

4 November 2016

BY E-MAIL and HAND

Shri Parveen Kumar
Under Secretary (FSLRC)
Department of Economic Affairs
Ministry of Finance
Room No. 48, North Block
New Delhi – 110001
India

E-mail: parveenk63@gov.in

FURTHER COMMENTS
(to be read together with
PRELIMINARY SUBMISSION
dated 14 October 2016)

Dear Sirs

Consultation on the draft Financial Resolution and Deposit Insurance Bill, 2016 and the Report of the Committee to Draft Code on Resolution of Financial Firms

Introduction

The International Swaps and Derivatives Association, Inc. (ISDA)¹ is grateful for the opportunity to provide these further comments (**Further Comments**) to the Consultation on the draft Financial Resolution and Deposit Insurance Bill, 2016 (**Bill**) and the Report of Committee to Draft Code on Resolution of Financial Firms (**Report**) released on 21 September 2016 (collectively, the **Consultation**).

We had provided our preliminary comments to the Ministry of Finance (**MoF**) in a submission made on 14 October 2016 (**Preliminary Submission**). For your easy reference, we have attached the Preliminary Submission in **Annex 5**. We appreciate your kind offer, as set out in your e-mail dated 5 October 2016, to provide preliminary comments by 14 October 2016 and further comments at a later date. We also note that the date for further comments to be provided to the MoF was extended to 31 October 2016, as set out in your e-mail dated 19 October 2016, which was further extended to 4 October 2016 based on the meeting we attended with the MoF in New Delhi on 28 October 2016 (**28 October Meeting**). As set out in the Preliminary Submission, we respectfully urge and request that the MoF considers the comments provided

¹ Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 850 member institutions from 67 countries. These members comprise of 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 the Association's web site: www.isda.org.

in the Preliminary Submission in addition to these Further Comments (collectively, the **Submissions**). You will note that we have provided more specific and granular comments to specific chapters, sections, and schedules of the Bill here in these Further Comments.

Where suggested amendments have been provided to the proposed wording in the Bill, we would also add that we would be happy to discuss with you further on how the provisions may be further refined and improved for consistency with the FSB Key Attributes.

As noted in the Preliminary Submission, we hope that the comments provided in our Submissions will assist the MoF in defining the policy goals and the preparation of the final legislation, as well as any implementation details of the proposed resolution regime in India. ISDA hopes to continue the constructive ongoing dialogue between the MoF and derivatives market participants to consider, for example, the practical concerns and risks surrounding the implementation of the policy proposals and draft legislation set out in the Consultation. ISDA and its members would also like to offer any assistance the MoF requires in better understanding global resolution regimes.

Further Comments

We have provided our further comments in the sections below and made the necessary cross-references to the Bill, as necessary.

Section of Bill	Comments
<p>Section 2</p>	<p>Our members have considered the definition of a “covered service provider”. We note that the Bill does not appear to distinguish between the <u>scope of functions and powers</u> under Chapter 3 of the Bill and the <u>scope of firms</u> which are subject to recovery and resolution planning.</p> <p>With respect to scope of firms subject to a resolution regime, FSB Key Attribute 1.1 provides that it should extend to:</p> <ul style="list-style-type: none"> a) holding companies of a firm; b) non-regulated operational entities within a financial group or conglomerate that are significant to the business of the group or conglomerate; and c) branches of foreign firms <p>With respect to scope of firms subject to recovery and resolution planning, FSB Key Attribute 11 provides that jurisdictions should put in place an ongoing process for recovery and resolution planning covering, at a minimum, domestically incorporated firms that could be significant or critical if they fail.</p> <p>We also note that Schedule 2 provides for the meaning of “non regulated operational entities within a financial group or conglomerate of a covered service provider” to be as notified. Based on FSB Key Attribute 11, we would urge the MoF to clarify that such non-regulated entity or holding company of a covered service provider (as set out or enumerated in the Bill) which, for</p>

Section of Bill	Comments
	<p>example, do not have a business or consumer/client facing activity and their closure would not impact the stability or resilience of the financial system of the country would be excluded from the requirement to put in place a recovery and resolution plan.</p>
<p>Section 39</p>	<p>We refer to our comments on the approach to recovery and resolution planning and note that in line with FSB Key Attribute 11.4, financial institutions (FIs) should not be required to submit or prepare a resolution plan. The resolution authority should be responsible for preparing institution-specific resolution plans. Instead, FIs should only be required to provide a resolution information pack with the necessary information that the resolution authority will use to prepare their resolution plans.</p> <p>We would also like to reiterate that local branches of foreign groups with group-level recovery and resolution planning arrangements should not be required to provide separate country-level plans.</p> <p>We would also like to suggest that the frequency of submission for such a resolution information pack should not be less than every two years.</p> <p>With regard to the sharing of information, we also note that a covered service provider with its home regulator in another jurisdiction may be bound by confidentiality obligations owed to its home regulator, i.e. information with respect to such entity's recovery and resolution planning activities that constitutes confidential supervisory information for the home regulator. Should the Indian authorities require such information from the home regulator, we would respectfully urge the Indian authorities to coordinate with the home regulator to obtain the relevant information.</p> <p>In the event that the Indian authorities require such information to be provided by the covered service provider, we would urge the Indian authorities to work closely with the home regulator to provide guidance on what information may be provided by the covered service provider in line with its confidentiality obligations.</p>
<p>Section 45</p>	<p>Our members have also asked and would like to emphasize that in relation to CCP recovery and resolution, that this be part of a separate consultation. This was noted in the Preliminary Submission.</p> <p>Based on the discussion we had with the MoF during the 28 October meeting, we understand that Section 45 is intended to be</p>

Section of Bill	Comments
	<p>read in conjunction with Section 114 (3). Notwithstanding this, we would like to highlight that the issues surrounding CCP recovery and resolution are complex and deserve to be considered separately, taking into account international discussions and developments on this front.</p> <p>Therefore, we would suggest that the issues surrounding CCP recovery and resolution be considered and addressed under separate legislation.</p> <p>In this Bill, the MoF may consider providing for an overarching, high-level enabling power with respect to CCP resolution and provide for greater detail and clarity in subsequent separate consultations, and separate legislation and regulations. This is consistent with the approach taken by Hong Kong and Singapore in their resolution proposals.</p> <p>This also takes into account, as we highlighted earlier, that much of the discussions on CCP resilience, recovery, and resolution are still developing and evolving. We urge the MoF to be part of these key discussions.</p>
Section 55	<p>As noted in the Preliminary Submission, the proposed Section 55 as set out in the Bill provides the safeguards for applying resolution tools. For the reasons stated above, we strongly urge that an <u>additional principle</u> is included here in Section 55 to ensure the protection of netting, set-off, collateral arrangements and security interests. These measures would be in line with the safeguards recommended by the FSB, as well as safeguards instituted and considered by certain other jurisdictions. In this regard, our members request that amendments should be made to the language of the proposed Section 55.</p> <p>The proposed amendments to Section 55 have been included in Annex 1. For your easy reference, these amendments have been marked up against the original text of the Bill. These are intended to clarify and support that netting and collateral safeguards be included as an underlying principle in the application of resolution tools. We had noted in the Preliminary Submission that the inclusion of safeguards to protect netting and collateral arrangements are crucial, taking into account, the non-cleared margin requirements, The safeguards should be expanded to protect netting and collateral arrangements in order to, for instance, facilitate the posting initial margin. We noted that the Reserve Bank of India (RBI) had released its proposals on margin requirements.</p>

Section of Bill	Comments
	<p>We also note the point made in the Preliminary Submission seeking clarification on proposed Section 55(2) (b).</p>
<p>Section 86</p>	<p>We refer to the comments made in the Preliminary Submission on proposed Section 86. We note that for reasons set out in the Preliminary Submission, MoF and the Central Government should provide transparency and clarity as to how these agreements with the government of any country outside India would work, and how the information sharing element on a reciprocal basis would work as well.</p> <p>We had also highlighted that the MoF considers putting into place the statutory basis for formal cross-border recognition of resolution actions in order to provide more certainty. In this regard, our members therefore request that amendments should be made to the language of the proposed Section 86.</p> <p>The proposed amendments to Section 86 have been included in Annex 2. For your easy reference, these amendments have been marked up against the original text of the Bill.</p> <p>It is also important to note that other jurisdictions, including the European Union (EU), Hong Kong, Singapore and Switzerland have provided statutory frameworks respectively, for the recognition of resolution by a foreign resolution authority.</p> <p>These frameworks are based on Key Attribute 7.3., which allows, among others, the resolution authority to use its powers either to support a resolution carried out by a foreign home authority or to take measures on its own initiative where the home jurisdiction is not taking action</p> <p>The Hong Kong framework provides that a resolution authority must not make a recognition instrument if the resolution authority is of the opinion that recognition would have an adverse effect on financial stability in Hong Kong and would not deliver outcomes that are consistent with the resolution objectives. Further, Hong Kong authorities would not make a recognition instrument where such recognition would disadvantage Hong Kong creditors or Hong Kong shareholders (or both) relative to other creditors or shareholders of the entity, The authorities may also consider any fiscal implications on Hong Kong.</p> <p>The Singapore framework in turn, provides that the Monetary Authority of Singapore (MAS) may recognize resolution by a foreign resolution authority if, among others, the recognition of the resolution would not have a widespread adverse effect on the financial system in Singapore or the economy of Singapore and</p>

Section of Bill	Comments
	<p>that such recognition would not result in inequitable treatment of any Singapore creditor relative to a foreign creditor.</p> <p>We would also highlight that in Hong Kong, a resolution authority may only make a recognition instrument after having first consulted the Financial Secretary. The Singapore proposals also provide that the MAS may submit the determination to the Minister for his approval. The Minister may approve the determination without modification, provide certain modifications, or refuse to approve such determination. We submit that the MoF may wish to consider including such a provision in the Bill where the Corporation submits a determination to the Central Government for approval. We would be happy to discuss this with the MoF.</p> <p>The EU Bank Recovery and Resolution Directive (BRRD) provides in Articles 94 and 95 for the recognition and enforcement of third country resolution proceedings. Article 94 for instance applies in respect of third country resolution proceedings unless and until an international agreement (which is referred in Article 93) is entered into and in force with a relevant third country. Article 94 also considers the establishment and working of a European resolution college.</p> <p>It is also useful to consider that Article 95 of the BRRD provides certain grounds for a European resolution college to refuse to recognise or enforce a third country resolution proceedings. Grounds for such refusal include, among others, where a third country resolution proceedings would have adverse effects on financial stability in a Member State.</p> <p>Under the Swiss Banking Act, the Swiss Financial Market Supervisory Authority (FINMA) has the discretion to recognize bankruptcy injunctions or insolvency measures pronounced abroad against banks and against banks in the country where their headquarters are domiciled. This is set against the treatment of claims of creditors domiciled in Switzerland and that these are adequately taken into account.</p> <p>As noted above, we have provided proposed amendments to Section 86 for your consideration.</p>
Section 87	<p>We had noted in the Preliminary Submission that the proposed Section 87 provides for, among others, the rights of local creditors to get priority and appears to include creditors of a covered service provider, including for example, financial market infrastructures and any payment system as defined under the Payment and Settlement Systems Act, 2007. We would reiterate our concern that the definition of "covered service provider" be re-assessed in</p>

Section of Bill	Comments
	<p>order to avoid a broad brush approach which may not be suitable in all circumstances. We would also like to reiterate the points made in the Preliminary Submission in relation to cross-border issues and particularly, the importance of (a) no ring-fencing of local assets of a foreign FI in the event of its local branch being made subject to resolution in the host jurisdiction; and (b) no discrimination against foreign creditors in the host jurisdiction.</p> <p>In the Preliminary Submission, we had considered certain other related points on FSB Key Attribute 7 and the no creditor worse off than in liquidation (NCWOL) principle. We would be grateful if the MoF would also consider these points.</p> <p>Our members understand that the underlying intention behind proposed Section 87 is to use the local assets to pay for local liabilities. It does not appear to be the intention, nor should it be the case, that unsecured creditors are treated on par with secured creditors or for that matter, creditors be discriminated on basis of nationality or location.</p> <p>The proposed Section 87(b) however appears to propose providing a first charge, which may in effect, create a new class of creditors. This would be in addition to the domestic secured creditor. This may also lead to the situation where an unsecured local creditor would by virtue of this proposed Section 87(b) be more secured than a secured creditor. Other implications surrounding the concept of the first charge proposed here include issues relating to the mechanics of how this would work (for example, whether registration of the charge is required) and how it would impact existing encumbrances.</p> <p>In this regard, our members therefore request that amendments should be made to the language of the proposed Section 87.</p> <p>The proposed amendments to Section 87 have been included in Annex 3 for your consideration. For your easy reference, these amendments have been marked up against the original text of the Bill. These proposed amendments are intended to be in line with the FSB Key Attributes.</p>
<p>Section 88 - 103 (Chapter 17)</p>	<p>Our members have also asked that the following points in relation to the offences and penalties regime be considered. In considering the scope of offences and penalties, the MoF should consider the proportionality or harshness of such penalties as well as the potential effect on the policy objectives which the MoF seeks to address and protect. In the event that such penalties lead to, for example, the resignation of key staff during a crisis, the same may create undue pressures on the relevant institution and the industry at large.</p>

Section of Bill	Comments
	<p>Our members have put forth a list of factors in this regard for the MoF to consider:</p> <ul style="list-style-type: none"> (a) in terms of reversing the burden of proof approach, it should be noted that jurisdictions, such as the United Kingdom, which had initially proposed to adopt this approach have not adopted this; (b) it is suggested that the MoF does not enact offences that do not exist in other jurisdictions, for example, offences related to recovery or resolution (or as noted in the Consultation, restoration) plans; (c) it is also suggested that the MoF should not impose potentially long custodial penalties for matters that in practice may be minor, for example, not updating restoration plans; (d) consistent with the approach in other jurisdictions, MoF should also consider limiting such penalties to the directors, senior managers and senior risk takers and not extend such offences and penalties to cover all staff; and (e) also consistent with the approach in other jurisdictions, MoF should not enact offences and penalties for offences that do not require a causal link between the action or omission of an individual and the failure of the financial institution in question.
<p>Schedule 14</p>	<p>We would like to reiterate the points made in the Preliminary Submission on the proposed Schedule 14 which sets out, among others, the proposed amendments to the Reserve Bank of India Act, 1934 (RBI Act) in relation to the netting of mutual transactions in insolvency, winding up or liquidation. We would like to emphasize the importance of considering that amendments be made to all relevant legislation and corresponding provisions of the Bill for the purpose of safeguarding netting and collateral arrangements with respect to all covered service providers.</p> <p>We further add that we strongly welcome the proposed amendments to the RBI Act in Schedule 14 as this would address concerns regarding the inconsistency of enforceability of netting in India. However, the Bill needs to ensure that netting rights agreed between two contracting parties are given finality without any intervention by or discretion of any public authorities, so that the net obligation is determined as per the provisions of the relevant netting agreement only.</p>

Section of Bill	Comments
	<p>We are concerned that the definitions of “netting” and “specified transaction” still give scope for intervention by the Reserve Bank of India, which introduces an element of uncertainty which would dilute the clear legal enforceability of contractual netting rights.</p> <p>The proposed amendments to Schedule 14 have been included in Annex 4. For your easy reference, these amendments have been marked up against the original text of the Bill.</p>

ISDA thanks the MoF for the opportunity to respond to the Consultation and welcomes dialogue with the MoF on any of the points raised. Please do not hesitate to contact Keith Noyes, Regional Director, Asia Pacific at (knoyes@isda.org at +852 2200 5909), Erryan Abdul Samad, Assistant General Counsel at (eabdulsamad@isda.org at +65 6653 4172) or Rahul Advani, Assistant Director, Public Policy at (radvani@isda.org at +65 6653 4171).

Yours sincerely,

For the International Swaps and Derivatives Association, Inc.



Keith Noyes
Regional Director,
Asia-Pacific



Erryan Abdul Samad
Assistant General Counsel



Rahul Advani
Assistant Director,
Public Policy

Annex 1

Proposed Amendments to Sections 55

Safeguards for applying resolution tools

55. (1) ~~For the purpose of~~When exercising its powers under this ~~chapter~~Act, the Corporation shall have regard to the following principles:

- ~~(a)~~ (a) ensuring the continuity of critical functions of the relevant covered service provider;
- ~~(b)~~ (b) ensuring that no ~~creditor~~class of creditors of the relevant covered service provider ~~is~~are left in a worse position as a result of application of any method of resolving such covered service provider under section 48, than such ~~creditor~~class of creditors would have been in the event of ~~its~~the liquidation ~~in accordance with chapter 14;~~of such covered service provider;
- ~~(c)~~ (e)—protecting client funds, and client assets of a covered service provider to no less an extent than they would be protected on liquidation in accordance with chapter 14.

Explanation: In this section, “client asset” and “client funds” shall have such meaning as may be specified.

~~(2)~~ Notwithstanding anything contained in sub-section (1), for the purpose of bail-in in accordance with section 52, the Corporation may have regard to the following additional principles:

- (a) cancellation of the liabilities of any covered service provider to its creditors shall be done in accordance with section 79 of this Act; ~~and~~
- (b) only those liabilities may be cancelled, the instrument creating which contain a provision to the effect that the parties to the contract agree that the liability is eligible to be the subject of a bail-in; ~~and~~
- (c) the tool of bail-in should be resorted to only after attempts of recovery of the covered service provider has, in the opinion of the Corporation, been attempted and not been successful.

(3) In connection with exercise of any of its powers under this Act and/or in relation to application of any of the resolution methods as set out under the provisions of Section 48 to Section 54, the Corporation shall, in addition to having regard to the principles set out in this Section, ensure that:

- (a) there is appropriate protection under the Protected arrangements, of the rights and liabilities of the parties to such Protected arrangements; and
- (b) adoption and usage of any of the resolution tools or methods under this Chapter will not adversely affect the rights and liabilities that are protected under such Protected arrangements.

Explanation: For the purpose of this sub-section,

“Arrangement” shall mean any arrangement between the covered service provider under resolution and any other party(ies), existing on account of an agreement or contract or trust or other means, or arising automatically on account of operation of law.

“Netting arrangement” shall mean an arrangement between the covered service provider under resolution and any other party or parties to the arrangement, under which a net balance of the values can be

determined by way of set-off or in any other manner, of any payment or delivery obligations or entitlements between the parties;

“Protected arrangement” shall mean the Security arrangement, the Set-off arrangement and/or the Netting arrangement;

“Security arrangement” shall mean an arrangement under which the covered service provider under resolution and/or any other party or parties to the arrangement, acquires, by way of security, an actual or contingent interest in the assets or property of another;

“Set-off arrangement” shall mean any arrangement under which all the claims, liabilities and obligations between the covered service provider under resolution and any other party or parties to the arrangement can be set off against each other.

Annex 2

Proposed Amendments to Section 86

Power to enter into memorandum of understanding and recognition of resolution effected by foreign resolution authority

86. (1) The Central Government may enter into an agreement with the government of any country outside India for enforcing the provisions of this Act.

