Staying Power*
ISDA 2015 Universal Resolution Stay Protocol

Introduction
In the aftermath of the financial crisis, there have been a large number of regulatory changes targeted at the banking industry. Partly driven by political pressure and partly by experience from the crisis itself, there has been a particular focus on the reduction of the ‘systemic risk’ posed by banks (i.e. the risk that any future default by a bank will send shockwaves throughout the wider economy) and the need to do so without recourse to public funds. In Europe, this has led to a new framework for the resolution of financial institutions – a set of tools that offers an alternative to standard insolvency proceedings. The Bank Recovery and Resolution Directive sets out basic requirements for the European Economic Area’s (EEA) resolution regimes, the majority of which were implemented in Member States by 1 January 2015 (the ‘bail-in’ provisions have a slightly extended timetable and are to be implemented by 1 January 2016 – although some Member States have chosen to implement certain of the provisions ahead of this deadline).

Despite the introduction of these new minimum standards, there remains uncertainty as to whether the terms of the new regimes will be recognised and upheld outside the EEA (and the same question has been asked by third country jurisdictions about the enforceability of their own regimes within Europe). Whilst the contractual recognition of the bail-in powers is already addressed in the BRRD, the Financial Stability Board (FSB) has led a separate initiative to require contractual recognition of stays imposed by resolution authorities.

This note aims to provide some explanation as to why cross-border recognition of resolution action continues to be an issue, why the industry has worked together to publish the new ISDA 2015 Universal Resolution Stay Protocol (the Universal Resolution Stay Protocol) and whether this new initiative is relevant to all market participants.

Background
What is the BRRD?
The Bank Recovery and Resolution Directive (the BRRD) is a European Directive that applies to credit institutions and investment firms. It seeks to harmonise the basic features of special resolution regimes across Europe by setting minimum requirements to be met by each such regime. Although the BRRD also introduces resolution and recovery planning requirements, together with certain early intervention powers, this note focuses on the resolution mechanics under Title IV and, in particular, the ability of resolution authorities to impose temporary stays.

Why are stays necessary?
The stays are intended to create a window of time in which the resolution authority can determine and implement the appropriate course of action, without being concerned about the contemporaneous collapse of the banking entity. As summarised by the FSB:

“Effective temporary stays on early termination rights… are important to prevent the close-out of financial contracts in significant volumes. Such close-out action upon entry into resolution could disrupt the provision of critical functions, lead to the firm in resolution having an unbalanced book and undermine the objective of a resolution action that seeks to maintain the continuity of critical functions.”

* Updated to reflect PRA Policy Statement PS25/15
1 Directive establishing a framework for the recovery and resolution of credit institutions and investment firms (2014/59/EU)
2 As such terms are defined in Regulation 575/2013 on prudential requirements for credit institutions and investment firms
What are the ‘stays’?

The BRRD requires that resolution authorities have the power to temporarily stay:

> payment and delivery obligations of the parties to any contract to which the entity in resolution is party (Article 69)
> enforcement of security interests by secured creditors of the entity in resolution (Article 70)
> termination rights of any party to a contract with the entity in resolution (Article 71)

In the UK, these powers are exercisable by the Bank of England under Sections 70A, 70B and 70C of the Banking Act 2009 (the Banking Act). In addition, Article 68 of the BRRD (and Section 4827 of the Banking Act) provides that action taken by the resolution authority cannot itself be an enforcement event or constitute insolvency proceedings.

What is the issue in a nutshell?

Most modern banking businesses operate on a cross-border basis. Whereas domestic legislation in the relevant entity’s place of incorporation may include detailed provisions which will apply in the event of resolution, there may nevertheless be an issue if a contract is governed by the law of a third country jurisdiction and the resolution authority wishes to ensure that relevant aspects of its regime are effective under that law. There are two obvious solutions – a change of law in that third country to ensure mutual recognition or contractual agreement by the parties to expressly recognise such regime and to restrict their respective rights accordingly.

Whilst legislative change would provide greater legal certainty (and is described by the FSB as the ultimate objective), experience with similar initiatives to recognise equivalence under EMIR and Dodd-Frank has taught us that the battle for mutual recognition is rarely short. In the meantime, the decision has been taken to pursue contractual recognition as a more immediate solution.

Why was the ISDA 2014 Resolution Stay Protocol published?

