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# A Step Closer to Ending Too-Big-To-Fail

## The ISDA 2014 Resolution Stay Protocol and Contractual Recognition of Cross-border Resolution

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## I. Introduction

The financial crisis of 2008 and the perception that certain firms were "too big to fail" ("TBTF")—that their size, market importance and interconnectedness were of such magnitude that their failure under ordinary insolvency law would jeopardize the functioning of the financial markets—led financial regulators and market participants to focus on developing new approaches to the resolution of systemically important financial institutions ("SIFIs") that did not rely on government bailouts.[1] These approaches have focused on ensuring the continuity of vital financial services, supporting global financial stability and preventing the costs of failures from being passed on to taxpayers. A key challenge in developing effective resolution strategies for SIFIs has been limiting the circumstances under which non-defaulting parties to over-the-counter swaps may exercise contractual early termination rights arising from a SIFI's financial distress or entry into resolution proceedings, which rights may arise due to a default of the direct counterparty of the non-defaulting party (referred to in this article as a "direct default") or as a result of the default of an affiliate of the direct counterparty (referred to in this article as a "cross default").

The exercise of early termination rights by derivatives counterparties is protected under many ordinary, pre-crisis insolvency regimes, including the US Bankruptcy Code (the

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"Bankruptcy Code").[2] While these "safe harbors" protect individual non-defaulting parties, some fear that they may impair the ability of a failed SIFI to reorganize and, in certain circumstances, pose a threat to the stability of markets.[3] In the wake of the crisis, statutory "special resolution regimes" ("SRRs") have been developed that, among other things, temporarily stay the exercise of certain default rights that arise in the context of resolution to give resolution authorities time to take actions to stabilize a failing SIFI; so long as certain creditor protections are satisfied, these temporary stays can become permanent overrides of resolution-based default rights. (This article uses the term "stay" as shorthand for both temporary stays and permanent overrides under SRRs.) Questions exist, however, as to the extraterritorial enforceability of these stays. In addition, despite the existence of a US SRR, the Orderly Liquidation Authority ("OLA") under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"),[4] the Dodd-Frank Act requires certain SIFIs to file resolution plans that provide for rapid and orderly resolution under the Bankruptcy Code and the FDIA, rather than under OLA.

In an effort to ensure all financial contract counterparties of a SIFI are subject to SRR stays, and to satisfy US resolution planning requirements, SIFIs have begun to amend their financial contracts by means of the ISDA 2014 Resolution Stay Protocol (the "Protocol") to provide for a stay on certain contractual early termination rights of counterparties that might otherwise arise upon the resolution of such SIFIs. The Protocol was developed by an International Swaps and Derivatives Association, Inc. ("ISDA") working group composed of dealer and buy-side firms, in consultation with financial regulators from around the world. This article addresses the history underlying the development of the Protocol, including an overview of the various approaches to resolution that have been developed, and provides an insight into the mechanics of the Protocol itself. It also provides a summary of next steps and Protocol-related open issues that will likely be addressed in 2015, as regulators and market participants alike try to find ways to enable failing SIFIs to restructure rather than liquidate.

## II. New Resolution Regimes and Strategies

During the recent financial crisis, the only options available to regulators when confronted with failing firms were disruptive liquidations, sales to larger firms, governmental ownership or recapitalization with taxpayer funds. For a variety of reasons, none of these options was seen by policymakers as desirable. Since then, financial regulators have focused on developing new tools and strategies to resolve firms and protect markets but without imposing losses on taxpayers.[5] This section provides an overview of the new resolution regimes developed since the financial crisis and the new approaches to resolution that they enable.

### a. The Key Attributes and the Development of SRRs

In 2011, the Financial Stability Board (the "FSB") published the *Key Attributes of Effective Resolution Regimes for Financial Institutions* (the "Key Attributes"), which sets out the basic elements the FSB considers necessary for an effective statutory resolution regime.[6] The focus of the Key Attributes is on ensuring the continuity of systemically important financial services provided by the failing SIFI, but doing so in a way that does not expose taxpayers to loss from solvency support (*i.e.*, without taxpayer injections of capital).[7]

The Key Attributes provide that a resolution authority, an administrative, non-judicial body, should be permitted to take control of a failing firm prior to its reaching the point of non-viability and exercise either stabilization or liquidation powers.[8] Stabilization powers include the authority to sell or transfer ownership in the firm or its assets, liabilities and business to third parties, either directly or through a specially-chartered bridge entity, regardless of any transfer restrictions that may otherwise apply.[9] Resolution authorities must also be able to carry out a "bail-in within resolution" of a failing firm, meaning the power to impose a creditor-financed recapitalization of the failing firm.[10] Such a recapitalization may entail, among other actions, a combination of (a) writing down or writing off equity interests in the firm or unsecured creditor claims (including uninsured deposit liabilities) in order to absorb losses and (b) converting into equity certain unsecured creditor claims (including uninsured deposit liabilities). Such a bail-in must respect creditor hierarchies and can be accomplished either by exercising statutory powers with respect to equity and liabilities of the failing firm directly, or by selectively transferring certain liabilities to a bridge or other successor together with some or all assets of the firm. In contrast to stabilization powers, which are aimed at preserving operations of the firm, the Key Attributes provide that liquidation powers should permit the resolution authority to wind down the firm's business in an orderly manner.[11]

