On July 31, 2018, the International Swaps and Derivatives Association published the ISDA 2018 US Resolution Stay Protocol. The US Protocol is intended to enable parties to ISDA Master Agreements and similar “Protocol Covered Agreements” (collectively, PCAs) to contractually recognize the cross-border application of special resolution regimes applicable to global systemically important entities and their affiliates.

In this alert, we provide a broad overview of the US Protocol and relevant resolution stay rules, then describe the effect and operation of the US Protocol.

I. OVERVIEW OF THE US PROTOCOL

Final rules enacted by the Board of Governors of the Federal Reserve System (12 C.F.R. §§ 252.2, 252.81-88) (the FRB Rule), the Federal Deposit Insurance Corporation (12 C.F.R. §§ 382.1-7) and the Office of the Comptroller of the Currency (12 C.F.R. § 47.1-8) (collectively, the US Resolution Stay Rules) require a "covered entity," a "covered FSI" and a "covered bank," as defined respectively in the relevant US Resolution Stay Rule (a Covered Party) that executes or becomes a party to a "qualified financial contract" or "QFC" on or after the relevant compliance date to expressly include certain provisions in each QFC.
A QFC includes, among other things, any swap agreement, commodity agreement or forward contract, and therefore generally includes any agreement for a transaction that ordinarily would be governed by an ISDA Master Agreement. Covered Parties generally consist of bank holding companies and foreign banking organizations that have been designated under Federal Reserve Board regulations as global systemically important and certain subsidiaries of these institutions, including state and national banks, and state and federal savings associations. While each of the US Resolution Stay Rules is substantially the same, the applicable rule will depend on the applicable regulator for the relevant Covered Party.

The US Protocol is separate from the ISDA Resolution Stay Jurisdictional Modular Protocol (the JMP) published by ISDA on May 13, 2016. The JMP is intended to enable parties to PCAs to comply with certain legislative and regulatory requirements applicable to certain financial companies in different jurisdictions that address the exercise of early termination and related rights upon the resolution or insolvency of such financial companies.

In general, under the laws of various jurisdictions, systemically important financial institutions that are parties to PCAs under any governing law are required to obtain counterparty consent to be subject to stays on or overrides of certain termination rights under these PCAs and enforcement of security interests under special resolution regimes applicable in the home countries of these financial institutions. ISDA has published separate modules to the JMP for the United Kingdom, Germany, Japan and Switzerland.

The US Protocol also is separate from the ISDA Bail-in Article 55 BRRD Protocol, which also contains contractual recognition of the application of certain non-US bank recovery and resolution regimes, some (but not all) of which also are covered by the US Protocol. Adherence to any module of the JMP or to the BRRD Protocol will remain effective without modification regardless of adherence to the US Protocol.

In addition, ISDA published the ISDA 2015 Universal Resolution Stay Protocol (the Universal Protocol) on November 12, 2015. The Universal Protocol was developed before resolution stay regulations were finalized in various jurisdictions, but was intended to provide a global solution to major dealers and other market participants that wished to pursue a generic consent to the application of resolution stays in the United States, France, United Kingdom, Germany, Japan, Switzerland (the Identified Regimes) and certain other jurisdictions identified as being applicable in accordance with the terms of the Universal Protocol.

The Universal Protocol has not been widely adopted by end-users and generally has been confined to major dealers and large institutional trading firms. Although it pre-dated the US Resolution Stay Rules, the Universal Protocol was drafted with proposed US Resolution Stay Rules in mind, and with the expectation that adherence to the Universal Protocol would comply with the US Resolution Stay Rules once adopted. Accordingly, the US Protocol is modeled after, and is largely similar to, the Universal Protocol.

The US Resolution Stay Rules provide that, unless the applicable regulator determines otherwise, a covered QFC complies with the US Resolution Stay Rules if it is amended by the Universal Protocol or the US Protocol, provided that the US Protocol is same as the Universal Protocol with certain expressly permitted modifications. For example, the opt-in to the resolution stay provisions in the Universal Protocol may be limited to resolutions of Covered Entities in the Identified Regimes. Since Covered Entities include institutions organized outside the US and that may be subject to resolution outside the US, the US Protocol contains an opt-in to the special resolution regimes in each of the Identified Regimes. This extends the scope of the US Protocol beyond the laws of the US, but not to an unlimited set of jurisdictions that have not yet adopted resolution stay provisions. Covered Parties should consider adherence by their counterparties to either the Universal Protocol or the US Protocol as sufficient for compliance by such Covered Parties with the US Resolution Stay Rules.

