a financial institution to the stability of the financial system, ensure the continuity of critical functions to the economy, and allow a distressed financial institution to restore its financial strength, be restructured, or to exit from the market in an orderly manner. The Key Attributes<sup>4</sup> also set out expectations for jurisdictions to put in place an ongoing process for recovery and resolution planning for financial institutions.

2.2 **MAS proposes legislative amendments to require financial institutions<sup>5</sup> that have been notified by MAS to formulate RRP s, adopt measures to address deficiencies in the RRP s and to remove impediments to the implementation of the RRP s. The policy intent is to apply such requirements to financial institutions that are systemically important or that maintain critical functions.** Specifically, the amendments will require the notified financial institutions to –

### *Recovery Plan*

- (a) prepare, maintain and submit a recovery plan setting out the procedures and establishing the systems necessary to restore the financial strength and viability of the financial institution in the event of financial pressure or stress;
- (b) make specific changes to the recovery plan to address material deficiencies in the recovery plan or material impediments to the implementation of the recovery plan;
- (c) implement recovery measures where necessary;

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<sup>4</sup> Key Attribute 11.1

<sup>5</sup> Banks, finance companies, merchant banks, financial holding companies, insurers, operators or settlement institutions of designated payment systems, approved exchanges, recognised market operators, licensed trade repositories, licensed foreign trade repositories, approved clearing houses, recognised clearing houses, approved holding companies, capital markets services licensees (excluding those in the business of providing credit rating services), trustees for collective investment schemes, and licensed trust companies, regulated by MAS under the relevant legislation.

*Resolution Plan*

- (d) furnish information or documents required for the purposes of resolution planning; and
- (e) take measures to improve resolvability by addressing or removing impediments to orderly resolution, including requiring changes to the financial institution's business practices, legal, operational or financial structures or organisation.

2.3 MAS will set out, in supporting Regulations or Notices, further technical details on the development and maintenance of RRP. These include the scope, coverage, essential components, frequency of update and submission requirements of a recovery plan, as well as requirements to facilitate resolution planning.

**Question 1:** MAS seeks views on the proposal for legislative amendments that will subject notified financial institutions that are systemically important or maintain critical functions, to the requirements in paragraphs 2.2(a) to (e).

2.4 The responsibility for the development and maintenance of a financial institution's recovery plan, as well as the submission of inputs to facilitate resolution planning, will rest on the board and executive officers of the financial institution. As the ongoing process of maintaining, updating and improving a financial institution's RRP is a fundamental pillar of the resolution framework, **MAS proposes that a failure to discharge such responsibilities by the board and executive officers of the financial institution would constitute an offence. This could arise where a contravention of the requirements relating to the RRP by the financial institution is committed with the consent or connivance of, or is attributable to any neglect on the part of the board and executive officers.** The proposed penalties will include fines for the financial institution and fines and/or imprisonment for the individual. This will be aligned with the penalties of other resolution provisions in the MAS Act. The European Union

Bank Recovery and Resolution Directive (“EU BRRD”) also imposes penalties and other administrative measures on both legal and natural persons for a failure to draw up, maintain and update recovery plans or provide requisite information for resolution plans.

**Question 2:** MAS seeks views on the proposal to impose the responsibility for ensuring compliance with RRP requirements on the financial institution’s board and executive officers, with contravention by the financial institution and/or any of its board members and executive officers constituting an offence with penalties.

### **3 TEMPORARY STAYS ON EARLY TERMINATION RIGHTS ON FINANCIAL CONTRACTS**

3.1 The ability of the resolution authority to carry out an orderly resolution of a financial institution could be significantly undermined if the exercise of the authority’s resolution powers was to trigger statutory or contractual set-off rights, or constitute an event that entitles any counterparty to exercise contractual acceleration or early termination rights (collectively known as “early termination rights”). Effective stays on early termination rights that arise only by reason of or in connection with a financial institution’s entry into resolution are therefore important to prevent the close out of financial contracts in significant volumes, upon the financial institution’s entry into resolution.

3.2 The Key Attributes<sup>6</sup> specify that entry into resolution and the exercise of resolution powers should not trigger early termination rights, provided that substantive obligations under the contract continue to be performed. Nevertheless, should early termination rights be exercisable under such circumstances, the resolution authority should have the power to temporarily stay such rights, subject to certain safeguards. Imposing a temporary stay on early termination rights would allow a resolution

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<sup>6</sup> Key Attributes 4.2 and 4.3

authority time to implement a resolution measure (e.g. via a transfer of the financial contracts to another financial institution or a bridge institution) and can assist the authority in carrying out an orderly resolution, while minimising disruption to the financial system.

3.3 Having the statutory power to impose a temporary stay on early termination rights for financial contracts complements a resolution authority's resolution toolkit. MAS notes its inclusion in the resolution regimes of the US, Canada, Japan, Switzerland, the UK, Germany, and France, with the other EU jurisdictions to follow suit in implementing the EU BRRD.

**3.4 MAS proposes to introduce statutory powers to temporarily stay early termination rights of counterparties to financial contracts entered into with a financial institution over which MAS may exercise its resolution powers<sup>7</sup>.** Key aspects of the proposal are outlined below.

#### Operation of Proposed Stay

3.5 In exercising its powers to stay early termination rights in relation to a distressed financial institution, MAS will consider the impact of exercising its power on the safety and orderly functioning of the financial markets, including capital market infrastructures<sup>8</sup> and designated payment systems ("DPS")<sup>9</sup> in Singapore. MAS' power to implement the stay would be discretionary (imposed on a case-by-case basis) and can be triggered on MAS' exercise of control or other resolution actions (e.g. a transfer of the financial contracts to another financial institution or a bridge institution) over a financial institution.

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<sup>7</sup> Banks, finance companies, merchant banks, financial holding companies, insurers, operators or settlement institutions of designated payment systems, approved exchanges, recognised market operators, licensed trade repositories, licensed foreign trade repositories, approved clearing houses, recognised clearing houses, approved holding companies, capital markets services licensees (excluding those in the business of providing credit rating services), trustees for collective investment schemes, and licensed trust companies, regulated by MAS under the relevant legislation.

<sup>8</sup> Capital market infrastructures refer to approved holding companies, approved exchanges, approved clearing houses and licensed trade repositories.