At the 2013 G-20 summit, the leaders of the G-20 committed to fully implementing the Key Attributes in each G-20 jurisdiction.[12] Today, special resolution regimes that are fully or nearly fully compliant with the Key Attributes are in effect in France,[13] Germany,[14] Japan,[15] Switzerland,[16] the United Kingdom[17] and the United States,[18] and are reflected in the EU Bank Recovery and Resolution Directive ("BRRD").[19]

## b. New Resolution Strategies

At the time of its bankruptcy filing, Lehman Brothers had operations in over 40 countries, and its failure resulted in over 80 proceedings, including in Australia, Bermuda, the Cayman Islands, China, France, Germany, Hong Kong, Luxembourg, Japan, the Netherlands, the Philippines, Singapore, Switzerland, South Korea, the United Kingdom and the United States.[20] While certain pieces of Lehman's operations were acquired by other firms and live on today, as a practical matter, Lehman ceased to exist when it filed for bankruptcy.[21] By contrast, new resolution powers focus on resolving and recapitalizing a failed firm (or parts of it) as a group and preserving it as a going concern. The new resolution strategies that have emerged from these new resolution powers can be broadly categorized as "single-point-of-entry" ("SPOE") and "multiple-point-of-entry" ("MPOE") strategies.

The SPOE strategy envisions a "top down" approach to exercising resolution powers. In an SPOE-style resolution, only the top-level entity in a failing financial group (whether a holding company or an operating company) would enter resolution proceedings, with its operating subsidiaries continuing operations uninterrupted outside of proceedings.[22] The top-level company of the failing financial group would be resolved, with losses imposed on that company's shareholders and creditors according to their priority, while viable subsidiaries would continue operations without being placed into insolvency proceedings.

Through its focus on resolving the top-level company only, SPOE allows otherwise viable operating subsidiaries to continue operations on a going-concern basis, with additional liquidity supplied by the resolution authority as needed. The strategy is designed to limit the Lehman-style cascades of separate insolvencies of subsidiaries within a financial group, the unwinding of group and subsidiary financial contracts and the potential systemic consequences of the failure of multiple companies within a large, cross-border financial group. Limiting insolvency proceedings to only the top-level company, while maintaining funding for the continued operation of subsidiaries, could limit many of the complications caused by the need to coordinate multiple insolvencies under frameworks in different jurisdictions.

The MPOE strategy envisions a similar top-down approach, but involves multiple iterations of the SPOE strategy at different points throughout the firm (likely by different resolution authorities in different jurisdictions), possibly coupled with the separate resolution or liquidation of certain entities within the group. This could result in the involvement of multiple resolution authorities executing differing regional resolution strategies.[23] For example, for a firm operating in four major jurisdictions, each with a regional holding company with multiple operating subsidiaries, an MPOE approach could be used. The SPOE recapitalization strategy described above might be executed at three of these regional holding companies by the resolution authority in the jurisdiction of each of the holding companies, with the fourth subgroup put into liquidation by a fourth resolution authority. Successful execution of an MPOE strategy may depend on coordination across jurisdictions in order to decrease the likelihood of conflicts that could obstruct each of the separate resolution actions or result in firm-wide contagion.[24] However, the MPOE strategy is generally focused on preserving as a going concern viable groups of entities within the broader group as intact subgroups and should therefore not be confused with the "all entities in insolvency proceedings" approach taken for Lehman Brothers.

In December 2013, the Federal Deposit Insurance Corporation ("FDIC") released a notice and request for comment that describes the manner in which it would implement an SPOE resolution strategy in the United States.[25] The FDIC indicated that, where there is no viable private-sector solution and resolution of an entity under the Bankruptcy Code would pose a systemic risk to the US economy, SPOE would be an alternative approach available to the FDIC, as receiver, upon a firm's entry into resolution proceedings under OLA.[26] Under such circumstances, upon the FDIC's appointment as receiver, the SPOE strategy would be implemented by the transfer of all of the top-level SIFI's assets, including ownership of its subsidiaries, to a newly-chartered bridge financial company. The transfer would also include secured creditor claims, obligations to critical vendors and guarantees related to subsidiaries. However, claims by equity, subordinated debt and senior unsecured creditors would remain in an FDIC receivership. Following the transfer, the bridge entity would become the new top-tier holding company of all the subsidiaries of the failed SIFI.[27]

Under the FDIC's SPOE strategy, the bridge entity's assets would consist principally of equity in the SIFI's subsidiaries. Therefore, the bridge entity would be expected to have a strong balance sheet because the vast majority of unsecured debt obligations, including all regulatory capital and capital debt, would be left as claims in receivership while all of the assets would be transferred. The FDIC describes the ultimate exit scenario following such a transfer as involving the exchange of those claims left behind in the receivership for equity, debt or possibly contingent securities (or combinations thereof) of the bridge entity (or its successor or successors), rather than payment in cash. This creditor claim-for-equity swap would capitalize the bridge or successor(s) and allow it (or them) to be spun off under full private-sector control and ownership. Such an exchange would be conducted according to the Dodd-Frank Act's established priority of claims.[28] The purpose of this exchange is to provide value to creditors without resorting to the liquidation of assets or wind-down of the SIFI's operations.

