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# COMMENTS ON THE SEPTEMBER 29, 2014 FSB CONSULTATIVE DOCUMENT, "CROSS-BORDER RECOGNITION OF RESOLUTION ACTION"

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WITH MARK JEWETT, E. BRUCE LEONARD, CATHERINE WALSH AND DAVID KEMPTHORNE

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## ABOUT THE INTERNATIONAL LAW RESEARCH PROGRAM

The International Law Research Program (ILRP) is an integrated multidisciplinary legal research program that strives to produce the world's leading international law research on global governance, with recognized impact on how international law is brought to bear on significant global issues. The program connects knowledge, policy and practice to build the international law framework and the globalized rule of law, and to support international governance for the future. One of the core areas that the ILRP is focused on is advancing knowledge and understanding in international economic law, in particular: the governance issues surrounding the cross-border resolution of corporate insolvency, sovereign debt and global systemically important financial institutions (G-SIFIs). We are interested in understanding the role and interests of the different international organizations, institutions and financial standard-setting bodies and the ways in which these institutions can assist in designing international law to address these challenges. The ILRP is committed to supporting the creation of international law to support cross-border resolution that is efficient, effective and fair.

## EXECUTIVE SUMMARY

The International Law Research Program (ILRP) of the Centre for International Governance Innovation (CIGI) welcomes the opportunity to comment on the Financial Stability Board's (FSB's) Consultative Document, "Cross-Border Recognition of Resolution Action" (hereafter referred to as the "Consultative Document") that was released on September 29, 2014.

The 2008-2009 financial crisis highlighted the costs and consequences of disorderly resolution procedures for large, complex and systemically important financial institutions. The appropriate design and implementation of resolution procedures for G-SIFIs is critical to limit taxpayers' exposure to the failure of systemically important financial firms and to reduce the costs of financial firms' failure for the wider financial system and the real economy. This paper's analysis concludes that a contractual approach intended to give effect to resolution proceedings in a jurisdiction outside the jurisdiction where the contract was issued has a number of limitations that cannot be effectively overcome through appropriate contract design.

A resolution regime based on contractual approaches has limited utility because it only binds parties that contractually agree to the regime and, even then, may have questionable enforceability. A statutory approach to a resolution regime should be much more effective in achieving financial stability. In designing such a regime, at least two goals should be recognized: enabling systemically important financial firms to achieve a successful resolution, and protecting financial markets whose collapse could be systemically risky. The Consultative Document appears to focus primarily on the first goal; that focus should be broadened to also take into account the second goal.

To ensure the effective and efficient resolution of financial firms it is necessary to establish a regime of uniform statutes that provide for enforcement provisions in financial contracts. In order to achieve the FSB's policy aims of ensuring the cross-border recognition of resolution actions the FSB should establish a Working Group on Statutory Mechanisms for the Cross-Border Resolution of Financial Firms for the purpose of designing model law for national resolution authorities and resolution procedures for financial firms. Having regard to the urgency of these critical issues this Working Group should seek the outside counsel of experts in international insolvency law, financial law and bankruptcy law, alongside the expertise of prominent members of the judiciary to develop a robust model law that would ensure the cross-border recognition of resolution actions and that could lead to adoption by FSB and non-FSB members. The ILRP would welcome the opportunity to contribute to this effort and looks forward to continuing our engagement with the FSB on these and related matters.

## INTRODUCTION

The FSB's Consultative Document proposes "a package of policy measures and guidance" on "how legal certainty in cross-border resolution [of troubled financial firms and groups] can be further enhanced."[1] That package is intended to respond to the FSB's earlier concern that legal "uncertainties about the cross-border effectiveness of resolution measures [are] an important impediment to cross-border resolution."[2] The package includes statutory and contractual approaches to cross-border recognition that focus on two particular cases where achieving cross-border recognition is said to be a critical prerequisite for orderly resolution: temporary restrictions or stays on early termination rights in financial contracts; and "bail-in" of debt instruments that are governed by the laws of a jurisdiction other than that of the issuing entity.