- (2) Without prejudice to sub-section (1), the Corporation may, with the prior approval of the Central Government, enter into one or more memorandum of understanding with such international organisations or other authorities outside India, which have functions similar to those of the Corporation, for sharing information on reciprocal basis to the extent permissible under the law.
- (3) Subject to the provisions of this Act or any other law for the time being in force, the information received by the Corporation from the authorities referred to in sub-section (1), shall be treated as confidential.
- (4) The Corporation shall require the authority outside India to undertake to maintain confidentiality of the information furnished by it under the memorandum of understanding and not to disclose that information to any person or authority:

Provided that in case the laws of the country of the authority outside India do not provide immunity from disclosure of the information furnished by the Corporation and such authority is directed by a court of law, tribunal or other authority to disclose such information, the said authority shall inform the Corporation forthwith of such direction.

- (5) Subject to ~~the provisions of this Act, the Corporation shall assist on a reciprocal basis the authority outside India with whom it has entered into a memorandum of understanding under sub-section (1), in the resolution of a branch or office, situated in India and which is~~subsection (6), where the Corporation has been notified of a resolution by a resolution authority (of any nature) of a foreign country or territory concerning a covered service provider, of a person situated in the country of such authority. The Corporation shall in the first instance make a determination to recognise the resolution;
- (6) ~~Notwithstanding anything contained in this Act or any law for the time being in force if, in the course of resolution or liquidation proceedings, as the case may be, under this Act, the Corporation is of the opinion that assets of the covered service provider, are situated in a country outside India with which reciprocal arrangements have been made under this section, the Corporation may make an application to the National Company Law Tribunal that evidence or action relating to such assets is required in connection with such process or proceeding. The Corporation may recognise only part of the resolution, refuse to recognize the resolution if the Corporation is of the opinion that –~~
(a) recognition would have a widespread adverse effect on financial stability in India;
- (7) ~~The National Company Law Tribunal on receipt of an application under sub-section (6) and, on being satisfied that evidence or action relating to assets under sub-section (6) is required in connection with resolution or liquidation proceedings, may issue a letter of request to a court or an authority of such country competent to deal with such request.~~

(b) recognition would not deliver the outcomes that are consistent with the solution objectives set out in Section 55;

(c) recognition would substantially disadvantage creditors of the Indian branch office of the body corporate or relative to other creditors of the entity in relation to which the foreign resolution relates to; or

(d) recognition would have material adverse fiscal implications for India.

(7) For the purposes of recognising the resolution or part thereof, the Corporation may exercise one or more of its powers under this Act, in support of the resolution.

(8) A determination in accordance with subsection (5) or (6) above shall not preclude the exercise of any power by the Corporation under this Act or any relevant Act applicable to the branch of the foreign covered service provider.

(9) Recognition of the resolution shall not preclude the right of the Corporation, at any stage, to make a de novo assessment of the recognition granted, and / or to add to, vary or revoke any part of such recognition, where the Corporation is of the reasoned opinion that such recognition, if continued, would have an impact of the nature as set out in subsection (6) above.

(10) Upon approval of the determination by the Corporation, the resolution by a resolution authority of a foreign country or territory concerning the foreign financial institution, or part thereof, will have substantially the same legal effect as if the resolution was taken by the Corporation under this Act.

(11) Such determination as referred to under subsection (10) above, will be required to be—

(a) served on the branch of the covered service provider, as the case may be, and any other person as the Corporation may consider necessary, and;

(b) published in the Gazette and in such newspaper or newspapers as the Central Government may determine.

Explanation: For the purpose of this section, “**creditor of the Indian branch office of the body corporate**” means a person whose rights as a creditor of an Indian branch office of the entity in relation to which a foreign resolution has been taken are, or may be, affected by the making of a recognition order.

Annex 3

Proposed Amendments to Section 87

Rights of local creditors to get priority.

Independent action in relation to India branches of foreign entities.

87. (1) Notwithstanding anything contained in this Act or in any law for the time being in force, in the event of entry into resolution, including liquidation of a body corporate incorporated outside India, whose Indian branch office is a covered service provider,

~~(a) — (a) and one of the circumstances referred to under Section 86(6) above applies,~~ such branch office shall be classified to be at “critical risk to viability” under section 46 and resolved as per the provisions of this Part; ₂

~~(b) the creditors of the covered service provider in India shall have first charge on the assets of the covered service provider for the purpose of resolution and liquidation under this Act, unless the agreement entered into between the Central Government and the country of the body corporate on reciprocal basis under section 86, provides otherwise.~~

(2) — Where the Corporation takes an action under this Part, to resolve the Indian branch office of a body corporate incorporated outside India, which is a covered service provider, it shall have regard to the principles set out in Section 55.

Explanation: For the purpose of this section, the meaning of the term “entry into resolution” shall be as specified by the Corporation, in consultation with the Appropriate Regulator.

Annex 4

Proposed Amendments to Schedule 14

Netting of mutual transactions in insolvency, winding up or liquidation

Schedule 14: Amendment to Reserve Bank of India Act, 1934 (2 of 1934)

See section 144

1. In section 45MC,

(i) in sub-section (1), for the words “the Companies Act, 1956 (1 of 1956)”, the words “the Financial Resolution and Deposit Insurance Act, 2016 (of 2016) or the Insolvency and Bankruptcy Code, 2016 (of 2016), as the case may be” shall be substituted.

(ii) in sub-section (4), for the words “the Companies Act, 1956 (1 of 1956) relating to winding up of a company”, the words ‘the Financial Resolution and Deposit Insurance Act, 2016 (of 2016) or the Insolvency and Bankruptcy Code, 2016 (of 2016), as the case may be, relating to winding up’ shall be substituted.

2. After section 45X, the following section shall be inserted, namely: -

“ 45XA (1) Notwithstanding anything to the contrary contained in any other law for the time being in force or any rule, regulation, scheme, direction or order that may be issued under any law or any order of a court, tribunal or other authority, where one of the parties to the specified transaction is a party referred to in section 45V, netting shall be applicable in the event of insolvency, winding up or liquidation of a party to such transaction, including a bank or a financial institution.

Explanation: For the purposes of this sub-section, -

(i) (i)—“netting” means determination of any payment or other obligation arising out of any exposure, including an exposure from specified ~~transaction~~transactions between the parties, whether or not due or payable, by set off or adjustment between the parties and whereby a net obligation is arrived at ~~in the manner specified by the Bank~~;

(ii) (ii)—“specified transaction” means any transaction permitted by the Bank including any transaction in securities, money market instruments, foreign exchange, derivatives or such other instruments or transactions, ~~as may be specified by the Bank from time to time.~~

(2) For the purpose of netting under sub-section (1), the following shall be taken into account –

(a) (a)—the value of cash or security or collateral provided by either party or a guarantor or other person and the proceeds of sale of securities available with either of the parties to the transaction; and

(b) (b)—the current value of payment or other obligations due at a future date arrived at by prematurely terminating the transactions.

(3) The amount payable or other claims that may be made, determined under sub-section (1) and sub-section (2), shall be final and irrevocable and shall be binding on the liquidator, receiver or trustee, by whatever name called, of the party in insolvency, winding up or liquidation.

(4) Notwithstanding anything to the contrary contained in any agreement or contract between the parties, for the realization, appropriation and/or liquidation of any collateral to determine the amount payable or other claims that may be made under sub-section (1) and sub-section (2), no prior notice to or consent of the party in insolvency, winding up or liquidation or its liquidator or receiver or trustee, by whatever name called shall be required.”

Annex 5

ISDA Preliminary Submission to MoF dated 14 October 2016

14 October 2016

BY E-MAIL and HAND

Shri Parveen Kumar
Under Secretary (FSLRC)
Department of Economic Affairs
Ministry of Finance
Room No. 48, North Block
New Delhi – 110001
India

E-mail: parveenk63@gov.in

**PRELIMINARY
COMMENTS
(Subject to Further
Comments)**

Dear Sirs

Consultation on the draft Financial Resolution and Deposit Insurance Bill, 2016 and the Report of the Committee to Draft Code on Resolution of Financial Firms

Introduction

The International Swaps and Derivatives Association, Inc. (**ISDA**)¹ is grateful for the opportunity to respond to the Consultation on the draft Financial Resolution and Deposit Insurance Bill, 2016 (**Bill**) and the Report of Committee to Draft Code on Resolution of Financial Firms (**Report**) released on 21 September 2016 (collectively, the **Consultation**).

The issues considered in the Consultation are of great importance to the safety, efficiency and stability of the financial markets in India, including the derivatives markets. We are supportive of a strong, internationally consistent resolution regime for financial institutions and one that is aligned with the Financial Stability Board's (**FSB**) Key Attributes of Effective Resolution Regimes (the **Key Attributes**). The release of the Consultation is a significant step made by India in implementing the Key Attributes to consider and contain the risks posed to financial stability by a non-viable financial institution without exposing the taxpayer to the risk of loss. As such ISDA appreciates the efforts of the Ministry of Finance (**MoF**) and the Committee (**Committee**) constituted to consider these issues as well as the work of the Financial Sector Legislative Reforms Commission (**FSLRC**) and the High Level Working Group on Resolution Regime for Financial Institutions.

We note the importance of this Consultation to India and the considerable impact it will have on the industry and economy at large. We had submitted a letter dated 4 October 2016 requesting an extension of the submission date. We would like to highlight that the comments contained in this submission are preliminary and are subject to any further comments ISDA and

¹ Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 850 member institutions from 67 countries. These members comprise of 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 the Association's web site: www.isda.org.

its members may separately have as to the Bill and the Report. We appreciate your kind offer to make a second submission in addition to this preliminary submission. We will consider making another submission highlighting any other comments or points which we may have. We respectfully request that the MoF considers the preliminary comments in this submission in addition to any other comments which we may provide in due course.

We also note that the Consultation contains both policy considerations as set out in the Report and the proposed draft legislation as set out in the Bill. We aim to refer to both the Report and the Bill in our efforts to discern the interplay of policy intent and legislative drafting. We hope that the comments provided in this submission and in any other submission we may make will assist the MoF in defining the policy goals and the preparation of the final legislation as well as any implementation details of the proposed resolution regime in India. ISDA hopes to continue the constructive ongoing dialogue between the MoF and derivatives market participants to consider, for example, the practical concerns and risks surrounding the implementation of the policy proposals and draft legislation set out in the Consultation.

Scope of Submission

In our submission, we primarily address the proposals relating to the following key areas:

- (a) Bail-in;
- (b) Temporary stay;
- (c) Cross-border recognition of resolution actions; and
- (d) Safeguards for netting, set-off and collateral arrangements.

We may take the opportunity in this response to make certain observations with respect to other issues in other parts of the Consultation. While we agree that the issues dealt with in the Consultation are closely interrelated, we note and believe that given our focus on the OTC derivatives markets, other respondents - in particular, other trade associations, both international and onshore in India, with a broader and less-sector specific focus and mission than ours - may be better placed to comment in detail on other parts and proposals of the Consultation.

Our membership includes the leading global, regional and national financial institutions as well as leading end-users and other key financial market participants. Our leading financial institution members are members of the other international financial trade associations to which we refer above, and their views on those other issues may be represented to you through those associations. Our members may also choose to make their own individual submissions to the MoF.

Consistent with our mission, we are primarily concerned in this submission with the effect of the proposed resolution tools and powers on the safety and efficiency of the derivatives markets in India, by considering, for example, the direct impact of the proposals on the rights of a market counterparty under its derivatives transactions with a failing financial institution (**FI**) and under related netting and collateral arrangements. It is crucial to consider and balance the need for resolution powers in order to allow a resolution authority to resolve distressed FIs and preserve the stability and efficiency of the Indian markets, while ensuring that such powers do not adversely impact market participants. In particular, we are concerned that legal uncertainty will be created if the resolution powers are not adequately defined and circumscribed upfront and if any related safeguards are not clearly defined in terms of their scope or effect, as well as the need for consistency with the approach adopted under the Key Attributes and other jurisdictions. This is to ensure that the Indian market and FIs are on the same footing as other jurisdictions. As we are primarily focused on the proposals relating to the areas set out above, we have structured our submission in the same manner. We provide more general observations and comments which we hope would be useful in providing the necessary context to our more specific responses to certain policy proposals and legislative amendments.

Our comments are provided in the sections below.

General Comments

Transparency and Certainty

Legal certainty must be ensured. In order to analyse the risks, including the credit and legal risks, associated with dealing with another counterparty including another financial institution (FI), a market counterparty needs to know in advance and with sufficient certainty whether the FI will, if it gets into difficulties to the point of non-viability, potentially be subject to a resolution regime, even if, within that regime, there is a choice of tools and approaches that could be applied by the resolution authority. The market would also need to know with sufficient certainty what the effects of such resolution would be on the FI.

In this regard, we would also strongly caution that an increase of flexibility on the part of the resolution authority's powers would necessarily come at the sacrifice of such certainty. While we understand the need for a resolution authority to ensure that its powers are sufficiently broad to ensure the effective resolution of a distressed FI, we also note that ensuring certainty in a resolution regime would likely enforce its effectiveness by inspiring confidence in market participants that they are being dealt with fairly and in a predictable manner consistent with their expectations.

Conversely, a lack of certainty would affect an FI's ability to manage its risk effectively, and may potentially lead to disorganisation and inefficiency during the resolution process. As noted in Key Attribute 5.1, there should be an assessment of the extent to which an FI's resolution is likely to cause disruptions in domestic or international financial markets, for example, because of lack of confidence or uncertainty effects.

Accordingly, we would stress the need to determine the scope of the resolution regime on transparent and objective grounds, to ensure that the powers of resolution of the resolution authority are clear and market counterparties have clarity on the effects of resolution.

In particular:

- (a) the resolution regime should be clear and transparent as to the institutions within its scope, and as to the effects of the resolution. For example, further clarification is needed on the scope of "covered service provider" – in particular whether branches of foreign banks, foreign banks' non-bank financial companies (registered with RBI) and merchant banking entities (registered with SEBI) are in scope. In addition, as currently drafted the definition of "covered service provider" includes "non-regulated operational entities within a financial group". Further clarification is also needed as to whether this is intended to include service companies such as global service centres in India. If so, we would query as to whether including such service companies within the scope of the definition would benefit the financial stability and resilience of the Indian financial market. We would respectfully submit that such service companies should be excluded, or at the very least to exclude such service companies which do not have a significant impact on the stability and resilience of the Indian financial market. We have provided further comments on "covered service provider" below;
- (b) as far as possible, private law contractual and property rights must be respected by the inclusion of appropriate safeguards. The ambit and scope of such safeguards should be as clear as possible;
- (c) the effects of the resolution regime and the scope of the resolution authority's power must be made clear. Where it is considered necessary to suspend or otherwise affect any private law right, there is clearly a balancing that needs to occur. Any such suspension or other effect should be the absolute minimum necessary to achieve the policy goal of the relevant resolution tool or power. This is particularly crucial where there is intervention by the resolution authority that affects the FI's counterparties. This

principle is particularly relevant to our discussion below of the proposed temporary stay on contractual early termination rights;

- (d) further clarity, including the formation of certain guiding principles, should be provided in relation to how the powers would be applied to entities incorporated in India vs. Indian branches of foreign entities, given that certain powers may be more appropriately applied to locally-incorporated entities and vice versa;
- (e) where the powers can be exercised at the discretion of a relevant resolution authority, clear principles guiding the exercise of that discretion would be important to provide some transparency and certainty around how those powers would be exercised; and
- (f) the remedy for a breach of safeguard must also be clear, and it must not be a purely administrative remedy, for example, one requiring an application to an authority, a period for determination by the authority and, if the application is granted, the payment of compensation or award of other relief only at the end of that period. The remedy must be immediate and self-executing. For example, a netting safeguard should ensure that netting is enforceable notwithstanding the transfer by the resolution authority of some but not all of the rights or obligations under a master netting agreement. Similarly, in relation to collateral and security arrangements, the safeguard should provide that a transfer of secured obligations is legally ineffective unless the related security arrangement together with the security assets are also transferred to the transferee (being the new obligee).

Preservation of netting, set-off, collateral and security arrangements

Given the necessarily wide powers and discretion that the Corporation has under this Bill, there may be concerns that such discretion could potentially be exercised in ways that may disrupt netting, set-off and security arrangements. The provision of clear safeguards for protecting netting, set-off and security arrangements in this Bill will therefore be key to furthering India's status as a netting-friendly jurisdiction. General safeguards such as those found in EU Bank Recovery and Resolution Directive (**BRRD**) and the Hong Kong Financial Institutions (Resolution) Ordinance are helpful in ensuring the preservation of netting, set-off and collateral rights.

We would also like to emphasise that netting safeguard language should be provided in both the main text of this Bill, as resolution or insolvency proceedings for all financial institutions are meant to be grandfathered under this bill, as well as specific Acts (such as RBI Act, State Bank of India Act, Insurance Corporation Act) in case the Central Government does not direct resolution to be taken up by the Corporation.

As you are aware, close-out netting is an essential component of the hedging activities of financial institutions and other users of derivatives. For swap dealers, which specialise in bringing counterparties together for transferring risk, the need for netting stems from the dealer's central role in risk intermediation. Each time a dealer enters into a transaction with a counterparty, the dealer takes on exposure to the transferred risk. The dealer does not normally wish to retain the exposure, however, so it enters into offsetting hedge transactions. By maintaining a matched book—or more accurately, balanced book—of offsetting transactions, the dealer avoids unwanted exposure to movements in interest rates, currencies, and other sources of market risk. The result of this hedging activity is that, over time, the aggregate of derivatives activity includes a large number of inter-dealer and other hedge transactions that function largely to adjust risk positions and limit exposure to market movements. Indeed, the trillions of dollars of derivative notional amounts outstanding are largely the result of this ongoing hedging and rebalancing process.

Dealer hedge transactions involve many counterparties, all of which pose some risk of default. If a counterparty were to default, the dealer can no longer assume its exposures are hedged. The dealer will consequently find itself exposed to unanticipated market movements. In order to neutralise the exposures, the dealer needs to adjust its portfolio to bring it back into balance

by either replacing the defaulted transactions or by unwinding the offsetting hedge transactions or both.

Netting and collateral arrangements facilitate this rebalancing process; (a) netting by reducing the exposure that needs to be rebalanced, and (b) collateral by providing resources that can be offset against replacement costs.

Even when derivatives are cleared through a central counterparty, it is necessary to balance market risks: if a default occurs under clearing, close-out netting is essential to the ability of the clearing house to manage its risks through rebalancing.

Similar considerations apply to users of derivatives. In contrast to dealers, derivatives users such as corporations do not maintain a matched book, yet they do seek to attain a desired risk profile. A corporation, for example, might use derivatives to control its exposure to currency fluctuations. If a dealer were to default, these counterparties would need to replace the defaulted transactions in order to return to their desired risk positions. As with dealers, netting would facilitate returning to the desired exposures.

It is also crucial to ensure that these safeguards also include collateral arrangements and the protection of security interests that are entered into in connection with financial contracts that are part of set-off and netting arrangements. These should be made clear at the outset; safeguards should also cover the treatment of collateral taken by way of security interest.

We also consider the interplay of these safeguards against the efforts of the industry to address the non-cleared margin requirements in various jurisdictions, including the United States (**US**) and the European Union (**EU**). In September 2013, the Basel Committee on Banking Supervision and the International Organization of Securities Commissions published a framework for margin requirements for non-centrally cleared derivatives (**BCBS-IOSCO Framework**) that was intended to be used by G-20 regulators in adopting their own margin rules. We should also highlight here that the RBI has issued draft margin rules.

These margin rules impose initial margin (**IM**) requirements that necessitate new documentation for transactions subject to IM. There is a requirement that IM must be segregated, which means the current English law ISDA Credit Support Annex (which provides for full title transfer instead of the creation of a security interest) will not be appropriate. The new IM documentation will therefore rely on the creation of a security interest, and the rules require that IM must be available to the posting counterparty in a “timely manner” should the collecting counterparty default.

