



ABU DHABI GLOBAL MARKET
سوق أبوظبي العالمي

CONSULTATION PAPER NO. 5 OF 2018

24 SEPTEMBER 2018

**CONSULTATION ON PROPOSED BANK
RECOVERY AND RESOLUTION
REGULATIONS**

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INTRODUCTION

WHY ARE WE ISSUING THIS PAPER?

1. The Financial Services Regulatory Authority ("**FSRA**") of Abu Dhabi Global Market ("**ADGM**") issued this Consultation Paper to invite public feedback and comments on (i) proposed new Bank Recovery and Resolution Regulations enabling the recovery or orderly resolution of eligible firms engaged in certain Regulated Activities; and (ii) certain associated and consequential amendments to other ADGM regulations and specific FSRA rules.
2. This proposal to introduce a recovery and resolution regime is in response to strong interest in ADGM by regional and international banking entities, which takes into account global regulatory development.
3. The Board of Directors of ADGM and the FSRA invite comments on the draft Banking Recovery and Resolution Regulations, as well as the associated amendments to ADGM regulations and FSRA Rules.

WHO SHOULD READ THIS PAPER?

4. This Consultation Paper will be of interest to Authorised Persons and Recognised Bodies generally, and specifically those Authorised Persons engaged in the Regulated Activities of Accepting Deposits or Dealing in Investments as Principal, persons considering seeking a Recognition Order enabling them to engage in clearing activities, and their respective professional advisors.

HOW TO PROVIDE COMMENTS

5. All comments must be in writing and sent to the address or email specified below. If sending your comments by email, please use the Consultation Paper number in the subject line. You may, if relevant, identify the organisation you represent in providing your comments. The FSRA reserves the right to publish, including on its website, any comments you provide, unless you expressly request otherwise at the time of making those comments. Comments supported by reasoning and evidence will be given more weight by the FSRA.

WHAT HAPPENS NEXT?

6. The deadline for providing comments on this proposal is **8 November 2018**. Following receipt of comments, we will consider whether any modifications are required to the proposed amendments to the ADGM’s legislative framework. The Board of ADGM and the FSRA will then proceed to enact the proposed legislative framework. You should not act on this proposal until the relevant regulations, rules and any related guidance are issued. We will issue a notice on our website when this happens.

COMMENTS TO BE ADDRESSED TO:

Consultation Paper No. 5 of 2018
Financial Services Regulatory Authority
Abu Dhabi Global Market Square
Al Maryah Island
PO Box 111999
Abu Dhabi, UAE
Email: consultation@adgm.com

STRUCTURE OF THIS PAPER

7. The substantive amendments under consideration are summarized in this paper, which is organized as follows:
 - a. Annex A – Draft Bank Recovery and Resolution Regulations;
 - b. Annex B – Draft amendments to Financial Services and Markets Regulations 2015;
 - c. Annex C – Draft amendments to Insolvency Regulations 2015; and
 - d. Appendix 1 – Draft amendments to the Prudential - Investment, Insurance Intermediation and Banking Rules.
8. Unless otherwise defined, capitalized terms referred to in this paper have the meanings attributed in the Financial Services and Markets Regulations 2015 (“**FSMR**”) and/or the Glossary (“**GLO**”).

BANK RECOVERY AND RESOLUTION

BACKGROUND

1. The Global Financial Crisis highlighted the shortcomings of insolvency regimes to address adverse economic effects arising from the insolvency of financial institutions considered 'too big to fail'. The desire to move away from the implicit state guarantee for such firms prompted a series of global and national initiatives, which culminated in the Key Attributes Model in 2011 by the leaders of the G20 and the Financial Stability Board. These regimes promoted continuity of critical economic functions in the event of the insolvency of large banks and other systemically important financial services institutions in order to protect depositors and client assets. Elements necessary for an effective resolution framework were identified as: (i) an experienced resolution authority; (ii) adequate resources and statutory powers; (iii) adequate and varied resolution tools (including bail-in and debt write down mechanisms); (iv) mechanisms to ensure that losses are ultimately borne by shareholders and unsecured creditors; and (v) legal enforcement of cross-border coordination during resolution processes.
2. Given the current stage of ADGM's development, the FSRA has developed a bank recovery and resolution regime as a proactive measure, in order to provide ADGM with a comprehensive regulatory regime. ADGM, being a jurisdiction within which banks may accept deposits and firms may trade in investments on a proprietary basis, is not immune to risks associated with large and complex institutions. Qualified new ADGM banks and the migration of the parent entities of existing banking groups to ADGM may require the FSRA to undertake consolidated supervision of financial groups. Branches and subsidiaries of existing institutions operating in ADGM may become involved in critical cross-border bank resolution strategies directed by foreign resolution authorities. Despite not having the capacity to provide credit as the lender of last resort in a crisis, the FSRA may be required to act as the consolidated supervisor of a distressed financial group operating in multiple jurisdictions.

