



SOUTH AFRICAN RESERVE BANK
Prudential Authority

Statement explaining the need for, intended operation and expected impact of the proposed prudential standard for designated institutions in respect of stays on early-termination rights and resolution moratoria

(Draft for Consultation)

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1. Introduction

- 1.1 A lesson learnt from the 2008 global financial crisis was that a disorderly termination of a financial institution's contracts on a mass scale could cause significant contagion effects to the financial markets, posing wider risks to the stability and effective working of the financial system. To address this, the Financial Stability Board (FSB) issued the Key Attributes of Effective Resolution Regimes for Financial Institutions (Key Attributes) in 2011 (revised in 2014). The Key Attributes were formally adopted as an international standard in 2015.
- 1.2 The Key Attributes set out the core elements that the FSB considers necessary for an effective resolution regime. As such, their implementation should enable authorities to resolve financial institutions in an orderly manner, without unduly exposing taxpayers to loss from solvency support, while maintaining continuity of their critical economic functions.
- 1.3 In line with the Key Attributes, the proposed prudential standard (the Standard) relating to stays on early-termination rights and resolution moratoria on contracts of designated institutions in resolution (stays and resolution moratoria) gives effect to the principles contained in the Financial Sector Laws Amendment Act, 2021 (Act No. 23 of 2021) (FSLA Act) and sets out the requirements for sound practices and processes on stays and resolution moratoria for designated institutions.
- 1.4 The Standard provides for powers for the South African Reserve Bank (SARB), as the resolution authority, to impose stays and resolution moratoria in relation to specified contracts, while protecting the enforcement of eligible netting and collateral agreements.
- 1.5 The objective of the Standard is to stipulate requirements on stays and resolution moratoria, in line with international standards and principles, for the orderly resolution of designated institutions.
- 1.6 This statement is prepared and published in accordance with and in fulfilment of the requirements under section 98(1) of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) (FSR Act).
- 1.7 The Statement is intended to communicate to the designated institutions, the policy context, intended outcomes and expected impact of the Standard.

1.8 This Statement will be published for consultation, together with the Standard on stays and resolution moratoria requirements for designated institutions.

2. The need for the Standard

2.1 The powers of authorities to impose stays on the exercise of early termination rights, that may be triggered upon entry of an institution into resolution or in connection with the use of resolution powers, and to impose moratoria on creditor actions, forms part of a suite of general resolution powers stipulated in the Key Attributes.

2.2 As a member of the G20, South Africa committed to implementing the Key Attributes and ending the Too-Big-To-Fail phenomenon. To this end, the South African authorities embarked on a review of the existing framework against the Key Attributes and that process culminated in the development of the recently enacted FSLA Act to strengthen the South African resolution framework in line with the Key Attributes and to designate the SARB as a resolution authority.

2.3 Prospects for an orderly resolution will be hampered if a failing designated institution's counterparties terminate their contracts with the designated institution in resolution on a mass scale based solely on such institution's entry into resolution or the exercise of resolution powers by the SARB on the financial institution. In this regard, it is important for the resolution framework to prevent this situation and to ensure that critical functions and shared services can continue, particularly in the case of an open resolution.

2.4 Effective stays on early-termination rights, that arise only because of, or in connection with, an institution's entry into resolution, are important to prevent the close-out of contracts in significant volumes. Such close-out action upon entry into resolution could disrupt the provision of critical functions or critical shared services and undermine the objective of an orderly resolution. Section 166L of the FSLA Act ensures that counterparties to a designated institution that is being placed in resolution may not exercise early termination rights solely on the grounds of such designated institution's entry into resolution.

2.5 In the absence of an appropriate and enforceable statutory framework or contractual recognition provisions, there is a risk that foreign courts could enforce an agreement governed by foreign law without due regard to South African statutory provisions on

the exercise of early termination rights as provided for under the FSLA Act. To complement the provisions under section 166L of the FSLA Act, the Standard provides for the adoption of contractual recognition provisions, in specified types of contracts that are not governed by South African law, to give effect to the objective and requirements of the FSLA Act relating to resolution stays on specified contracts of designated institutions in resolution.

