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

Beginning January 1, 2019, regulations issued by the Board of Governors of the Federal Reserve System,¹ the Federal Deposit Insurance Corporation² and the Office of the Comptroller of the Currency³ (the “**U.S. Stay Regulations**”) will impose certain requirements on the terms of swaps, repurchase agreements and other qualified financial contracts (“**QFCs**”) of global systemically important banking organizations and their subsidiaries and affiliates (“**GSIBs**”) to support the policy goal of an orderly resolution of those entities. The International Swaps and Derivatives Association (“**ISDA**”) created the ISDA 2018 U.S. Resolution Stay Protocol (the “**Resolution Stay Protocol**”)⁴ to enable market participants to amend their covered agreements to comply with the requirements of the U.S. Stay Regulations. This Client Alert summarizes the U.S. Stay Regulations and adherence to the Resolution Stay Protocol.

What Are the U.S. Stay Regulations?

The U.S. Stay Regulations are intended to help implement the U.S. special resolution regimes by requiring each GSIB to ensure that its QFCs include contractual recognitions of the application of the special resolution regimes. Specifically, the U.S. Stay Regulations require each QFC of a GSIB expressly to:

- (1) provide that in the event the GSIB becomes subject to a proceeding under a U.S. special resolution regime, the exercise of default rights against the GSIB is limited and can only be exercised to the same extent they could be exercised under such resolution regime,
- (2) recognize the powers of the FDIC under the U.S. special resolution regimes to transfer contracts to a successor of the defaulted GSIB notwithstanding any prohibition or condition to the contrary in such QFC,
- (3) limit the ability of counterparties of the GSIB to exercise default rights related to affiliates of the GSIB entering insolvency proceedings, and

¹ 12 C.F.R. §§ 252.2, 252.81-88

² 12 C.F.R. §§ 382.1-7

³ 12 C.F.R. §§ 47.1-8

⁴ See [https://www.isda.org/a/6EjEE/3431552_40ISDA-2018-U.S.-Resolution Stay Protocol-Final.pdf](https://www.isda.org/a/6EjEE/3431552_40ISDA-2018-U.S.-Resolution%20Stay%20Protocol-Final.pdf).

- (4) permit the transfer of credit enhancements provided by an affiliate subject to such insolvency proceedings.

The U.S. Stay Regulations thereby impose time limited restrictions on termination rights following the initiation of resolution proceedings of a GSIB, as well as restrictions on cross-default rights that are related to the insolvency of an affiliate of the GSIB, in order to preserve the possibility of a transfer of the assets and liabilities of the failed GSIB to a performing bridge entity or other third party in furtherance of the policy goal of an orderly resolution of the GSIB's affairs.

Contractual termination rights unrelated to the insolvency of a GSIB or its affiliates are not affected by the U.S. Stay Regulations. Additionally, changes to margin requirements that arise solely from a change in economic exposure or the value of collateral are permitted.

How Do the U.S. Stay Regulations Impact Derivatives?

QFCs, as referred to in the U.S. Stay Regulations, include most swaps, forward agreements, repurchase agreements and similar agreements.⁵ The U.S. Stay Regulations require changes to QFCs of GSIBs where such QFCs contain provisions that (1) provide for termination rights that may be exercised against the GSIB subject to a relevant insolvency proceeding or (2) restrict or condition the transfer of the QFC from a GSIB ("**Covered QFCs**") in violation of the U.S. Stay Regulations.

To comply with the U.S. Stay Regulations, Covered QFCs must either be subject to the U.S. special resolution regime by choice of law or explicitly provide for limitations equivalent to those under the special resolution regimes on the exercise of early termination rights against the GSIB in the event the GSIB becomes subject to a relevant insolvency proceeding. They also must provide regulators the ability to transfer the Covered QFC from such GSIB to a performing bridge entity or other third party.

How Does the Resolution Stay Protocol Help?

The Resolution Stay Protocol provides market participants a proven mechanism to amend their existing QFCs to comply with the U.S. Stay Regulations. The substance of the Resolution Stay Protocol provides a contractual "opt-in" to certain identified special resolution regimes that stay the exercise of termination rights upon insolvency of a GSIB and permit for the possible transfer of the Covered QFC to a performing entity. The Resolution Stay Protocol also provides, as a matter of contract, limitations on cross-default rights triggered by the insolvency of an affiliate of the GSIB, in the event no such limitation independently exists under applicable statutes.

⁵ The term "qualified financial contract" as used in the U.S. Stay Regulations has the same meaning as defined in section 210(c)(8)(D) of Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. § 5390(c)(8)(D)).