## c. Early Termination Rights under Swaps and Stays on their Exercise

Under an ISDA Master Agreement, the insolvency of a party, and in some circumstances of a guarantor or affiliate of a party, generally gives the other party the right to exercise early termination rights with respect to the transactions documented thereunder, including rights to terminate the transaction, net amounts owing between the parties, set off and, if the transactions are collateralized, enforce remedies against the collateral. Insolvency regimes in many nations typically protect or "safe harbor" the exercise of such direct default rights, notwithstanding any stays on the exercise of similar rights by other creditors, and do not impose stays on cross defaults.[29] As noted above, there is concern that the widespread exercise of such protected rights in the context of a resolution could undermine the viability of the resolved entity and potentially create systemic risk.

To address these concerns, the Key Attributes provide that a resolution authority should be empowered to place a temporary stay (on a discretionary basis or automatically) on a non-defaulting party's contractual right to exercise early termination rights that arise solely because of entry into resolution or the exercise by the resolution authority of resolution powers, which temporary stay may become a permanent override if certain creditor protections are satisfied.[30] Certain limitations on stays under the Key Attributes provide protection to creditors. Temporary stays must be "strictly limited in time," with a clear beginning and ending point, and they should not affect early termination rights that arise because of a payment or delivery default. Among other creditor protections, the Key Attributes require measures to prevent cherry picking of contracts subject to a stay.

The effect of these stays therefore would be to prevent counterparties to a SIFI in resolution from exercising early termination rights so long as the SIFI continues to pay and perform. These stays are considered a cornerstone of a resolution authority's ability to preserve a failed SIFI as a going concern. Many of the special resolution regimes discussed above have such stays in place, and Key Attribute compliant stays are expected to be included in the special resolution regimes being developed in other jurisdictions

## d. Enforceability of Stays in a Cross-border Context

Even if a stay (or the exercise of another resolution power) is intended to have extraterritorial effect, its enforcement outside of the jurisdiction of the resolution is subject to uncertainty, particularly where the contract at issue is governed by a law different from that which imposed the stay (or authorized the other resolution action). For example, if the holding company of a US-headquartered global SIFI were to be placed into resolution under OLA, the FDIC, as receiver for the holding company, could, under many circumstances, stay the exercise of both direct default rights by counterparties of the holding company and cross-default rights of counterparties of subsidiaries of the holding company.[31] Where those default rights arise under contracts governed by US law (*e.g.*, by the law of the State of New York), the OLA stay will almost certainly be effective and enforced within the United States and should be enforced by non-US courts so long as relevant choice of law rules respect the parties' choice of law. However, where default rights arise under contracts governed by, for example, English law, there is greater uncertainty as to whether an English court would enforce the stay imposed by non-English law. This uncertainty is particularly acute with respect to cross-default rights in contracts of subsidiaries who are not themselves in proceedings (*e.g.*, the UK subsidiary of the US holding company). The result of this uncertainty means that whether a counterparty is stayed could depend on which entity within a SIFI group it faces, the governing law of the contract and potentially the jurisdiction of the counterparty.

Given these uncertainties, two main approaches to addressing the issue of cross-border recognition have emerged, either of which would likely be necessary for the successful application of an SPOE or MPOE resolution strategy: a statutory approach and a contractual approach.

- Under the statutory approach, SRRs provide for (a) a process by which stays and other resolution actions taken by foreign resolution authorities are made enforceable in the home jurisdiction or (b) the ability to exercise powers under a resolution regime that are consistent with the resolution measures taken by the foreign resolution authority.[32]
- Under the contractual approach, the parties to an agreement either (a) agree that the contracts will be subject to the exercise of powers by foreign resolution authorities under the relevant SRRs, even if the contract is not governed by the law of the jurisdiction of the applicable regime, or (b) agree that early termination rights simply do not arise as a result of resolution actions.

In the long term, the FSB has indicated that statutory recognition processes that are consistent with the FSB's Key Attributes are "the preferred goal."[33] Until relevant jurisdictions have widely adopted comprehensive statutory regimes, contractual approaches are viewed as a "workable interim solution."[34] While some jurisdictions provide for the "recognition" and enforcement of foreign resolution actions, such as stays, most do not.[35] Moreover, such recognition will likely be permissive, and not mandatory, which gives rise to further uncertainty. Therefore, a contractual approach may be needed even after statutory recognition regimes are in place.