Consistency with FSB standards

Many India-incorporated financial institutions have a global footprint, and India is an important host to many foreign global financial institutions. It is therefore crucial to ensure that the resolution regime in India is consistent with FSB standards, so as to achieve the objectives outlined in the Key Attributes². We would strongly support an approach by the MoF to align the Indian resolution regime with the Key Attributes. Consistency with FSB standards would be crucial in ensuring that the Indian market and FIs in India are not placed in a weaker position than their counterparts in other jurisdictions, and to ensure that India is in a position to achieve a coordinated approach to the resolution of cross border FIs.

Cross-border cooperation

We highlight that in line with Key Attribute 2.3, the duty to consider the potential impact of the resolution actions of a resolution authority on financial stability in other jurisdictions should be explicitly added as a resolution objective under the proposed resolution regime. To this end, we strongly support a coordinated and cooperative approach to the resolution of a cross border firm is critical to protect financial stability across home and host jurisdictions.

² The Preamble of the Key Attributes states that “In order to facilitate the coordinated resolution of firms in multiple countries, jurisdictions should seek convergence of their resolution regimes through the legislative changes needed to incorporate the tools and powers set out in [the] Key Attributes into their national regimes.”

The Indian resolution regime must allow for resolution strategies for cross-border groups to be set at a group level and intervention at a local level independent of the home resolution authority of a cross-border group must be kept to a minimum and be used in exceptional cases only. Co-operation between home and host authorities at the point of failure will be key to the successful resolution of a cross-border group and Key Attribute 7.1 urges such co-operation as far as possible. It is imperative that home and host jurisdictions provide for transparency over processes that would give effect to foreign resolution measures. Any alternative has the potential to descend into a disorderly break up and significant value destruction across multiple jurisdictions.

As a preliminary point, resolution of cross-border groups should be achieved via home authorities. Cooperation between home and host authorities at the point of failure will be key to the successful resolution of a cross-border group. In most cases, globally systemically important financial institutions (**G-SIFIs**) incorporated outside India would have comprehensive recovery and resolution plans³ that are closely monitored by their respective home regulators. Leveraging these plans to facilitate resolution being undertaken by a home authority or support a local resolution would be, in our opinion, the most efficient and effective way to deal with local FIs that are branches or subsidiaries of G-SIFI's. In order to facilitate resolution undertaken by home authority, branches and subsidiaries of foreign financial institutions could be brought within the scope of the proposed regime. We are concerned that the failure to recognise the actions of a home resolution authority, on the other hand, may result in a real risk that some groups reduce their footprint in such host jurisdiction. In this respect, we note that the Key Attributes state that G-SIFIs should have an overall group plan and the resolution for such an entity should be led by the home regulator.

As a result, in respect of country level plans, where there are group plans in place, there should not be a separate requirement for country level plans, or country level plans should be kept to a minimum. Accordingly, for local branches and subsidiaries of FIs that are part of a broader international group, we would urge MoF and the relevant resolution or regulatory authority in India to consider the resolution plan at the holding company level of such banks and work with the relevant group to ensure that exercise of local resolution powers are not in contradiction to the group's resolution plan. Similarly, local branches that have a group level plan in place should not be required to formulate separate country level plans.

Further, Section 39 of the draft Bill provides that the timeline for submission of a resolution and restoration plan is thirty days of classification (in the case of a covered service provider being classified as material or imminent risk to viability) or ninety days of designation (in the case of a covered service provider designated as a SIFI). We would point out that this timeline is not practical and would recommend that MoF consider timelines proposed by other regulators. For instance, in Hong Kong, the Hong Kong Monetary Authority (**HKMA**) has proposed a timeline of six months post notifying an authorized institution for the submission of a recovery plan. In addition, in relation to Section 42 of the draft Bill which requires that these plans be updated once every six months, we would note that the requirement by the US regulators is to submit the plans annually.

Further consultation on policy intent and legislation

We note that further information and details are required with respect to the policy proposals and details are required with respect to the policy proposals contained in the Report and the proposed legislation as set out in the Bill. We will highlight certain gaps in our more specific and detailed comments below.

We would however seek clarification, at this juncture, as to how the MoF plans to address such gaps. Will these be addressed through subsidiary legislation? Or would the MoF or the relevant regulatory or resolution authority issue notification or circulars? If so, we would urge that these

³ While the Bill refers to "restoration and resolution plans", for consistency with common terminology, we use the globally recognised term, "recovery and resolution plans" throughout this response.

be subject to further consultation. Industry participants would be grateful for the opportunity to engage with the MoF to provide further feedback and input.

Adequate time should be provided to industry participants to consider the consequences of the proposals and to provide feedback, particularly so, as the detail in the proposals will be critical in ensuring that the resolution regime is effective both in resolving a distressed FI and ensuring market stability and efficiency during the resolution process.

As the proposed changes would have a substantive impact on financial institutions and their operations, we request that the MoF provides a longer transition period for industry participants to put in place the necessary frameworks and controls to ensure compliance.

CCP resolution

We note that the Consultation includes certain points on central counterparty (**CCP**) resolution. As you are aware, CCP resilience, recovery and resolution give rise to different concerns from the resolution of FIs – for instance, with regards to resolution funding, there would need to be consideration of the interplay between resolution funding and the contributions that members of CCPs are already required to make under the CCP's rules.

We would submit that these issues are complex and should be the subject of a separate consultation process, where they can be considered in depth. Our members are also supportive of a separate consultation process.

ISDA, together with other trade associations, has made submissions in respect of the Financial Stability Board (**FSB**) consultation document on *Application of the Key Attributes of Effective Resolution Regimes to Non-Bank Financial Institutions* and the consultative report issued by the Committee on Payments and Market Infrastructures (**CPMI**) and the International Organization of Securities Commissions (**IOSCO**), *Recovery of financial market infrastructures*, in which we discussed key principles regarding financial market intermediary (**FMI**) recovery in detail.⁴

In addition, ISDA has also published:

- (i) a position paper on principles of CCP recovery⁵;
- (ii) a position paper titled “CCP Default Management, Recovery and Continuity paper” in November 2014 that sets out a proposed recovery and continuity framework for CCPs⁶; and
- (iii) a white paper on the resolution framework for systemically-important CCPs (together with The Clearing House)⁷.

These may serve as a starting point to set out some of the issues involved in CCP resolution.

ISDA recently also released its “ISDA CCP Resolution for OTC derivatives: Proposed Framework”.

We would also note that the FSB has stated in its November 2015 report to the G20 on *Removing Remaining Obstacles to Resolvability* that it will examine the need for, and may develop proposals for further guidance to support CCP resolvability and resolution planning

⁴ See response to the CPMI-IOSCO consultative report *Recovery of financial market infrastructures* (Oct. 11, 2013) and Response to FSB Consultation on *Application of the Key Attributes of Effective Resolution Regimes to Non-Bank Financial Institutions* (October 15, 2013), available at <http://www2.isda.org/functional-areas/risk-management/page/2>

⁵ See <http://www2.isda.org/news/isda-launches-principles-on-ccp-recovery>

⁶ See <http://www2.isda.org/news/isda-proposes-ccp-recovery-and-continuity-framework>

⁷ See https://www.theclearinghouse.org/~media/TCH/Documents/20160523_TCH_ISDA_White_Paper_Considerations_for_CCP_Resolution.pdf

and to enhance pre-funded financial resources and liquidity arrangements for CCPs in resolution. We believe that these proposals for further guidance would be a logical precursor to local implementation of resolution regimes for CCPs.

We would also highlight that on 16 August 2016, CPMI-IOSCO issued a consultative report on the Resilience and Recovery of Central Counterparties (CCPs): Further Guidance on the PFMI. Also on 16 August, the FSB issued its Discussion Note on Essential Aspects of CCP Resolution Planning. ISDA intends to make submissions to both the CPMI-IOSCO paper and the FSB paper.

As much of the global discussions on CCP resilience, recovery and resolution are still evolving and developing, we urge the MoF, the regulatory authorities in India, and the CCPs in India to stay abreast of such developments, be part of such discussions, and to adapt and suit its proposed plans and proposals as well as the timing and timelines accordingly.

Approach to recovery and resolution planning

Recovery and resolution planning should take place before any crisis has occurred and should not be triggered by an assessment of non-viability. As such, there are concerns that the Risk to Viability framework proposed in Chapter 8 of the Bill would not be an appropriate framework to trigger recovery and resolution planning as set out in Chapter 9 of the Bill.

The requirement to prepare such plans should be linked to the systemic importance of the financial institution for the Indian financial system, taking into account the institution's nature, complexity, interconnectedness, level of substitutability and size. Institutions identified to require recovery and resolution planning should be provided sufficient time to prepare initial plans, and in the case of cross-border groups, be allowed to leverage existing group plans. There should be some flexibility to impose appropriate timelines for planning, but a timeline of 30 or 90 days (as proposed in the draft Bill) will likely be too short for meaningful planning. As we have mentioned above, in other jurisdictions institutions have six months to submit initial plans. The plans should then be developed and refreshed periodically in consultation with the resolution authority.

Specific Comments

Bail-in

We support the principle of statutory bail-in within resolution as this will align the regime in India to the regimes in the US, United Kingdom and EU, provided that it only applies as a last resort after all other feasible measures to rescue the failing firm (that is, to prevent it from reaching the point of non-viability) have, in the reasonable determination of the relevant authorities, been exhausted.

However, as in those regimes, the scope of application must also be sufficiently clear ex-ante (i.e. well before the point of resolution, and not – as seems to be the case under section 52 – only defining the liabilities in scope when the firm enters into resolution) and its basis legally certain. The trigger for its application, including the scope of liabilities subject to bail-in, should be aligned with the resolution trigger, and as outlined below under “Determination of risk to viability” this should be restricted to when an institution is at “critical” risk to its viability and the approach to identifying this must be set out in significantly more detail than is currently the case in Chapter 10 of the draft Bill. Without a clear, transparent scope for statutory bail-in and triggers for its application, the risk of whose application can be priced in by investors, liabilities may “run” even during temporary difficulty that can be easily recovered from, potentially increase the risk of the firm's failure.

In addition, numerous legal issues in relation to bail-in will need to be addressed in some detail, including (but not necessarily limited to) company, securities, property, insolvency, commercial and private international law issues. As such, we strongly urge the MoF to ensure more detailed rules can be developed underpinning the bail-in tool at a later date, in close consultation with market participants.

We would urge MoF to consider various issues as to, for example, the interaction between the bail-in resolution tool and other resolution tools, change of control provisions in contracts entered into by the FI and regulatory restrictions on investors. For example, a regulated fund that has previously invested in debt obligations of the FI could find itself in breach of its own investment restrictions following a statutory conversion of that debt to equity.

Also, very careful attention needs to be paid to the cross-border aspects and the relative responsibilities of home and host country. As a general principle, bail-in should only be exercised by the authority with primary responsibility for resolution of the entity, for example, the home authority in relation to a parent FI. Accordingly, we would not expect MoF bail-in requirements to apply to India branches of foreign incorporated FIs since home rules on bail-in should apply to these entities. At this juncture, we would urge the MoF to limit the statutory bail-in to Indian incorporated banks and bank holding companies in the first instance. However, in the event the MoF subsequently intends to extend these powers to local branches, it would be necessary to consider how this bail-in would tie in with the resolution regime applicable to the parent FI.

We submit that the Indian regime must allow for resolution strategies for cross-border groups to be set at a group level and intervention at a local level independent of the home resolution authority of a cross-border group must be kept to a minimum and be used in exceptional cases only. Co-operation between home and host authorities at the point of failure will be key to the successful resolution of a cross-border group and Key Attribute 7.1 urges such co-operation as far as possible. Any alternative has the potential to descend into a disorderly break up and significant value destruction across multiple jurisdictions.

A statutory bail-in regime should also respect the principle of “no creditor worse off than in liquidation” (**NCWOL**), should provide an appropriate mechanism for compensation where this principle can be shown to be breached and should provide for expedited judicial review of bail-in decisions, where appropriate (but in a manner that does not interfere with the speed or flexibility of the use of the tool that the authorities will need when implementing an actual resolution).

Application of statutory bail-in regime

We believe that bail-in must respect, as far as possible, *pari passu* treatment of creditors and the statutory order of priorities. In relation to the application of bail-in, recapitalisation should be effected by starting at the bottom of the capital structure, that is, with the equity level and then moving up the structure in reverse order of priority. Senior debt should only be subject to statutory bail-in after exhaustion of subordinate levels of capital. And, of course, senior debt should only be bailed in to the extent necessary to recapitalise a FI or, as the case may be, the portions of its business transferred to a bridge institution, at a reasonable level. We would welcome clarification on which liabilities which are within the scope of the bail-in regime.

In particular, we note that derivatives transactions give rise to specific concerns, which we have described below. In relation to the specific impact of a statutory bail-in power on the derivatives markets, there are two aspects:

(1) First, there is the question of the impact of bail-in on a FI equity or debt instrument that is the subject of or referenced by a derivative transaction. The principal concern of market participants in this regard is to ensure that there is sufficient clarity and certainty as to the rules that will apply and as to the full legal and tax effects, as mentioned above, so that market participants can analyse the market and other risks of the transaction, structure and document it properly, price it accurately and hedge it effectively and reliably. It is also important, in relation to any actual exercise of such a power by a resolution authority, that there is clarity and transparency as to the timing and effect of the exercise. Market participants should be notified promptly of the exercise via an appropriate market information mechanism with details of the terms of the exercise so that parties to a transaction referring to the securities of the failing firm are quickly in a position to assess the impact of the exercise, determine their rights under the relevant contract and take any appropriate actions, for example, in relation to any hedge

positions to protect their financial and commercial interests. This clarity and transparency is important not merely to the individually affected market counterparties but to the market as a whole, as any shock caused by uncertainty as to the timing or effect of the exercise could have contagion effect and/or could result in market counterparties taking unnecessary actions (for example, liquidating hedge positions or establishing new ones) based on inaccurate or incomplete information.

(2) Secondly, there is the question of whether and, if so, how statutory bail-in could be applied to a derivative transaction itself as a form of debt of a FI. This is part of the more general question as to the scope of the application of the statutory bail-in power.

There are a number of cases of liabilities of a FI where the beneficial effect of the application of statutory bail-in may be outweighed by negative effects for the FI itself (particularly in terms of its access to credit and liquidity), for counterparties to FIs and for systemic stability. Potential special cases include (but are not necessarily limited to) deposits (in particular, retail deposits), inter-bank borrowings, foreign exchange transactions, liabilities relating to unsettled securities trades (that is, securities trades initiated and still in the course of settlement), trade debt and liabilities under derivative transactions.

As a general rule, liabilities of a party to a derivative transaction are largely or wholly contingent while the transaction is outstanding. Derivative transactions contemplate both payment obligations and, where physical settlement is permitted or required, delivery obligations, that is, obligations to deliver an agreed form of asset. For present purposes it is sufficient to focus on payment obligations.

While an amount may, after satisfaction of relevant conditions precedent, become due and payable on a particular payment date, for example, under a swap transaction, liabilities will remain contingent in relation to subsequent payment dates. The amount of any future payment obligation under the swap transaction will also potentially be subject to payment netting against any amount due on the same day by the same party and potentially also to netting against amounts due on the same day by the same party under other transactions under the same master agreement.

Given the foregoing and given also the wide variety of possible derivative product types (swap, forward, option, cap, collar, floor and many variations and sub-variants of these product types) as well as the wide range of possible underlying assets and other measures of value that can be used to determine the value of a derivatives transaction (for instance rates, prices and indices relating to interest rates, foreign exchange rates, equities, debt securities, credit risk, commodities, and bullion), it is likely that there would be severe practical difficulties in applying a statutory bail-in power to a “live” derivative transaction, that is, a derivative transaction still in effect, with obligations remaining to be performed, at the time the power is exercised.

The difficulties would include valuation and operational difficulties, without considering the disruptive impact on related positions (which are either hedges for or hedged by the transactions subject to the bail-in power). These difficulties would be magnified where there are dozens, hundreds or even thousands of trades between a G-SIFI, and a major counterparty. The possibility of the application of bail-in to derivative transactions still in effect would also probably have negative implications for regulatory capital that would need to be worked through very carefully.

The foregoing points apply to derivative transactions of a FI that are traded “over-the-counter” or off an organised market or exchange and not cleared through a clearing house or other clearing system. Where derivative transactions are exchange-traded and cleared or traded OTC and cleared, as is increasingly required by legislative changes in effect or under way in the G20 economies and presumably in other countries as well, then additional operational and other difficulties are likely to arise in applying the bail-in power. In this respect, we note that cleared derivatives transactions are exempted from the bail-in tool under the BRRD.

It would, of course, be considerably simpler to apply a statutory bail-in power to a net amount due under the close-out netting provisions of a master agreement, such as the ISDA Master

Agreement. Such an amount, once determined, is normally simply an unconditional debt owed by the party that is “out of the money” on a net basis under the relevant master agreement, whether the party is the defaulting party or the non-defaulting party. That debt is capable, therefore, of being written down or converted to equity without the difficulties and complexities referred to above in relation to applying bail-in to “live” transactions.

Two points to note immediately, however, are: (1) all transactions under the master agreement would need to be terminated and valued and this is a process that can take some time depending on the nature, number and complexity of the transactions then outstanding and the state of the market at the time of close-out; and (2) the FI will not necessarily be debtor in such a case and therefore the resulting net amount following close-out might therefore not be available to be bailed in.

Regarding the first point, the timing of the process of close-out is unlikely to be sufficiently rapid to meet the speed with which the authorities will want to recapitalise a FI in order to minimise disruption to the market and to allow the FI to continue trading.

Regarding the second point, although in the circumstances described the net amount, being owed to the FI, would represent an asset of the FI and therefore strengthen (however, minimally) its balance sheet, the benefit of realising that asset may be outweighed by the disadvantage of losing the on-going risk protection offered by the transactions under the master agreement. Early termination for this purpose is also directly at odds with the general aim to prevent early termination occurring in the event of the exercise of certain resolution tools.

In addition to the foregoing considerations, there are cogent reasons of principle why derivative transactions should be excluded from the scope of the bail-in power. Bail-in is concerned with recapitalisation. Liabilities under derivatives transactions do not form part of the capital of a FI, other than, perhaps, in the very limited case where a specific derivative transaction is closely related to a capital transaction of the FI. The vast majority of derivative transactions constituting the normal derivatives trading of the FI would not fall into this category.

This is similar to the position of trade debt, and indeed for a FI liabilities under derivative transactions are functionally trade debt. We think it unlikely that G20 ministers intended that bail-in could apply to day-to-day claims such as those of a landlord under a lease of a building to a FI or of a supplier in relation to the supply of goods or services to a FI. The potential application of a statutory bail-in power to trade debt could have a significant effect on a FI's ability to access goods and services on credit and on the cost to the FI of those goods and services. Similarly, the potential application of bail-in to liabilities under derivative transactions could have a disruptive effect on the availability and cost of derivatives trades to a FI.