3. The proposed Bank Recovery and Resolution ('BRR') Regulations reflect the elements of the Key Attributes Model, familiar to institutions operating under the European Union's Bank Recovery and Resolution Directive. As in other international jurisdictions, the resolution powers contained in the BRR Regulations create an alternative to wind up pursuant to ADGM's Insolvency Regulations 2015. The availability of this option in exceptional circumstances will enhance the stability and resilience of the ADGM financial system, reduce the likelihood of failure of a critical institution, and reduce the impact of failure, should one occur.
4. The BRR Regulations intend to achieve these objectives in two ways. Firstly, by requiring the FSRA to identify those in-scope institutions whose failure, due to their unique size and nature, would threaten the integrity of ADGM or the financial system generally. Such qualifying institutions may be obligated to engage in formal recovery and resolution planning in advance of financial distress.
5. Secondly, by providing the FSRA with specific resolution powers, to be used only if the FSRA would be unable to achieve the objectives set by the BRR Regulations with the application of the Insolvency Regulations 2015. The decision to apply resolution powers will be based upon qualitative tests to be applied by the FSRA in its discretion, having reference to its objectives and the guiding principles contained in the BRR Regulations, and will be conditional upon the satisfaction of specific prerequisites and subject to certain safeguards, as described below in greater detail.

ITEM 1 – KEY FEATURES OF THE BANK RECOVERY AND RESOLUTION REGULATIONS

THE RESOLUTION AUTHORITY AND ITS GUIDING PRINCIPLES

6. Under the proposed regime, the FSRA, alongside being the supervisory authority, would undertake the additional role of being the resolution authority; this is the body charged with promoting an orderly wind-down of a failed or failing institution, through the exercise of resolution powers and the use of resolution tools. Following examination of a number of leading international BRR regimes, such a dual role would not be unique

and may lead to efficiencies, given the alignment of its potential objectives as a resolution authority, which include the protection of depositors and investors and the continuity of critical functions. These objectives are consistent with and complement the FSRA's existing objectives established by both FSMR and ADGM's Founding Law, Abu Dhabi Law No. (4) of 2013.

7. The BRR Regulations will initially task the FSRA with identifying which, if any, in-scope institutions, should be compelled to engage in formal recovery and resolution planning, and to engage with such institutions. Should the number of in-scope institutions engaging in formal recovery and resolution planning grow over time, the Board may consider whether the establishment of a separate resolution authority would be warranted.

IN-SCOPE ENTITIES

8. ADGM firms which accept deposits (Islamic or conventional), trade in investments on a proprietary basis (Dealing in Investments as Principal) or provide clearing services would be 'in-scope' for the purposes of the BRR Regulations, However, only those firms whose risk profile meets specified criteria would be compelled to engage in recovery and resolution planning. In the case of branches or subsidiaries of foreign institutions, any planning requirements imposed would take into consideration any supervisory directions undertaken to satisfy the home regulator or resolution authority of the firm or financial group.

ISSUES FOR CONSIDERATION

Q1: SHOULD A QUANTITATIVE TEST ESTABLISHING A MINIMUM SIZE THRESHOLD FOR IN-SCOPE INSTITUTIONS ALSO BE EMPLOYED IN ADDITION TO THE QUALITATIVE TEST TO BE USED BY THE FSRA? IF SO, WHAT THRESHOLD WOULD BE APPROPRIATE?

RECOVERY AND RESOLUTION PLANNING

9. In-scope institutions and ADGM-based members of their financial groups, whose failure would have a significant adverse impact upon confidence in ADGM, its economy, reputation, or the financial system, may be directed by the FSRA to engage in periodic, formal recovery and resolution planning. Senior management will be required to assess and formally approve all recovery and resolution plans as part of the planning process.

ISSUES FOR CONSIDERATION

Q2: SHOULD THE BOARD OF DIRECTORS OF THE IN-SCOPE INSTITUTION ALSO BE REQUIRED TO FORMALLY RESOLVE TO ADOPT THE PROVISIONS CONTAINED IN ANY RECOVERY AND RESOLUTION PLAN?

