

8 November 2016

Swiss Financial Market Supervisory Authority FINMA
Attn: Kaspar Ulmann
Laupenstrasse 27
CH-3003 Bern

By Email: regulation@finma.ch

Re: Partially Revised FINMA Banking Insolvency Ordinance (BIO-FINMA)

Ladies and Gentlemen:

The International Swaps and Derivatives Association, Inc. (“**ISDA**”)¹ appreciates the opportunity to provide the Swiss Financial Market Supervisory Authority (“**FINMA**”) with comments and recommendations regarding the partially revised FINMA Banking Insolvency Ordinance (the “**Consultation**”) promulgated by FINMA regarding the requirement for banks and securities dealers (“**Covered Entities**”) to include in certain enumerated financial contracts (“**Covered Contracts**”) a recognition of a postponement of the termination of contracts in accordance with Article 30a of the Swiss Banking Act (the “**Banking Act**”). ISDA supports the objectives of the Consultation of ensuring the orderly resolution of large financial institutions and protecting the stability of the financial system. In addition, ISDA supports FINMA providing guidance in the Consultation on complying with the requirements under Article 12 para. 2^{bis} of the Banking Ordinance (the “**Stay Requirement**”). However, there are certain areas in which we believe further clarification or changes would make compliance more feasible and efficient for market participants without detracting from FINMA’s policy objectives.

I. FINMA should narrow the scope of entities and contracts subject to the Stay Requirement.

ISDA generally supports the Consultation narrowing and clarifying the scope of the Stay Requirement. However, there are certain areas in which ISDA proposes furthering narrowing

¹ Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 68 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on ISDA’s web site: www.isda.org.

the scope of the Stay Requirement in order to reduce the compliance burden of remediating contracts that do not raise the same resolvability concerns motivating the Stay Requirement.

As FINMA itself noted, the Stay Requirement “will only affect contracts whose continued existence is essential for a bank requiring restructuring” and therefore should only cover transaction types and agreements that raise the policy concerns that FINMA is attempting to address—generally, term transactions with termination rights against a Covered Entity.² We therefore request that FINMA exclude the following types of contracts from the definition of Covered Contract:

- Underwriting agreements, subscription agreements and similar contracts: Underwriting agreements typically do not contain default rights against the Covered Entity that would need to be conformed to the Stay Requirement and termination of such contracts is unlikely to be disruptive to the Covered Entity group.
- Contracts with natural persons: The scope of the Stay Requirement should be limited to Covered Contracts entered into with “entreprises” as defined under article 77 of the Swiss Financial Market Infrastructure Ordinance and not include contracts entered into with natural persons. Amending such contracts present compliance challenges that are disproportionate to the resolvability benefit achieved through amending such contracts. The vast majority of contracts with natural persons would not be material to the resolvability of a Covered Entity and therefore would not pose a risk in the event of a Covered Entity’s resolution. Further, natural persons are likely to be less knowledgeable on these issues and may require significant education.
- Interbank borrowings with a duration greater than three months: Under the EU Bank Recovery and Resolution Directive (“**BRRD**”), the definition of “financial contracts” only includes short-term interbank borrowings (those with a term of three months or less). While the stays under BRRD are not limited in application just to “financial contracts,” the requirements to date in BRRD jurisdictions to amend contracts to ensure the enforceability of stays has been limited generally to “financial contracts.” As FINMA intends that the list of contracts be “internationally harmonised and coordinated with the definition of financial contracts in accordance with [BRRD],”³ such longer-term interbank borrowings should be excluded from the scope of the Stay Requirement to facilitate harmonization and consistency across jurisdictions.

In addition, in order to provide clarity and certainty regarding which contracts must be conformed by Covered Entities, FINMA should remove clause 1(f), which expands the scope of Covered Contracts to “any other contracts having the same effects as” the other contract types enumerated in the Consultation.

