

U.S. Resolution Stay Regulations and the ISDA 2018 U.S. Resolution Stay Protocol

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U.S. banking regulators have issued final rules (“U.S. Resolution Stay Rules”) requiring U.S. global systemically important banking organizations (“GSIBs”), certain of their subsidiaries, and the U.S. operations of non-U.S. GSIBs (collectively, the “Regulated Entities”) to amend all of their qualified financial contracts (“QFCs”), which are typically documented under ISDA Master Agreements and master repurchase agreements, to:

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- Explicitly provide that the exercise of default rights by their counterparty will be subject to certain limitations under the Orderly Liquidation Authority provisions of Title II of the Dodd-Frank Act (“OLA”) and the Federal Deposit Insurance Act (“FDIA”), and to the powers of the Federal Deposit Insurance Corporation (“FDIC”) under OLA and FDIA to transfer contracts (“Submission to U.S. Regulations Amendment”); and
- Limit the exercise of default rights by the counterparty based on the insolvency, bankruptcy or resolution of an affiliate of the Regulated Entity (*i.e.*, “cross-default rights”), and to permit the transfer of credit support provided by such affiliate in a resolution (“Limitation of Cross-Default Rights Amendment”).

WHY ARE THE U.S. RESOLUTION STAY RULES NECESSARY?

U.S. banking regulators introduced the U.S. Resolution Stay Rules to ensure the uniform application of OLA and FDIA¹ to all Regulated Entities, which have affiliates and operations worldwide and enter into QFCs that may or may not be governed by U.S. laws, and also to facilitate orderly resolution when default rights under a QFC may be triggered by entities that are resolved under non-OLA bankruptcy regimes.

¹ To give the FDIC time to transfer QFCs of a failed financial institution to a solvent bridge entity, both OLA and FDIA impose a one business day stay on the rights of non-defaulting counterparties of the failed institution to exercise termination, netting and collateral liquidation rights “solely by reason of or incidental to” the failed entity’s entry into resolution, its insolvency or its financial condition. In addition, OLA imposes certain restrictions on the exercise of cross-default rights by the counterparties of the failed financial institution.

The new rules aim to accomplish this in two ways:

- Including the Submission to U.S. Regulations Amendment in QFCs is designed to reduce the risk that courts in foreign jurisdictions would disregard statutory stay-and-transfer provisions under OLA and FDIA when a Regulated Entity enters into a resolution proceeding in the United States.
- Including the Limitation of Cross-Default Rights Amendment in QFCs will effectively import OLA's restrictions on cross-default rights into the non-OLA insolvency regimes and thus facilitate the resolution of a failed Regulated Entity under the U.S. Bankruptcy Code and FDIA.

HOW WILL THE RULES AFFECT COUNTERPARTIES OF REGULATED ENTITIES?

What will a counterparty of a Regulated Entity be asked to do?

If you have entered into a QFC (e.g., ISDA Master Agreements, repurchase agreements, certain securities contracts, forward contracts or commodities contracts) with a Regulated Entity, you will be asked by the Regulated Entity to either amend your QFC bilaterally or by using an ISDA-published protocol.

What is the deadline for amending QFCs?

All Regulated Entities must amend their QFCs with another Regulated Entity by January 1, 2019.

If you are a "Financial Counterparty" (e.g., financial institution, private fund, mutual fund, commodity pool, among others), and are not a "Small Financial Institutions" (i.e., financial institutions with assets of \$10 billion or less), you will be required to amend your QFCs (and your affected affiliate QFCs) with a Regulated Entity by July 1, 2019.

If you are neither a Regulated Entity nor a Financial Counterparty (or if you are a Small Financial Institution), you will be required to amend your QFCs (and your affected affiliate QFCs) with a Regulated Entity by January 1, 2020.

After the relevant compliance date, your Regulated Entity counterparty would be prohibited from entering into additional QFCs with you unless all QFCs between the Regulated Entity (or any of its Regulated Entity affiliates) and you (or any of your consolidated affiliates) have been amended.

Do the U.S. Resolution Stay Rules only apply to new QFCs?