The ISDA 2014 Resolution Stay Protocol (the 2014 Protocol) was published on 4 November 2014 and took effect as between the initial wave of adhering parties on 1 January 2015. The initial wave was principally comprised of the ‘G-18’ banks and their affiliates – in effect, a list of the largest cross-border banking institutions (a full list of the current adhering parties is available on the ISDA website).

The 2014 Protocol amended the terms of existing ISDA Master Agreements and related credit support documents in order to achieve two changes: (i) ensure that the parties’ rights only arose in circumstances that would be permitted under applicable resolution regimes; and (ii) specifically in the context of U.S. resolution action, introduce limitations on certain cross-default rights which did not otherwise exist in domestic legislation.

This sounds similar to the contractual recognition of bail-in. Are the two initiatives related?

They do sound similar and that is because they both address the same issue of cross-border recognition in documents governed by the law of a third country jurisdiction. The difference, however, is that Article 55 of the BRRD sets out the requirements for contractual recognition of the effect of the bail-in powers4, whereas the requirements in respect of the stay provisions have been introduced directly into the PRA rulebook.

ISDA 2015 Universal Resolution Stay Protocol

Why is the Universal Resolution Stay Protocol required?

The 2014 Protocol only amends existing ISDA Master Agreements between adhering parties. In its November 2014 report5 to the G-20, the FSB stated that it would develop proposals to address the cross-border close-out risks in other financial contracts and products (i.e. beyond the ISDA Master Agreement). In order to address that goal, the Universal Resolution Stay Protocol includes the following changes:

> inclusion of a new Securities Financing Transaction Annex
> expansion of the list of Protocol-eligible Jurisdictions to include the jurisdiction of any ultimate parent entity of a ‘global systemically important bank’ (or G-SIB)
> removal of certain existing annexes (French, German, UK and Swiss) and a refresh of the Japanese Annex
> introduction of the concept of Other Agreement Annexes and Country Annexes

How does the Universal Resolution Stay Protocol interact with the 2014 Protocol?

For parties that have already adhered to the 2014 Protocol, adherence to the Universal Resolution Stay Protocol will, with effect from the later of (i) 1 January 2016 and (ii) the relevant Implementation Date (i.e. the date on which each pair of parties has adhered to the Universal Resolution Stay Protocol), replace the amendments made by the 2014 Protocol. ISDA has designated 2 November 2015 as the Cut-off Date under the 2014 Protocol, which means that no further parties may now adhere to the 2014 Protocol.

Who will adhere to the Universal Resolution Stay Protocol?

The requirement to contractually recognise stays is not set out in the BRRD or the Banking Act. It has been driven by the FSB initiative discussed above and, in England, has been reflected in a change to the PRA rulebook. The Prudential Regulation Authority (PRA) set out the detail of the new rule in Policy Statement PS25/15 published on 13 November 2015 (see more on that below).

Whilst a number of the largest banks have already announced their adherence to the Universal Resolution Stay Protocol, there is no direct requirement for any other entities to adhere to it. The real question is which other entities are caught by the new PRA rule and whether they should comply with the related requirements by adhering to the Universal Resolution Stay Protocol.

What is the Securities Financing Transaction Annex (SFT Annex)?

The Universal Resolution Stay Protocol only amends Covered Agreements between pairs of adhering parties. Whereas, under the 2014 Protocol, the concept was restricted to the ISDA Master Agreement (and related credit support documents), the SFT Annex to the Universal Resolution Stay Protocol extends the scope of the Covered Agreements to also include (amongst others):

> the Global Master Securities Lending Agreement (GMSLA) published by ISLA, including the 2000, 2009 and 2010 editions (and the Overseas Securities Lender’s Agreement (OSLA), including the 1994 and 1995 editions)

---

4 Regulation 648/2012 on derivatives, central counterparties and trade repositories and the Dodd–Frank Wall Street Reform and Consumer Protection Act

5 Implementation of that requirement in the UK is set out in PRA Policy Statement PS1/15 (January 2015) and in FIFPRU 11.6 published in FCA Policy Statement PS15/2 (January 2015). The PRA requirements have been in effect in respect of certain debt instruments since 19 February 2015. The remaining rules are stated to apply to other liabilities of relevant entities from 1 January 2016, however, the PRA has recently provided for a waiver process whereby firms may request a direction if compliance with that timetable is impracticable

**What has happened to the Protocol-eligible Jurisdictions?**

The 2014 Protocol established two categories of resolution regime – Identified Regimes and Protocol-eligible Regimes. The Identified Regimes (France, Germany, Japan, Switzerland, the UK and the U.S.) were automatically included within scope for the amendments. Where the terms of those regimes applied, related rights under Covered Agreements were amended so as to be consistent with any temporary stay imposed under those regimes. That list has not changed under the Universal Resolution Stay Protocol.