<sup>9</sup> Designated payment systems are payment systems considered to be of systemic or system-wide importance and which have been designated pursuant to the Payment Systems (Oversight) Act.

### Scope of Contracts Covered

3.6 MAS is considering the appropriate scope of financial contracts that should be covered by the regime. This is expected to include financial contracts that have early termination and acceleration clauses. The equivalent regime in the US covers securities contracts; commodity contracts; forward contracts; repurchase agreements and swap agreements. Canada's regime covers specified derivatives agreements; agreements to borrow or lend securities or commodities; agreements to clear or settle securities, futures, options or derivatives transactions; agreements to act as a depository for securities; repurchase agreements; specified margin loans; and specified master agreements.

### Duration of Stay

3.7 It is intended that the stay will operate from the publication of a notification in the *Gazette* or any such date specified in the notification. The duration of the stay for financial contracts is generally intended to be up to two business days (which excludes weekends, Singapore public holidays and bank holidays), or the earlier of the following dates –

- (a) the completion of a transfer of business, shares, or restructuring of the financial institution in resolution; or
- (b) the receipt of written notice from MAS to the party that the financial contract will not form part of the business that is to be transferred.

3.8 **MAS proposes to have the flexibility to specify a longer duration when imposing the stay**, and is considering the circumstances in which it may be necessary to extend the duration of the stay in order to achieve an effective resolution or to support the stability of the financial system.

### Safeguards

3.9 It is intended that the temporary stay of the exercise of early termination rights should be subject to the following safeguards –

- (a) The stay will only apply to early termination rights that arise by reason only of entry into resolution or in connection with the use of resolution powers (including, for example, a change in control of the relevant financial institution or its business arising from such proceedings). Other termination rights that arise independently of the entry into resolution will be preserved;
- (b) MAS will transfer all of the eligible contracts with a particular counterparty to a new financial institution and will not selectively transfer individual contracts with the same counterparty and which are subject to the same netting set (i.e. “no cherry-picking”);
- (c) For contracts that are transferred to a third party or bridge institution, the acquiring financial institution will assume all the rights and obligations of the financial institution from which the contracts were transferred;
- (d) The early termination rights of the counterparty will be preserved against the financial institution 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);
- (e) Following a transfer of financial contracts, the early termination rights of the counterparty will be preserved against the acquiring financial institution in the case of any subsequent independent default by the acquiring financial institution;
- (f) The counterparty will be able to exercise its right to close out immediately against the financial institution in resolution on expiry of the stay or earlier if MAS informs that the relevant contracts will not be transferred; and

- (g) After the duration of the stay, early termination rights may be exercisable for financial contracts that are not transferred to a financial institution, bridge institution or other public entity.

**Question 3:** MAS seeks views on the proposal to introduce statutory powers to stay early termination rights of counterparties to financial contracts, in particular –

- (a) the scope of financial contracts to be subject to the stay;
- (b) the proposed duration of the stay and the circumstances in which it may be necessary to extend the duration of the stay in order to achieve an effective resolution or to support the stability of the financial system;
- (c) the proposed safeguards to be introduced in connection with the stay as set out in paragraph 3.9 and whether any additional safeguards should be provided for; and
- (d) whether the exercise of statutory powers to stay early termination rights for financial contracts of a distressed financial institution traded, cleared, settled or reported on a capital market infrastructure or DPS, as the case may be, will compromise the safe and orderly operations of the relevant capital market infrastructure or DPS and if so, how this may be mitigated.

## **4 TEMPORARY SUSPENSIONS AND STAYS ON INSURANCE CONTRACTS**

4.1 It is important to secure the continuity of insurance coverage for policy owners as far as reasonably practicable in the resolution of an insurer. An example of how this can be achieved would be to transfer insurance policies from an insurer undergoing resolution to another insurer. To be able to implement such resolution actions effectively, the FSB's guidance on resolution of insurers<sup>10</sup> sets out expectations for resolution authorities to be able to temporarily suspend the rights of policy owners to withdraw from their insurance contracts with an insurer, and to stay rights of reinsurers of an insurer or of another reinsurer in resolution.

4.2 For direct insurance contracts, imposing a temporary suspension of policy owners' surrender rights on these contracts will ensure that policy owners would not rush to terminate their contracts, which could worsen the financial condition of the insurer in resolution. A large number of policy owners terminating their policies could also cause other policy owners to lose confidence in the insurance industry. In addition, early termination of life insurance policies may cause a substantial loss to policy owners due to surrender penalties. Further, some policy owners may no longer be able to secure similar alternative cover if they are in poor health or advanced in age when their insurer fails.

4.3 For reinsurance contracts, in particular for outward reinsurance, the FSB's guidance states that the resolution authority should be able to stay rights of reinsurers to terminate or not reinstate coverage relating to periods after the commencement of resolution for the ceding insurer/reinsurer in resolution. As outward reinsurance is a risk management tool that allows insurers/reinsurers to reduce their risk exposure, should reinsurers choose to terminate or not reinstate coverage due to resolution, the ceding insurers/reinsurers could be exposed to increased risk, placing greater strain on their financial resources.

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<sup>10</sup> Annex 2 of Appendix II to the Key Attributes

**4.4 MAS proposes to introduce statutory powers to –**

- (a) suspend policy owners' rights to withdraw from their insurance contracts with an insurer in resolution; and**
- (b) stay the rights of reinsurers to terminate or not reinstate coverage relating to periods after the commencement of resolution.**

4.5 Key aspects of the proposed statutory powers in paragraph 4.4 are as follows –

- (a) MAS will have the discretion to exercise the powers which may only be triggered upon the exercise of resolution actions (e.g. a transfer of policies to another insurer);
- (b) The exercise of the powers will not be for longer than a specified duration; and
- (c) The exercise of the powers will be subject to safeguards similar to those proposed for financial contracts in paragraph 3.9. However, as direct insurance contracts do not contain early termination clauses that can be triggered by resolution actions, the need to preserve the other termination rights<sup>11</sup> that arise independently of the entry into resolution are not applicable for direct insurance contracts.

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<sup>11</sup> One of the safeguards is to preserve the early termination rights of the counterparty against the financial institution 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 reinsurance contracts, there could be termination clauses whereby either party (reinsurer or insured) could terminate the contract if obligations of the contract are not met or when either party has merged with, been acquired by, or relinquished control of itself to any other company, corporation, or individual(s). Such termination rights should be preserved under the safeguards.