If the statutory bail-in powers are applied to derivatives transactions, the following points should be observed:

(a) a bail-in measure should only be applied in respect of the net amount following the termination of an agreement (whereby the termination, valuation and determination of the net sum are effected following the contractually agreed method) and after the application of any security. Although applying bail-in to a net sum due following termination of derivatives transactions is less complicated than applying bail-in to “live” transactions, it is not without challenges. As noted, (1) all transactions under the master agreement would need to be terminated and valued, and the timing of the process of close out is unlikely to be sufficiently rapid to meet the speed with which the authorities will want to recapitalise a FI in order to minimise disruption to the market and to allow the FI to continue trading; and (2) the benefit of realising that asset may be outweighed by the disadvantage of losing the on-going risk protection offered by the transactions under the master agreement;

(b) we would consider that any liabilities arising from derivatives which are collateralised (whether as cleared or non-cleared derivative transactions) would be considered as excluded from bail-in on that basis. This would be consistent with the approach that only unsecured subordinated debt and unsecured subordinated loans will be subject to the bail-in regime. However, in the case of derivatives transactions, there is a possibility that fluctuations in the

underlyings and the security can result in only a portion of the liability being secured, with excess liability above the value of that security potentially being eligible for bail-in. This will necessarily involve a valuation of the relevant security. Consideration will need to be given as to how and on what basis this valuation will be conducted. Consequently, the extent to which a liability will be excluded from bail-in cannot be estimated. In order to provide certainty for market participants, it would be helpful if the MoF could clarify the method of valuation to be used, if derivatives transactions are to be included in scope.

Proposed Section 52

As noted above, we would not expect MoF bail-in requirements to apply to India branches of foreign incorporated FIs since home rules on bail-in should apply to these entities and at this juncture, would urge the MoF to limit the statutory bail-in to Indian incorporated banks and bank holding companies in the first instance. However, in the event that the MoF subsequently intends to extend these powers to local branches, it would be necessary to consider how this bail-in would tie in with the resolution regime applicable to the parent FI.

We also note that Schedule 2 of the Bill provides a list of persons who would fall under the definition of "covered service provider". This list appears to include not only banking institutions and branch offices of body corporates incorporated outside India, carrying out the business of providing financial service in India, but also, among others, financial market infrastructures, any payment system as defined under the Payment and Settlement Systems Act, 2007 and any other financial service provider (excluding individuals and partnership firms).

Therefore, this appears to subject certain entities, including for example, CCPs to the proposed bail-in requirements under the proposed Section 52. We would reiterate that the considerations highlighted with respect to CCP resolution and urge that this be discussed separately. We also note that bail-in provisions are intended to apply to CCPs as noted in sub-section 6. ISDA urges a separate discussion on these points in order to assess the suitability of resolution tools in a CCP recovery and resolution scenario.

We would also note that it is not clear whether the haircutting referred to here would be applied to initial margin or variation margin. ISDA recognizes the use of variation margin gains haircutting as a source of additional resources for default management for derivative products. Most members support the use of the tool and argued that it is comprehensive, creates the right incentives for risk management, offers clearing participants with the choice of either re-balancing their clearing portfolios, or accepting the haircut in the end and, by doing so, assists the CCP with its recovery efforts. This is in contrast with initial margin gains haircutting which do not create the right incentives for clearing members. Again, owing to the complexity of the issue and the evolving discussions on CCP resolution, we urge the MoF to consider these issues separately.

We would therefore also suggest that the definition of "covered service provider" is re-assessed in order to avoid a broad brush approach which may not be suitable in all circumstances.

We also note the requirement for a "bail-in provision". We would like to query as whether this involves a contractual recognition of the bail-in regime? If so, we note that it is expected that the requirement for contractual recognition of the bail-in regime under the BRRD is expected to be reviewed in the next few months, and that no other jurisdiction imposes such a requirement. We would recommend the MoF reconsider this requirement.

Temporary Stay

As a preliminary point, we would highlight that it is not necessarily currently the case that exercise of recovery or resolution powers would, of itself, trigger early termination rights in most financial contracts. Only that aspect of the resolution regime that could be characterised as either a form of liquidation or reorganisation proceeding for the benefit of all creditors or related or preparatory acts would normally be caught by existing "bankruptcy" events of default, such as the Bankruptcy Event of Default in Section 5(a)(vii) of the ISDA Master Agreement. Thus, for example, the exercise of a resolution power to transfer the shares of a troubled bank into

temporary public ownership or to a private sector purchaser would not, of itself, trigger an Event of Default under either the 1992 or the 2002 version of the ISDA Master Agreement, at least as far as the standard form as published by ISDA is concerned.

Of course, parties are free to contractually amend the existing provisions of the ISDA Master Agreement and to supplement it as they see fit. In order to address developments in resolution regimes and powers granted to authorities under such regimes, it may well be the case that parties will need to consider additional early termination rights specifically to address the exercise of resolution powers beyond the commencement of special bank liquidation, administration or other reorganization procedures.

The first point to note, which is essentially a technical point in relation to the scope of the proposed suspension, is that the stay should only relate to the right of a counterparty under a derivatives master agreement, such as the ISDA Master Agreement, with a failing FI subject to the resolution regime to terminate transactions early as a result of the triggering of the resolution regime against the FI. Early termination of transactions is the essential first step in the process of close-out netting, the other steps being valuation of the terminated transactions and then determination of the net balance owing by or to the defaulting party under the close-out provisions. Every master netting agreement operates on this basis, even if the details of the close-out mechanism vary.

It is not necessary, in other words, to suspend a counterparty's "right to enforce" or "rights to close-out netting". Nor is it, in our view, necessary or desirable, to stay the rights and obligations of the parties under the relevant contract, subject to some qualifications discussed below.

During the period of the temporary stay, the market counterparty's rights and the failing firm's obligations (and, of course, vice versa) under the master agreement should not otherwise be affected. Throughout this period, the counterparty should (bearing in mind the necessity to protect the enforceability of close-out netting) be permitted to consider its exposure to the failing FI to be fully net. In that important sense, the proposed suspension should not "suspend" close-out netting. At most, it should simply stay temporarily the initiation of the close-out netting process, namely, the early termination of transactions following an event of default.

Also, where a master agreement is collateralised, it should be clear that the temporary stay has no effect on the obligations of each party under the collateral arrangement. Collateral calls should be capable of being made and should be complied with in the agreed manner, including the operation of any relevant dispute resolution mechanism.

Thus, a failure by a FI to make a payment that is due during the period of the temporary stay or an intervening (non-resolution) insolvency event should constitute an event of default (assuming the appropriate notice has been given and any relevant cure period elapsed), and the other party should be free to exercise its early termination rights in relation to that event of default notwithstanding the temporary stay.

Safeguards

We strongly support FSB Key Attribute 4 and the related guidance in Annex V, which was developed after a careful and detailed consultation with all relevant stakeholders, including ISDA and its members.

If such a power to suspend early termination rights is to be included in India's regime for financial institution resolution, we believe that it must be made subject to certain conditions, namely that:

- (a) 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;
- (b) the ability of the resolution authority to suspend early termination rights is strictly limited in time (ideally for a period not exceeding 24 hours and should not exceed two business days in all circumstances);

(c) where the relevant contract permits a counterparty to the FI not to perform as a result of a default or potential event of default in relation to the other party (as is the case, for example, under Section 2(a)(iii) of the ISDA Master Agreement), that provision should be unaffected by the stay;

(d) the relevant master agreement and all transactions under it are transferred to an eligible transferee as a whole or not at all, together with any related collateral (there is no possibility of “cherry-picking” of transactions or parts of transactions or divorcing the collateral from the obligations secured or supported by it);

(e) the proposed transferee is a financially sound entity with whom the counterparty would prudently be able to contract in the normal course of its business (including a bridge institution backed by appropriate assurances from the resolution authority and its government) and the transferee should be subject to the same or a substantially similar legal and tax regime so that the economic (apart from the issue of credit quality) and tax position of the counterparty is not materially affected by the transfer;

(f) the early termination rights of the counterparty are preserved as against the FI entering resolution in the case of any default by the FI occurring during the period of the stay that is not related to the exercise of the relevant resolution power (for example, a failure to make a payment, as discussed above, or the failure to deliver or return collateral, in either case, on a due date occurring during the period of the stay);

(g) the early termination rights of the counterparty are preserved as against the transferee in the case of any subsequent independent default by the transferee; and

(h) the counterparty retains the right to close out immediately against the failed financial institution should the authorities decide not to transfer the relevant master agreement during the specified transfer window.

Automatic or discretionary operation

With respect to whether a stay should be discretionary or automatic, our view is that we should consider this from the principal point that a stay should be clear and certain in its operation. The advantage, however, may lie on the side of a discretionary stay, as this can be used in a thoughtful and targeted way, backed, as proposed in the Consultation Paper, by a public announcement by the resolution authority. The discretionary stay would avoid possible unintended consequences of an automatic stay. The making of a public announcement would provide a clear signal to the market and therefore, potentially, greater certainty as to the commencement of the stay than might be the case with an automatic stay. (This depends, in turn, on whether the trigger of the automatic stay is itself public and clear as to timing.)

Where parties have included in their contractual arrangements, automatic early termination provisions, such as Automatic Early Termination under an ISDA Master Agreement, they will wish to consider whether it applies in relation to the exercise of a resolution tool and, if so, whether it should be amended, for the sake of certainty, to accommodate the principle of a temporary stay. It will only be possible for parties to do this effectively once the precise scope and operation of such a stay under a specific resolution regime are known.

Proposed duration of temporary stay

We submit that the stay should be strictly limited in time, ideally for a period not exceeding 24 hours and should not exceed two business days in all circumstances, and are strongly opposed to the proposal to extend the duration of the stay. This is in line with Key Attribute 4.3 which provides that the stay should be strictly limited in time. Moreover, a shorter period limits the possible negative financial impacts of the stay and avoids legal uncertainty.

Regulatory capital treatment

We believe that the regulatory capital treatment of a temporary stay or suspension of contractual rights, and possible transfer of those rights to a third party, needs careful consideration. A temporary stay or transfer of contractual rights should not result in increased regulatory capital requirements against relevant positions because the netting and associated mitigating arrangement would no longer be considered as effective. This kind of measure should be capital neutral.

ISDA's discussion with policymakers on a contractual stay of early termination rights

As you may be aware, ISDA has been discussing and working with policymakers and OTC derivatives market participants issues related to the early termination of OTC derivatives contracts following the commencement of an insolvency or resolution action. We have developed and shared papers that explore several alternatives for achieving a suspension of early termination rights in such situations. One of those alternatives, which is supported by a number of key global policymakers and regulatory authorities, would be to amend ISDA derivatives documentation to include a standard provision in which counterparties agree to a short-term suspension. While there are limitations on what may be achieved contractually, ISDA believes that it is important that supervisors and the private sector should maintain a dialogue on these critical issues. We would welcome the opportunity to discuss this topic with MoF.

As a result, ISDA released the Resolution Stay Protocol (**2014 Protocol**) in 2014⁸. The Protocol enables parties to amend the terms of their ISDA Master Agreements and any related credit support arrangements between, or provided for the benefit of, adhering parties to the Protocol by opting in to resolution regimes that stay and, in certain cases, override certain cross-default and direct-default rights included in derivatives contracts that arise upon the entry of a bank, or certain of its affiliated entities, into receivership, insolvency, liquidation, resolution or similar proceedings. In addition, the Protocol introduces similar stays and overrides under certain US insolvency regimes where none exist. In short, it prevents derivatives counterparties that have adhered to the Protocol from immediately terminating outstanding derivatives contracts, giving regulators time to resolve the troubled institution in an orderly way.

The 2014 Protocol has since been replaced by the by the 2015 ISDA Universal Resolution Stay Protocol⁹. ISDA also released the Resolution Stay Jurisdictional Modular Protocol in 2016¹⁰.

We would also note that ISDA, together with the International Capital Market Association, International Securities Lending Association and Securities Industry and Financial Markets Association, have also drawn up a Securities Financing Transaction Annex to the 2015 ISDA Universal Resolution Stay Protocol extending the stay protocol to securities financing transactions¹¹.

G-SIFIs have generally adhered to the 2015 Universal Resolution Stay Protocol. We urge the MoF to consider the structure and contents of these protocols in determining the requirements for the contractual provisions (if any), and would submit that the use and recognition of standard industry documentation would be beneficial for industry participants, and would also help to ensure that there is harmonisation with other jurisdictions.

We have also received feedback that the scope of any requirement to impose such contractual recognition should be appropriate and proportionate in terms of the contracts and the entities to which such requirement should apply. In particular, such requirement should not apply or

⁸ Available online: <http://www2.isda.org/functional-areas/protocol-management/protocol/20>

⁹ See <https://www2.isda.org/functional-areas/protocol-management/protocol/22>

¹⁰ See <http://www2.isda.org/news/isda-launches-resolution-stay-jurisdictional-modular-protocol>

¹¹ See <http://www.icmagroup.org/News/news-in-brief/icma-announces-publication-of-2015-universal-resolution-stay-protocol-with-securities-financing-transaction-annex/>

extend to contracts entered into by a within-scope FI or any of its group companies if the relevant entity is already subject to substantially similar or equivalent requirements relating to contractual recognition on stay of termination rights in the jurisdiction of its incorporation in another Group of 20 (**G20**) jurisdiction in line with the FSB Key Attributes.

Members request that the industry be given the opportunity to consult before any such additional regulations with respect to contractual provisions are promulgated and to have the opportunity to provide comments on any draft regulations and consider the impact of such proposed rules. Members have also requested that the implementation of any such proposed regulation be in phases, as appropriate, on contracts entered into from a specified date in the future.

Proposed Section 47

We consider the proposed Section 47 as set out in the Bill. In the explanation, it is set out that “the term ‘entry into resolution’ shall have such meaning as may be specified in the consultation with the Appropriate Regulator”. We submit that this should be defined and made clear upfront.

In addition, Section 47 provides that the temporary stay powers apply with respect to a “specified contract”. We would seek further clarification as to the scope of such contracts.

Cross-border recognition of resolution actions

It is important that the resolution regime in India supports cooperative, coordinated and effective approaches to the resolution of cross-border groups. We strongly support Key Attribute 8 which requires home and key host authorities of all G-SIFIs to maintain Crisis Management Groups to facilitate the planning and management of the resolution of a cross-border financial crisis. There is a growing consensus amongst all international regulators that a coordinated and cooperative resolution of a cross-border group has the potential to better protect financial stability across home and host jurisdictions. Mechanisms to ensure the cross-border effectiveness of resolution action are set out in recent FSB guidance, which makes clear that a strong statutory basis for cross-border recognition is required.

Given the global nature of the derivatives markets, the cross-border issues are crucial. We underline the importance for the derivatives markets of ensuring, in particular, that there is:

- (a) no ring-fencing of local assets of a foreign FI in the event of its local branch being made subject to resolution in the host jurisdiction; and
- (b) no discrimination against foreign creditors in the host jurisdiction, or such a difference between creditor treatment in India that it presents a barrier to cross-border recognition of foreign resolution action.

Each of these is objectionable on a number of grounds, including grounds of efficiency, equity and systemic stability in the financial market as a whole. The precise impact of each will depend on how it operates both *de jure* and *de facto* and on its scope of application. Specifically from a derivatives perspective, the existence of either in India as a host jurisdiction will have a potential adverse impact on the enforceability of close-out netting and any related financial collateral arrangement entered into with a multibranch FI with a local branch in India. Considering the Bill seeks to enshrine netting enforceability in Indian law, it is particularly critical that the creditor treatment under resolution does not inadvertently undermine the potential for netting recognition for foreign bank branches operating in India.

Need for mutual recognition

Irrespective of the model that is adopted to ensure cross border coordination, it is imperative that home and host jurisdictions provide for transparency over processes that would give effect to foreign resolution measures. Despite the intent set out in the Report, we do not believe that the current proposals in Chapter 16 of the Bill are a sufficient legal basis for this, and we strongly encourage the MoF to consider a statutory basis for cross-border recognition, similar to the one

in the Hong Kong, Singapore and EU BRRD, such that the Corporation would be empowered to “recognise” a foreign resolution order, but reserves the right to refuse it should outcomes for Indian creditors be different from those of creditors in the foreign firm’s home jurisdiction. Such an approach would be consistent with the FSB Principles for Cross-Border Effectiveness and would help to overcome the challenges from differences in regimes.

There is also a need for clarity on, amongst other things, the basis of the assessment to use local resolution powers, treatment of local creditors, treatment of assets and liabilities and/or rights and obligations located in host countries in the event a transfer to a third party or bridge institution is being considered by the home authorities, safeguards, resolution of conflicts with home and host regulators and so on. Any alternative model has the potential to descend to a disorderly break up and significant value destruction in the financial stability across multiple jurisdictions.

Separately, we would also ask that MoF considers the ambit of these resolution powers with respect to an India incorporated FI and a local branch of a foreign incorporated FI and considers whether its resolution powers are appropriate in each instance.

Further, in order to avoid the potential for conflict with actions taken a home resolution authority, we would suggest that MoF considers whether it is necessary to formalise a regime to recognise and give effect to foreign resolution actions.

Also, although there are difficulties in achieving this in the short-term, the longer term goal must be to ensure that any action taken in a resolution is recognised as legally effective under the laws of all other jurisdictions relevant to the particular case. For example, a statutory transfer by the a resolution authority in India, during the resolution of an Indian FI, of an ISDA Master Agreement governed by New York law must be recognised as effective by the New York courts. Similarly, a temporary stay imposed by the MoF, during the resolution of an Indian FI, on a counterparty’s right to designate an Early Termination Date under an English law governed ISDA Master Agreement must be recognised as effective by the English courts.

In each case, we understand that there is currently doubt about whether that would be true under the current state of the law. It may take a binding international agreement to ensure that the necessary mutual recognition is achieved not only as between the various G20 countries but also as between the many other jurisdictions, including emerging market countries, where active participants in the global derivatives market are based.

There is specific concern that a discretionary “case-by-case” evaluation on whether to give effect to a foreign resolution action would result in uncertainty. Although we do note that recognition or support of any foreign resolution action in a group-wide resolution should not prejudice domestic financial stability, we would highlight that, conversely, a lack of transparency and certainty as to whether and to what extent foreign resolution actions would be recognised would generate uncertainty as to the position of Indian FIs, which would in turn affect the ability of market participants to manage their risk effectively.

Home country versus host country

We would strongly recommend that the proposed regime in India should allow for the recognition of resolution proceedings being undertaken in the home country as well as other third countries, as outlined above. This is particularly relevant where foreign-incorporated institutions adopt a “single-point-of-entry” strategy at the holding company level to minimise systemic risk and are also subject to the requirements of their home regulators. We are concerned that a failure to recognise resolution actions of a home authority may result in a real risk that groups reduce their footprint in such host jurisdictions.

Statutory approaches to support cross-border resolution

As mentioned above, the FSB published a consultative document on a proposed approach to the cross-border recognition of resolution action published on 29 September 2014 (the **FSB cross-border CP**). We have attached ISDA’s response to the FSB cross-border CP at Annex

1. We would refer you to the response for a detailed analysis of the cross-border issues, and in particular, would like to highlight the following points made in the ISDA response to FSB:

(a) we broadly agree with the themes of the FSB cross-border CP, including, that a contractual approach to the cross-border recognition of resolution measures has certain limitations and a legislative approach is preferable;

(b) we see the need to enshrine within any legislative approach the protection of safeguards whilst ensuring transparency and clarity for the market and the resolvability of firms. The immediate and automatic recognition of any such resolution measure on a cross-border basis is preferred provided certain specified safeguards are satisfied;

(c) a coordinated approach is needed between jurisdictions to identify a primary regulator responsible for resolution and also to address group questions (i.e. the risk that multiple resolution authorities implement conflicting resolution measures); and

(d) we propose the exploration of alternative legislative solutions as set out in the ISDA's response to FSB which aim to achieve the immediate and automatic recognition of a resolution measure to the extent that the specified safeguards are satisfied.