10. Firms would only be compelled to engage with the FSRA to conduct formal recovery and resolution planning on an exceptional basis, upon grounds established by the BRR Regulations. Mandated recovery and resolution plans will be subject to FSRA review, in order to identify potential impediments, and, in cases where deficiencies are not addressed, will be subject to direction powers compelling rectification. To assist affected in-scope institutions to engage in recovery and resolution planning, the schedules to the BRR Regulations identify necessary elements of a recovery and resolution plan. Given the need for candor in discussions and the inclusion of proprietary information in any plan, the FSRA will not publish the contents of any plan, nor publicly declare any in-scope institution as resolvable. Consistent with the Key Attributes Model, the FSRA may however, share details of recovery and resolution plans with other regulators in circumstances of an in-scope institution operating in multiple jurisdictions.

RECOVERY – EARLY INTERVENTION ACTIONS, ADDITIONAL DIRECTION POWERS

11. In-scope institutions of a profile which the BRR Regulations are meant to monitor may be subject to BRR Regulation direction powers which expand the current powers contained in FSMR and the Prudential - Investment, Insurance Intermediation and Banking Rules, in circumstances where

compliance with minimum capital requirements, Threshold Conditions or Recognition Requirements are threatened.

12. For example, in circumstances where the FSRA is of the view that an in-scope institution may be undercapitalized in relation to its interconnectedness and relevant risks, additional discretionary direction powers beyond those contained in FSMR would enable the FSRA to develop tailored minimum capital requirements for such entity.
13. Such early intervention powers include the power to compel management to take steps to halt the deterioration, including by convening a meeting of shareholders to consider restructuring measures. In circumstances where the FSRA considers the replacement of management necessary for early intervention action to be successful, the FSRA may replace management with one or more qualified temporary administrators. A FSRA appointed administrator would be required to take proportionate action, including seeking shareholder approval for the adoption of recovery measures, including the implementation of any pre-existing recovery plan.

RESOLUTION PRECONDITIONS

14. The proposed BRR Regulations would empower the FSRA, as resolution authority, to exercise one or more resolution powers in exceptional circumstances in relation to those in-scope entities whose failure may threaten the integrity of the ADGM or the financial system generally.
15. Prior to taking resolution action, the FSRA, acting in its capacity as resolution authority, must be satisfied that:
 - a. The application of resolution powers would be consistent with the objectives of the FSRA and the guiding principles described in paragraph 6 above, and must be for the purpose of preserving the integrity of the ADGM or the financial system generally;
 - b. The resolution conditions specified in Section 22(1) of the BRR Regulations have been met:

- i. a systemically important, in-scope institution is failing or likely to fail;
 - ii. no reasonable prospect of avoidance of failure exists without the application of resolution powers; and
 - iii. the application of the resolution powers is in the public interest; and
 - c. The choice of proposed resolution action would result in the minimal collateral destruction of value, consistent with the resolution objectives contained in section 21 of the BRR Regulations.
16. For the purpose of considering the public interest, the FSRA must consider the resolution action to be proportionate to the achievement of the resolution objectives, which could not be satisfied to the same extent using the winding up process in the Insolvency Regulations 2015.
17. Any proposed resolution action must adhere to general resolution principles established within the BRR Regulations, which impose priority for the allocation of losses to shareholders and unsecured creditors, and an allocation of responsibility for failure to persons responsible, to the extent permissible under ADGM law.

PRIOR JUDICIAL DETERMINATION

18. Prior to taking any resolution action which would interfere with property rights, the FSRA will first be required to petition the ADGM Court for a determination that the FSRA has reasonable grounds to conclude that the resolution conditions imposed by the BRR Regulations have been satisfied. As the window for the successful application of resolution tools or resolution powers may be brief, such applications would be sought on an expedited basis, in private and without prior notice to any party.
19. Appeals concerning the FSRA's decision to employ resolution powers under the BRR Regulations would differ from the exercise of powers under FSMR, insofar as the process would involve proceedings before the ADGM Court, rather than the ADGM Regulatory Committee and Appeals

Panel. While a right of appeal from any judicial proceedings and judicial review remains available to aggrieved parties through the ADGM Court's appellate jurisdiction, given the time-sensitive nature of resolution decisions, any subsequent decision of the Court may not impair or invalidate the application of any resolution measure.

20. Insolvency proceedings brought by creditors of all in-scope firms would become conditional upon prior notice to, and the consent of, the FSRA. As noted above, in the absence of exceptional circumstances relating to the risks posed by the failure of the in-scope entity, the FSRA would not object to the application of the Insolvency Regulations 2015.