The second category referred to a list of Protocol-eligible Jurisdictions. The regimes established in those jurisdictions would only be included within the scope of the 2014 Protocol if the regimes met certain minimum requirements (at which point they are referred to as Protocol-eligible Regimes). Those requirements related to features of the regime, such as the availability of liquidity support, the treatment of overseas creditors and the role of the resolution authority. In the 2014 Protocol, the list was comprised of the 18 remaining FSB member states (i.e. those not already listed as an Identified Regime) and the federal bankruptcy rules of the U.S. This has now been extended under the Universal Resolution Stay Protocol to also include the jurisdiction of any ultimate parent entity within the banking group of a G-SIB.

**What is a G-SIB?**

The term ‘global systemically important bank’ refers to the list of entities that is published by the FSB on an annual basis. The list published in November 2015 comprises 30 banks.

**What are Other Agreement Annexes and Country Annexes?**

The Universal Resolution Stay Protocol also envisages the future publication of Other Agreement Annexes, which provide for an extension to the scope of the Covered Agreements, and of Country Annexes, which may amend the existing definitions of Identified Regime or Protocol-eligible Regime. In order for any such changes to take effect, the relevant parties are required to complete an additional adherence letter (although, notably, in the case of Country Annexes, adhering to a particular Country Annex will take effect in respect of all existing Country Annexes at the point of adherence).

**Why have the existing annexes to the 2014 Protocol been changed?**

The jurisdiction annexes to the 2014 Protocol are a reflection of the timing of the original publication. The 2014 Protocol was published prior to the finalisation of the legislative framework for a number of the relevant resolution regimes – in Europe, the deadline for implementation of the BRRD was 31 December 2014 (almost two months after the publication date of the 2014 Protocol). At the point of publication, a number of key jurisdictions had published final drafts of the new legislation and the 2014 Protocol provided that the regimes, if implemented in the specified form, would not prejudice the application of the 2014 Protocol (such that a party could then opt out in respect of that regime).

As the final legislation is now in place for many of those jurisdictions, the annexes have been removed in the Universal Resolution Stay Protocol.

---

**PRA Policy Statement PS25/15**

**What is included in Policy Statement PS25/15?**

On 13 November 2015, the PRA published Policy Statement PS25/15, Contractual stays in financial contracts governed by third-country law, which introduced a new rule in the PRA rulebook requiring the contractual recognition of UK resolution stays in certain financial contracts governed by non-EEA law.

**What is the scope of the new PRA rule?**

The new rule prohibits BRRD undertakings from creating new obligations (or materially amending existing obligations) under third-country law financial arrangements unless the counterparty has agreed to restrict its termination rights and ability to enforce relevant security interests in accordance with the Banking Act.

**What are third-country law financial arrangements?**

Any financial arrangement that is governed by non-EEA law and includes a relevant termination right or security interest provided that contracts that are solely with an excluded person are not subject to the restriction (including contracts with central counterparties, certain settlement systems and central banks).

For these purposes:

Financial arrangements are defined as:

- financial contracts as defined in point 100 (a) to (d) of Article 2(1) of the BRRD
- derivatives as defined in Article 2(5) of EMIR (which leads to the definition of financial instrument used in Annex I to MiFID)
- master agreements relating to either of the two categories above or to contracts for the sale, purchase or delivery of currency

**Which termination rights and security interests are affected?**

The rule refers to the scope of the rights that may be restricted under Sections 70C(10) and 4BZ of the Banking Act, in the case of termination rights, and Section 70B(7) in the case of security interests. These are broadly defined categories that capture the majority of rights that would normally be associated with these terms.

**What is meant by a ‘material amendment’ in this context?**

It is not entirely clear, however, the PRA has published a Supervisory Statement SS42/15 that explains that non-material amendments may include (i) automatic changes under the contract (such as roll-over or renewal); and (ii) administrative changes (such as changes to notice details or business day conventions).