We submit that a framework should be developed to give effect to a foreign resolution action.

We would also recommend that these conditions should be tied up to the safeguards featured in the Key Attributes. Key safeguards include the following:

(a) the protection of netting arrangements;

(b) the protection of rights of set-off;

(c) the preservation of credit support arrangements (including title transfer arrangements);

(d) there is no discrimination between creditors (e.g. the resolution measure does not discriminate on the basis of the nationality of the creditor or the jurisdiction of its claim);

(e) the no creditor worse off principle (i.e. the creditor's position is no worse relative to the position the creditor would have been in had normal insolvency proceedings been commenced with respect to its counterparty (including with respect to priority));

(f) appropriate procedural protections are in place (e.g. due process is observed such that, for example, affected parties are given proper notice and the opportunity to be heard); and

(g) only resolution measures which have been introduced and are publicly available are recognised (e.g. a press release containing a generic summary of a confidential measure which has been implemented would be insufficient).

We urge the MoF to consider an automatic recognition mechanism. Although we understand that the MoF or regulatory authorities in India may need some discretion in assessing whether the cross-border conditions are met, market participants also need the resolution law to be clear in terms of the resolution authority's powers and the extent by which the resolution measures will be recognised on a cross-border basis. This is important to market participants as they need to understand its potential impact at inception of contract. This is necessary for various reasons, including good credit risk mitigation. There also needs to be consistency in recognition between all jurisdictions. If there is discretion in terms of how each jurisdiction gives effect to the same measure, inconsistencies may be introduced which could undermine a cross-border resolution. In this respect, we note that recognition of FI resolution regime is different to previous attempts at cross-border recognition of insolvency proceedings (where the relevant insolvency proceedings looked very different). Broadly speaking, resolution powers do look very similar (as do the nature of the safeguards), including because of an attempt by jurisdictions to be consistent with the Key Attributes. ISDA members would prefer an automatic and immediate recognition (unless clearly articulated safeguards are not satisfied) without the

need for additional domestic steps to implement resolution measures. A general public policy exception to such automatic and immediate recognition should be limited in scope.

Last but not the least, we would like to further stress that home and host authorities collaboration is absolutely key to resolving a cross-border FI. A coordinated and cooperative approach to the resolution of cross-border FIs has the potential to better protect financial stability across home and host jurisdictions. In this respect, we strongly support Key Attribute 8 which requires home and key host authorities of all G-SIFIs to maintain Crisis Management Groups to facilitate the planning and management of the resolution of a cross-border financial crisis.

In particular, we would be grateful if the MoF could consider and provide further clarity on:

- (a) how it would propose to enable a cooperative solution; and
- (b) whether MoF has considered either restricting the scope of the recognition process to foreign resolution actions taken by the home resolution authorities or whether the resolution authorities of other third countries are to be included as well.

As a general comment, we would highlight that we are supportive of a statutory framework for the cross-border recognition of resolution actions. As set out in the FSB's *Principles for Cross-Border Effectiveness of Resolution* (the **Principles**), the foundation for resolution should be in statute, and contractual provisions are an interim solution with statutory bases as the ultimate goal.

We would note that in determining issues of cross-border resolution, as the Key Attributes and other FSB publications recognise, it is important to remove insofar as possible incentives for jurisdictions to resolve local branches or subsidiaries on a local, individual basis. Ultimately, as the 2012 IIF report¹² emphasised, every jurisdiction will be better off if a cooperative regime is firmly established, but in the conditions of an actual resolution, the temptations to eschew cooperation and go it alone may be substantial. While these risks cannot be removed altogether, a good pattern of international recognition statutes could make a big difference in assuring more effective, fairer results, focusing on groups as a whole (for the good of the entire global economic system) rather than attempting to maximise local benefits. This does not imply necessarily the same process in every country, but it does imply a serious effort to enact the same principles on a consistent basis that would lead to consistent interpretations.

As statutory changes proceed, it will be important to be sure that effective statutory bases for cross-border recognition are included, and that no friction arises between the contractual solutions that the industry has already put in place and the statutory powers. We would submit that it is important to create incentives for cooperation and structures through which international cooperation can be achieved more readily, and good statutory underpinnings can greatly enhance the chances of fair and appropriate outcomes in resolution.

Consideration should be given not only to the question of how foreign resolution measures can be recognised under national law but also the question of how to prevent other local-law provisions (e.g. supervisory rules, foreign banking act requirements, or securities law requirements) from impairing the effect of recognition (e. g. by asset transfer restrictions, liquidity maintenance requirements, or the like), once recognition is granted.

The European Banking Authority has published *Regulatory Technical Standards on Resolution Colleges*¹³ that, while specific to implementation of the BRRD, provide a useful point of

¹² See: IIF, Making Resolution Robust — Completing the Legal and Institutional Frameworks for Effective Cross-Border Resolution of Financial Institutions, June 2012 (<https://www.iif.com/publication/iif-proposes-key-steps-strengthen-cross-border-resolution-major-multinational-banks>).

¹³ See: EBA, FINAL draft Regulatory Technical Standards on resolution colleges under Article 88(7) of Directive 2014/59/EU, EBA/RTS/2015/03, 03 July 2015 (<https://www.eba.europa.eu/documents/10180/1132831/EBA-RTS-2015-03+Final+draft+RTS+on+Resolution+Colleges.pdf>).

reference for guidance that could be developed at the international level on processes and steps to enable good cross-border cooperation on resolution planning and execution via cross-border crisis management groups (**CMGs**). Provisions that could be adapted for use include the following key principles¹⁴:

- organisational requirements of CMGs;
- suggested processes to follow during planning and to remove disagreements about strategy; and
- transparency.

We should also add that we support the principles set down in Key Attribute 7 relating to the legal framework conditions for cross-border cooperation, 8 on Crisis Management Groups and 9 on Institution-specific cross border cooperation agreements in relation to the topic of cross-border cooperation between home and host jurisdictions.

In particular, we highlight the emphasis placed on pre-planning between the resolution authorities of the home and host jurisdictions, as well as the need for comprehensive information sharing between regulators.

Furthermore, we draw attention to paragraph 4.1(v) of Annex I to the Key Attributes, which provides that a home resolution authority should "coordinate a resolution of the firm as a whole, with the aim of maintaining financial stability, and protecting depositors, insurance policy holders, and retail investors in all relevant jurisdictions", and paragraph 5.1(iii), which provides that a host resolution authority should not "pre-empt resolution actions by home authorities while reserving the right to act on their own initiative if necessary to achieve domestic stability in the absence of effective action by the home authority". There is greater consensus that the coordinated and cooperative resolution of a cross-border FI has the potential to better protect financial stability across home and host jurisdictions. A coordinated approach to the resolution of a cross-border financial services group is only likely to be achievable where home and key host authorities ensure that all relevant FIs in each jurisdiction are within the scope of their resolution regimes with a full and comparable menu of resolution options and powers.

Proposed Section 86

We refer to proposed Section 86 in the Bill which states, among others, that the Central Government may enter into an agreement with the government of any country outside India. For the reasons stated above, we would urge that MoF and the Central Government provide transparency and clarity as to how these agreements would work and how the information sharing element on a reciprocal basis would work as well.

Taking into account the reasons stated above, we also urge the MoF to consider putting into place the statutory basis for formal cross-border recognition of resolution actions in order to provide more certainty.

Safeguards for netting, set-off and collateral arrangements

We had provided our comments on these safeguards in the section on "General Comments" above but would further explain here that the legal framework governing set-off rights, contractual netting, collateralisation agreements and the segregation of client assets should be clear, transparent and enforceable during the resolution of a FI. We would welcome greater detail on these safeguards. Experience with existing resolution regimes has already shown that the detail of the safeguards is crucial.

We further note that there should be an express safeguard that the proposed transferee is a financially sound entity with whom the counterparty would prudently be able to contract in the

¹⁴ This list suggests helpful process points that could make CMGs and colleges more effective; however it is not intended to suggest prescription to the point that cooperation becomes cumbersome or impeded by red tape; as always, balancing is required, but directional guidance may be helpful.

normal course of its business (including a bridge institution backed by appropriate assurances from the resolution authority and its government) and the transferee should be subject to the same or a substantially similar legal and tax regime so that the economic (apart from the issue of credit quality) and tax position of the counterparty is not materially affected by the transfer.

We would submit that safeguards should expressly provide that a master agreement and all transactions under it are transferred to an eligible transferee as a whole or not at all, together with any related collateral (the "**No Cherry Picking Condition**").

We also note in relation to the No Cherry Picking Condition that under the US regime, the US resolution authority, the FDIC, must transfer all "qualified financial contracts" (**QFCs**) to a transferee or none, regardless of whether the QFCs are linked by a common master agreement. In addition, it must transfer all QFCs not only of the counterparty but also all QFCs of all of that counterparty's affiliates with the failing firm. Although these requirements may restrict the flexibility of the resolution authorities in relation to the restructuring of the failing firm's business, there are clearly risk management advantages to both of these additional features, which maximise available set-off rights (subject to some legal uncertainty about the full enforceability of cross-affiliate set-off).

Additionally, we would submit that there should be express provision that the MoF or the relevant resolution authority cannot modify transferred contracts.

Remedies for safeguards

We would also like to address the issue of a remedy for any breach of a safeguard by the MoF or a relevant resolution authority, and would welcome further detail and the chance to consult with the MoF and the relevant resolution authority on this subject. The remedy for a breach of safeguard must be clear – this has implications for the effectiveness of the safeguard as the certainty of its application. Such a remedy must not be a purely administrative remedy, for example, one requiring an application to an authority, a period for determination by the authority and, if the application is granted, the payment of compensation or award of other relief only at the end of that period. The exercise of such rights and the time required to resolve the review would generate uncertainty as to the counterparties' position in the meantime. The remedy must be immediate and self-executing. For example, a netting safeguard should ensure that netting is enforceable notwithstanding the transfer by the resolution authority of some but not all of the rights or obligations under a master netting agreement. Similarly, in relation to security, the safeguard should provide that a transfer of secured obligations is legally ineffective unless the related security arrangement together with the security assets are also transferred to the transferee (being the new obligee).

The remedies should also be tailored for specific safeguards. For instance, for breaches of safeguards against partial property transfers, it may be necessary to consider that a remedy here should be that the transfer must not be void, while for a breach of a safeguard against contractual modification, the remedy should be that the modification should be void.

Achieving consistency of netting application in India

We also attach in Annex 2 our submission to the Reserve Bank of India (**RBI**), the MoF and the FSLRC dated 12 October 2012 on consistency of netting application to spur financial market growth. We would highlight that it is crucial to market participants and the Indian market that consistency is achieved in the application of netting directives with respect to financial derivative transactions in India. We would also suggest that any such effort to resolve these issues be done in a clear, consistent and coherent manner. While the MoF and the regulatory authorities may consider certain interim measures or addressing these inconsistencies as set out in the different legislation, notifications or circulars, in addition, the MoF and the regulatory authorities in India should consider the feasibility of introducing a netting legislation in India which would provide a comprehensive and holistic solution to the current issues facing the Indian market. This is consistent with past statements made by RBI to address concerns and the need for netting legislation in India.

Proposed Section 55

Proposed Section 55 as set out in the Bill provides the safeguards for applying resolution tools. For the reasons stated above, we strongly urge that an additional principle is included here in Section 55 to ensure the protection of netting, set-off, collateral arrangements and security interests.

We seek clarification on sub-section 55(2)(b) which refers to a principle where "only those liabilities may be cancelled the instrument creating which contains a provision to the effect that the parties to the contract agree that the liability is eligible to be the subject of a bail-in". Does the MoF intend that parties include such statement in their agreements, failing which such liability would not be subject to bail-in?

Proposed Schedule 14, Other Amendments

We refer to proposed Schedule 14 which sets out, among others, proposed amendments to the Reserve Bank of India Act, 1934 (**RBI Act**) in relation to the netting of mutual transactions in insolvency, winding up or liquidation.

It appears from the drafting provided in the proposed Schedule 14 that netting certainty has only been provided for banks and institutions regulated by RBI. This does not appear to cover all covered service providers. We urge that consistency of netting application be provided for **all** covered service providers and strongly urge that necessary amendments to all relevant legislation be made.

Taking into account the broad definition of "covered service provider" and also our comments on this definition, we would also highlight that achieving netting consistency would also require amendments to certain other Acts and legislation such as the Companies Act, and other acts governing for instance, mutual funds, insurance companies and housing finance companies. This takes into account, for instance that the RBI for example, does not regulate other covered service providers, apart from the banks and the FIs.

We would also suggest that, in order to achieve netting consistency in India, the MoF considers the inclusion of **all** relevant legislation and corresponding provisions in the Schedules of the Bill, for the purpose of safeguarding netting and collateral arrangements with respect to all covered service providers. As noted previously, netting safeguard language should be provided in both the main text of this Bill as well as specific Acts in case the Central Government does not direct resolution to be taken up by the Corporation.

Definition of netting

We note that the definition of "netting" makes reference to "...in the manner specified by the Bank". We submit that the definition of netting should not include such a qualification and should be clear. Based on the reasons given above on netting, we further submit that netting should not be subject to any form or manner of determination as described.

We would also like to highlight that "netting" has been defined differently under various regulations such as the Reserve Bank of India Act, 1934, Securities Contract Regulation Act, 1956, and Payment and Settlement Systems Act, 2007. We would urge the MoF to have a consistent definition for "netting" across all regulations.

Schedules

We also refer to Schedules 5, 10, 11 and 12 of the Bill and in particular, note that these schedules appear to provide for an added layer of Central Government discretion with respect to government owned banks. As such, we are concerned that the purpose of ensuring that the Corporation (as defined in the Bill) is the determining authority with respect to covered service provider is therefore not achieved. This discretion and power of the Central Government to deal with government-owned banks therefore remains unfettered. We submit that any broad powers or discretion may affect the enforceability of bilateral netting arrangements which parties had

legitimately entered into. We are also concerned that this may lead to the “cherry picking” of which transactions to close out. In considering the implementation of the resolution powers, it is important to ensure that the netting and set-off rights are safeguarded, while balancing this against the need to prevent netting and set-off from hampering the effective implementation of resolution.

Additional Comments

CCP Resolution

In addition to our comments in the “General Comments” section above, it is worth reiterating that as CCP resilience, recovery and resolution give rise to different concerns from the resolution of FIs, we submit that these issues are complex and should be the subject of a separate consultation process. These should be considered in depth and our members support a separate consultation process on CCP resolution.

We would also refer to the proposed Section 45 in the Bill which considers the situation where a CCP has been classified to at material or imminent risk. We would highlight that these additional measures of recovery be considered carefully and apart from the discussion on resolution of FIs. A detailed framework should be formulated separately.

Careful thought should be given to each of these additional measures and how each one of these would work in tandem with the other, taking into account the separate measures undertaken by the CCP. In ISDA’s view, a CCP-led recovery based on the rulebook of the CCP, should be allowed to take its course, as long as it continues to be viable.

ISDA further recognizes that there may be situations where the application of certain recovery tools may lead to systemic instability. Moreover, the need for a credible resolution which relies on sufficient quantum of resources may induce the regulatory authority to consider entering a CCP into resolution, before a CCP-led recovery has run its course.

In such cases, ISDA would recommend that:

- (1) conditions for entry by the relevant resolution authority should be defined upfront, as the additional clarity would provide certainty to the process;
- (2) the point of entry should be considered presumptive and not an automatic trigger, allowing the possibility for a CCP-led recovery if the situation warrants it. Proportionality and overall financial stability should be the leading principles;
- (3) the timing of the entry is significant and should be considered very carefully, so that the CCP recovery process and market confidence are not undermined, and if possible, identifiable and key conditions need to be met for the resolution authority to step in; and
- (4) CCP resolution should also follow the CCP rulebook and the established playbook with respect to the tools and sequence to be used.

We would also like to highlight that the Payment and Settlement Systems Act, 2007 has been amended recently to provide more clarity on CCP insolvency, winding up, or dissolution. We would urge the MoF to ensure that any proposals related to CCP resolution are consistent across all such regulations.

ISDA and its members are happy to separately discuss this subject with the MoF and the regulatory authorities in India. As much of the discussions at the global level are still evolving, we urge the MoF to adapt the timing for its proposed CCP resolution framework accordingly.

Proposed Section 45

In considering Section 45 of the Bill, we would ask that the MoF considers the interplay of these regulatory measures proposed to be taken by the appropriate regulators against the CCP rulebook. These measures should be part of a comprehensive CCP recovery and continuity framework that is comprised of tools and aims at providing maximum predictability of outcomes to clearing participants.

Rights of local creditors to get priority

Proposed Section 87

Proposed Section 87 provides for, among others, the rights of local creditors to get priority and appears to include creditors of a covered service provider, including for example, financial market infrastructures and any payment system as defined under the Payment and Settlement Systems Act, 2007. We would reiterate our earlier point that the definition of "covered service provider" is re-assessed in order to avoid a broad brush approach which may not be suitable in all circumstances. We would also like to reiterate our earlier point as to cross-border issues and particularly, the importance of (a) no ring-fencing of local assets of a foreign FI in the event of its local branch being made subject to resolution in the host jurisdiction; and (b) no discrimination against foreign creditors in the host jurisdiction.

It is also important to highlight that this may interfere with the ability of foreign home regulators to execute group resolution plans. We would also like to highlight Key Attribute 7, that states (i) that whilst there should be reservation of discretionary national action to achieve domestic stability, such national action should be taken after giving prior notification to and consultation with the foreign home authority and there should not be triggers for automatic action as a result of initiation of resolution or insolvency in another jurisdiction, and (ii) that national laws should not discriminate against creditors on the basis of their nationality, location of their claim or the jurisdiction where it is payable.

On a related note, we would like to highlight that whilst we support the no creditor worse off than in liquidation (**NCWOL**) principle and the importance of providing a compensation mechanism for NCWOL, we do expect that a NCWOL valuation would be a complex exercise based on various assumptions (which may be subject to challenge). We would also point out that the process of appointing an NCWOL valuer and conducting an NCWOL valuation, which should only begin after formal resolution proceedings have been initiated, may create additional uncertainties and timing delays on the resolution process. In the event that the MoF is considering this, we would urge that the MoF considers and provides clarity on the following points:

- (a) the valuation process and in particular whether the valuation process is intended to be run separately but in parallel to the bail-in valuation process and to what extent the two valuation processes could create inter-dependencies and/or knock-on impact on the resolution plan and powers. Any requirements for firms to develop capabilities to perform valuations should be consistent with those of other regimes. The implementation of these requirements involves costly system builds, therefore alignment between regimes will be beneficial;
- (b) the valuation principles and how these would affect different classes of contracts. General valuation principles would involve consideration of creditor hierarchy and disregarding any public source of financial assistance. In particular, we would query whether if the stay results in a delay of termination rights such that the market shifts resulting in a creditor being worse-off, this would be an item for which the creditor would need to be compensated;
- (c) timing - we suggest that the valuation reference date should be the date when the public notice announcing the formal commencement of resolution proceedings is issued as it is less subjective and is clearly defined compared to the date on which an FI would otherwise have entered into liquidation;
- (d) assumptions and qualifications;

- (e) process of appointment or removal of the valuer - general principles of transparency and that the valuer undertaking the valuation should be independent and not perceived to be in a position of conflict or in a position of authority should apply;
- (f) costs of funding of the compensation and how this is to be financed; and
- (g) appeal process.