## i. The Statutory Approach

The FSB has proposed statutory recognition as a long-term solution to ensuring the enforceability of resolution measures in a cross-border context. Statutory recognition would enable a local resolution authority to support the actions of a home resolution authority where a firm is being resolved under the law of the home jurisdiction.[36] Specifically, Key Attribute 7.5 states that jurisdictions should give effect to foreign resolution actions in one of two ways: (a) through mutual recognition (*i.e.*, making the action taken under foreign law enforceable under local law) or (b) by authorizing actions under local law that are consistent with, and that give effect to, the actions taken by a foreign resolution authority.[37] For example, Article 94 of the BRRD requires that European Union member states implement statutory recognition regimes under local law.[38] However, such recognition is not mandatory or automatic, and therefore cannot be assured in advance.[39] Further, if the SIFI has material operations in multiple foreign jurisdictions, recognition may be necessary in each of those jurisdictions, which increases the coordination burden of resolution authorities and the risk that a single non-cooperative jurisdiction could undermine a global resolution effort.

## ii. The Contractual Approach

An alternative approach to statutory recognition regimes is the contractual approach of either consenting to the application of foreign resolution powers or modifying terms so that default rights do not arise in resolution scenarios. Given the time required to implement recognition regimes in all relevant jurisdictions, the contractual approach is seen by financial regulators as a necessary step toward alleviating resolvability concerns. However, some, including the FSB, have indicated that the ideal approach is a combination of both the statutory and contractual approaches because, even with statutory recognition regimes in place, contractual provisions help reinforce certainty and predictability.[40]

Although transacting parties are not yet required to implement contractual solutions to the issue of cross-border recognition, the FSB has suggested that such requirements are forthcoming. As part of this process, in November 2013, the regulatory authorities from Germany, Japan, Switzerland, the United Kingdom and the United States requested that ISDA review its standard ISDA Master Agreement with an eye toward implementing a contractual approach to ensuring the cross-border enforcement of stays on the exercise of termination rights.[41] In response to this request, and in anticipation of expected regulatory requirements for such an approach, ISDA developed the Protocol with a working group composed of dealer and buy-side member firms and in consultation with the four requesting regulatory authorities, together with regulators from France, Japan and other FSB members.[42]

## III. Implementing the Contractual Approach: The ISDA 2014 Resolution Stay Protocol

The Protocol provides a contractual approach to addressing the challenges of ensuring the enforceability of stays in a cross-border resolution context by amending the terms of ISDA Master Agreements between parties that have adhered to it.[43] In November 2014, 18 major dealer banks[44] voluntarily adhered to the Protocol, thereby amending the terms of the ISDA Master Agreements between such banks. As a result of their adherence, more than 90% of the outstanding derivatives notional of the adhering dealer banks are subject to the stays that would apply during their resolution under an SRR.[45] Although the Protocol was developed as an initial matter on a voluntary basis, it is anticipated that broader market adherence to the Protocol will be driven by the implementation of regulations requiring that major dealers implement contractual approaches. Such regulations are expected to restrict SIFIs' ability to enter into swaps unless their counterparties contractually agree to limit their ability to exercise their default rights in a manner similar to the limitations described in the Protocol.

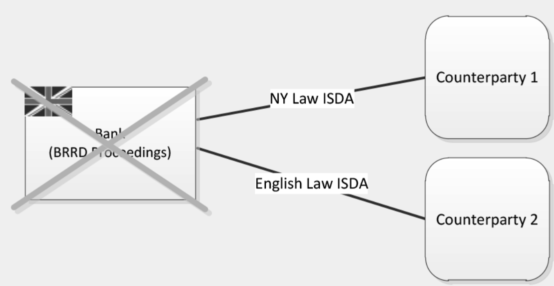
The Protocol takes two approaches to amending adhering parties' ISDA Master Agreements. First, Section 1 of the Protocol addresses close-out rights that arise because a party to an ISDA Master Agreement, or any of its "related entities" (affiliates whose defaults give rise to close-out rights),[46] becomes subject to resolution proceedings. Under Section 1, adhering parties "opt in" to certain provisions, including stays on the exercise of default rights, of qualifying SRRs if their counterparty, or its related entities, become subject to such SRRs. Second, Section 2 addresses insolvency proceedings under ordinary US insolvency regimes. Under Section 2, adhering parties contractually agree to override certain default rights under ISDA Master Agreements if an affiliate (including a parent) of its counterparty becomes subject to ordinary US insolvency proceedings, including under the Bankruptcy Code and the FDIA.