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1 Consultative Document, at iii. The Consultative Document also appears to focus at times more narrowly on G-SIFIs. *Id.* G-SIFIs are a subset of cross-border financial firms and groups.

2 *Id.* (quoting from the FSB's September 2013 report on "Too Big To Fail.")

These comments respond to the FSB's invitation for comments on a list of specific questions in the Consultative Document. Because those questions largely address substantive issues of international insolvency law, the authors of these comments include legal experts on international insolvency and financial regulation.[3]

## QUESTION 4

This paper comments first on question no. 4, and thereafter on question no. 3, of that list. Question no. 4 asks whether contractual approaches can reduce legal uncertainties about the cross-border effectiveness 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?

Because this is a compound question, the comments on the question are divided below into Parts I and II for analytical simplicity.

### Part I: Do you agree that contractual approaches can fill the gap where no statutory recognition framework is in place?

Contractual approaches cannot fill the gap, but to a limited extent they can help to reinforce legal certainty and predictability absent a statutory framework.[4] The extent to which they are helpful will depend, other things being equal, on how widely parties include them in their financial contracts. The comments in Part I focus on how widely parties are likely to include contractual approaches in their contracts. There will be comments in subsequent parts[5] on whether included contractual approaches are likely to be enforceable.

For financial contracts constituting derivatives, the unique dominance of the International Swaps and Derivatives Association (ISDA) over derivatives documentation suggests that contractual approaches can help to fill the gap. The Consultative Document indicates that ISDA is preparing a draft protocol to its Master Agreement — intended for adoption by market participants using that Agreement to document derivatives transactions — to support the cross-border enforcement of a temporary stay of early termination rights.[6] Eighteen of the most significant banks globally have since agreed in principle to a "Resolution Stay Protocol" under which ISDA derivatives contracts would be rewritten to provide for a contractually agreed temporary stay (from 24 to 48 hours) on termination rights by counterparties of foreign-based bank subsidiaries when a subsidiary's parent is subject to resolution within its home jurisdiction. So far, however, the Resolution Stay Protocol applies only to these 18 banks, and then only for contracts entered into with each other. The prospect for more widespread "voluntary" adoption is uncertain.[7]

For other types of financial contracts, contractual approaches are much less likely to fill the gap. The holdout problem in sovereign debt restructuring provides a useful precedent. As a solution to this problem, many nations attempted for years to include collective action clauses in their financing agreements, thereby enabling the supermajority (as opposed to unanimous) voting of creditors to change essential payment terms.[8] The recent Greek debt crisis revealed, however, that 90 percent of Greek debt was *not* governed by those clauses.[9] Moreover, even if all Greek debt contracts had included collective action clauses, "such clauses (being contractual) would most likely work on an agreement-by-agreement basis."[10] That would enable an individual debt issue to act as a holdout vis-à-vis other debt issues.[11] A statutory approach, in contrast, would work across all debt issues.[12] For these reasons, a statutory approach would be "much

3 References in these comments to "insolvency" and "bankruptcy" have the meaning of those terms under the relevant law applicable to a proceeding for restructuring, liquidating or otherwise addressing the liabilities or capital structure of financially troubled firms; and references in these comments to "resolution" mean any such proceeding.

4 References in these comments to a statutory framework or approach mean one that is nationally multilateral.

5 See *infra* Parts II and IV.

6 Consultative Document, at 12 (which includes discussion on a temporary stay as a contractual term). The author has not attempted to examine how that contractual approach would harmonize with national bankruptcy-law safe harbours.

7 Investment funds and "buy-side firms" generally have expressed strong opposition, for example, to incorporating similar contractual limitations in view of their perceived fiduciary responsibilities to their clients. See Chris Flood, "New Derivative Rules Offer Asset Managers Nothing." *Financial Times*, October 12, 2014, available at www.ft.com/intl/cms/s/0/59855dda-4fc2-11e4-a0a4-00144feab7de.

8 Steven L. Schwarcz, "Sovereign Debt Restructuring Options: An Analytical Comparison," 2 *Harvard Business Law Review* 95 (2012).

9 *Id.* at 105.

10 *Id.* at 106.