By adhering to the Resolution Stay Protocol, market participants can amend their trade documentation to ensure that their Covered QFCs comply with the requirements of the U.S. Stay Regulations without having to individually amend each relevant QFC. The U.S. Stay Regulations specifically recognize adherence to an industry protocol as a valid method of complying, and the Resolution Stay Protocol was created with such safe harbor in mind.

What Is the Timeline for Adherence to the Resolution Stay Protocol?

Adherence to the Resolution Stay Protocol is currently open on ISDA's website as well as on the ISDA Amend facility on IHS Markit. There is no cut-off date by which market participants must adhere to the Resolution Stay Protocol. As is typical, however, ISDA reserves the right to designate a cut-off date on 30 days' advance notice.

The deadline for compliance with the U.S. Stay Regulations is phased in based on counterparty status as shown on the chart below. The amendments effectuated by the Resolution Stay Protocol will become effective as between two adhering parties on the later of (1) the adherence date of the second adhering party and (2) the relevant Compliance Date.

<u>Type of Covered QFC</u>	<u>Compliance Date</u>
Covered QFCs between two GSIBS	January 1, 2019
Covered QFCs between a GSIB and a non-GSIB financial counterparty	July 1, 2019
Covered QFCs between a GSIB and all other market participants	January 1, 2020

It should be noted, however, that all Covered QFCs entered into on or after January 1, 2019 or entered into before January 1, 2019 if the relevant GSIB also enters into a Covered QFC with the same counterparty on or after January 1, 2019 will be subject to the compliance requirements of the U.S. Stay Regulations, beginning on the relevant Compliance Date. As a result, it should be expected that GSIBs will want to ensure that all post-2018 Covered QFCs are entered into only if compliance is assured by the relevant Compliance Date, including by means of prior adherence to the Resolution Stay Protocol or other bilateral arrangements.

Do Buy Side Institutions Need to Adhere to the Resolution Stay Protocol?

There is no legal or regulatory requirement for non-GSIB entities to adhere to the Resolution Stay Protocol. However, GSIBs will need to amend Covered QFCs to conform to the described U.S. Stay Regulation requirements in order to be able to continue trading under those contracts on or after January 1, 2019.

How Does the Resolution Stay Protocol Relate to Prior Resolution Stay Protocols?

ISDA previously published the 2014 Stay Protocol, the 2015 Universal Stay Protocol and the Jurisdictional Modular Protocol (the “**Past Resolution Stay Protocols**”) to address various resolution stay requirements. However, the Past Resolution Stay Protocols were published before the U.S. Stay Regulations were adopted. The Resolution Stay Protocol is a new, standalone protocol developed specifically in response to the U.S. Stay Regulations and the safe harbors included therein. The Resolution Stay Protocol covers the requirements included in the Past Resolution Stay Protocols, and it is expected that going forward most market participants will utilize the Resolution Stay Protocol to comply with resolution stay requirements.

Section 1 of the Resolution Stay Protocol provides an opt-in to specific identified special resolution regimes. In addition to the U.S. special resolution regimes under Title II of the U.S. Dodd-Frank Wall Street Reform and Consumer Protection Act, the U.S. Federal Deposit Insurance Act and regulations promulgated thereunder, the provisions relating to the exercise of default rights under, and the transfer of, Covered QFCs apply to the special resolution regimes of France, Germany, Japan, Switzerland and the United Kingdom. Section 2 of the Resolution Stay Protocol introduces a separate, new override of cross-affiliate termination rights and transfer restrictions, subject to certain conditions, where the applicable insolvency regime, such as those under the U.S. Bankruptcy Code and the U.S. Federal Deposit Insurance Act, does not itself provide for statutory stays.

How Do I Adhere?

In order to adhere, market participants must provide ISDA (via the Protocol-section of ISDA’s website) with an adherence letter indicating their desire to adhere to the Resolution Stay Protocol. Once properly completed and uploaded, ISDA will confirm the approval and acceptance of each adherence letter and publish a conformed copy of the letter containing the name of the adhering principal or agent.

Where an investment advisor acts on behalf of multiple funds, the investment advisor may execute a single adherence letter on behalf of all or a specified subset of the clients for which it acts. In the event an agent chooses to adhere on behalf of some but not all of its clients, the agent will be responsible for identifying the relevant clients to be bound by the terms of the Resolution Stay Protocol. Such identification may be effectuated through the ISDA Amend platform on IHS Markit.

Adherence letters can be obtained on ISDA’s website at the following URL (login required): <https://www.isda.org/protocol/isda-2018-us-resolution-stay-protocol/submit/>.

A \$500 fee applies for the submission of each letter.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Manuel S. Frey
+1-212-373-3127
mfrey@paulweiss.com

Associates Andrew MacLachlan and Elanit A. Snow contributed to this Client Memorandum.