### a. Section 1: The Exercise of Default Rights upon Resolution

Section 1 of the Protocol provides an "opt in" to the SRR of the counterparty to an ISDA Master Agreement and the SRRs of certain "related entities" of the counterparty. Related entities include the intermediate and ultimate parents of the counterparty, Specified Entities of the counterparty and Credit Support Providers[47] of the counterparty. Under Section 1, adhering parties agree that their ability to exercise "default rights"[48] is subject to the resolution regime applicable to the entity in resolution, including any stays on the exercise of direct defaults or cross defaults, to the same extent they would be limited if the ISDA Master Agreement were governed by the law of the jurisdiction of that SRR. In addition, restrictions on the transfer of the relevant ISDA Master Agreement, or related credit support document, to a successor entity pursuant to that SRR are overridden to the same extent they would be overridden if the ISDA Master Agreement or related credit support document were governed by the law of the jurisdic-

**Section 1 Example**

**Direct Defaults**




In this example, Bank, Counterparty 1 and Counterparty 2 have all adhered to the Protocol. Bank is subject to resolution under the UK's implementation of BRRD, so Section 1 is applicable to Counterparty 1 and Counterparty 2. Counterparty 1 can only exercise default rights in respect of the ISDA Master Agreement to the extent it could do so if the ISDA Master Agreement were governed by the laws of the jurisdiction of the SRR of Bank. Thus, Counterparty 1 cannot close out the ISDA Master Agreement because of the direct default unless it could do so under UK BRRD under an English law ISDA Master Agreement. Counterparty 2 has an English law ISDA Master Agreement with Bank, so UK BRRD already applies; Counterparty 2 cannot close out the ISDA Master Agreement unless it could do so under UK BRRD. Thus, as a result of the Section 1 opt-in, parity of treatment for Counterparty 1 and Counterparty 2 is achieved.

tion of that SRR. The goal of Section 1 is to ensure the parity of treatment of all counterparties to a SIFI regardless of the governing law of the applicable ISDA Master Agreement. For example, under a New York-law-governed ISDA Master Agreement with the subsidiary of a UK SIFI, upon the resolution of the UK parent, cross-default rights arising because of the parent's resolution could only be exercised to the extent they could be exercised if the contract were instead governed by English law.

Section 1 became effective on January 1, 2015, and applies to resolution proceedings under SRRs in six specified jurisdictions: France, Germany, Japan, Switzerland, the United Kingdom and the United States. Section 1 will also apply to resolution proceedings under newly created SRRs implemented in other FSB jurisdictions,[49] provided that such regimes meet creditor safeguards described in the Protocol, which include, among other elements:

- Requiring that creditors of the financial company in resolution are not discriminated against on the basis of nationality, their location or domicile or the jurisdiction in which claims are payable;
- If a temporary stay is imposed on the exercise of termination rights, limiting such stay to two business days or less;
- Requiring the satisfaction of certain payment and delivery obligations during such stay;
- Requiring protection of all netting and setoff rights under the applicable agreements as a condition to permanent override; and
- Requiring the party in resolution (or its transferee) to remain obligated under the applicable agreements to the same extent it was obligated prior to the exercise of authority under the regime. [50]

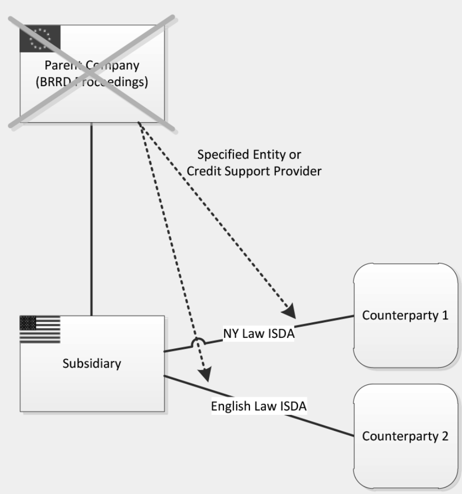
**Section 1 Example — Cross Defaults**

In this example, Subsidiary, Counterparty 1 and Counterparty 2 have all adhered to the Protocol. Parent Company is a Related Entity of Subsidiary and is subject to resolution under BRRD, so Section 1 is applicable to Counterparty 1 and Counterparty 2. Counterparty 1 and Counterparty 2 can only exercise default rights in respect of the ISDA Master Agreements to the extent they could do so if their ISDA Master Agreements were governed by the laws of the jurisdiction of the SRR of the Parent Company.

If Parent Company is an English institution:

- Counterparty 1 cannot close out the ISDA Master Agreement because of the cross default to Parent Company, unless it could do so under UK BRRD under an English law ISDA.
- Counterparty 2 has an English law ISDA Master Agreement with Subsidiary, so UK BRRD already applies. Thus, Counterparty 2 cannot close out the ISDA Master Agreement unless it could do so under UK BRRD.

If Parent Company is a German institution, neither Counterparty 1 nor Counterparty 2 can close out the ISDA Master Agreement because of the cross default to Parent Company, unless close out is permitted under the German implementation of BRRD under a German law ISDA Master Agreement.