Determination of risk to viability

Proposed Sections 43 & 46

We urge the MoF to reconsider the decision to require firms to prepare recovery and resolution plans with the determination of risk to viability. As outlined above under “Approach to recovery and resolution”, the requirement to prepare such plans should be linked to the systemic importance of the financial institution for the Indian financial system, as required by the FSB Key Attributes which says jurisdictions should cover “domestically incorporated firms that could be systemically significant or critical if they fail”.

As such, domestic systemic importance should be the primary determinant of whether a recovery and resolution plan should be developed. In the case of banks, this should be whether they are designated D-SIB and, in the case of other types of financial institution, designated a SIFI under this law. Furthermore, as previously highlighted, the 30 and 90 days suggested in section 39 is far too short a period to prepare a meaningful recovery and resolution plan. In other jurisdictions, institutions have six months to submit initial plans, which are subsequently refreshed periodically.

As SIFIs should prepare recovery and resolution plans in advance, Sections 43 and 46 should instead focus exclusively on the escalating circumstances in which the Appropriate Regulator or the Resolution Corporation would intervene, and what respective powers are needed depending on whether the risk to viability is material, imminent or critical. Proposed Section 46 provides for, among others, the critical risk to viability. However, this requires transparent and clear indicators and factors to be provided upfront with respect to determining material, imminent or critical risk of viability. Section 37 says that the Board may specify additional criteria – we would welcome this as, in our view, the classifications require much greater detail around the criteria, process for assessment and how they will be identified. This is crucial to the safe and efficient functioning of the Indian financial markets to avoid uncertainty over when regulators will intervene.

In addition, there should be much greater differentiation between the types of intervention possible depending on whether the financial institution is classified as subject to material, imminent or critical risk to its viability. Given “material” classification would apply where the probability of failure is “marginally” above the acceptable level of failure, it would be disproportionate to apply many of the actions listed in sub-sections (2) and (3) of section 43. At this stage, preparation for a further deterioration in conditions would be appropriate. In fact, it may be counterproductive to prevent transactions with the rest of the group or repayment of any debt which is not due under at this stage of classification, as these actions may be necessary to restore the firm’s viability (e.g. redeployment of capital or liquidity from elsewhere in the group or restoring market confidence through a debt buy-back to demonstrate the institution’s strength). Therefore, at least points (f) and (g) in sub-section (2) of section 43 should be reconsidered.

Only once an institution is at “imminent” risk of failure – i.e. the probability of failure is “substantially” above the acceptable level - should interventions outlined in sub-sections (2) and (3) of section 43 be considered, as these types of actions are broadly aligned with early intervention measures set out in the Basel framework for identifying weak banks or the BRRD. Even then some of the potential actions listed would be disproportionate when a firm’s viability can still be restored through private sector action, and care must be taken that their used does not result in exacerbating the risk of failure.

The type of interventions outlined in section 46, where a firm is classified at “critical” risk to viability, seem to suggest that this would be the “resolution trigger” as defined by the FSB. As stated recently by the FSB in its peer review, jurisdictions should provide as much as transparency as possible about resolution triggers in order to provide certainty and confidence to market participants and investors, while retaining some discretion and flexibility to act. This is crucial to the safe and efficient functioning of the Indian markets.

The Report sets out that the classification of "critical risk to viability" would be done through an order in writing. We would welcome clarification on whether this order is purely an administrative tool, and will not impose additional burdens on the covered service provider.

In addition, Section 37(5) suggests the classification of a covered service provider shall be final and binding. We would urge the MoF to provide an opportunity for the covered service provider to be heard or present before such a classification.

Designation of SIFIs

In light of RBI's existing D-SIB framework, we would like to seek clarification as to the interaction between the SIFI designation proposed in the draft Bill and the existing D-SIB classification, and whether the assessment criteria will be the same. In particular, we would welcome clarity on Section 25(2)(e) of the draft Bill on SIFI criteria to understand what “such other related matter as may be prescribed” may encompass. We would also seek clarity on how the SIFI designation may impact entities that have not been designated as D-SIBs.

Funding of resolution costs

While we are broadly supportive of the intent to ensure that the Corporation includes the three types of funds outlined in Section 21, we seek confirmation that the fund for meeting the expenses of carrying out resolution under sub-section (1) point (b) would be collected following resolution action. This “ex-post” mechanism is the norm in Asia-Pacific resolution regimes proposed to date, for example in Japan, Hong Kong and Singapore, as distinct from deposit insurance which requires ex-ante premiums.

We would also highlight that generally, use of resolution funds to absorb losses creates moral hazards and potentially undermines the key objectives of shareholders and creditors bearing losses and instilling market discipline – the FSB Key Attributes state that effective resolution regimes should “not rely on public solvency support and not create an expectation that such support will be available” (see paragraph (iv) of the Preamble). Conceptually, any resolution funds should be used for liquidity purposes. While the Bill seems to be in line with this, we would welcome clarification on this front.

In particular, we suggest that further detail would need to be considered, particularly in respect of:

- (a) costs to be covered by the resolution fund, for example as per Article 102 of the EU BRRD;
- (b) the parameters of use of the resolution fund, in particular that the costs of resolution would first be recovered from the residual assets of the firm under resolution before being socialised;
- (c) greater detail on how any remaining costs would be apportioned among other firms, including assurance that contributions would be adjusted according to size/risk proportionality; and
- (d) any caps or phasing contributions to ensure such costs would not result in contagion to the wider financial system.

We would also like to seek confirmation that the resolution fund contemplated in the draft Bill is a pre-funding mechanism (not post-funding). Further clarification is also sought as to how the amount of pre-funding required will be assessed, and in particular, how the amount is going to be calculated so that financial institutions can size their liability.

We note that any resolution funding should be collected proportionate to the systemic importance of a particular entity as defined by reference to the risk such entity brings to the Indian system, for example by reference to the size of the retail deposits such entity holds in India. The risk associated with any non-India operations should be excluded for such purposes to avoid the potential double taxation of cross-border groups. Furthermore, a financial institution should not be penalized and required to contribute more just because it is financially strong.

ISDA thanks the MoF for the opportunity to respond to the Consultation and welcomes dialogue with the MoF on any of the points raised. Please do not hesitate to contact Keith Noyes, Regional Director, Asia Pacific at (knoyes@isda.org at +852 2200 5909), Erryan Abdul Samad, Assistant General Counsel at (eabdulsamad@isda.org at +65 6653 4172) or Rahul Advani, Assistant Director, Public Policy at (radvani@isda.org at +65 6653 4171).

Yours sincerely,

For the International Swaps and Derivatives Association, Inc.



Keith Noyes
Regional Director,
Asia-Pacific



Erryan Abdul Samad
Assistant General Counsel



Rahul Advani
Assistant Director,
Public Policy

Annex 1

ISDA Submission to FSB on Cross-Border Recognition dated 1 December 2014

BY E-MAIL

1 December 2014

Secretariat to the Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Per e-mail to: fsb@bis.org

Ladies and Gentlemen

Cross-border recognition of resolution action

The International Swaps and Derivatives Association, Inc. (**ISDA**) is grateful for the opportunity to respond to the consultative document (the **Consultative Document**) of the Financial Stability Board (**FSB**) on a proposed approach to the cross-border recognition of resolution action, published on 29 September 2014. We set out in Annex 2 to this letter information regarding ISDA, our members and our activities.

Executive summary:

1. We broadly agree with the themes of the Consultative Document, including, that a contractual approach to the cross-border recognition of resolution measures has certain limitations and a legislative approach is preferable.
2. We see the need to enshrine within any legislative approach the protection of safeguards whilst ensuring transparency and clarity for the market and the resolvability of firms. The immediate and automatic recognition of any such resolution measure on a cross-border basis is preferred provided certain specified safeguards are satisfied. See Part A of this letter.
3. A coordinated approach is needed between jurisdictions to identify a primary regulator responsible for resolution and also to address group questions (i.e. the risk that multiple resolution authorities implement conflicting resolution measures). Existing laws do not provide for an appropriate cross-border recognition framework. See Part B of this letter.
4. We propose the exploration of alternative legislative solutions which aim to achieve the immediate and automatic recognition of a resolution measure to the extent that the specified safeguards are satisfied. We prefer solution 1 of the two solutions which we have proposed. See Part C of this letter.

A. GENERAL APPROACH

Our members comprise a mix of buy-side and sell-side institutions. Sell-side institutions have the perspective both of being required to demonstrate that they are resolvable and also as a creditor of another institution potentially subject to a resolution measure. Generally, the buy-side have the perspective of being a creditor of an institution potentially subject to resolution measures.

Given the varying perspectives, objectives can therefore conflict. Our response therefore seeks to accommodate three themes important to all of these perspectives:

1. **Safeguards:** Safeguards are critical to the integrity, safety and efficiency of the derivatives market and, in principle, have been widely accepted¹. We note that safeguards featured in the previous FSB paper relating to Key Attributes of Effective Resolution Regimes for Financial Institutions (October 2011) (the **Key Attributes Paper**). Recognition of resolution measures should therefore only be to the extent safeguards are preserved. Key safeguards include the following: (a) the protection of netting arrangements; (b) the protection of rights of set-off; (c) the preservation of credit support arrangements (including title transfer arrangements); (d) there is no discrimination between creditors (e.g. the resolution measure does not discriminate on the basis of the nationality of the creditor or the jurisdiction of their claim); (e) the no creditor worse off principle (i.e. the creditor's position is no worse relative to the position the creditor would have been in had normal insolvency proceedings been commenced with respect to its counterparty (including with respect to priority)); (f) appropriate procedural protections are in place (e.g. due process is observed such that, for example, affected parties are given proper notice and the opportunity to be heard); and (g) only resolution measures which have been introduced and are publicly available are recognised (e.g. a press release containing a generic summary of a confidential measure which has been implemented would be insufficient).

The devil is in the detail for these safeguards. The requirement that "appropriate protections" are in place for netting agreements or that "public policy" be taken into account are insufficient and will lead to a divergence of recognition. There is a need to explicitly provide for what is protected and what will not be recognised. Examples include: (i) specifically stating that a bail-in measure can only be applied in respect of the net amount following the termination of an agreement (whereby the termination, valuation and determination of the net sum are effected following the contractually agreed method) and after the application of any security; (ii) all rights and obligations are transferred (i.e. no "cherry picking"); (iii) any security in respect of a secured obligation transfers with the secured obligation including all rights *in rem* and *in personam*; (iv) the suspension of payments runs both ways so as not to distort overall net exposure; (v) in respect of the resolution of a member of a clearing house, the clearing house rules are respected including that client transactions should continue, terminate or transfer in line with the default management processes engaged by the clearing house; (vi) the suspension of termination rights should not affect the exercise of termination rights which do not relate to the resolution measure and such suspension should be strictly limited in time, as contemplated by the Key Attributes Paper; (vii) any transferee is bound by the terms of a transferred agreement; and (viii) if a counterparty is left behind with transferor whilst substantially all the assets are transferred, the exercise of termination rights should be unrestricted. Furthermore, none of the above should be capable of being indirectly undermined (e.g. via a general power to modify contracts so as remove or alter the effect of a netting provision). We recognise that it may be very difficult to identify and agree on a definitive list. As such, we have proposed alternative solutions in Part C of this letter which do not necessarily require the safeguards to be identified.

¹ Directive 2001/24/EC on the reorganisation and winding up of credit institutions (the **Winding Up Directive**) and Directive 2014/59/EU of the European Parliament and the Council of 15 May 2014, as published in the Official Journal of the EU on 12 June 2014 (**BRRD**).

2. **Transparency/clarity for the market:** Market participants need the resolution law to be clear in terms of the resolution authority's powers and the extent by which the resolution measures will be recognised on a cross-border basis. This is important to market participants as they need to understand its potential impact at inception of contract. This is necessary for various reasons, including good credit risk mitigation.

Furthermore, at the time of an actual resolution measure, market participants need transparency. In particular, they need quickly to be able to determine what resolution measures have been introduced, when they were introduced, the extent by which they are effective and when they are effective. This is necessary for market stability including to ensure the continuity of business where appropriate (e.g. so a new bank can continue to transact under a transferred netting agreement because it can clearly determine that the governing law of the agreement recognises the transfer).

The remedy for breach of a safeguard should be that the resolution is ineffective to the extent of breach of the safeguard, not, for example, an administrative remedy involving a judicial review claim. By "the extent of breach" we mean for example:

- (a) if the power under the resolution law could in theory involve the splitting of netting sets, but the actual resolution measure which is invoked does not in fact involve the splitting of netting sets, then such resolution measure will be recognised in full; or
- (b) if the transfer of a branch is effected under a resolution measure in such a way so as to split netting sets because the ISDA Master Agreement covers transactions via multiple branches, then such transfer will not be recognised.

There also needs to be consistency in recognition between all jurisdictions (rather than discretions conferred on local courts or authorities).

3. **Resolvability:** This involves ensuring that financial institutions are resolvable on a timely basis. A process which is automatic and immediate is preferable to a mechanism which instead requires fresh local proceedings or action by a domestic authority. An immediate and automatic recognition (subject to safeguards) would help to ensure that institutions are resolvable because the resolution measures can be implemented promptly.

B. RESPONSE TO SPECIFIC FSB QUESTIONS

The Consultative Document raises five specific questions. Taking each in turn:

1. *Are the elements of cross-border recognition frameworks identified in the report appropriate? What additional elements, if any, should jurisdictions consider including in their legal frameworks?*

Themes set out in section 1.2 of the Consultative Document

There is broad agreement with the themes in section 1.2 of the Consultative Document. As stated above, however, there is a preference for automatic and immediate recognition (unless clearly articulated safeguards are not satisfied) without the need for additional domestic steps to implement resolution measures. A general public policy exception to such automatic and immediate recognition should be limited in scope. Individual counterparties should make any determination as to whether safeguards are satisfied rather than wait for a domestic authority to confirm after a period of time.

If there were not to be an automatic and immediate recognition of resolution measures, we anticipate that there could be a significant divergence in terms of : (i) the capacity of domestic authorities to give effect to, and the extent of such effect of, resolution measures; (ii) the process for giving effect to resolution measures; (iii) the grounds for non-recognition of resolution measures; (iv) the requirements as to the equality of treatment of creditors; (v) the speed of implementation of resolution measures; and (vi) the liability of the resolution authority as a result of implementing resolution measures.

A distinction needs to be made between recognition and enforcement. Recognition of the resolution proceedings, in the traditional sense, will not result in the recognition and enforcement of the **effects** (i.e. the actual resolution measure). In order for “recognition” of the resolution actions to be effective, there needs to be both recognition of the proceedings and recognition and enforcement (with appropriate safeguards) of the actual effects of those proceedings.

It is also critical to establish:

- (a) a coherent process for determining the home jurisdiction of a firm and which law predominantly governs its resolution. In this respect, the home state regulator may be appropriate. The centre of main interests (COMI) and establishment concepts are not appropriate in the context of institutions who operate a global business as the concepts are too uncertain and subject to potential challenge; and
- (b) a coordinated approach for circumstances where a group comprises various legal entities (or branches) regulated in different jurisdictions. This needs to be coordinated so different jurisdictions’ resolution measures do not conflict.

It would be very helpful if the FSB criteria also encouraged ex-ante coordination between authorities in order to help provide more predictability. For example, support measures around, transfer orders and operational continuity should be planned in advance.

In addition, it would also be helpful if, where practicable, all affected regulators agreed to consult with each other prior to the implementation of any individual resolution measure.

Identification of existing frameworks

The identified statutory frameworks have various advantages and disadvantages. Each of these is considered in turn in Annex 1 below. While aspects of the identified statutory frameworks can be taken and adapted to give effect to foreign resolution measures, each can be improved from the perspective of achieving a good standard of transparency and clarity for the market, resolvability and appropriate safeguards (although it is recognised that achieving perfection would be nigh on impossible). In the corporate insolvency context, the UNCITRAL Model Law is the most appropriate comparator. While implementing an equivalent regime to the UNCITRAL Model Law for resolution is not attractive for the reasons set out below, some of the broad principles set out in the Model Law (and the Winding Up Directive) could be used by way of inspiration for an alternative solution.

Our view is therefore that the FSB should move away from the existing examples of laws relating to cross-border recognition. We propose the consideration of alternative solutions as outlined in Part C of this letter below.

2. ***Do you agree that foreign resolution actions can be given effect in different ways, either through recognition procedures or by way of supportive measures taken by domestic authority under its domestic resolution regime? Do you agree with the report's analysis of these approaches?***

If there is discretion in terms of how each jurisdiction gives effect to the same measure, inconsistencies may be introduced which could undermine any of the three themes. Importantly, there is also the potential to create additional conflicts of laws if the recognition of the resolution action requires what is effectively a local resolution procedure to perfect and give effect to the foreign resolution. See question 1.

We recognise that some of the alternative approaches suggested by us in Part C below may be difficult to achieve. In the event that they are not achieved, "recognition procedures" would be preferable to "support mechanisms" for sections 1.2.1, 1.2.2 & 1.2.3 of the Consultative Document. This is because recognition procedures increase the likelihood that a resolution is carried out in a cohesive and consistent manner (rather than the implementation of support mechanisms which may conflict with each other). However, for the reasons stated elsewhere in this response, we would have concerns that recognition procedures may not be able to cover all of the themes identified: safeguards, transparency and clarity for the market and resolvability.

3. ***Do you agree that achieving cross-border enforceability of (i) temporary restrictions or stays on early termination rights in financial contracts and (ii) 'bail-in' of debt instruments that are governed by the laws of a jurisdiction other than that of the issuing entity is a critical prerequisite for the effective implementation of resolution strategies for global systemically important financial institutions (G-SIFIs)? Is the effective cross-border implementation of any other resolution actions sufficiently relevant for the resolvability of firms that the FSB should specifically consider ways of achieving their cross-border enforceability?***

Broadly speaking, we agree. Depending on the circumstances it could be equally critical to address the recognition of:

- (a) resolution measures which effect the transfer of assets, rights and liabilities of an entity to another entity; and
 - (b) permanent restrictions on termination rights triggered solely as a result of resolution measures.
4. ***Do you agree that contractual approaches can both fill the gap where no statutory recognition framework is in place and reinforce the legal certainty and predictability of recognition under the statutory frameworks once adopted?***

We agree with the Consultative Document that any use of a contractual solution is very much an interim measure, although it is a useful interim solution and backstop. A contractual approach has certain limitations and so a statutory approach is preferred. We have set out some of these limitations below.

- (a) It requires an agreement between the parties concerned. Various market participants have expressed the view that they have no commercial incentive to agree to the resolution measures (and may have fiduciary duties meaning they cannot).
- (b) We agree with the additional concern raised by the FSB that not every entity is regulated meaning the approach of compelling entities by regulation does not seem to be an optimal solution. Inconsistencies in terms of the extent by which each local regulation demands a contractual opt-in may mean the ISDA 2014 Resolution Stay Protocol published on 12 November 2014 (the **ISDA Protocol**) and other similar protocols may not be consistently adopted (e.g. if one regulator demands

recognition of stays of termination rights only, buy-side market participants in that jurisdiction would not agree to sign up to the ISDA Protocol as it goes further than this type of measure).