- 2.6 The effect of the contractual recognition provisions provided for in the Standard will be to extend the application of the SARB's resolution powers in terms of the FSLA Act to specified contracts that are governed by foreign laws.
- 2.7 Section 166R (1)(d) of the FSLA Act empowers the SARB to temporarily suspend a designated institution's contractual obligations, subject to certain specified conditions. The Standard provides clarity on the principle contained in the FSLA Act and ensures that the South African resolution framework complies with international best practices by stipulating that the moratoria provided for under section 166R of the FSLA Act will not exceed forty-eight (48) hours.

3. The intended operation of the Standard

- 3.1 The Standard shall apply to all designated institutions and to contracts, entered by designated institutions, that are governed under foreign law; and contain provisions for early termination rights.
- 3.2 The Standard shall affect early-termination rights that arise only because of entry of a designated institution into resolution or in connection with the use of resolution powers by the SARB in relation to a designated institution.
- 3.3 A stay on early termination rights, as provided for in Section 166L of the Act, does not affect the rights of counterparties that may arise due to the non-performance of obligations by a designated institution. Therefore, if a designated institution in resolution fails to perform its obligations in terms of its contracts, counterparties may exercise their rights in terms of the contracts.
- 3.4 A moratorium may only be issued by the SARB when the conditions for triggering a resolution have been met and a designated institution is placed in resolution. The suspension should, however, only be temporary in nature and section 166R (4) requires that the moratorium state the period which should be a reasonable period.

- 3.5 To ensure that moratoria issued by the SARB are in line with international best practice, the suspension of any obligations that may be provided for in moratoria issued by the SARB shall not exceed forty-eight (48) hours.
- 3.6 Central banks, Market Infrastructures as defined under section 1 of the FSR Act, as well as Payment Systems as defined in the Principles for Financial Market Infrastructures are excluded from the provisions of the Standard.
- 3.7 Designated institutions will be required to ensure that affected contracts contain clauses that recognise the SARB's stays and resolution moratoria powers, and to put measures in place to ensure that they have detailed records on the affected contracts. Additionally, designated institutions will be required to put measures in place to enable them to report the extent of their compliance with the requirements in the standard to the SARB. The board of directors (or corporate governing body of similar standing) will be ultimately responsible for overall compliance with the Standard.
- 3.8 The Standard is envisaged to come into effect in line with the implementation schedule to be published by the Minister of Finance in due course.

4. Expected impact of the Standard

- 4.1 It is expected that the Standard will at a minimum, place an additional administrative burden on designated institutions.
- 4.2 Because the SARB and the Prudential Authority cannot ascertain the full extent of the expected impact or any other unintended consequences, a set of questions to solicit industry inputs on the expected impact of implementing the Standard are included under Section C of the Comments Template.
- 4.3 The responses to Section C of the Comments Template, in particular, will be used to ascertain the expected impact or any other unintended consequences of the Standard.
- 4.4 A revised Statement will be prepared, taking into account the feedback that will be received from the industry.
- 4.5 Designated institutions and other interested stakeholders are encouraged to respond to the questions under Section C of the Comments template as well as

identify any potential risks or unintended consequences that might arise from the implementation of the Standard and submit those to the Prudential Authority as part of this consultation process.

5. Conclusion

It is an established practice for designated institutions to enter into contracts with foreign counterparties and for such contracts to be regulated in terms of foreign law. The standard seeks to ensure that such contracts contain clauses that recognise the provisions of the FSLA Act. The stays and resolution moratoria powers provided for in the Standard are a key element of the South African resolution framework because they enable the SARB to prevent counterparties from terminating their contracts with a designated institution in resolution on a mass scale based solely on such designated institution's entry into resolution or because of the exercise of resolution powers by the SARB.