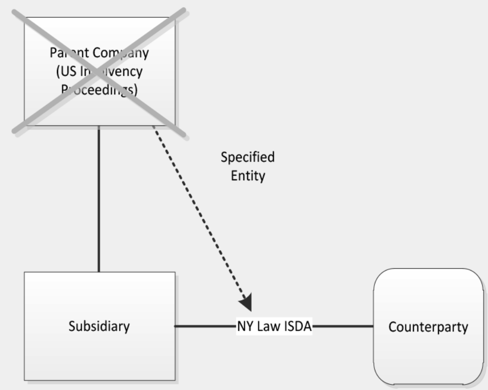
These criteria are aimed at ensuring that such additional FSB jurisdiction regimes substantially conform to the requirements of the Key Attributes.

## b. Section 2: Limitation on the Exercise of Default Rights upon US Ordinary Insolvency Proceedings

While Section 1 of the Protocol addresses default rights that arise upon resolution actions taken under SRRs, Section 2 was developed as a direct response to US resolution planning requirements under Title I of the Dodd-Frank Act.[51] Under the Dodd-Frank Act, certain large banking groups with operations in the United States are required to plan for their potential resolution under ordinary US insolvency regimes, such as the Bankruptcy Code and FDIA, rather than under OLA. Such planning entails developing effective resolution strategies, potentially including going-concern recapitalization strategies, where entities are being resolved under the Bankruptcy Code or under other ordinary US insolvency regimes. None of these ordinary insolvency regimes stay or override cross-default rights in contracts of affiliates. Under certain circumstances, Section 2 of the Protocol creates such a stay contractually, in an effort to support successful resolution proceedings under these regimes. Notably, Section 2 does not interfere with the exercise of default rights that arise because a direct party to an ISDA Master Agreement enters ordinary insolvency proceedings—these safe harbored right are unaffected by the Protocol.

**Section 2 Example**

**Cross Default to Parent "Specified Entity" in Proceedings**




In this example, Subsidiary and Counterparty have adhered to the Protocol. Parent Company is a Specified Entity under the ISDA Master Agreement between Subsidiary and Counterparty. Upon Parent Company's entry into ordinary US insolvency proceedings (*e.g.*, under the Bankruptcy Code), Section 2 will be applicable to Counterparty. Because of Section 2's unconditional override on the exercise of default rights arising from a Specified Entity's entry into insolvency proceedings, Counterparty will only be entitled to exercise performance-based default rights and unrelated default rights in respect of the ISDA Master Agreement. Thus, because Subsidiary has not defaulted, Counterparty cannot close out the ISDA Master Agreement.

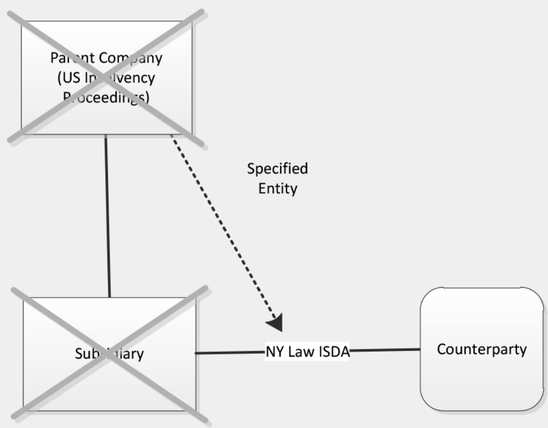
Specifically, Section 2 creates contractual stays on early termination rights under ISDA Master Agreements in cases where an affiliate (including a parent) of a counterparty becomes subject to insolvency proceedings under certain US regimes, including the Bankruptcy Code, the bank receivership provisions of the FDIA or the Securities Investor Protection Act (applicable to broker-dealers). In these cases, default rights arising because an affiliate that is a Specified Entity enters into ordinary insolvency proceedings are overridden.[52]

Where default rights arise because of the entry by a Credit Support Provider[53] into insolvency proceedings under Chapter 11 of the Bankruptcy Code, the non-defaulting party may not exercise its default rights during a temporary stay period (the longer of 48 hours and one business day). In order for the temporary stay to override default rights permanently, among other things, the defaulting party must either (a) remain obligated, with respect to the credit support obligations, as a debtor in possession ("DIP") or (b) transfer the credit support obligations to a third-party transferee or a newly-instituted bridge entity. In either case, the permanent override will not be effective unless the party in proceedings satisfies certain conditions, which differ under the DIP scenario and the transfer scenario.

In the DIP scenario, default rights under the applicable ISDA Master Agreement will be overridden if (a) the direct counterparty of the stayed party (not the party in Chapter 11 proceedings) remains registered with and licensed by its primary regulator to continue its business and (b) the bankruptcy court for the entity in proceedings

**Section 2 Example**

**Cross Default and Direct Default**




In this example, Subsidiary and Counterparty have adhered to the Protocol. Parent Company is a Specified Entity under the ISDA Master Agreement between Subsidiary and Counterparty. Upon Parent Company's entry into ordinary US insolvency proceedings (*e.g.*, under the Bankruptcy Code), Section 2 will be applicable to Counterparty. In addition to Parent Company's entry into proceedings, Subsidiary also fails to perform under the ISDA Master Agreement or enters into insolvency proceedings. Because of Section 2's unconditional override on the exercise of default rights arising from a Specified Entity's entry into insolvency proceedings, Counterparty may not exercise its cross-default right based on Parent Company's bankruptcy. However, Performance Default Rights are not overridden by the Protocol, and Counterparty is therefore permitted to close out the ISDA Master Agreement because of Subsidiary's failure to pay or perform or its entry into bankruptcy. Thus, while the Specified Entity cross default is overridden, Section 2 of the Protocol does not override the direct default.