The US Resolution Stay Rules generally will apply regardless of contractual provisions to the contrary. However, the risk exists that courts in non-US jurisdictions will not enforce these rules against non-US counterparties. Therefore, US Resolution Stay Rules, and therefore the US Protocol and the Universal Protocol, seek to address the risk that a non-US court will not enforce the stay and transfer provisions of Title II of the Dodd-Frank Act and the Federal Deposit Insurance Act. In addition, the US Resolution Stay Rules seek to limit the potential contagion that may result from a counterparty to a Covered Party being able to exercise cross default rights that are related, directly or indirectly, to certain affiliates, including its parent or any affiliate that is identified in an ISDA Master Agreement as a "Credit Support Provider" or "Specified Entity" (collectively, a Related Party) becoming subject to a receivership or insolvency proceeding.2
The US Resolution Stay Rules do not include the following three additional creditor protections that appear in the Universal Protocol:

1. priority rights in an insolvency proceeding of an affiliated credit support provider or transferee
2. a right to submit claims in an insolvency proceeding of an affiliated credit support provider if the obligations are transferred and the transferee also becomes insolvent
3. the ability to exercise Default Rights, subject to applicable law, against both the Covered Party and the transferee if the transferee defaults under a transferred QFC.

Accordingly, those protections do not appear in the US Protocol.3

As generally set forth in the US Resolution Stay Rules and the US Protocol, Default Rights include early termination, setoff and netting rights and remedies, rights and remedies with respect to collateral (including rights to suspend deliveries or returns of collateral), rights to suspend payments, and rights to modify contractual obligations.

In order to achieve those objectives, the US Resolution Stay Rules, and therefore the US Protocol, include the following provisions.

1. **Opt-In Provisions to Identified Regimes (generally not applicable to New York law ISDA Master Agreements between a Covered Party and a US organized company)**

The US Resolution Stay Rules do not require any conforming language in QFCs between a Covered Entity and any company organized under the laws of the US or any State or having its principal place of business anywhere in the US as long as the QFC (i) explicitly provides that it is governed by the laws of the US or any State, and (ii) does not explicitly exclude application of a US special resolution regime.4 Accordingly, the provisions set forth in Section 1 to the Attachment to the US Protocol (the Section 1 Provisions) generally will not apply to such ISDA Master Agreements and related credit support documents that provide for the laws of the State of New York as the governing law. However, the resolution stay and transfer provisions of the US Resolution Stay Rules (or corresponding provisions of another Identified Regime) likely already will apply to QFCs entered into under such an ISDA Master Agreement in the event of a special resolution regime even without the application of the Section 1 provisions.

The Section 1 Provisions contain the following key terms:

a. The Counterparty only may exercise "Default Rights" in the resolution of a Covered Party or Related Party to the same extent permitted under the laws of that Identified Regime.

b. The Counterparty only may exercise Default Rights in respect of certain guarantees and other third party credit support arrangements to the extent permitted under the laws of the relevant Identified Regime.

c. A transfer made under an ISDA Master Agreement or related credit support to a successor of the Covered Party or Related Party that has entered a resolution proceeding is effective to the same extent that transfer would be permitted under the laws of the Identified Regime. Similarly, transfers of collateral or other credit support provided by either party are effective to extent that transfer would be permitted under the laws of the Identified Regime. That is, restrictions on transfer in the ISDA Master Agreement or other applicable agreement will not apply to the extent the laws of the Identified Regime permit such transfer. This provision is intended to facilitate transfers away from Covered Parties in resolution to transferees that are capable of performance, thereby avoiding the exercise of Default Rights. However, if such a transfer is effected, and the Counterparty does not benefit from the preservation of collateral by operation of law, then in certain circumstances the Counterparty may exercise any Default Rights it may have against the transferee.

d. For as long as a Default Right is not exercisable, no event of default, termination event or similar event is deemed to have occurred or be continuing for purposes of application of cross default provisions under other agreements to the extent application of such cross default provisions would be unenforceable under the laws of the Identified Regime.