**Question 4:** MAS seeks views on –

- (a) the proposal to introduce statutory powers for MAS to temporarily suspend policy owners' rights to withdraw from their insurance contracts with an insurer in resolution and to stay rights of reinsurers to terminate or not reinstate coverage relating to periods after the commencement of resolution;
- (b) the duration of the suspension for policy owners and stays for reinsurers;
- (c) the factors to take into account in determining the duration of such temporary suspensions and stays; and
- (d) the proposal to apply safeguards similar to those proposed for financial contracts in paragraph 3.9, with the exception that the safeguard to preserve other termination rights that arise independently of the entry into resolution would not be applicable for direct insurance contracts.

## **5 ENSURING CONTINUITY OF ESSENTIAL SERVICES AND FUNCTIONS**

5.1 Non-financial contracts between financial institutions and their service providers<sup>12</sup> could have termination clauses that allow either party to terminate the agreement when the other party becomes insolvent, ceases business, or enters into liquidation. Depending on the scope of the contractual clause, such rights could be triggered by a financial institution's entry into resolution. Such rights, if exercised, could result in a disruption of essential services required by the financial institution to perform critical functions, and lead to the disruption of functions vital for the functioning of the real economy or for financial stability.

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<sup>12</sup> Examples of such contracts include those with service providers for IT infrastructure support or operational and transaction processing.

**5.2 MAS proposes to introduce powers to suspend the termination rights of non-financial contracts, or to require these contracts to continue to be performed on the same terms and conditions that were in place prior to the resolution.** The Key Attributes<sup>13</sup> expect resolution authorities to have powers to ensure continuity of essential services and functions. This can be achieved by requiring service providers to continue to provide essential services to the entity in resolution, any successor or an acquiring entity.

**Question 5:** MAS seeks feedback on the proposal to introduce powers to ensure continuity of essential services and functions by suspending the termination rights of non-financial contracts, or requiring these contracts to be performed on the same terms and conditions that were in place prior to the resolution. Views are invited, in particular, on –

- (a) the scope of non-financial contracts to be subject to such powers; and
- (b) the potential implications on existing and future non-financial contracts.

## 6 STATUTORY BAIL-IN REGIME

6.1 Statutory bail-in powers enable resolution authorities to write down or convert into equity or other instruments of ownership, all or part of unsecured and uninsured creditor claims. This helps to recapitalise the financial institution or a bridge institution to achieve continuity of critical functions, reduce the use of public funds and maintain public confidence in the financial system. The Key Attributes<sup>14</sup> specify that resolution authorities should have powers to carry out bail-in within resolution as a means to help achieve continuity of critical functions.

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<sup>13</sup> Key Attribute 3.2(iv).

<sup>14</sup> Key Attributes 3.2(ix) and 3.5.

### Statutory bail-in regime for banking sector

6.2 **MAS proposes to introduce statutory powers to carry out the bail-in of liabilities<sup>15</sup> under the MAS Act.** The proposal would complement MAS' resolution toolkit for dealing with distressed financial institutions. A number of jurisdictions, for example the US, the UK and Germany, have instituted statutory bail-in powers within their resolution framework. Other EU jurisdictions are expected to institute statutory bail-in powers as required under the EU BRRD.

6.3 As the implementation of the Key Attributes in the non-bank financial sectors is less advanced than in the banking sector<sup>16</sup>, **MAS proposes to first apply the statutory bail-in powers to Singapore-incorporated banks and bank holding companies<sup>17</sup> (collectively referred to as “banks” in this section).** MAS will continue to monitor international developments before considering a bail-in regime for the non-bank financial sectors that may be systemically important or critical in Singapore's context.

**Question 6:** MAS seeks views on the proposal to introduce statutory bail-in powers under the MAS Act and for the bail-in powers to be first applied to Singapore-incorporated banks and bank holding companies.

### Liabilities within the scope of bail-in

6.4 In designing the scope of the proposed bail-in regime, MAS has considered the risk of contagion from the bailing in of banks' liabilities and the possible impact on banks' funding costs.

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<sup>15</sup> For the avoidance of doubt, the proposed powers will also cover any equity instrument that is not in the form of share capital. For share capital, MAS currently has powers under the MAS Act to reduce the share capital of a financial institution incorporated in Singapore, over which MAS may exercise resolution powers under Part IVB of the MAS Act, by cancelling the whole or any part of any share capital not paid up or any paid-up share capital.

<sup>16</sup> FSB, “Towards full implementation of the FSB Key Attributes of Effective Resolution Regimes for Financial Institutions”, 12 Nov 2014. (<http://www.financialstabilityboard.org/wp-content/uploads/Resolution-Progress-Report-to-G20.pdf>)

<sup>17</sup> The proposed statutory bail-in powers would apply to all bank holding companies and bank entities within the consolidated group of a Singapore-incorporated bank holding company or a Singapore-incorporated bank.

6.5 A contagion impact to the financial system and the broader economy could arise from the bail-in of a bank, as losses are imposed on creditors of the bailed-in bank. To mitigate this, certain liabilities (e.g. interbank liabilities and liabilities owed to payment systems) should be excluded from the scope of bail-in because their repayment is necessary to ensure the continuity of essential services and to avoid widespread and disruptive contagion to other parts of the financial system.

6.6 The bail-in of a bank's liabilities may also increase the affected bank's cost of funding, as the possibility of claims being written off or converted to equity increases the risk borne by debtholders. MAS takes the view that it is not equitable to existing debtholders of a bank, if the proposed statutory bail-in regime can be applied retrospectively to debt issued before the effective implementation date of the bail-in regime.

6.7 MAS has also considered that the Singapore-incorporated banks are well-capitalised and are already subject to capital standards that are stricter than Basel standards<sup>18</sup>. They are also subject to rigorous stress testing requirements, close supervisory oversight and processes to allow for timely intervention by MAS in a range of stress situations. These factors strengthen the resilience of Singapore-incorporated banks under stress conditions and argue for a less encompassing bail-in regime.