- (c) Concerns around the lack of motivation of parties are exacerbated in derivatives and other markets (e.g. repo market) as opt-in involves changing existing master agreements so as to have a retrospective effect on existing transactions.
 - (d) Contractual agreements can be overridden by other considerations relevant to the recognising jurisdiction. This observation is made in the Consultative Document with respect to public policy. Other examples include on grounds of capacity, authority, recognition of a foreign composition of local law debt and insolvency clawbacks. As a contract, it is open to challenges, whereas a legislative approach could ensure certainty of outcome (but this may depend on the specifics of the approach, see discussion as to alternative proposals in Part C below).
 - (e) Contractual solutions may not work so as to transfer rights *in rem* (or, if they do, there may be perfection requirements, clawback periods may be reset, the secured party's priority may be changed, third party consent or action may be needed etc.). Consider, for example, an English law charge on securities held in a non-English clearing system as credit support for an English law ISDA Master Agreement with a US bank. If the US bank resolution action involves a transfer to a bridge bank, a contractual opt-in as a matter of English law under the ISDA Master Agreement may not be sufficient of itself to effect a transfer of the property rights as a matter of the law applicable to such cleared securities. This issue will be exacerbated by the move away from title transfer in respect of mandatory requirements for initial margin.
 - (f) Any contractual solution potentially requires thousands of new contracts which will take time (and may be subject to their own negotiations). The mere existence of an ISDA Protocol does not guarantee adherence, particularly when an attempt is made to expand potential adherents more widely, so as to cover all market participants.
 - (g) Whilst it is prudent for market participants to take steps to ascertain the enforceability of any contractual approach, such steps will not represent an assurance that the contractual approach will be enforceable. Legal opinions may have a role in this respect, but their use will be limited and they will invariably contain reasoning based on qualifications and assumptions, and risks will remain. A legislative approach would be better able to mitigate such risks.
5. *Are the key principles for recognition clauses in debt instruments set out in the report appropriate? What other principles or provisions do you consider necessary to support the exercise of 'bail-in' powers in a cross-border context?*

We believe other industry bodies are better suited in providing a response with respect to bond markets.

C. ALTERNATIVE APPROACHES TO RECOGNITION

The alternative approaches suggested below are designed with the intention of accommodating all three themes relating to safeguards, transparency and clarity for the market and resolvability. They are also designed with the objective of managing the inherent conflicts between these themes. These alternative approaches involve immediate and automatic recognition of the resolution measures and proceedings without the need for fresh judicial or administrative proceedings in the recognising jurisdiction. If immediate and automatic recognition of resolution measures and proceedings is in place, clearly safeguards become critical.

We recognise there is no “silver bullet” solution to meet all three themes and we recognise that these solutions are ambitious. However, the concept of being able to provide relief in aid of a foreign insolvency proceeding to the extent available under a law other than the law of the State where the proceedings have been opened has some precedent in the Model Law. Equally, the principle that safeguards can be established by reference to the governing law of the contract has precedent in the Winding Up Directive. Furthermore, it may be helpful in terms of achieving a consensus between sovereign states that the context now is different to previous attempts at cross border recognition of insolvency proceedings (where the relevant insolvency proceedings looked very different). Broadly speaking, resolution powers do look very similar (as do the nature of the safeguards), including because of an attempt by jurisdictions to be consistent with the Key Attributes Paper.

Solution 1 is preferable to solution 2 on the basis of a comparison of their potential respective advantages and disadvantages, as outlined below.

SOLUTION 1: Recognition but let choice of law effect safeguards

This solution effectively provides for the immediate and automatic recognition of resolution measures and proceedings but only to the extent that any such resolution measure and proceeding could have been taken under the governing law of the relevant contract. There is some precedent for this - this approach is analogous to an interpretation of Article 25 of the Winding Up Directive. It may also be helpful to include a temporary (e.g. a 2 business day) restriction or stay on early termination rights in financial contracts arising from such resolution measure (including the exercise of any cross-default rights). This will allow some time for counterparties to map the resolution action against the equivalent resolution regime of the governing law of the relevant contract.

Advantages:

1. This solution respects the choice of law that the parties made when entering into the contract and uses it as a proxy to define the safeguards which protect creditors.
2. Most cross-border contracts are governed by New York or English law, which have robust and reasonably developed regimes.
3. This achieves the protection of safeguards which are already documented (without the need for protracted negotiation between jurisdictions as to the scope and coverage of a fresh list of safeguards).
4. Resolution regimes which are lacking will automatically fail and therefore be unattractive. This may ensure the further harmonisation of regimes with the Key Attributes Paper.

Disadvantages:

1. This approach requires a comparison between two regimes. This analysis could prove to be time consuming and difficult in some circumstances.

SOLUTION 2: Recognition mirrors contractual approach under ISDA Protocol

This solution effectively proposes the implementation of the ISDA Protocol as a legislative solution. The legislative framework, as in the ISDA Protocol, would specify six identified regimes between which there is automatic recognition of any resolution measure.

In respect of other regimes, there would be automatic recognition of resolution measures subject to the safeguards. Alternatively, the six identified regimes could: (i) collectively agree (or agree via the FSB's existing peer review programme) whether or not to admit other jurisdictions to the club of six regimes or (ii) individually agree their own recognition of such other jurisdictions on a bilateral and reciprocal basis.

Advantages:

1. This approach capitalises on the degree of political consensus already agreed between the six identified regimes which led to the development of the ISDA Protocol.
2. This approach would also encourage other regimes to implement laws that achieve the higher status afforded to such identified regimes.
3. As most derivative contracts are governed by English and New York law, this may be highly effective to the extent of rights *in personam* (because both the UK and the US are identified regimes).

Disadvantages:

1. Certain changes may need to be made in order to fit the ISDA Protocol into a legislative framework. For example, is it politically acceptable for the Annexes (which, broadly speaking, limit recognition to the extent of the current law and anticipated changes in certain laws in each of the six jurisdictions) to be reflected as a concept in a cross-border treaty? Equally, is it politically acceptable for Section 2 of the ISDA Protocol (*Limitation on Exercise of Default Rights upon U.S. Insolvency Proceedings*) to be reflected?
2. The safeguards for regimes (other than the identified regimes) need to be agreed in detail by each relevant jurisdiction
3. This is dependent on reciprocity. The identified six regimes agreeing safeguards may mean that they will recognise resolution measures implemented by other regimes but does not mean such other regimes will recognise resolution measures introduced by the identified regimes.
4. The two tier system of recognition may not be palatable for jurisdictions outside of the six identified regimes.
5. This solution may not be ambitious enough.

We hope that you find our comments useful in your continuing deliberations on the cross-border recognition of resolution action. Please do not hesitate to contact the undersigned if we can provide further information about the derivatives market or other information that would assist the FSB in its work in relation to the implementation of a legislative framework for the cross-border recognition of resolution action.

Yours faithfully,



Scott O'Malia

Chief Executive Officer

ANNEX 1

EXISTING STATUTORY FRAMEWORKS

UNCITRAL Model Law (as expanded to cover entities subject to resolution):

This statutory framework is potentially unsuitable because it cannot deliver appropriate protections for safeguards, transparency and clarity for the market and resolvability for the following reasons.

- (a) It is subject to local law implementation which results in divergences in scope and approach.
- (b) There is no concept of automatic recognition of proceedings. Instead, recognition is by way of court application and there can be differences in views as to what proceedings are capable of recognition.
- (c) Save for an automatic, but limited, stay (see (d) below), upon recognition of the proceedings everything is discretionary before the courts, which could result in an inconsistent application of safeguards.
- (d) The court process for discretionary relief (e.g. the extension of the stay, the grant of an order preventing the termination of contracts) can take an extended period of time. For example it is possible for such process to take between three to six months (although shorter periods are possible). The appeal process can also lengthen this process (e.g. *Fairfield Sentry Limited, Debtor Kenneth Kryz v Farnum Place, LLC*² in the US and *Fibria Celulose S/A v Pan Ocean Co. Ltd & Anor*³ in the UK).
- (e) The ability to recognise the effect of a foreign law (e.g. the effects of resolution measures) is unclear. In particular, it is unclear as to whether this is possible (e.g. we understand that, broadly speaking, the position in the US is yes, whereas, the position in the UK is no) and, if so, in what circumstances and to what extent foreign law will be applied (e.g. the recognition of a foreign composition). However, the ability to provide discretionary relief in the form of **any** relief that may be available under the laws of the State that has recognised the foreign insolvency proceeding (the **Recognising State**) does provide a helpful precedent. Clearly, it contemplates a Recognising State giving effect to a foreign proceeding to the extent that the relevant measure is available under the laws of the Recognising State⁴. This principle is analogous to solution 1 of our suggested alternate approaches.
- (f) The automatic stay is not very effective (and its precise scope is subject to local law implementation) as the stay's principal effect applies only in relation to commencing or continuing legal proceedings in respect of the debtor's assets and preventing the debtor from transferring or disposing of its assets. It is not a stay on contractual termination rights or other self-help steps such as the suspension of payment obligations or the enforcement of security.
- (g) It does not cover financial institutions and also relies on COMI. See earlier comment on how this concept is not suitable for credit institutions.

² *Fairfield Sentry Limited, Debtor Kenneth Kryz v Farnum Place, LLC* 768 F.3d 239 (2nd Circuit 2014)

³ *Fibria Celulose S/A v Pan Ocean Co. Ltd & Anor* [2014] EWHC 2124 (Ch)

⁴ Although it should be noted that the scope of the relevant provision in the Model Law is untested in this context in the UK

Swiss Legislation

Based on the description contained in the Consultative Document, this statutory framework, is unhelpful in terms of delivering appropriate safeguard protections, transparency and clarity for the market and resolvability for the following reasons:

- (a) the two month period for the recognition of proceedings is too long; and
- (a) the issues raised are similar to those which arise in respect of non-Member States under BRRD. Please see further under “BRRD/Winding Up Directive” below.

Monetary Authority of Singapore (MAS) Act

Based on the description contained in the Consultative Document, this statutory framework, is unhelpful in terms of delivering appropriate safeguard protections, transparency and clarity for the market and resolvability for the following reasons:

- (a) the exercise of power to transfer shares is subject to Ministerial approval, which creates high political risk; and.
- (a) there is limited assistance as the power only relates to the transfer or issuance of shares and therefore is not wide enough.

We note, however, that as there is no need to go to a court, this is helpful for resolvability.

BRRD/Winding Up Directive

Recognition between Member States

This provides for automatic recognition between Member States (of both proceedings and, subject to exceptions, the effects of the proceedings). As such, this framework is generally helpful for resolvability, safeguards and transparency and clarity for the market. However, the devil is in the detail and, in certain respects, discretion is conferred on individual Member States. Examples of where these legislative frameworks defer to local implementation (which may diverge) include the following.

- (a) There is a discretion in how the safeguards are transposed by Member States. For example, see Article 77 of BRRD.
- (b) The scope of the exceptions (safeguards) in the Winding Up Directive is unclear in many aspects and in need of clarification from the CJEU and/or EFTA court. This is unhelpful from the perspective of achieving transparency and clarity for the market.⁵

⁵ Broadly speaking, the Winding Up Directive sets out the basis of recognition by each member state of other member states' resolution measures. It provides for very broad recognition by one member state of another's resolution laws. There are various exceptions to this, for example, with respect to "netting agreements" (including standard ISDA Master Agreements). Article 25 of the Winding Up Directive provides that netting agreements will be governed solely by the governing law. The prevailing view, at least from English law perspective, is that, taking an example of an English law governed ISDA Master Agreement with an Italian credit institution under resolution, the use of "solely" confirms that the governing law of the contract (i.e. English law) will be unamended by the Italian reorganisation measures. It will, however, include English insolvency law assuming that the Italian credit institution had undergone the closest equivalent English proceedings or measures. The Winding Up Directive is unclear, however, and there are other views. Assuming this is the correct interpretation, broadly speaking, this means Italian resolution will be recognised via the Winding Up Directive under English law contract if you could do the same thing under for example the Banking Act 2009. See second solution in Part C below as to how this approach could be adapted.

Recognition in respect of non-Member States

In terms of recognition in respect of non-Member States, the safeguards are so broad and potentially politically biased so that it may become difficult for market participants to predict how they will be applied in practice. The result is that it is also unclear in terms of resolvability. Recognition of non-Member States resolution measures is subject to exceptions which can be construed quite broadly. The dual approach applied in BRRD of: (i) enforcement of the resolution proceedings in accordance with national law; together with (ii) ensuring that domestic resolution authorities have certain minimum powers to implement and perfect aspects of the foreign resolution in their State are bad for transparency and clarity. It also has the potential to create another conflict of laws, between the foreign law resolution measure and the domestic actions in support of the foreign law resolution measure.

ANNEX 2

ABOUT ISDA

Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 64 countries. These members include a broad range of OTC 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 including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

Annex 2
ISDA submission to RBI, MoF and FSLRC on
Consistency of netting application to spur financial market growth
dated 12 October 2012

October 12, 2012

Shri Anand Sinha
Deputy Governor
Reserve Bank of India
Central Office Building
Shahid Bhagat Singh Marg
Mumbai 400001
India
anandsinha@rbi.org.in

Shri D.K. Mittal
Secretary (Department of Financial Services)
Ministry of Finance
North Block
New Delhi 110001
India
secy-fs@nic.in

Shri Justice (Retired) B.N. Srikrishna
Chairman
Financial Sector Legislative Reforms Commission
Mittal Court 'B' Wing
1st Floor
224 Nariman Point
Mumbai 400021
India
bnsrikrishna@gmail.com
BCC: uday_a04@yahoo.co.in (PA to Shri Srikrishna)

Dear Sirs

Consistency of netting application to spur financial market growth

1. **Introduction:** The International Swaps and Derivatives Association, Inc. (“**ISDA**”)¹ is writing to you in the context of achieving greater consistency in the application of netting directives with regard to financial derivatives transactions in India. With such consistency, our members believe that India’s CDS market will grow, the move of OTC derivatives to central counterparty (“**CCP**”) clearing, which is one of

¹ ISDA’s mission is to foster safe and efficient derivatives markets to facilitate effective risk management for all users of derivative products. ISDA has more than 800 members from 58 countries on six continents. These members include a broad range of OTC derivatives market participants: global, international and regional banks, asset managers, energy and commodities firms, government and supranational entities, insurers and diversified financial institutions, corporations, law firms, exchanges, clearinghouses and other service providers. For more information, visit www.isda.org.

India's G20 commitments, will be incentivized and take-up rates for margining of INR derivative transactions will receive a boost in line with global moves towards incentivizing bilateral margining of uncleared OTC derivative transactions². The higher capital charges that will result from the implementation of Basel III will also mean that the cost of trading OTC derivatives on a gross exposure basis will increase significantly. Achieving greater consistency on netting in line with the recognition granted to netting under the Basel accords will we believe have a positive effect on the future growth of the INR derivatives markets by reducing costs to the benefit of real economy companies' looking to manage their business risks, banks and other financial institutions as well as the broader financial market in India. We have set out below a summary of our view of the netting position in India and the regulatory capital incentives for netting under the Basel framework and current Indian regulations. This is followed by a number of suggestions where directives and regulatory initiatives in India could benefit from a consistent recognition of netting.

2. **OTC derivatives and the ISDA Master Agreement:** As you know, in India as well as globally, the practice is for OTC derivatives to be traded under the ISDA Master Agreement. The point to note is that transactions entered into under the ISDA Master Agreement are **not** separate, but rather form a single whole: that is, the effect of the ISDA Master Agreement is to treat **all** transactions between two parties which are governed by the agreement as a single legal whole with a single net value upon early termination of such transactions. This is achieved by the close-out netting provisions under the ISDA Master Agreement which consist of three principal elements: early termination; valuation of the terminated transactions; and an accounting of those values, together with amounts previously due but unpaid, to arrive at a single net sum owing by one party to the other.

3. **Enforceability of close-out netting under the ISDA Master Agreement:** Of course, the key issue is whether each of these three elements is enforceable. "Enforceability" in this context comprises two key components: first, enforceability as a matter of contract law under the governing law of the contract (typically English law or New York law); and second, consistency with and enforceability under the bankruptcy laws of the jurisdiction where the counterparty is located. The latter is critical since, regardless of the law selected to govern the contract, local insolvency law in an insolvent party's jurisdiction will always override in the event of an insolvency. Note that "enforceability" relates to the fact of net payments, not to their amount. Parties may from time to time have commercial disagreements concerning the valuation of derivatives, as they can for other financial instruments, but these do not tend to take issue with the enforceability of netting. Note also that the issue of the enforceability of close-out netting is separate from the issue of the legal capacity of a party to enter into derivatives transactions.

4. **Enforceability under Indian law:** As a contractual matter, outside of bankruptcy, all three of these elements contained in the close out netting provisions of the ISDA Master Agreement are effective as a matter of both English and New York law and also under some other laws, including we believe Indian law. With regard to India, we understand that legal experts in India generally concur that enforceability in insolvency is not an issue with regard to entities incorporated under the Indian Companies Act (or previous laws relating to companies) which would include private sector banks – and we believe that this is a view shared by the Reserve Bank of India ("RBI")³. However, we understand that there may be some doubt as regards enforceability in insolvency insofar as nationalized banks and the State Bank of India and its subsidiaries are concerned. This stems from the fact that the Indian government banks acts⁴ provide that no provisions relating to the winding-up of companies shall apply to such banks and that they can only be liquidated by order of, and in such manner as, the Indian Government directs. In any event, ISDA's Indian counsel, Juris Corp, has confirmed that close-out netting

² BCBS-IOSCO Consultation Paper on Margin Requirements for non-centrally-cleared derivatives dated July 6, 2012.

³ Please refer to paragraph 15 below.

⁴ Namely the State Bank of India Act, 1955, the State Bank of India (Subsidiary Banks) Act, 1959 and the Banking Companies (Acquisition and Transfer of Undertakings) Acts, 1970 and 1980.

will ultimately be enforceable even in respect of nationalized banks and the State Bank of India and its subsidiaries.

5. **Netting of exposures for regulatory capital purposes:** Basel requires banks to set aside a prescribed minimum percentage of capital (that will increase significantly with Basel III) against their risk-weighted assets (counterparty credit exposure multiplied by a risk-weight percentage). If close-out netting is enforceable, under the Basel framework, counterparty credit exposure is treated as the sum of positive and negative replacement costs⁵ of all the outstanding transactions between the bank and that counterparty. If close-out netting is not enforceable, counterparty credit exposure is treated as the sum of positive replacement costs (with negative replacement costs deemed to be zero). Thus, the ability of banks to net their exposures has a significant impact on their regulatory capital requirements and in turn, the price that they will have to charge the counterparty for entering into a transaction.

6. **Position of Reserve Bank of India on netting exposures for regulatory capital purposes:** RBI in its Master Circulars on Prudential Guidelines on Capital Adequacy and Market Discipline – New Capital Adequacy Framework (“**Prudential Guidelines Master Circular**”) requires banks to **not** net their exposures for regulatory capital purposes. Thus, in India, Indian-incorporated banks and Indian branches of foreign banks cannot net their exposures for regulatory capital purposes.