² Press Release, FINMA, FINMA Opens Consultation on the Partial Revision of the FINMA Banking Insolvency Ordinance (27 September 2016), available at <https://www.finma.ch/en/news/2016/09/20160927-mm-biv-finma/> (the “Consultation Press Release”).

³ Consultation Press Release.

Finally, we understand that contracts without termination rights relevant to the stays under the Banking Act are not required to conform to the Stay Requirement. Therefore, contracts with no termination rights whatsoever would be excluded from the scope of the Stay Requirement, as would contracts with termination rights that are not tied to the resolution of the Covered Entity. We further understand that termination rights that are relevant to the stays under the Banking Act because they are “directly or indirectly” triggered by resolution would not include (i) the ability to terminate at will or (ii) a termination right triggered by a ratings downgrade. This scope limits the Stay Requirement to those contracts that are relevant to the policy goals of FINMA and avoids the remediation of contracts without the relevant contractual provisions, which would yield no resolvability benefit. In addition, this limitation mirrors the approach taken in the United Kingdom and Germany, providing for consistency across jurisdictions. Therefore, ISDA supports the exclusion of such contracts from the scope of Covered Contracts. However, if our understanding is incorrect, we would appreciate the opportunity to discuss this issue further with FINMA.

II. ISDA seeks clarification about certain ambiguous provisions of the Consultation

The Consultation requires contracts that “provide for the jurisdiction of foreign courts” to be conformed to the Stay Requirement. Our understanding is that this would only capture contracts that provide for the jurisdiction of non-Swiss courts by enumerating non-Swiss jurisdictions and not contracts that merely provide for the non-exclusive jurisdiction of Swiss courts. If our understanding is incorrect, we would appreciate the opportunity to discuss this further with FINMA.

Additionally, the Consultation excludes contracts “entered into or cleared, directly or indirectly, through a financial market infrastructure.” We interpret this language to apply to the customer leg of cleared contracts (whether under an agency or principal-to-principal clearing model). In the context of principal-to-principal clearing, it is important to establish parity between a central counterparty’s ability to exercise default rights against a clearing member and a customer’s ability to exercise default rights against the clearing member under the related back-to-back transaction. If a central counterparty is able to exercise default rights due to the exclusion for cleared contracts and the customer cannot exercise similar default rights in the customer-facing leg of the transaction, a clearing member could be left with an unbalanced book (which could undermine both the orderliness of the resolution and the viability of the clearing member), and the customer could be left with a contract that was intended to be cleared but is not. We believe that the current language is sufficiently broad to exempt both legs of a cleared transaction from complying with the Stay Requirement. However, we ask that FINMA confirm and clarify this understanding in the final revisions to the Banking Ordinance.

Finally, it is our understanding that Covered Entities would only need to comply with the Stay Requirement for contracts that are entered into after the compliance date for the Stay Requirement. Contracts that exist at the time of the compliance date would only need to be conformed to the Stay Requirement if they are amended. For these existing contracts, the Consultation distinguishes between amendments that occur “automatically on the basis of pre-existing contract terms,” which would not trigger the Stay Requirement and amendments that require “further actions of the parties,” which would. We ask that FINMA provide clarification about the types of amendments that they consider to occur “automatically,” and therefore that

would not require compliance with the Stay Requirement. In addition, we ask that FINMA provide clarification regarding all other amendments to existing contracts, including whether non-material amendments would trigger the obligation to comply with the Stay Requirement.

III. FINMA should extend the compliance deadlines and allow for case-by-case “hardship” exceptions.

Under the Consultation, Covered Entities would have three months to conform Covered Agreements with banks or securities dealers and six months to conform Covered Agreements with all other counterparties. Compliance with the Consultation will require Covered Entities to amend a significant number of contracts with a significant number of counterparties. Importantly, counterparties to Covered Agreements will vary in the degree of sophistication and knowledge about the Stay Requirement and the issues that FINMA seeks to address. We therefore expect that compliance will require a substantial effort by the industry to educate the market about the substance of the Stay Requirement and the steps necessary to comply—e.g. adhering to a Swiss Jurisdictional Module to the ISDA Resolution Stay Jurisdictional Modular Protocol (“**ISDA JMP**”). In addition, the development of a Swiss Jurisdictional Module to facilitate compliance with the Stay Requirement can only begin after the revisions to the Banking Insolvency Ordinance are finalized and would take at least 3-6 months to complete.