11 There currently are attempts by the International Capital Market Association and other groups to broaden collective action clauses to work across all debt issues.

12 "Sovereign Debt Restructuring Options," *supra* note 8, at 109.

more effective[] and predictabl[e]" to solve the holdout problem than a contractual approach.[13]

In what might be viewed as a bootstrap fashion, the Consultative Document suggests that contractual approaches could be more widely implemented if regulators require financial firms already subject to their prudential regulatory authority to adopt any necessary language in contracts with their counterparties.[14] To the extent regulators have that authority (and regard its exercise, including any associated costs, as politically acceptable), this would certainly increase the widespread adoption of contractual approaches. Whether regulators have that authority not only would vary by the jurisdiction and regulated firm but, as explained below, would also depend on how its exercise would work.

The relatively easy case would occur if a bank's regulators require it to include a provision in each of its financial contracts, to which the contract's other parties consent, temporarily staying, for example, early termination rights under the contract. That case would not bind unregulated financial firms, including many firms in the shadow banking sector, except to the extent of their specific contracts with regulated firms. There is a harder case that would cover many more unregulated firms and contracts: if the bank's regulators require it to include a provision in each of its financial contracts, to which the contract's other parties consent, that purports to require those other parties to include that type of provision in all of their other contracts. But that case would appear to be unreasonably intrusive and unenforceable.

Finally, even if parties were to agree to a contractual approach that purports to reduce legal uncertainties about the cross-border effectiveness of resolution measures, the success of that approach would depend not only (as mentioned[15]) on the legal enforceability of the relevant contractual provisions but also on the speed and reliability in enforcing such provisions. That enforcement may depend on such variables as the factual background and the intentions and representations of the parties. At the least, therefore, a contractual approach would have greater litigation risk and less certainty and finality than a statutory approach.

13 *Id.* at 109 (citing, among other sources, Douglas Gale, "Standard Securities," 59 *Rev. Econ. Stud*. 731, 731 (1992) (arguing that investors will charge an "uncertainty premium" on unfamiliar securities). A statutory approach also "should be more efficient from a market perspective" because "[m]arkets do not function efficiently when investors are uncertain what will happen." "Sovereign Debt Restructuring Options," *supra* note 8, at 109.

14 Consultative Document, at 13.

15 See *supra* note 5 and accompanying text.

## Part II: Do you agree that contractual approaches can reinforce the legal certainty and predictability of recognition under the statutory frameworks once adopted?

The answer to this depends critically on the facts. A contractual approach to cross-border recognition will become largely superfluous once a statutory approach is adopted by enough major jurisdictions.[16] But a contractual approach might help if some parties are from nations that have not yet adopted a statutory approach. Contractual approaches might then provide some statutory transitional certainty and predictability.[17]

Such a contractual approach could combine the inclusion of a resolution provision recognized by the statutory approach with a choice-of-law provision choosing the law of a nation that has already enacted that approach. Say, for example, that an issuer of debt instruments is located in jurisdiction X, which has no laws regarding debt bail-in. If those debt instruments are governed by the laws of jurisdiction Y, which has a statute recognizing bail-in, and if those debt instruments have a contractual bail-in provision that is consistent (or, at least, not inconsistent) with that statute, the legal certainty and predictability of the bail-in would be reinforced.[18]

On the other hand, a contractual approach would be much less likely to reinforce legal certainty or predictability of recognition if, instead of binding creditors, it purported to bind or impair the rights of an issuer in resolution. For example, say that the issuer of debt instruments is located in jurisdiction X, which has no laws regarding early termination rights in a contract. If those debt instruments are contractually governed by the laws of jurisdiction Y, which has a statute imposing a temporary stay of early termination rights, that jurisdiction-Y statute would likely be disregarded in a jurisdiction-X adjudication as to whether the issuer, in resolution, could exercise any of its contractual termination rights, or as to whether the holders of those debt instruments could exercise, adversely against the issuer in resolution, any of their contractual termination rights. These views reflect the principle that an insolvency estate is normally protected under the laws of the jurisdiction in which the resolution is taking place.