7. **RBI’s Circulars on Prudential Norms for Off-Balance Sheet Exposures of Banks (“Prudential Norms Circulars”):** In its Circular on Prudential Norms for Off-Balance Sheet Exposures of Banks – Bilateral netting of counterparty credit exposures dated October 1, 2010, RBI stated as follows: *“On receipt of requests from banks, the issue of allowing bilateral netting of counterparty credit exposures, in such derivative contracts, has been examined within the existing legal framework. Since the legal position regarding bilateral netting is not unambiguously clear, it has been decided that bilateral netting of mark-to-market (MTM) values arising on account of such derivative contracts cannot be permitted. Accordingly, banks should count their gross positive MTM value of such contracts for the purposes of capital adequacy as well as for exposure norms.”* This position was reiterated in RBI’s Circular on Prudential Norms for Off-balance Sheet Exposures of Banks dated August 11, 2011: *“Since the legal position regarding bilateral netting is not unambiguously clear, receivables and payables from/to the same counterparty including that relating to a single derivative contract should not be netted.”*

8. **Concerns caused by the Prudential Norms Circulars:** In the Prudential Norms Circulars, RBI, a regulator, has expressed the view that the *“legal position regarding bilateral netting is not unambiguously clear”*. In order to net exposures for regulatory capital purposes in any particular jurisdiction, Basel requires a bank to satisfy its national supervisor that the legal basis for netting is clear and that it has inter alia *“written and reasoned legal opinions”* that confirm the enforceability of netting under the relevant agreement. Basel states further that: *“The national supervisor, after consultation when necessary with other relevant supervisors, must be satisfied that the netting is enforceable”*. We understand that various ISDA member banks had, in reliance upon the ISDA-commissioned legal opinion for India⁶, taken the position that close-out netting is enforceable against all banking entities and corporates established in India and the potential adverse impact of RBI’s expressed view, particularly given the reference in Basel to consultation with the national supervisor and with other relevant supervisors, is a concern for all banks trying to comply with the Basel framework.

⁵ When a transaction is in-the-money for the bank, it has a positive replacement cost and when a transaction is out-of-the-money for the bank, it has a negative replacement cost.

⁶ We understand that a number of banks have separately obtained additional advice from ISDA’s opinion counsel (Juris Corp) on specific points. In their update opinion of February 17, 2011, ISDA’s opinion counsel (Juris Corp) confirmed that their view on enforceability remained unchanged notwithstanding RBI’s Circular of October 1, 2010.

9. **Impact on onshore margining:** We understand that currently the bulk of INR derivatives transactions are traded on an uncollateralized basis in India. While there are a number of issues associated with margining (or collateralization) arrangements for OTC derivative transactions in India, one key factor that disincentivizes the use of margining arrangements is non-availability of bilateral netting of exposures for regulatory capital purposes under RBI's Prudential Guidelines Master Circular. While RBI's Prudential Guidelines Master Circular implements Basel and allows banks to offset the adjusted collateral value against the adjusted exposure using the comprehensive approach where the collateral arrangements meet *inter alia* the general requirements for legal certainty, there are the following aspects:

(a) The collateral agreement best suited to India's legal system and regulatory regime that is generally used when margining arrangements are put in place in connection with OTC derivatives transactions is the ISDA English law Credit Support Annex ("**English law CSA**"). It is relevant to note here that RBI has, in the context of the Indian CDS market, permitted the use of the English law CSA for either: (i) onshore INR CDS transactions only, or (ii) all onshore transactions including INR CDS transactions. From a legal standpoint, the English law CSA constitutes a confirmation of a transaction under the ISDA Master Agreement and is not a separate or security document as that term is commonly understood. The effectiveness and enforceability of the English law CSA therefore hinges upon close-out netting under the ISDA Master Agreement. There is now a concern that courts in India, in light of RBI's expressed view in its Prudential Norms Circulars that "*the legal position regarding bilateral netting is not unambiguously clear*", may take the position that the English law CSA does not meet the requisite level of legal certainty to allow for collateral received under the English law CSA to be recognized as risk reducing under the Basel framework. Further, as the English law CSA is deemed to be a transaction under the ISDA Master Agreement and as RBI's Prudential Guidelines Master Circular directs banks to **not** net their exposures for regulatory capital purposes, the "exposure" under the English law CSA cannot be netted against the other exposures under the ISDA Master Agreement. Without associated regulatory capital savings, entry into margining arrangements will involve banks incurring costs in implementing and maintaining such arrangements and in funding the cost of collateral to be posted and the risk reducing activity of taking and posting collateral will not be incentivized.

(b) Given RBI's position that exposures cannot be netted for regulatory capital purposes, there is concern that RBI will require margining of gross and not net exposures. Assuming bilateral margining and that close-out netting is not enforceable, margining on a gross exposure basis leaves a party worse off than margining on a net exposure basis. We refer you to Annex I for examples. Thus, parties that enter into margining arrangements would wish to margin exposures on a net basis.

(c) Even if RBI permits bilateral margining on the basis of net exposures, and parties enter into bilateral margining based on net exposures, parties are required by RBI's Prudential Guidelines Master Circular to monitor exposures on a gross basis and set aside regulatory capital against their gross exposures. This leads to an anomalous situation where a party's gross exposures and regulatory capital requirements increases when it posts collateral with the counterparty (and the party may be required to post collateral where it is out-of-the-money on the transactions or as initial margin). If close-out netting is recognized as enforceable, exposures and regulatory capital requirements will be reduced when a margining arrangement is put in place. Contrary to this, implementation of margining arrangements in India in the current framework as it stands makes the party face the cost of funding collateral that it is required to post to its counterparty and a higher regulatory capital charge due to its increased gross exposures when it posts collateral with the counterparty.

(d) Given that banks in India cannot net exposures for regulatory capital purposes, banks are currently monitoring their exposures on a gross exposure basis. This means that banks that wish to put in place margining arrangements will have to implement parallel exposure monitoring systems - on a gross basis (for regulatory capital purposes) and a net basis (for margining purposes) which for the banks, and therefore the system as a whole, is inefficient and costly.

10. **Impact on India's CDS market:** RBI's Guidelines on Introduction of CDS for Corporate Bonds dated May 24, 2011 requires margining of CDS transactions and allows margining to be done on a net basis. We believe that permitting bilateral netting of exposures for regulatory capital purposes under RBI's Prudential Guidelines Master Circular and resolution of the other aspects as described elsewhere in this letter including paragraph 9 will help incrementally in the development of the CDS market as banks will perceive a real benefit in exchanging collateral in an efficient way.

11. **Impact on central clearing:** RBI's Prudential Guidelines Master Circular prohibiting netting of exposures for regulatory capital purposes currently applies to exposures to the Clearing Corporation of India Limited ("CCIL"). However, CCIL's forex forward segment is margined based on net exposure calculations. Currently, this inconsistent approach to netting is not particularly problematic because RBI's Prudential Guidelines Master Circular provides for a zero risk weight for trade exposures to CCPs including CCIL. It also provides for a risk weight for collateral posted with the CCP that varies depending on the credit rating of the CCP – the risk weight is 20% for collateral posted with CCIL. However, given that the RBI has committed to implementing Basel III when finalized⁷, once exposures to CCIL are no longer given a zero risk weight (we refer you to paragraph 12 below), the fact that exposures to CCIL cannot be netted under RBI's Prudential Guidelines Master Circular will be a significant issue for all bank members of CCIL and may have a material impact on the performance and growth of the portion of India's derivatives market that is required to be cleared through CCIL.

12. **Impact of Basel III on CCPs:** Basel III proposes a risk weight of 2% for trade exposures to a CCP where the CCP is a qualifying CCP ("QCCP"), viz., a licensed CCP that is compliant with CPSS-IOSCO's Principles for Financial Market Infrastructures ("FMI Principles")⁸. For QCCPs, Basel III also proposes a risk weight of 0% for collateral posted by a clearing member with the QCCP, provided the collateral has been segregated and is bankruptcy-remote. If the qualifying proviso is not met, collateral posted with the QCCP will bear a risk weight of 2% or 4%, depending on the degree of segregation and bankruptcy-remoteness. For a non-qualifying CCP ("non-QCCP"), risk weights for both trade exposures and collateral posted with the non-QCCP will range from 20% to 150%. We understand that market participants are concerned that CCIL currently does not meet all the FMI Principles and will thus have to be treated as a non-QCCP. Under Basel III, banks will be at a disadvantage when clearing their trades through CCIL if it is a non-QCCP as trade exposures will not qualify for the risk weight of 2% for QCCPs.

13. **Concerns stemming from absence of close-out netting rights upon default or insolvency of CCIL:** Another major problem with the netting of exposures to CCIL is that CCIL's rules currently do not contemplate the possibility of a default by, or the insolvency of, CCIL and thus do not include a mechanism that will allow clearing members to terminate their transactions with CCIL in the event of a CCIL default or insolvency and to crystallize a net sum payable by or to CCIL as a result of such termination. This is out of line with international developments on the key features of OTC derivatives CCPs given that all major CCPs including LCH, ICE, CME and SGX now have express rules granting

⁷ RBI has stated on May 2, 2012 in regard to its Guidelines on Implementation of Basel III Capital Regulations in India that: "*Capitalisation of Bank Exposures to Central Counterparties' etc., are also engaging the attention of the Basel Committee at present. Therefore, the final proposals of the Basel Committee on these aspects will be considered for implementation, to the extent applicable, in future.*"

⁸ <http://www.bis.org/publ/cpss101a.pdf>.

their members close-out netting rights in the event of the CCP's default or insolvency. Regardless of any changes made to the RBI's Prudential Guidelines Master Circular, if CCIL's rules remain in their current form, under the Basel framework, banks may need to treat their exposures to CCIL as gross because it would not be clear that members would have enforceable close-out netting rights upon the default or insolvency of CCIL. Again, this may have a material impact on the performance and growth of the portion of India's derivatives market that is required to be cleared through CCIL.

14. **Central clearing and exposure norms:** In addition, RBI's Master Circulars on Exposure Norms also prohibits the netting of exposures for exposure norms purposes. There is no carve-out for CCIL exposures from the application of the exposure norms. Thus, when clearing of INR/USD FX forwards through CCIL becomes mandatory from early next year and with mandatory clearing of INR interest rate derivatives also expected in due course, banks will hit the single borrower exposure limit of 15% of capital funds for CCIL sooner rather than later given that exposures cannot be netted. Thus, while mandating clearing through CCIL fulfills India's G20 commitments to promote central clearing of OTC derivatives, the RBI's current approach to exposure norms creates an issue for bank clearing members of CCIL that needs to be addressed. Given that banks are required under the rules of the Foreign Exchange Dealers' Association of India to clear INR/USD FX forwards through CCIL, the RBI's current approach to exposure norms can lead to only one outcome – banks will have to stop entering into transactions that must be cleared once they hit the single borrower limit for CCIL. As the RBI's current approach does not recognize the fact that the transactions already cleared with CCIL carry very little counterparty risk due to CCIL's margining and loss mutualization mechanisms, this threshold will be reached far more quickly than is necessary. In our view, this limitation will affect the continued performance and growth of India's FX and interest rate derivatives markets, which are together crucial sources of business risk management for real economy companies.

15. **Need for netting legislation:** RBI has noted⁹:

“There is a strong case for reviewing these legislations and recasting them for a number of reasons. First, prudential regulations are ownership neutral. However, the fact that different banks are governed by different laws has resulted in an uneven playing field which needs to be addressed. For example, while amendments were carried out to enable SBI, SBI subsidiary banks and nationalised banks to issue preference shares, though at different points of time, banks in private sector cannot issue preference shares as the amendments to the BR Act is still to be carried out. Similarly, while bilateral netting in the event of liquidation is admissible for private sector banks governed by the Companies Act and the normal bankruptcy laws, the position in this regard for public sector banks, SBI and its subsidiaries, is not clear in law, as liquidation, if at all, of such banks would be as per the Notification to be issued by the Government in this regard. Second, a single, harmonized and uniform legislation applicable to all banks will provide transparency, comprehensiveness and clarity and provide ease of regulation and supervision to the Reserve Bank. Third, there is also a need to sort out the conflicts and overlaps between the primary laws governing the banking sector and other applicable laws. For example, the Competition Act, 2002 (as amended by the Competition (Amendment) Act, 2007) is in conflict with the provisions of the Banking Regulation Act, SBI Act and other statutes dealing with the amalgamation of banks. Consolidation of banking sector laws and laying down of common regulatory framework for commercial banks are issues requiring serious consideration.”

16. ISDA and its members believe that introduction of netting legislation offers the most effective holistic solution to the current issues facing the markets and would enthusiastically offer up any support that would help assist this process. ISDA has published a Model Netting Act together with a

⁹ Legislative Reforms- Strengthening Banking Sector (Address by Shri Anand Sinha, Deputy Governor, Reserve Bank of India at Financial Planning Congress '11 organized by Financial Planning Standards Board of India at Mumbai on December 18, 2011).

memorandum on its implementation¹⁰ and would be pleased to discuss this further. UNIDROIT's project to develop a set of draft principles regarding the enforceability of close-out netting provisions is also fairly well-advanced¹¹. ISDA could also provide an analysis of netting legislation in other relevant jurisdictions.

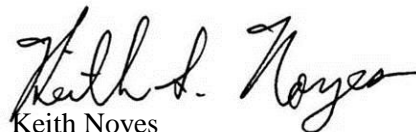
17. **Interim measures:** ISDA and its members recognize that the introduction of netting legislation is not something that "can be done overnight". Thus, ISDA requests the taking of certain interim measures that could be of assistance to the regulators and market participants. ISDA understands that the Prudential Norms Circulars resulted from RBI's desire to maintain a level playing field between public sector banks and private sector banks. Thus, we presume that RBI may consider allowing the netting of exposures both for regulatory capital and exposure norms purposes if the enforceability of bilateral netting of exposures with government banks is made clearer. As the doubt in regard to government banks stems, in our assessment, from the position that they can only be liquidated by order of, and in such manner as, the Indian Government directs, we believe that significant comfort would be provided if the Ministry of Finance (or other appropriate ministries of the Government of India) were to issue a written statement to the effect that in the liquidation of any government bank, the right to close-out transactions under the ISDA Master Agreement would be recognized and enforced. In addition and in the interim, we believe that a statement from RBI as regards the enforceability of close-out netting in the case of private sector banks, branches of foreign banks in India and corporates would be of tremendous assistance.

18. We would also request RBI to permit banks to net their exposures against corporates for regulatory capital purposes as the enforceability of close-out netting against corporates is not in doubt.

We would be most pleased to assist in any way. Please contact Jacqueline Low (jlow@isda.org, +65 6538 3879) or Keith Noyes (knoyes@isda.org, +852 2200 5909) at your convenience.

Yours faithfully,

For the International Swaps and Derivatives Association, Inc.



Keith Noyes
Regional Director, Asia Pacific



Jacqueline ML Low
Senior Counsel Asia

¹⁰ <http://www2.isda.org/functional-areas/legal-and-documentation/opinions/>.

¹¹ <http://www.unidroit.org/english/studies/study78c/main.htm>.

ANNEX I

Impact on margined transactions if close-out netting is not enforceable

Assumes no change in replacement cost or collateral value at different points in time.

Party A's Replacement Cost on Transaction 1	Party A's Replacement Cost on Transaction 2	Party A's Collateral Position (collateral received)	Party B's Collateral Position (collateral received)	Party A must pay to Party B's insolvency trustee	Party A claims in Party B's insolvency	Party A must pay to Party B's insolvency trustee	Party A claims in Party B's insolvency
		No margining		Party B insolvent, close-out netting enforceable		Party B insolvent, close-out netting not enforceable	
-13	+10	0	0	3	0	13	10
+13	-10	0	0	0	3	10	13
		Margining on net MTM basis		Party B insolvent, close-out netting enforceable		Party B insolvent, close-out netting not enforceable	
-13	+10		3	0	0	13	10 + 3
+13	-10	3		0	0	10 + 3	13
		Margining on gross MTM basis		Party B insolvent, close-out netting enforceable		Party B insolvent, close-out netting not enforceable	
-13	+10	10	13	0	0	13 + 10	10 + 13
+13	-10	13	10	0	0	10 + 13	13 + 10
		Party A margining on net MTM basis, Party B on gross MTM basis		Party B insolvent, close-out netting enforceable		Party B insolvent, close-out netting not enforceable	
-13	+10	10	3	10	0	13 + 10	10 + 3
+13	-10	13	0	10	0	10 + 13	13 + 0

Where Party A owes the net MTM:

- Margining on a net MTM basis compared with not margining leaves Party A worst off – write off 13 instead of 10.
- Margining on a gross MTM basis results in the worst off outcome – write off 23 instead of 10 (paying 23 instead of 13 could be viewed as neutral since Party A had received the extra 10 as collateral).
- Party A margining on a net MTM basis while Party B margins on a gross MTM basis leaves Party A in the same position as both margining on a net MTM basis – write off 13 instead of 10 (paying 23 instead of 13 could be viewed as neutral since Party A had received the extra 10 as collateral).

Where Party A is owed the net MTM:

- Margining on a net MTM basis compared with not margining could be viewed as neutral – write off 13 in each case (paying 13 instead of 10 could be viewed as neutral since Party A had received the extra 3 as collateral).
- Margining on a gross MTM basis results in a worst off outcome – write off 23 instead of 13 (paying 23 instead of 10 could be viewed as neutral since Party A had received the extra 13 as collateral).
- Party A margining on a net MTM basis while Party B margins on a gross MTM basis leaves Party A in the same position as not margining or both margining on a net MTM basis – write off 13 in each case (paying 23 instead of 10 could be viewed as neutral since Party A had received the extra 13 as collateral).

Impact on margined transactions if close-out netting is not enforceable

	Party A owes net MTM of 3	Party A is owed net MTM of 3
Both parties do not margin	1	2
Both parties margin on net MTM basis	2	2
Both parties margin on gross MTM basis	3	3
Party A margins on net MTM basis, Party B margins on gross MTM basis	2	2

Value scale: 1 is best, 3 is worst from Party A's perspective.

Counterparty Credit Exposure

Assumes no change in replacement cost or collateral value at different points in time.

Party A's Replacement Cost on Transaction 1	Party A's Replacement Cost on Transaction 2	Party A's Collateral Position (collateral received)	Party B's Collateral Position (collateral received)	Party A must pay to Party B's insolvency trustee	Party A claims in Party B's insolvency	Party A must pay to Party B's insolvency trustee	Party A claims in Party B's insolvency
		No margining		Party B insolvent, close-out netting enforceable		Party B insolvent, close-out netting not enforceable	
-13	+10	0	0	3	0	13	10
+13	-10	0	0	0	3	10	13
		Margining on net MTM basis		Party B insolvent, close-out netting enforceable		Party B insolvent, close-out netting not enforceable	
-13	+10		3	0	0	13	10 + 3
+13	-10	3		0	0	10 + 3	13
		Margining on gross MTM basis		Party B insolvent, close-out netting enforceable		Party B insolvent, close-out netting not enforceable	
-13	+10	10	13	0	0	13 + 10	10 + 13
+13	-10	13	10	0	0	10 + 13	13 + 10
		Party A margining on net MTM basis, Party B on gross MTM basis		Party B insolvent, close-out netting enforceable		Party B insolvent, close-out netting not enforceable	
-13	+10	10	3	10	0	13 + 10	10 + 3
+13	-10	13	0	10	0	10 + 13	13 + 0

Counterparty Credit Exposure

	Party A owes net MTM of 3		Party A is owed net MTM of 3	
	Close-out netting is		Close-out netting is:	
	Enforceable	Not enforceable	Enforceable	Not enforceable
Both parties do not margin	0	10	3	13
Both parties margin on net MTM basis	0	13	0	13
Both parties margin on gross MTM basis	0	23	0	23
Party A margins on net MTM basis, Party B margins on gross MTM basis	0	13	0	13
From Party A's perspective If close-out netting is not enforceable, better off not margining at all.				