(the "debtor") enters an order that gives priority to any payments due under its credit support over payments to other creditors of the debtor.[54]

In the transfer scenario, default rights under the applicable ISDA Master Agreement will be overridden if, among other things:

- the direct counterparty of the stayed party (not the debtor in Chapter 11 proceedings) remains registered with and licensed by its primary regulator to continue its business;
- the debtor in Chapter 11 proceedings transfers its credit support obligations in respect of the applicable ISDA Master Agreement to a transferee (and the transferee assumes such obligations);
- the debtor in Chapter 11 proceedings transfers all of its direct or indirect ownership interests in the direct counterparty to the applicable ISDA Master Agreement to the same transferee; and
- during the temporary stay period, the transferee continues to satisfy its material payment and delivery obligations to each of its creditors and does not become subject to insolvency or resolution proceedings.

In each case, these actions must be accomplished before the end of the stay period. The conditions above are designed to preserve the value and effectiveness of the credit support as much as possible, notwithstanding the insolvency of the Credit Support Provider. In doing so, Section 2, much like OLA, attempts to maintain balance between enabling resolution strategies that are similar to those utilized in the SRR context (*e.g.*, bail-in of creditors or transfers of credit support to bridge entities) and preserving the value of the credit support as much as possible.

Notwithstanding the application of the temporary stay and possible permanent override of default rights, at all times the non-defaulting party may exercise default rights arising due to performance-based default rights. Under the Protocol, "Performance Default Rights" include rights arising from (a) the direct counterparty's entry into insolvency proceedings, (b) the direct counterparty's failure to satisfy a payment or delivery obligation to the non-defaulting party under the applicable ISDA Master Agreement, credit support document or a related contract or (c) the relevant Credit Support Provider's failure to satisfy a payment or delivery obligation to the non-defaulting counterparty under the applicable ISDA Master Agreement or credit support document.[55] In addition, the non-defaulting party may exercise any "Unrelated Default Rights," which include any default rights that (a) do not arise solely as a result of the affiliate entering proceedings and can be shown by clear and convincing evidence not to be related to such affiliate's entry into proceedings or (b) are based solely on an affiliate that is not a US parent company entering insolvency or resolution proceedings that are non-US insolvency proceedings.

Unlike Section 1, which became effective without the implementation of regulations, Section 2 will not become effective until the introduction of "regulatory restrictions" in the United States. Just as the

FSB has indicated that regulatory restrictions with respect to Section 1 are forthcoming, adhering parties expect that US regulators will require the market to implement similar contractual approaches to address the lack of a stay under certain ordinary US insolvency proceedings because of resolution-planning requirements. Such regulations are expected to require the market to transact on terms similar to those reflected in Section 2, thus eliminating any concerns about an unfair competitive advantage in favor of those entities who have not adhered to the Protocol.

## IV. Next Steps and Additional Considerations

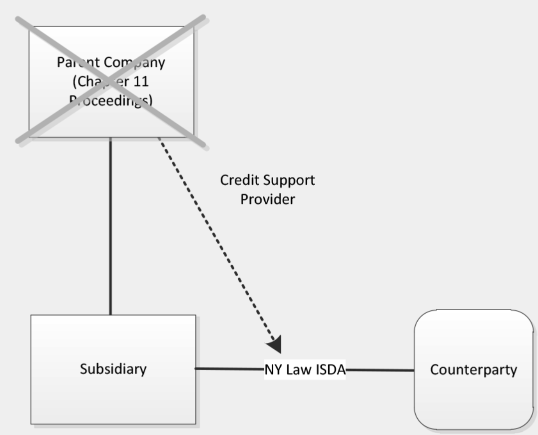
Although the contractual overrides in the Protocol represent a major step in decreasing the likelihood of large-scale terminations of financial contracts when entities enter into resolution proceedings, there are additional issues that need to be addressed. Throughout 2015, regulators will be working to delineate more clearly the restrictions that will be imposed on market participants, which will likely result in broader adherence to the Protocol, and exactly who those market participants will be. While the FSB views the Protocol as a "success," it has indicated that it needs to be extended to the broader market and to other contracts and products that may pose similar risks in the cross-border context.[56] The adoption of regulations, consideration of a broader scope of application of the Protocol and assessment of arrangements beyond bilateral over-the-counter derivatives are all on the horizon for 2015 and beyond.