16 The comments in this paper do not currently address which jurisdictions those would be. Identifying those jurisdictions will ultimately be critical. *Cf.* John C. Coffee, Jr., "Extraterritorial Financial Regulation: Why E.T. Can't Come Home," 99 *Cornell Law Review* 1259, 1298 (2014) (examining, in the context of derivatives, "what is the minimum number of nations that need to agree" to international financial regulation that protects against systemic risk in order to "effectively compel the rest of the world to conform to their agreed standards").

17 That might be especially useful, for example, if a statutory approach takes significant time to be widely adopted.

18 Compare *infra* notes 36-37 and accompanying text (raising this hypothetical).

## QUESTION 3

This paper will also comment, as indicated, on question no. 3 of the Consultative Document's list of specific questions. This question asks whether specific resolution actions are critical prerequisites for the effective implementation of resolution strategies:

> 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?

Because this is, again, a compound question, comments on it are divided below into Parts III, IV and V for analytical simplicity.

### Part III: Do you agree that achieving cross-border enforceability of temporary restrictions or stays on early termination rights in financial contracts is a critical prerequisite for the effective implementation of resolution strategies for G-SIFIs?

In addressing this question, it is necessary to first clarify the meaning of "financial contracts" and "early termination rights." It is assumed in these comments that the first phrase includes not merely derivatives contracts, but any type of financial contract (including, for example, loan agreements). Regarding the latter phrase, although the Consultative Document's use of "early termination rights" is often unqualified, suggesting it would include a party's rights to terminate a financial contract with a financial firm prior to its stated maturity for any reason, the phrase appears to mean termination rights that are tied in some way to the financial firm's resolution. For example, footnote 4 and accompanying text of the Consultative Document state that such rights "arise only by reason of or in connection with a firm's entry into resolution"[19] and that "[t]his would be broad enough to include early termination rights based on the direct default of the [financial firm] under resolution, cross default provisions, default of a specified reference entity and defaults based on credit support."[20] The phrase is therefore interpreted (and used below) to mean termination rights that are tied in some way to the financial firm's resolution.

Restrictions and stays on early termination rights in financial contracts can be important for the effective implementation of resolution strategies. For that reason, insolvency laws often restrict the early termination of contracts, other than derivatives contracts, that are favourable to the debtor.[21] The rationale is to better enable the debtor to reorganize by keeping advantageous contracts in place.[22] In contrast, restrictions and stays on early termination rights in derivatives contracts that hinder the close out netting of those contracts have been thought (although not proved) to be systemically risky,[23] with the result that those early termination rights are often protected by so-called "safe-harbour" rules.[24]

This disparate treatment reflects, among other things, two different (although not necessarily inconsistent) views on how systemic risk can arise. Restricting the early termination of contracts that are favourable to a debtor enables the debtor, as mentioned, to reorganize.[25] From a systemic risk perspective, that also helps to assure that a firm, including a G-SIFI, can achieve a successful resolution (thus reducing counterparty risk — the risk that a G-SIFI's failure becomes systemic by triggering the failure of parties to which the G-SIFI contractually owes obligations). On the other hand, allowing the early termination of derivatives contracts has been thought to help protect markets whose collapse could be systemically risky.[26]

19 Consultative Document, at 3.

20 Consultative Document, at 3 n. 4.

21 See, for example, 11 U.S.C. § 365(e) (of the US Bankruptcy Code), nullifying so-called *ipso-facto* clauses.

22 Steven L. Schwarcz and Ori Sharon, "The Bankruptcy-Law Safe Harbor for Derivatives: A Path-Dependence Analysis," 71 Washington and Lee Law Review 1715, 1720 (2014) (hereinafter, "Bankruptcy-Law Safe Harbor").

23 *Id*. at 1742–53.

24 For comparative overviews of safe harbour rules, see, for example, Philipp Paech, "Close-Out Netting, Insolvency Law and Conflict of Laws," *Journal of Corporate Law Studies* (forthcoming 2014), available at http://ssrn.com/abstract=2414400; Jan De Corte, "Enforcement of Close-Out Netting" (May 15, 2014 draft), available at http://ssrn.com/abstract=2437996.