**6.8 Given the above considerations, MAS proposes that the statutory bail-in regime be applied to unsecured subordinated debt and unsecured subordinated loans<sup>19</sup>, issued or contracted after the effective date of the relevant legislative amendments implementing the statutory bail-in regime.** The proposed scope of bail-in would hence exclude liabilities such as secured liabilities, short-term liabilities owed to financial institutions and payment systems<sup>20</sup>, amounts owed to vendors for goods and services that are critical to the affected bank's operations, senior debt and all deposits.

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<sup>18</sup> Singapore-incorporated banks are required to maintain minimum capital requirements that are 2% points higher than those imposed by the Basel Committee on Banking Supervision.

<sup>19</sup> Issued out of the bank holding companies or bank entities within the group of the Singapore-incorporated bank or bank holding company.

<sup>20</sup> Including the operators, settlement institutions and participants of the systems.

**Question 7:** MAS seeks views on the proposal to apply the statutory bail-in regime to unsecured subordinated debt and unsecured subordinated loans, issued or contracted after the effective date of the relevant legislative amendments implementing the bail-in regime.

Complementing the statutory bail-in regime with contractual bail-in provisions

6.9 The effectiveness of statutory bail-in powers proposed in paragraph 6.2 may be uncertain where the liabilities subject to statutory bail-in are governed by the law of a foreign jurisdiction. This is because the write-down or conversion of the liability may not be recognised and enforced by the relevant courts.

6.10 The FSB similarly recognises that contractual recognition clauses can help support the cross-border enforceability of resolution actions, where an entity has issued debt governed by the law of a foreign jurisdiction<sup>21</sup>. Provisions on contractual bail-in also feature in other jurisdictions' resolution regimes. For instance, the EU BRRD requires that contractual provisions be included for liabilities within the scope of bail-in which are governed by the laws of third countries, in order to ensure the ability to write down or convert these liabilities to equity.

**6.11 To complement the statutory bail-in regime, MAS proposes that for liabilities within the scope of MAS' statutory bail-in powers which are governed by the law of a foreign jurisdiction, banks would have to comply with the following requirements –**

- (a) include a contractual term, which states that the liability may be subject to write-down or conversion by MAS under Singapore's statutory bail-in regime;

<sup>21</sup> FSB, "Consultative document for cross-border recognition of resolution actions", 29 Sep 2014. ([http://www.financialstabilityboard.org/wp-content/uploads/c\\_140929.pdf](http://www.financialstabilityboard.org/wp-content/uploads/c_140929.pdf))

- (b) draft the recognition provisions to ensure that the contractual provisions referred to in (a) do not conflict with how the statutory bail-in regime may be applied in practice;
- (c) seek independent legal advice from the jurisdiction of the governing law to ensure that the drafting of the contractual provision fully takes into account any relevant legal issues under that law so that MAS' exercise of bail-in powers would be enforceable; and
- (d) demonstrate to MAS that any statutory bail-in by MAS will be enforceable, including providing a reasoned independent legal opinion.

**6.12 In addition, for liabilities within the scope of MAS' statutory bail-in powers, it is proposed that banks prominently disclose the consequences of a bail-in of the relevant debt to the debtholders.**

**Question 8:** MAS seeks views on the proposal to complement the proposed statutory bail-in regime with contractual bail-in provisions for liabilities within the scope of MAS' statutory bail-in powers which are governed by the law of a foreign jurisdiction. MAS also seeks views on requiring banks to comply with the conditions set out in paragraph 6.11.

**Question 9:** MAS seeks views on the proposal for banks to prominently disclose the consequences of a bail-in to debtholders for liabilities within the scope of MAS' statutory bail-in powers.

Powers to convert into equity or write down contingent convertible instruments and contractual bail-in instruments

6.13 There could be instances where the bank is placed into resolution prior to the triggering of the conditions for conversion into equity or write-down of contingent convertible instruments or contractual bail-in instruments. Converting to equity or writing down of such instruments

would strengthen the bank's capital position. In addition, such instruments would cease to accrue interest upon conversion or write-down and therefore alleviate liquidity pressures on the bank to some extent.

6.14 The Key Attributes<sup>22</sup> provide that resolution authorities should have powers, upon entry in resolution, to convert or write down any contingent convertible or contractual bail-in instruments whose terms had not been triggered prior to entry into resolution. This is also provided for in the EU BRRD.

**6.15 MAS proposes that statutory powers be introduced for MAS to either convert into equity or write down contingent convertible instruments and contractual bail-in instruments, whose terms had not been triggered prior to entry into resolution.** Consistent with the proposal in paragraph 6.8, the powers would only be applied to contingent convertible instruments and contractual bail-in instruments issued after the effective date of the relevant legislative amendments implementing the statutory bail-in regime.

**Question 10:** MAS seeks views on the proposal for statutory powers to be introduced for MAS to either convert into equity or write down those instruments that are contingently convertible or which can be contractually bailed in, but whose terms and conditions for conversion or bail-in had not been triggered prior to entry into resolution.

## 7 CROSS-BORDER RECOGNITION OF RESOLUTION ACTIONS

7.1 The FSB Report to the G20 on Progress and Next Steps Towards Ending "Too-Big-To-Fail"<sup>23</sup> identified legal uncertainties about the cross-border effectiveness of resolution measures as one of the main obstacles to the orderly resolution of systemically important financial institutions that

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<sup>22</sup> Key Attribute 3.5(iii)

<sup>23</sup> FSB, "Progress and Next Steps Towards Ending "Too-Big-To-Fail"", 2 Sep 2013 ([http://www.financialstabilityboard.org/publications/r\\_130902.pdf](http://www.financialstabilityboard.org/publications/r_130902.pdf))

operate across borders. It was recognised that a coordinated and cooperative approach to the resolution of cross-border financial institutions would have the potential to facilitate orderly resolution and better protect financial stability across home and host jurisdictions.

7.2 The Key Attributes provide that regimes should encourage and support coordinated and cooperative approaches to resolution, at the same time recognising the importance of “reserving the right of discretionary national action if necessary to achieve domestic stability in the absence of effective international cooperation and information sharing”<sup>24</sup>. The statutory mandate of a resolution authority should empower and strongly encourage the authority wherever possible to act to achieve a cooperative solution with foreign resolution authorities<sup>25</sup>. Jurisdictions should provide for transparent and expedited processes to give effect to foreign resolution measures<sup>26</sup>.