2. **Limitations on Exercise of Default Rights**
The US Resolution Stay Rules do not require covered QFCs to contain specified cross default provisions if the QFC (i) does not explicitly provide any Default Right with respect to the covered QFC that is related, directly or indirectly, to an affiliate of the Covered Party becoming subject to an insolvency, resolution or similar proceeding; and (ii) does not explicitly prohibit the transfer of credit enhancement (e.g., guarantees or collateral) provided by an affiliate to support a QFC in which the Covered Party is the obligor. Accordingly, the provisions set forth in Section 2 to the Attachment to the US Protocol (the Section 2 Provisions) generally will not apply to ISDA Master Agreements and related credit support documents that meet these conditions. ISDA Master Agreements generally would contain the Default Rights described in (i) above to the extent an affiliate of the Covered Party is listed as a "Specified Entity" or "Credit Support Provider" in the Schedule or if any Additional Termination Events exist that relate to credit rating downgrades or similar credit triggers applicable to an affiliate of the Covered Party. Even if no affiliate of the Covered Party is referenced in the ISDA Master Agreement or provides a guarantee or other credit support in respect of the Covered Party's obligations under the ISDA Master Agreement, the Section 2 Provisions, if applicable, limit the exercise of Default Rights. While Section 2 should not apply to the extent there are no Default Rights applicable to an affiliate of a Covered Party and no such an affiliate provides any credit enhancement, the limitation language is sufficiently narrow that it is unclear whether a Covered Party that is not itself in insolvency or resolution would seek to enforce Section 2 broadly in the context of an affiliate insolvency or resolution that gives rise to Default Rights. To that end, a conservative approach would be to read in the application of Section 2 even if no affiliate provisions are included in the Master Agreement.

The Section 2 Provisions contain the following key terms:

a. If an affiliate of a Covered Party is subject to insolvency, resolution or similar proceedings under chapter 7 or 11 of the US Bankruptcy Code, the US Federal Deposit Insurance Act (the FDIA), or the US Securities Investor Protection Act (collectively, US Proceedings), and such affiliate does not provide credit enhancement under the related ISDA Master Agreement or QFC, then the Counterparty only may exercise:

- **Performance Default Rights**, namely Default Rights that arise as a result of (i) the Covered Party's insolvency, resolution or similar proceedings, or (ii) the Covered Party's or credit enhancement provider's failure to satisfy a payment or delivery obligation to the Counterparty under the QFC or relevant credit support document or

- **Unrelated Default Rights**, namely Default Rights that are not based solely on the affiliate of the Covered Party becoming a party in US Proceedings and can be shown by clear and convincing evidence to be not related, directly or indirectly, to (x) an affiliate of the Covered Party becoming a party in US Proceedings or (y) any transfer pursuant to a motion filed in a chapter 11 bankruptcy case by (A) such affiliate to transfer all or substantially all of its assets to a bridge company or unaffiliated third party (a Transfer Motion) or (B) the US parent of the Covered Party to remain obligated with respect to relevant credit enhancements (a DIP Motion), or, if the US parent of the Covered Party is not a party in US Proceedings, are not based solely on the affiliate of the Covered Party becoming a party in insolvency proceedings that are not US Proceedings.

b. If credit enhancement provider to a Covered Party is subject to insolvency, resolution or similar proceedings under chapter 11 of the Code or under the FDIA, and such affiliate provides credit enhancement under the related ISDA Master Agreement or QFC, then the Counterparty may exercise Performance Default Rights or Unrelated Default Rights at any time, and may not exercise any other Default Rights, during:

- the stay period ending on the later of (i) 5 pm eastern time on the business day following commencement of the chapter 11 case and (ii) 48 hours after commencement of the chapter 11 case (the Chapter 11 Stay Period) or the applicable stay period under the FDIA (the FDIA Stay Period) and

- thereafter, in a chapter 11 case, only if such credit enhancement provider files a Transfer Motion or DIP Motion before expiration of the Chapter 11 Stay Period, and certain conditions are satisfied, and in an FDIA proceeding, only after the FDIC has transferred the credit enhancement in accordance with the FDIA.

II. QUESTIONS AND ANSWERS
1. Who has compliance obligations?

A party to a QFC that is not a Covered Party does not have any obligations under the US Resolution Stay Rules. However, Covered Parties will require compliance in order to enter into new QFCs on or after January 1, 2019.