No. The U.S. Resolution Stay Rules require that if any QFC is entered into between a Regulated Entity (or any Regulated Entity affiliate thereof) (“Regulated Entity group”) and a counterparty (or any of its consolidated affiliates) (“counterparty group”) on or after January 1, 2019, then all QFCs between any member of the Regulated Entity group and any member of the counterparty group, whether entered into before or after January 1, 2019, must be amended to comply with the U.S. Resolution Stay Rules.

Are there exceptions to the QFC amendment requirements?

The U.S. Resolution Stay Rules require two sets of amendments to QFCs; however, there are certain exceptions to each set of amendments.

A QFC is not required to be amended under the U.S. Resolution Stay Rules to include the Submission to U.S. Regulations Amendment if it:

- Explicitly provides that it is governed by the laws of the United States or any State thereof (without excluding OLA and/or FDIA); and
- Is entered into with a U.S. counterparty.

A QFC is not required to be amended under the U.S. Resolution Stay Rules to include the Limitation of Cross-Default Rights Amendment if it:

- Does not explicitly provide any default right related to an affiliate of the Regulated Entity that is the direct party to the QFC (the “direct party”) becoming subject to insolvency or resolution proceedings; and
- Does not explicitly prohibit the transfer of an affiliate credit enhancement if the Regulated Entity affiliate were to become subject to insolvency or resolution proceedings.

COMPLIANCE METHODS: BILATERAL AMENDMENTS OR ISDA PROTOCOLS

The U.S. Resolution Stay Rules currently permit three different ways for parties to comply with the U.S. Resolution Stay Rules:

- Adherence to the ISDA 2015 Universal Resolution Stay Protocol,
- Adherence to the ISDA 2018 U.S. Resolution Stay Protocol, or
- Bilateral amendments with each counterparty to a QFC.

ISDA 2015 Universal Protocol: Before the U.S. Resolution Stay Rules were finalized, a number of large banks had already adhered voluntarily to ISDA's 2015 Universal Resolution Stay Protocol (the "2015 Universal Protocol").² The U.S. Resolution Stay Rules provide a safe harbor for that Protocol so any QFC that is amended by that Protocol is deemed to be in compliance with the rules.

However, adhering to the 2015 Universal Protocol requires incorporating applicable stay-and-transfer provisions of special resolution regimes in the United Kingdom, Germany, France, Switzerland and Japan, as well as those of other "Protocol-eligible Regimes" (as defined in the 2015 Universal Protocol). For this reason, most entities that are not Regulated Entities are expected to adhere to the ISDA 2018 U.S. Resolution Stay Protocol or enter into bilateral amendments rather than adhering to the 2015 Universal Protocol.

ISDA 2018 U.S. Resolution Stay Protocol: The ISDA 2018 U.S. Resolution Stay Protocol (the "2018 Stay Protocol")³ was drafted so that it is safe-harbored under the U.S. Resolution Stay Rules. Because of this, a QFC that is amended by the 2018 Stay Protocol is deemed in compliance with the rules. Adhering to the 2018 Stay Protocol requires incorporating all "Identified Regimes" (i.e., those of the United States, United Kingdom, France, Germany, Switzerland and Japan), but not necessarily other Protocol-eligible Regimes.

Bilateral amendments: Counterparties may also ask Regulated Entities to provide their own bilateral amendment provisions. However, bilaterally incorporating the terms of the 2018 Stay Protocol will not be deemed in compliance with U.S. Resolution Stay Rules unless both parties have adhered to one of the above Protocols.

Pros and cons of each approach: There are some differences between adhering to the 2018 Stay Protocol and amending a QFC bilaterally. We would look forward to discussing the pros and cons of each approach with you.

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² The 2015 Universal Protocol is available at: <https://www.isda.org/protocol/isda-2015-universal-resolution-stay-protocol/>.

³ The 2018 Stay Protocol is available at: <https://www.isda.org/protocol/isda-2018-us-resolution-stay-protocol/>.

Please do not hesitate to contact us with any questions.

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