7.3 FSB has acknowledged the need to develop guidance “on how legal certainty in cross-border resolution can be further enhanced”. FSB’s consultative document on Cross-Border Recognition of Resolution Actions (“Consultative Document”)<sup>27</sup> sets out three distinct scenarios which highlight the importance of cross-border recognition in giving effect to foreign resolution measures –

- (a) a foreign bank undergoing resolution in its home jurisdiction operates a foreign branch. Home resolution measures need to have effect throughout the whole legal entity, including the branches in host jurisdictions. In this scenario, the protection of the domestic creditors and local financial stability will generally be primary considerations for the host authorities;
- (b) a foreign financial institution undergoing resolution in its home jurisdiction controls a subsidiary in another jurisdiction. In order

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<sup>24</sup> Key Attribute 7.2

<sup>25</sup> Key Attribute 7.1

<sup>26</sup> Key Attribute 7.5.

<sup>27</sup> FSB, “Consultative document for cross-border recognition of resolution actions”, 29 Sep 2014

for home resolution measures to be effective, host jurisdictions may, in particular, need to provide a process to allow the transfer of shares in the subsidiary to another institution or to require local subsidiaries to continue to provide essential services to the parent company or other group entities. Particular concerns of host authorities may relate to local financial stability given the potential spill-over between entities of the same group, and prudential matters (for example, ‘fit and proper’ test for the acquirer of the subsidiary); and

- (c) assets, liabilities or contracts of a foreign firm in resolution are located or booked in, or subject to the law of, another jurisdiction in which the firm is not established. In order for home resolution measures to be effective, the relevant jurisdiction would need to allow the implementation of the resolution measures adopted by a foreign authority.

7.4 The process for giving effect to foreign resolution measures in a manner consistent with the Key Attributes<sup>28</sup> may take the form of (1) a recognition procedure or (2) the taking of measures under the domestic legal framework that support and are consistent with the resolution measures taken by the foreign home resolution authority.

7.5 The FSB intends to finalise further guidance on core elements of statutory recognition frameworks by end-2015. The results of the FSB’s work in this area will be taken into account in further refining MAS’ eventual approach.

#### Recognition of Foreign Resolution Actions

7.6 Given the cross-border nature of the financial institutions operating in Singapore, MAS agrees that our resolution framework should enable a cooperative solution to be reached with foreign resolution authorities. MAS has robust resolution powers which are in line with the Key Attributes, and is currently able to take supportive measures to implement and support

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<sup>28</sup> Key Attribute 7.5

resolution measures taken by a foreign home authority in a group-wide resolution. For example, MAS has powers to transfer the business or shares of a financial institution or to restructure or require issuance of shares, in support of a foreign resolution action. These powers extend to local branches of foreign financial institutions.

7.7 MAS notes FSB's ongoing work in this area and the progress of other FSB jurisdictions in developing cross-border frameworks for coordination and cooperation in the resolution of cross-border financial institutions. It is noted that jurisdictions have adopted a combination of recognition and supportive measures in developing their frameworks. The regimes in Switzerland and the UK provide for the resolution authority to give effect to resolution actions taken by foreign resolution authorities<sup>29</sup> through a statutory recognition process.

7.8 MAS is evaluating the necessity of a recognition process in view of existing powers to take supportive measures to achieve a cooperative solution with foreign resolution authorities in a group-wide resolution of cross-border financial institutions. It is essential that the recognition or support of any foreign resolution action in a group-wide resolution should not prejudice domestic financial stability. MAS' decision to give effect to a foreign resolution action is thus intended to be contingent on the following considerations –

- (a) the foreign resolution action should not have an widespread adverse effect on the financial system in Singapore or the economy of Singapore, or both;
- (b) the foreign resolution action should not in any way discriminate against creditors resident in Singapore compared to creditors in other countries or territories with similar legal rights; and
- (c) the implementation of the foreign resolution action should not be against public interest.

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<sup>29</sup> In the UK's case, this refers to resolution authorities of non-EU member states.

7.9 MAS may decline to give effect to a foreign resolution action if doing so would prejudice any of the above considerations.

**Question 11:** MAS seeks views on –

- (a) the possibility of achieving a cooperative solution with foreign resolution authorities by giving effect to foreign resolution actions through a recognition process, subject to the considerations set out in paragraphs 7.8(a) to (c); and
- (b) the scenarios where a foreign resolution action may not be in the interest of a local branch or subsidiary of a foreign financial institution, which MAS would need to take into consideration when deciding if it should recognise or support the foreign resolution action.

## 8 CREDITOR SAFEGUARDS

8.1 Creditors<sup>30</sup> would have greater certainty and clarity on their relative positions within the creditor hierarchy in a resolution if resolution authorities, as a principle, exercise their resolution powers in a way which respects the hierarchy of claims under liquidation and treats creditors of the same class equally. As a resolution tends to be less value destructive than liquidation, creditors as a whole should be made better off in resolution under most circumstances. However, there may be instances where in order to preserve financial stability or maximise the financial institution's value for the benefit of creditors as a whole, the resolution strategy may render certain creditors worse off as compared to liquidation<sup>31</sup>.

<sup>30</sup> The term "creditors" in this section includes shareholders. There is a possibility that resolution actions could be initiated before all equity has absorbed losses fully.

<sup>31</sup> For example, in exercising powers to direct a compulsory transfer of business of a financial institution, the resolution authority may transfer partially certain liabilities, which are ranked *pari passu* with other liabilities, to a bridge institution. In such an event, the creditors of the liabilities transferred to the bridge institution could receive a higher value, as compared to the creditors of the liabilities which remained in the failed financial institution, even though the liabilities are ranked *pari passu*.

8.2 As a guiding principle, in exercising any of MAS' resolution powers, MAS intends to respect the statutory creditor hierarchy of claims in liquidation, along with the principle of equal treatment of creditors of the same class. MAS would only depart from such principles where it is deemed appropriate, for instance, to ensure financial stability<sup>32</sup>.

#### Creditor compensation framework

8.3 As highlighted in paragraph 8.1, certain creditors could be worse off under resolution compared to liquidation. The Key Attributes<sup>33</sup> provide that creditors should have a right to compensation where they do not receive at a minimum what they would have received in a liquidation of the financial institution.