25 See *supra* notes 21-22 and accompanying text.

26 "Bankruptcy-Law Safe Harbor," *supra* note 22, at 1724 and 1737; Edward J. Janger, Riz Mokal and Robin Phelan, "Discussion Paper: Treatment of Financial Contracts in Insolvency — Analysis of the ICR Standard" (discussion paper for October 24, 2014 meeting of World Bank Insolvency and Creditor/Debtor Regimes Task Force), at 2. See also *supra* notes 23-24 and accompanying text.

In designing an effective resolution system to achieve financial stability,[27] regulators should try to recognize both of these goals: to enable systemically important financial firms to achieve a successful resolution, and to protect financial markets whose collapse could be systemically risky.[28] Although the Consultative Document is sometimes ambiguous on this point,[29] it appears to focus primarily on enabling systemically important financial firms, in particular G-SIFIs, to achieve a successful resolution.[30] That focus should be broadened, however, to take into account the possibility that early termination rights in financial contracts sometimes might be important to protect financial markets whose collapse could be systemically risky.

The initial answer to the question posed in Part III above is therefore the following: although achieving cross-border enforceability of temporary restrictions or stays on early termination rights in financial contracts can facilitate the effective implementation of resolution strategies for G-SIFIs, it sometimes might undermine the integrity of financial markets, with systemic consequences; and therefore the desirability of achieving such cross-border enforceability should be assessed after case-by-case review of the applicable restriction or stay.[31]

Assuming arguendo that review of a particular restriction or stay indicates that it should have cross-border enforceability, this paper also questions whether temporary restrictions or stays on early termination rights would always be sufficient for the effective implementation of resolution strategies for G-SIFIs. The rationale for a merely temporary stay appears to reflect a regulatory practice to quickly (within two days) transfer a failed bank's performing assets — including the financial contracts — to a bridge bank, after which the conditions triggering early termination rights of those contracts would no longer exist.[32] Such a prompt transfer of assets is rare, however, outside of the banking context.[33] Absent such a prompt transfer, one or more financial contracts may be critical to a G-SIFI's successful resolution — such as where a contract provides critically needed financing.[34] To that extent, any otherwise needed restrictions and stays should continue longer through the resolution process.[35]

27 To the extent a resolution regime addresses troubled firms, it should also at least take into account the traditional goals associated with insolvency and bankruptcy law, including economic efficiency. *Cf.* Douglas G. Baird, "Bankruptcy's Uncontested Axioms," 108 *Yale Law Journal* 573 (1998) (explaining and distinguishing those traditional goals); Eilis Ferran, "European Banking Union: Imperfect, But It Can Work," University of Cambridge Leg. Studs. Research Paper No. 30/2014, at 11-12 (April 2014) (distinguishing "resolution" from "conventional corporate insolvency regimes," the former being a "specialized process for dealing with distressed banks and, ideally, other systemically important financial actors as well"). One thus might characterize a resolution regime as focusing on macroprudential-related restructuring and a conventional corporate insolvency regime as focusing on microprudential-related restructuring.

28 See, for example, Steven L. Schwarcz, "Systemic Risk," 97 *Georgetown Law Journal* 193, 202 (2008) (showing that both firm risk and market risk contribute to systemic risk).

29 See, for example, Consultative Document, at 11-12 (stating that "Effective stays on termination rights that arise only by reason of or in connection with a firm's entry into resolution are important to prevent the close out of financial contracts in significant volumes.")

30 Janger, Mokal and Phelan, *supra* note 26, at 7, confirm this focus by the FSB: "The Financial Stability Board has published a list of 'Key Attributes' for resolution of financial institutions. The approach to netting [therein] tracks the FDIC regime [which focuses primarily on counterparty risk], not the bankruptcy regime" which focuses primarily on market-failure risk.

31 This case-by-case review should include a balancing of the risks. *Cf.* Janger, Mokal and Phelan, *supra* note 26, at 4 (observing that "protecting the early termination and netting rights of Lehman [Brother]'s counterparties may have actually increased counterparty risk, because Lehman was unable to honor its other contracts"). Another example of a risk might include a firesale of assets. Because the types of assets that financial firms own are often correlated to the types of assets held by other financial firms, a significant forced sale of assets might trigger a market-value decline that (through margin calls and marking to market) has self-reinforcing tendencies.