With that in mind, we believe that a longer timeline for compliance would be appropriate in order to facilitate market education and the development of a Jurisdictional Module to the ISDA JMP. ISDA has requested similar extended compliance periods in the context of regulations implemented in the United States, the United Kingdom and Japan. Given the lead-time required to launch a Jurisdictional Module, ISDA suggests that FINMA adopt the following schedule for phasing in compliance:

- Phase 1: One year from the effective date for compliance with respect to Covered Agreements with banks or securities dealers.
- Phase 2: Eighteen months from the effective date for compliance with respect to Covered Agreements with all other counterparties.

Further, we request that FINMA ensure it retains the discretion to grant exemptions from the Stay Requirement for particular counterparties or particular Covered Contracts. Such discretion could be used to accommodate specific scenarios where conforming a contract to the Stay Requirement would be impossible, impracticable or would lead to procedural or other difficulties that would be disproportionate to the resolution benefit of conforming such contract.

IV. Approach to a Possible Swiss Jurisdictional Module

Under Section 1 of the ISDA 2015 Universal Resolution Stay Protocol (the “**ISDA 2015 Protocol**”), parties agree that the stays under a special resolution regime applicable to a counterparty (or related entity of a counterparty) will be effective with respect to contracts subject to the ISDA 2015 Protocol, regardless of the law governing such contracts. This “opt-in” approach is also the approach that is taken under the UK (PRA Rule) Jurisdictional Module and

the German Module to the ISDA JMP, and that would be used to develop a Swiss Jurisdictional Module.

Our understanding is that the stays under the Banking Act apply to the exercise of default rights under contracts to which an entity in resolution is a party. However, we understand that it is unclear whether such stays would, as a matter of Swiss law or regulation, also apply to the exercise of default rights in contracts of subsidiaries or other affiliates of the entity in resolution that may arise because of such entity's resolution ("**Cross Defaults**") if such subsidiaries or affiliates are not otherwise subject to FINMA's resolution powers. Accordingly, a Swiss Jurisdictional Module to the ISDA JMP developed under the "opt-in" approach would clarify that the postponement of termination under Article 30a of the Banking Act would be effective with respect to Covered Contracts with an entity subject to resolution proceedings under the Banking Act, regardless of the governing law. However, to the extent the Banking Act stays do not, as a matter of Swiss law or regulation, apply to Cross Defaults, these rights would be outside of the scope of such a Swiss Jurisdictional Module.

V. Compliance via the ISDA 2105 Protocol

ISDA requests that FINMA clarify that any Covered Contract subject to the terms of the ISDA 2015 Protocol satisfies the Stay Requirements. The ISDA 2015 Protocol was developed in consultation with and in response to guidance from regulators, including FINMA, and was designed to address the concerns about cross-border resolutions that also motivate the Consultation. Clarification from FINMA regarding the ISDA 2015 Protocol as a means of compliance with the Stay Requirement would allow Covered Entities to address these issues in a standardized and transparent fashion, supporting market stability in the event of an institution's resolution, and avoid duplicative efforts to conform Covered Contracts already subject to the terms of the ISDA 2015 Protocol.

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ISDA appreciates the opportunity to provide these comments. We hope that FINMA finds our comments useful in its continuing deliberations on the implementation of contractual stays in financial contracts. Please do not hesitate to contact Samantha Riley (sriley@isda.org) or the undersigned if we can provide further information about the derivatives market or other information that would assist FINMA in its work in relation to the Consultation.

Yours sincerely,



Katherine T. Darras, General Counsel

cc: Thomas Bauer, President, FINMA

Mark Branson, Director, FINMA