Under the US Resolution Stay Rules, Covered Parties may not enter into new QFCs after January 1, 2019 with a particular counterparty unless both parties have agreed to conform all of their existing and future QFCs to the requirements of the US Resolution Stay Rules by the applicable compliance date. Adherence by both parties to the US Protocol is expressly deemed compliance under the US Resolution Stay Rules.

2. What are the applicable compliance dates?

The compliance date for covered QFCs between:

- two Covered Parties is January 1, 2019
- a Covered Party and a financial counterparty for purposes of application of final US margin rules applicable to swaps (other than a small financial institution) is July 1, 2019 and
- a Covered Party and any other party, including a small financial institution, is January 1, 2020.

A QFC with a Covered Party is a “covered QFC” if it is executed on or after January 1, 2019. To the extent a party enters into a “covered QFC” with a party on or after January 1, 2019, all prior QFCs become covered QFCs. Therefore, notwithstanding the compliance dates, Covered Parties ultimately will require compliance with the US Resolution Stay Rules from all Counterparties that enter into QFCs after January 1, 2019 under an ISDA Master Agreement. For that reason, Covered Parties may request that their counterparties adhere to the US Protocol by January 1, 2019 even though the applicable compliance date for QFCs may be later.

3. Can adherence be revoked?

A party adhering to the US Protocol may revoke adherence by delivering to ISDA, as agent, a revocation notice on the form attached to the US Protocol on any business day between October 1 and October 31 of each calendar year. Upon proper delivery of such notice, revocation will become effective on December 31 of that calendar year.

The ability to revoke is a benefit not available to parties that pursue bilateral solutions, which generally may not be amended or revoked without the consent of the other party. The annual revocation process is designed to prevent an immediate revocation in anticipation of an imminent Covered Party insolvency.

Find out more about the implications of the US Protocols by contacting the author.

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1 See 82 Fed. Reg. 42887 (September 12, 2017). For example, the Federal Deposit Insurance Corporation has certain powers once it takes over a failed financial institution under its jurisdiction, including the right to suspend the exercise of Default Rights for a limited period of time after the FDIC becomes the receiver for such financial institution and the right to transfer QFCs to a bridge financial company that is not in resolution. A key purpose of these provisions is to permit the FDIC to effect a transfer of a failing financial institution’s QFCs to a solvent financial institution before the failing institution’s counterparties can terminate these QFCs in order to mitigate the contagion effect of all of a failed financial institution’s counterparties exercising termination rights and remedies at approximately the same time. See 82 Fed. Reg. 42903.

2 The US Resolution Stay Rules generally prohibit (i) the exercise of Default Rights related, directly or indirectly (such as by a credit rating downgrade), to resolution or similar proceedings of an affiliate of a covered party and (ii) the transfer of a guarantee or other credit support, or any security therefor, once any affiliate of a Covered Party becomes the subject of a resolution or similar proceedings. See § 252.83(b)(2) and § 252.84(b)(2) of the FRB Rule. However, the US Resolution Stay Rules do not prohibit the exercise of Default Rights as a result of (a) the insolvency or resolution of the Covered Entity itself (subject to any applicable stays) or (b) the failure to pay or deliver by (i) the Covered Entity under the QFC or another contract between the parties that results in a Default Right under the QFC or (ii) a credit support provider or transferee under the related support document. See § 252.84(d) of the FRB Rule. In addition, the US Resolution Stay Rules contain * (a) additional credit protections for supported QFCs “that generally permit exercise of Default Rights directly or indirectly related to an affiliated credit support provider’s insolvency or resolution after lapse of a stay period beginning on the commencement of the proceeding and ending at the later of 5pm eastern time on the next business day or 48 hours after commencement of the proceeding, whichever is later, if (1) the credit support provider becomes subject to an insolvency or resolution proceeding (other than under chapter 11 of the US Bankruptcy Code, as amended) and remains obligated under the credit enhancement, (2) the credit enhancement is transferred and the transferee becomes subject to any insolvency or resolution proceeding, or (3) the credit support does not remain, and a transferee does not become obligated to that or similar credit support. See § 252.84(f) of the FRB Rule. The US Resolution Stay Rules do not restrict the exercise of Default Rights in a chapter 11 bankruptcy case of a Covered Party. See 82 Fed. Reg. 42904.

3 See § 252.83(a)(1) of the FRB Rule.

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