32 Janger, Mokal and Phelan, *supra* note 26, at 3 and 8.

33 In orderly resolutions, most countries impose a stay of proceedings to permit opportunities for resolution to be explored and pursued, and allow for the stay to be modified where necessary to balance the best interests of all of the parties involved.

34 Incongruously, due to bank lobbying, the US Bankruptcy Code restricts early termination rights *except for* financial contracts that provide financing. See 11 U.S.C. 365(c)(2).

35 Cf. Janger, Mokal and Phelan, *supra* note 26, at 4 (observing that "the early termination of financial contracts proved a serious problem in maximizing the value of Lehman [Brother]'s assets"). Although beyond the scope of the Consultative Document, this paper also notes that a G-SIFI's successful resolution could be enhanced by restrictions and stays on early termination rights in all contracts to which the G-SIFI is a party. See *supra* note 22 and accompanying text. *Cf.* De Corte, *supra* note 24 (questioning the adequacy of the European Union's resolution proposals in view of the very limited nature of the contemplated stay and the qualifications on its exercise).

### Part IV: Do you agree that achieving cross-border enforceability of "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 G-SIFIs?

If, as this question implicitly assumes, the debt bail-in is essential to the G-SIFI's loss-absorbing resources in resolution, the answer to this question is trivial: achieving cross-border enforceability of "bail-in" of debt instruments is a critical prerequisite for the effective implementation of resolution strategies for G-SIFIs. That answer would not change merely because the debt instruments happen to be governed by the laws of a jurisdiction other than that of the issuing entity.

The real import of this question goes to assessing the cross-border enforceability of the bail-in of debt instruments that are governed by the laws of a jurisdiction other than that of the issuer.[36] The Consultative Document questions this enforceability on the grounds that "the write down or conversion [contemplated by the bail-in provisions of the debt instruments] might not be recognised and enforced by courts outside the issuer's home jurisdiction."[37] Although that enforceability would be less likely absent laws that specifically recognize bail-in in the countries involved, the bail-in nonetheless should be generally enforceable against creditors — subject to the risk that courts, citing public policy, might not enforce a bail-in that harms local creditors or impairs local financial stability or, if a creditor is itself in resolution, that undermines local insolvency law policy.[38] Some comfort could be obtained by requiring legal opinions in the relevant jurisdictions confirming such enforceability as a condition to issuance of the debt instruments.[39]

As a practical matter, it is noted that most debt instruments issued to investors internationally are governed either by the laws of the issuer's jurisdiction or by New York or English law. If, therefore, the bail-in provisions are enforceable under those laws, that would significantly help to ensure that such provisions facilitate a G-SIFI's loss-absorbing resources in resolution. The FSB therefore may wish to consider preparing and disseminating model bail-in provisions that would be enforceable under those laws.

This paper will also make three broader observations about bail-in provisions. The Consultative Document states that a "key principle" for cross-border bail-in clauses is that "the contractual [bail-in] provisions should make it clear that the terms of the bail-in will be determined by the relevant resolution authority, rather than any conversion set out in the debt documentation."[40] To the extent that leaves the terms of the bail-in conversion open ended, it is unclear how to price, or why an investor would ever invest in, those debt instruments.

Second, the Consultative Document appears to address the enforceability, not only of bail-in provisions that the parties themselves (for example, the issuer and investors) contractually choose, but also of regulatory-imposed bail-in provisions. Any regulatory determination whether to impose bail-in provisions should take into account the possibility of raising the cost of capital or having other unforeseen consequences.[41]

Finally, although question no. 3 does not ask about, and the Consultative Document does not address, the cross-border enforceability of the bail-in of equity securities,[42] it sometimes may be important to confirm that enforceability.[43] The enforceability of an equity bail-in would be critical, for example, if it is designed to harmonize with a bail-in of debt instruments. Thus, consider a scenario in which similar conditions trigger bail-in provisions in an issuer's debt instruments (converting them into common equity) and bail-in provisions in the same issuer's equity securities (converting them into a class subordinate to common equity). If the latter conversion is not enforceable, then, regardless of the governing law, a court may well refuse to enforce the debt bail-in because the debtholders bargained to have senior, not *pari passu* (and thus diluted), equity positions after the conversion.