**Which entities will be caught by the new PRA rule?**

BRRD undertakings, which are defined as CRR firms (meaning UK banks, building societies and investment firms), financial holding companies and mixed financial holding companies. BRRD undertakings that are parent companies must also ensure that each relevant subsidiary that is not itself a BRRD undertaking complies with the rule. For these purposes, the relevant subsidiaries are those classified as credit institutions, investment firms (or would be if their head office were in the EEA) and financial institutions.

Other jurisdictions have introduced (or are expected to introduce) similar rules – Germany, for example, has already introduced similar requirements in respect of financial contracts entered into by German institutions or group entities which are governed by third country law.

---

7 The current list is available here: http://www.financialstabilityboard.org/2015/11/fsb-publishes-the-2015-update-of-the-g-sib-list/

8 http://www.bankofengland.co.uk/prapages/publications/fs/2015/ps2515.aspx


10 The guidance is consistent with related provisions in the form of RTS included in the EBA Final Report relating to Article 55 (EBA/RTS/2015/06)
When will the new rule apply?
The rule will be phased in depending on the category of counterparty that is facing the BRRD undertaking:
> in respect of third-country law financial arrangements with credit institutions and investment firms (or those that would be, if their head office were in the EEA), from 1 June 2016
> in respect of third-country law financial arrangements with any other type of counterparty (other than excluded persons), from 1 January 2017

If I am not a BRRD undertaking, will the new rule affect me?
Yes, albeit indirectly. After the relevant implementation date (see above), it will not be possible for a BRRD undertaking to enter into a new third-country law financial arrangement (or materially amend an existing one) with you unless you agree to the restrictions.

Do I need to adhere to the Universal Resolution Stay Protocol in order to comply with the new PRA rule?
There is no requirement for market participants to comply by adhering to the Universal Resolution Stay Protocol. Notably, the scope of the Universal Resolution Stay Protocol differs from the scope of the new PRA rule.

For example, the Universal Resolution Stay Protocol amends all of the Covered Agreements between the parties, irrespective of whether those agreements have been subject to material amendment after the PRA rule is implemented. The Protocol also results in the recognition of the resolution regimes established in a number of jurisdictions (not only the UK). These elements clearly go beyond the requirement set out by the PRA.

It should also be noted that the list of agreements amended by the Universal Resolution Stay Protocol is potentially narrower than the list of financial arrangements contemplated by the new PRA rule, which means that adhering to the Protocol alone may not be sufficient.

What happens next?
ISDA is developing a Jurisdictional Modular Protocol for publication in 2016. The new protocol will allow parties to adhere in respect of particular jurisdictions on a modular basis, whereby the scope of the modules will be tailored to meet the requirements in the relevant jurisdiction. As a result, the scope of the changes under that new protocol may vary from module to module, as required to satisfy local requirements.

It is expected that parties to the Universal Resolution Stay Protocol will also adhere to the ISDA Jurisdictional Modular Protocol.

Timeline

- **2 Nov 2015**: Publication of the Universal Resolution Stay Protocol
- **12 Nov 2015**: Date designated as ‘Cut-off-date’ in respect of the 2014 Protocol
- **1 Jan 2016**: Implementation Date of the Universal Resolution Stay Protocol as between the initial wave of Adhering Parties
- **1 June 2016**: A. PRA rule to apply to relevant contracts with credit institutions and investment firms (or those that would be, if their head office were in the EEA)
- **1 Jan 2017**: B. PRA rule to apply to all remaining relevant contracts (irrespective of counterparty)

**Key contacts**

- **Deepak Sittiani**
  Partner
  Tel: +44 20 7456 2612
deeap.sittiani@linklaters.com

- **Doug Shaw**
  Managing Associate
  Tel: +44 20 7456 5081
doug.shaw@linklaters.com

linklaters.com

Author: Doug Shaw (1 December 2015)

This publication is intended merely to highlight issues and not to be comprehensive, nor to provide legal advice. Should you have any questions on issues reported here or on other areas of law, please contact one of your regular contacts, or contact the individuals listed above.

© Linklaters LLP. All Rights reserved 2015

Linklaters LLP is a limited liability partnership registered in England and Wales with registered number OC326345. The term partner in relation to Linklaters LLP is used to refer to a member of the LLP or an employee or consultant of Linklaters LLP or any of its affiliated firms or entities with equivalent standing and qualifications. A list of the names of the members of Linklaters LLP and of the non-members who are designated as partners and their professional qualifications is open to inspection at its registered office, One Silk Street, London EC2Y 8HQ, England or on www.linklaters.com and such persons are either solicitors, registered foreign lawyers or European lawyers.