8.4 Compensating creditors who are worse off under resolution as compared to liquidation would reduce the uncertainty faced by creditors of a financial institution, in the event of its failure. This would help maintain creditors' willingness to provide credit to financial institutions, stabilise the cost of funding of financial institutions and reduce incentives for herd behavior by creditors during stress events that may accelerate the financial institution's failure. The right of creditors affected by a resolution to compensation is also provided for in the resolution regimes of the US and the UK, and in the EU BRRD.

**8.5 MAS proposes to establish a framework to compensate creditors who are worse off in resolution as compared to liquidation.** The framework would apply to creditors of banks, merchant banks, finance companies, insurers, capital market infrastructures, DPS operators and their settlement institutions, and financial holding companies regulated by MAS. The key features of the creditor compensation framework would include –

- (a) Appointment of an independent valuation agent – a qualified independent valuation agent would be engaged to assess if any

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<sup>32</sup> Other reasons include maximising the value of the financial institution for the benefit of all creditors or where it is necessary for the effective resolution of the financial institution.

<sup>33</sup> Key Attribute 5.2

creditor of the financial institution, which has been put into resolution, is worse off under resolution than under liquidation.

- (b) Valuation of compensation – the qualified independent valuation agent would need to compute the amount that would have been received by each creditor had a liquidation been carried out, and compare this against the amount received by each creditor in the actual resolution. MAS may develop a set of high-level principles for fair and consistent valuation.
- (c) Right of appeal – Creditors should be provided with the right to appeal against their determined compensation eligibility or entitlement.

**Question 12:** MAS seeks views on the proposal to establish a creditor compensation framework applicable to creditors of banks, merchant banks, finance companies, insurers, capital market infrastructures, DPS operators and settlement institutions, and financial holding companies regulated by MAS.

**Question 13:** MAS seeks views on the features of the proposed creditor compensation framework –

- (a) the proposal to engage a qualified independent valuation agent to determine any creditor compensation payable and the criteria (if any) for the appointment of such a valuation agent;
- (b) the valuation principles that such a valuation agent should adopt;
- (c) the appeal process on the compensation amount determined by the valuation agent; and
- (d) other features that MAS should consider including in its creditor compensation framework.

## 9 RESOLUTION FUNDING

9.1 For the successful and orderly resolution of a financial institution that is systemically important or that maintains critical functions, it is important to establish resolution funding arrangements to ensure timely access to funds. The Key Attributes<sup>34</sup> set out the principles on the funding of financial institutions in resolution. Broadly, the Key Attributes expect resolution authorities not to be constrained to rely on public ownership or bail-out funds as a means of resolving a financial institution<sup>35</sup>.

9.2 The following paragraphs set out MAS' proposed general approach to resolution funding, with respect to –

- (a) the uses of resolution funding arrangements;
- (b) the proposed resolution funding arrangements for the overall financial sector; and
- (c) sector-specific arrangements.

### Uses of resolution funding arrangements

9.3 The purpose of resolution funding arrangements is to ensure timely access to funds to implement resolution measures. **MAS proposes that such arrangements may be used to support any costs incurred in implementing resolution measures**<sup>36</sup>. For instance, in order to achieve the objectives of resolution, MAS may, depending on the resolution measure taken, grant loans to a bridge institution or asset management company, or another financial institution acquiring the assets or shares of a financial institution

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<sup>34</sup> Key Attribute 6.

<sup>35</sup> In addition, temporary sources of public funding should only be provided where necessary to foster financial stability, and where all private sources of funding have been exhausted. If such temporary funding is provided, authorities are to impose losses on shareholders and unsecured creditors, subject to the “no creditor worse off than in liquidation” safeguard. If necessary, the losses should then be recovered from the financial industry.

<sup>36</sup> This would be inclusive of administrative and interests costs.

that is being resolved (“acquiring financial institution”). MAS may also enter into loss-sharing agreements<sup>37</sup> with an acquiring financial institution.

**9.4 In addition, MAS proposes that resolution funding arrangements may be used to address any creditor compensation claims<sup>38</sup> that may arise.** This is because such claims, if they do arise, are consequential to the implementation of resolution measures.

**Question 14:** MAS seeks views on the proposal for resolution funding arrangements to be used for – (i) costs incurred in the implementation of resolution measures; and (ii) any creditor compensation claims that may arise.

Proposed resolution funding arrangements for the overall financial sector

9.5 Any costs incurred in resolving a financial institution should first be borne by that financial institution. Losses should also be imposed on its equity holders and unsecured creditors. For example, a certain percentage of the financial institution’s liabilities could be bailed in before resolution funding arrangements are tapped upon.

**9.6 Where the above is insufficient, MAS proposes to recover the costs incurred in resolving a financial institution from the industry<sup>39</sup>.** Where applicable, the financial institutions bearing the costs would include the “restored” financial institution (in the event the resolution measure restores the viability of the financial institution that is being resolved), and the acquiring financial institution. The orderly resolution of a financial institution that is systemically important or maintains critical functions would preserve

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<sup>37</sup> Under a typical loss-sharing agreement, the resolution authority commits to bear a specified percentage of future losses experienced by the acquiring financial institution, on a specified pool of assets of the financial institution that was resolved, within a specified period of time.

<sup>38</sup> Please refer to **Section 8** for details on the proposed creditor compensation framework.

<sup>39</sup> MAS’ view is that the entities who should share in the costs of resolving a financial institution are those that would have been adversely impacted by the failure of that financial institution, and who would therefore benefit from an orderly resolution of that financial institution. This is discussed further under sector-specific arrangements in paragraphs 9.11 to 9.23.

financial stability and maintain market confidence, which would benefit the industry as a whole. This approach would also be consistent with the Key Attributes<sup>40</sup>.

9.7 Recoveries from the industry can be achieved through a privately-financed ex ante resolution fund or a funding mechanism for ex post recovery from the financial industry or both. An ex ante resolution fund would be built up over time through ex ante premiums collected from financial institutions, similar to the Deposit Insurance (“DI”) Fund and Policy Owners’ Protection Scheme (“PPF”) Funds. In contrast, an ex post recovery mechanism would entail MAS providing liquidity on a temporary basis; any costs incurred would be recovered from the industry after the resolution event. Either way, these recoveries will be by way of risk-based levies on contributing financial institutions. MAS will consult on the framework for the levies at a later stage.