36 This assumes that the laws of the issuer's jurisdiction respect the bail-in. If those laws do not contemplate the bail-in, investors may actually prefer the debt instruments to be governed by the laws of a foreign jurisdiction that respects the bail-in. *Cf. supra* note 18 and accompanying text (observing that if the issuer's jurisdiction has no laws regarding debt bail-in, the enforceability of a bail-in would be reinforced by governing the debt instruments by the laws of a jurisdiction that recognizes a bail-in).

37 Consultative Document, at 4.

38 *Cf.* Consultative Document, at 14-15 (citing some of these concerns).

39 The Consultative Document recognizes the possibility of requiring legal opinions and its inherent limitations. See *id*.

40 See Consultative Document, at 14, paragraph 2.2.1(3).

41 For example, automatic conversions of debt claims to equity interests might create counterparty risk by reducing the value of firms holding those claims.

42 The rationale for this omission would appear to be that the issuer's law always governs equity securities. The comments in this paper do not currently purport to address the merits of including bail-in provisions in equity securities.

43 That could be done, for example, through a legal opinion from counsel in the issuer's jurisdiction.

### Part V: 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?

As already mentioned,[44] the FSB should consider whether restrictions and stays on early termination rights, which are otherwise necessary for the effective implementation of resolution strategies for G-SIFIs, should continue longer through the resolution process (and not be merely temporary).

The FSB should also consider whether a stay on the seizure of a financial firm's assets should also be enforceable outside of the firm's jurisdiction. Absent that enforceability, creditors of the firm would likely engage in a grab race to seize foreign assets, thereby potentially impairing the firm's viability.[45]

Finally, to the extent some debt instruments issued by financial firms do not include contractual bail-in provisions and are not subject to a statutory bail-in regime, those firms in resolution might need to negotiate changes to essential payment terms.[46] To accomplish that, those firms would need to solve the holdout problem, discussed above in the sovereign-debt-restructuring context.[47] The analysis and (statutory) solution to that problem discussed in the sovereign-debt-restructuring context should also be applicable to solving that problem in the financial-firm-resolution context.

## CONCLUSION

A resolution regime based on contractual approaches has limited utility because it only binds parties that contractually agree to the regime and, even then, may have questionable enforceability. A statutory approach to a resolution regime should be much more effective in achieving financial stability. In designing such a regime, at least two goals should be recognized: enabling systemically important financial firms to achieve a successful resolution, and protecting financial markets whose collapse could be systemically risky. The Consultative Document appears to focus primarily on the first goal; that focus should be broadened to also take into account the second goal.

A statutory approach to a resolution regime could best be accomplished by a treaty. Treaties, however, typically involve years of negotiation. A more practical alternative might be to propose the text of a model law, which could be enacted as parallel legislation — thereby becoming the functional equivalent of an international treaty entered into by the enacting jurisdictions. This type of alternative has proved successful in a related context, as evidenced by the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency, which has been adopted by over 22 countries.[48]

44 See *supra* notes 21-22 and accompanying text.

45 Compare national legislation based on the United Nations Commission on International Trade Law Model Law on Cross-Border Insolvency; a list of enacting States is available at www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model_status.html.

46 See *supra* note 8 and accompanying text

47 See *supra* notes 8–13 and accompanying text.

48 See *supra* note 45. UNCITRAL's Model Law on International Commercial Arbitration has also been adopted by over 60 countries.

## ABOUT CIGI

The Centre for International Governance Innovation is an independent, non-partisan think tank on international governance. Led by experienced practitioners and distinguished academics, CIGI supports research, forms networks, advances policy debate and generates ideas for multilateral governance improvements. Conducting an active agenda of research, events and publications, CIGI's interdisciplinary work includes collaboration with policy, business and academic communities around the world.

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