RESOLUTION TOOLS

21. The BRR Regulations include resolution tools empowering the FSRA to write-down or convert debts of a failing in-scope institution, to the extent necessary to recapitalize or resolve that institution. Available measures include the writing down of debt or its conversion to equity and the power to execute a sale of all or a portion of a qualifying in-scope institution.
22. These measures may be used on a standalone basis to restore the viability of the institution, or as a precursor to the transfer of the shares or assets of a failing institution to a third-party purchaser. Notably, liabilities subject to netting arrangements may only be subject to resolution action on a net basis, and assets which serve as collateral may only be transferred with such security interests intact.
23. A series of general resolution powers commonly found in other BRR regimes have been included in the BRR Regulations. For instance, the FSRA, in its capacity as resolution authority, may compel the delivery of information, replace management, temporarily suspend payment or delivery obligations, temporarily stay the enforcement of security and require that critical arrangements continue by suspending default rights.
24. Given the nature of ADGM as a jurisdiction and the statutory mandate of the FSRA, resolution tools that enable the FSRA to assume temporary ownership of a failing institution, or create a temporary bridge institution were considered unsuitable for inclusion in the BRR Regulations.

RESOLUTION SAFEGUARDS

25. The application of any resolution measure shall be subject to the Resolution Safeguards contained in sections 67 to 75 of the proposed BRR Regulations, which include the publication of resolution instruments and the protection of netting and collateral arrangements as well as trading, clearing and settlement systems. In addition, a mandatory calculation of the incremental effects of resolution action upon affected persons, in comparison with the result of Insolvency Regulations 2015 would be undertaken by the FSRA, as summarized below.

VALUATION

26. As a means to consider the consequences of resolution action prior to employing resolution measures, the FSRA is required to engage in a pre-resolution valuation exercise. The FSRA must engage an independent party to perform a pre-resolution valuation in order to compare the result of the application of resolution tools to the alternative of winding up the institution under the Insolvency Regulations 2015. In the circumstances of a rapidly deteriorating financial position, a provisional valuation may take the place of a definitive valuation.
27. At the conclusion of any resolution process, a difference in treatment valuation (the '**DTV process**') shall determine the extent to which relevant parties have been affected by the application of resolution tools, by comparing the post-resolution outcome with the theoretical losses which would have resulted had the institution been wound up in accordance with the Insolvency Regulations 2015.

TREATMENT OF CREDITORS

28. As a general principle of resolution, and to the extent reasonably possible, no creditor should be placed in a worse position due to the application of resolution measures than would have resulted if the institution had been wound up in accordance with the Insolvency Regulations 2015.
29. As the achievement of resolution objectives might result in additional incremental losses to some creditors, the BRR Regulations enable such disadvantaged parties to claim the amount of additional losses calculated

in accordance with the DTV process from the post-resolution institution or any residual institution. It is important to note, however, that neither the ADGM nor the FSRA will assume responsibility to compensate persons disadvantaged by the resolution process.

FOREIGN RESOLUTION ACTION

30. Cross-border coordination, a core feature of Key Attributes Model, is contemplated by the proposed BRR Regulations. If consistent with the resolution objectives enshrined in the BRR Regulations and upon satisfaction of resolution conditions, including prior judicial determination if necessary, the FSRA may recognize foreign resolution action by employing a resolution power in support of a foreign resolution authority. Recognition of foreign resolution action will not be given in all circumstances, including those where the effect of recognition would adversely affect the financial stability of the ADGM or the UAE, or ADGM-based creditors would be disadvantaged in comparison to those located in other jurisdictions.

ITEM 2 – CONSEQUENTIAL AMENDMENTS TO ADGM REGULATIONS AND RULES

31. In order to implement the introduction of the BRR Regulations, it will be necessary to make a number of consequential changes to ADGM's and FSRA's existing regulations and rules.
32. Section 202 of FSMR would be amended to expand the FSRA's direction powers when acting as a consolidated supervisor of a financial group, enabling it to issue directions to address specific risks facing group members located outside ADGM. In conjunction with these amendments, defined terms appearing in section 258 would be supplemented with the addition of 'Financial Group', 'Financial Institution' and 'Holding Company'.
33. Section 276 of the Insolvency Regulations 2015 would be amended to contemplate that the application of resolution powers may impact the enforceability of netting arrangements, including the potential for a

twenty-four hour stay of enforcement, as contemplated by the BRR Regulations.

34. PRU 8.1.2 would be amended to enable the FSRA to elect to become, by way of notice, the consolidated supervisor of a financial group to which an Authorised Person belongs. The decision to assume responsibility for consolidated supervision will be made by the FSRA after considering a number of factors, including whether the ultimate holding vehicle for the group is located within the ADGM.

ISSUES FOR CONSIDERATION

Q3: DO YOU HAVE ANY CONCERNS ABOUT THESE PROPOSALS OR CONSEQUENTIAL AMENDMENTS? IF SO, WHAT ARE THOSE CONCERNS AND HOW SHOULD THEY BE ADDRESSED?