9.8 MAS’ view is that full ex ante funding would generally not be practical. As the costs of resolving a financial institution that is systemically-important or maintains critical functions could be large, building up an ex ante fund of a credible size would entail significant costs and inefficiencies for the industry.

**9.9 MAS proposes to establish an ex post recovery mechanism, which would be more appropriate for the funding of resolution measures. Nevertheless, where privately-financed ex ante funds (e.g. DI or PPF Funds) exist, these may be tapped on to implement resolution measures.**

9.10 In determining the resolution measure to be taken, MAS’ primary objective will be to preserve financial stability and maintain the continuity of critical financial services and functions. MAS will also take into consideration the possible costs to the industry.

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<sup>40</sup> Key Attribute 6

**Question 15:** MAS seeks views on the proposal not to establish full ex ante funding to implement resolution measures, but to establish an ex post recovery mechanism and tap on prevailing ex ante funds.

**Question 16:** MAS seeks suggestions on the appropriate level of losses to be imposed on equity holders and unsecured creditors of the financial institution to be resolved, before resolution funding arrangements are tapped upon.

### Sector-specific arrangements

9.11 The following paragraphs detail the proposed resolution funding arrangements for banking entities, insurers, capital market infrastructures, DPS operators and settlement institutions, based on the above approach of establishing an ex post recovery mechanism and tapping on prevailing ex ante funds.

9.12 There will be differences between the sectoral arrangements, as the resolution funding arrangements for the specific sectors depend on – (i) whether there are existing ex ante funds that can be tapped on; and (ii) the class(es) of financial institutions or persons that would benefit from an orderly resolution of that financial institution.

#### *Banking entities*<sup>41</sup>

##### *Ex ante component*

9.13 Currently, the DI Fund can only be used to compensate non-bank depositors of full banks and finance companies that are insured under the DI Scheme, in the event the full bank or finance company fails<sup>42</sup>. **MAS proposes expanding the use of the DI Fund to include the implementation of resolution measures, for existing DI Scheme Members**<sup>43</sup>. This is not

<sup>41</sup> Banking entities cover banks, merchant banks and finance companies.

<sup>42</sup> For more information on the DI Scheme, please refer to the website of the Singapore Deposit Insurance Corporation at [www.sdic.org.sg](http://www.sdic.org.sg).

<sup>43</sup> In designing the risk-based levies under the resolution funding framework, MAS will study how to avoid imposing additional costs on DI Scheme Members, by taking into account the DI premium made. MAS will consult on the framework for the levies at a later stage.

inconsistent with the objective of the DI Fund, which is to limit the impact of a bank failure on small depositors. In addition, the use of the DI Fund would be a more efficient use of a ready and standing pool of funds, and would be aligned with the updated Core Principles for Effective Deposit Insurance Systems by the International Association of Deposit Insurers (“IADI”)<sup>44</sup>.

9.14 Nevertheless, any use of the DI Fund to implement resolution measures should be circumscribed to ensure that funding remains adequate to support future depositor payouts. **Specifically, MAS proposes the following safeguards –**

- (a) DI Scheme Members only – The use of the DI Fund in implementing resolution measures should be limited to the resolution of DI Scheme Members. This means that the DI Fund would not be used to support the resolution of a non-DI Scheme Member<sup>45</sup>; and
- (b) Equivalent cost criterion – The amount drawn on the DI Fund should be capped at the amount that would have been paid out in a depositor payout situation for that particular DI Scheme Member in resolution (i.e. if the DI Scheme Member had failed)<sup>46</sup>.

9.15 The DI Fund will, however, not be used to satisfy any creditor compensation claims that may arise. While creditor compensation claims are consequential to resolution measures taken, their impact on depositor protection is less evident.

*Ex post recovery mechanism*

9.16 **MAS proposes that ex post levies be applied on the rest of the banking sector, i.e. all other banks, merchant banks and finance companies, other than the banking entity in resolution.** This is on the basis

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<sup>44</sup> IADI, “IADI Core Principles for Effective Deposit Insurance Systems”, Nov 2014 (<http://www.iadi.org/docs/cprevised2014nov.pdf>)

<sup>45</sup> For avoidance of doubt, MAS is not proposing an expansion of the DI Scheme membership.

<sup>46</sup> This would be the estimated cost of depositor payout, net of asset recoveries. This is also consistent with the IADI’s Core Principles for Effective Deposit Insurance Systems.

that the disorderly failure of any banking entity may undermine market confidence and therefore adversely impact all other banking entities.

**Question 17:** MAS seeks views on the proposal to expand the use of the DI Fund to include the funding of the resolution of DI Scheme Members, but excluding any creditor compensation claims that may arise, subject to the equivalent cost criterion.

**Question 18:** MAS seeks views on the proposal to apply ex post levies on all other banking entities.

### Insurers<sup>47</sup>

9.17 **MAS proposes to include all insurers in the scope of resolution funding arrangements, except for captive insurers and Lloyd's**, given that captive insurers insure their own risks. The risks underwritten by Lloyd's service companies in Singapore are borne by the members of Lloyd's syndicates in London.

#### *Ex ante component*

9.18 Unlike the DI Fund, the PPF Funds can already be used to implement resolution measures. Specifically, the PPF Funds can be used to provide funding for the transfer for the whole or part of the business (with PPF protected liabilities) of a failed PPF Scheme Member to another insurer<sup>48</sup>.

9.19 Similar to the proposed approach for the DI Fund, MAS does not intend for the PPF Funds to be used to satisfy any creditor compensation claims that may arise. This means that there will be no change to the current scope and use of the PPF Funds.

#### *Ex post recovery mechanism*

9.20 **MAS proposes that ex post levies be applied by classes of insurers, i.e. direct life insurers, direct general insurers and reinsurers.** For example,

<sup>47</sup> This section covers insurers, including reinsurers.

<sup>48</sup> This is to ensure continuity of insurance coverage, so as to minimise financial hardship to an individual.

if temporary funding is provided by MAS to resolve a direct life insurer, MAS will recover any costs incurred from direct life insurers only. The proposed approach of recovery by classes is because it is less evident that the orderly resolution of a direct life insurer, for example, would benefit the general insurance sector.

**Question 19:** MAS seeks views on the proposal to include all insurers in the scope of resolution funding arrangements, except for captive insurers and Lloyd's.

**Question 20:** MAS seeks views on the proposal to apply ex post levies by classes of insurers, i.e. direct life insurers, direct general insurers and reinsurers. For example, if temporary funding is provided by MAS to resolve a direct life insurer, MAS will recover any costs incurred from direct life insurers only.

### Capital Market Infrastructures and DPS Operators

#### *Ex ante component*

9.21 Unlike the banking and insurance sectors, there is no existing ex ante fund available to implement resolution measures for capital market infrastructures or DPS operators. **As such, MAS proposes an ex post recovery mechanism in resolving capital market infrastructures or DPS operators.**

#### *Ex post recovery mechanism*

9.22 MAS seeks views on the appropriate scope of ex post recovery; specifically, on persons who would benefit from an orderly resolution of a capital market infrastructure or DPS operator, and who should therefore contribute to any costs that may be incurred in resolving that capital market infrastructure or DPS operator. For example –

- For capital market infrastructures, costs could be recovered through –

- (a) Levies on participants in the capital market, e.g. members of the resolved entity, other capital markets services licensees, other capital market infrastructures in the same line of business or performing the same functions, or other market infrastructures<sup>49</sup> generally; and/or
  - (b) Transaction Levies on users of any capital market infrastructure (e.g. as a percentage of trading or clearing fees).
- For DPS Operators, costs could be recovered from levies on participants of the DPSs under the resolved DPS operator. Costs may not need to be recovered from other DPS Operators and their participants, where the DPS operators operate in different markets.

**Question 21:** MAS seeks views on the scope of ex post recovery, i.e. the scope of entities from which costs should be recovered. In the case of a DPS operator, MAS seeks views on the recovery of funds from all direct and indirect participants of the resolved DPS operator.

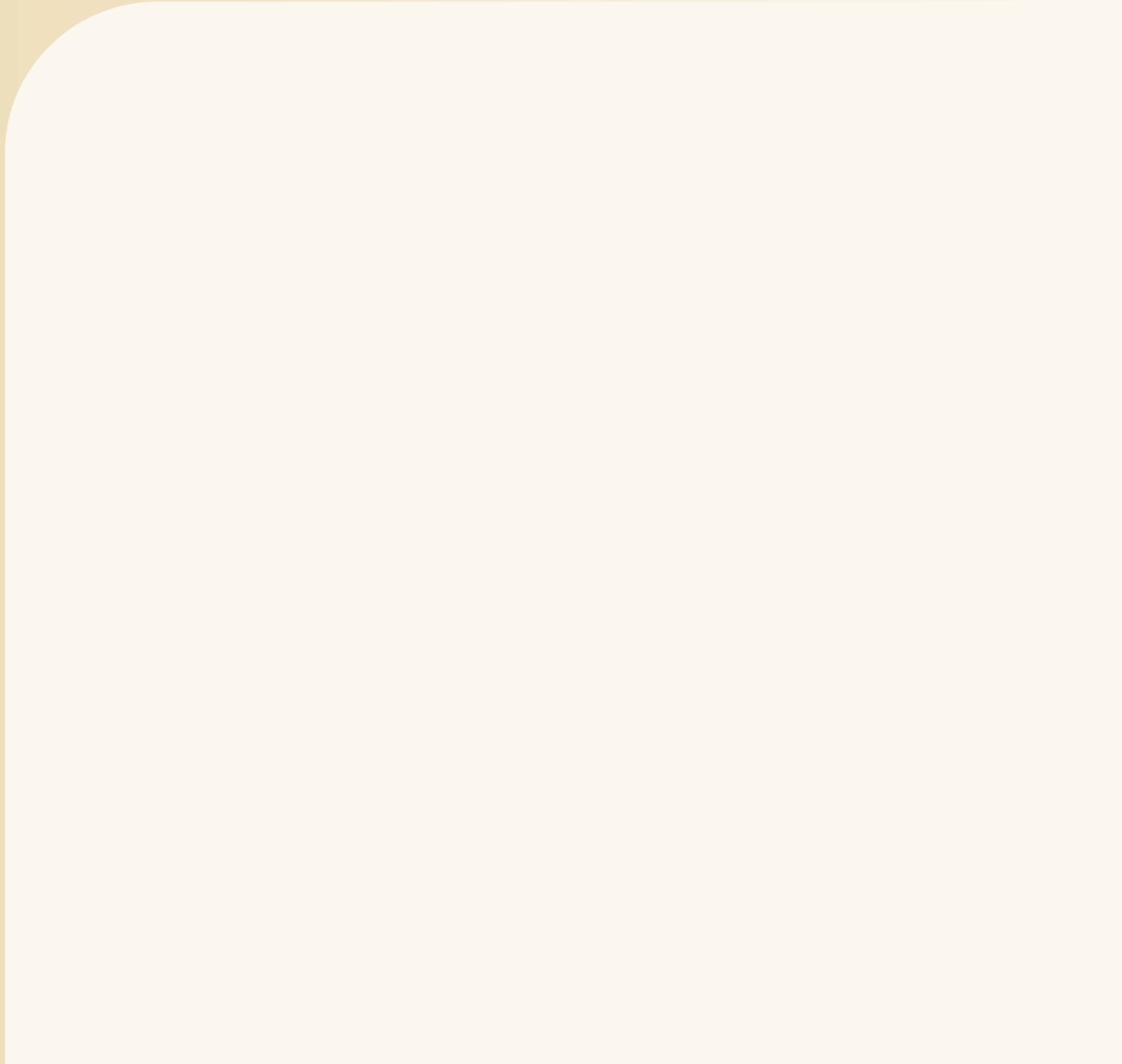
**Question 22:** MAS seeks views on the manner by which costs should be recovered, for example, whether this may be through levies on participants or transaction levies, and the apportionment of such levies.

#### DPS Settlement Institutions

9.23 DPS Settlement Institutions are banks, and their settlement function cannot be isolated from their banking functions. **Therefore, MAS proposes that these institutions be resolved as banks; this means that the resolution funding arrangements for the banking entities would apply to DPS Settlement Institutions.**

**Question 23:** MAS seeks views on the proposal to apply resolution funding arrangements for banking entities to DPS Settlement Institutions.

<sup>49</sup> Such as market operators, clearing houses and trade repositories.



Monetary Authority of Singapore