### a. Regulations: Need and Timing

While additional SIFIs beyond the initial 18 and other firms with significant derivatives exposures are expected to adhere voluntarily to the Protocol in 2015,[57] other market participants are not expected to adhere unless regulations require them to adopt contractual arrangements similar to those in the Protocol. Because the Protocol, in certain circumstances, eliminates parties' rights to exercise early termination in resolution scenarios, adherence is viewed by many buy-side participants as undesirable (particularly without widespread adoption) or contrary to fiduciary obligations, in that it would result in the party giving up economically valuable rights. As a result, as discussed above, regulations are expected to be introduced that will require market participants to adopt contractual solutions on terms substantially similar to those in the Protocol. Similarly, it is expected that US regulators will implement regulations requiring parties to certain financial contracts to adopt contractual stays with respect to parties that enter ordinary US insolvency proceedings. Because the Protocol was drafted with an eye toward compliance with those anticipated regulations, it is expected that widespread adherence to the Protocol will result upon the implementation of such regulations. In fact, the Protocol permits adhering parties to "opt out" of Section 1 in the event such regulations are not implemented. Specifically, under Section 1, if a party to the Protocol does not become

**Section 2 Example**

**Credit Support Provider in Proceedings**




In this example, Subsidiary and Counterparty have adhered to the Protocol. Parent Company is a Credit Support Provider under the ISDA Master Agreement between Subsidiary and Counterparty. Upon Parent Company's entry into Chapter 11 proceedings, Section 2 will be applicable to Counterparty. Under Section 2, Counterparty is only permitted to exercise performance-based default rights and unrelated default rights in respect of the ISDA Master Agreement. As a result, Counterparty cannot close out the ISDA Master Agreement because of the cross default to Parent Company, so long as, prior to the expiration of the temporary stay period, Parent Company satisfies either the DIP conditions or the transfer conditions.

**US Capital Regulations**

In the United States, regulators at the Board of Governors of the Federal Reserve System and the Office of the Comptroller of the Currency have clarified in an interim final rule that banking organizations that adhere to the Protocol will not lose netting treatment of swaps subject to the Protocol for capital and other purposes, easing market concerns that the treatment of over-the-counter swaps would have been affected by adherence.[58] Specifically, the interim final rule provides that transactions under netting agreements, such as the ISDA Master Agreement, may be accounted for on a net basis when determining capital and other requirements, even if the agreements are subject to stays as a result of either the governing law of the agreement or because of a contractual opt-in, as provided under the Protocol.

subject to regulation in its home jurisdiction prior to specified deadlines, other parties who have opted out will not be subject to the Protocol with regard to the relevant SRR and could exercise their rights to the extent permitted under applicable law.[59] No such opt-out provision was required for Section 2, given that it will not be effective until the adoption of related regulations.

The FSB's 2014 consultation noted that contractual approaches should be "supported by official sector action", either as regulations or other measures enforceable by authorities. Regulation in the FSB jurisdictions supporting broad market adherence to the SRR provisions of the Protocol are expected this year, with effectiveness in 2016 or possibly 2017. Such regulations are expected to prohibit certain large banking groups from facing any counterparty that does not opt in to the special resolution regimes applicable to the group. Additional regulations in the United States supporting broad market adherence to the US insolvency regime provisions of the Protocol are also expected during 2015, with effectiveness in 2016 or possibly 2017.

## b. Scope of Products

The issue of the enforceability of stays in a cross-border resolution is not limited to ISDA Master Agreements and exists with respect to other types of financial contracts, such as repurchase agreements and other agreements governing a variety of financial transactions. Thus, it is certainly a possibility that the approach taken under the Protocol may become a template for addressing other products. Whether the Protocol will be expanded to cover financial products beyond derivatives governed by ISDA Master Agreements—and the scope of such products—remains open. While the standardized documentation for other products may not contain options for including cross-default provisions, such provisions can—and have been—added in by parties. Further, because of differences in SIFI structures that give rise to direct-default scenarios, enforceability of stays on direct defaults must still be addressed.

When FSB jurisdictions implement regulations, such regulations are expected to address financial contracts generally and are not expected to be limited to transactions under ISDA Master Agreements. Because much of the groundwork has been laid by the Protocol, it is expected that the expansion of the Protocol to cover additional product types (or adoption of similar approaches) will proceed more rapidly than it has with swaps.[60] However, while the general framework for a contractual approach has been created by the Protocol, industry and the official sector will need to carefully consider any issues particular to other types of agreements and products and how to safely cover such agreements.

In addition, the market has recently seen an increased move toward the segregation of "independent amounts" (*i.e.*, margin in excess of mark-to-market margin) and an increased reliance on tri-party custodial arrangements. These changes come as a response to regulatory initiatives, particularly under the Dodd-Frank Act[61] and under regulatory technical standards being developed under the European Market Infrastructure Regulation,[62] that are intended to decrease risk for end users. While the Protocol provides for a stay on the exercise of default rights, a third-party custodian would not be considered an "Affiliate" under the Protocol, nor does the Protocol address the concept of "custodian" in any way. As a result, the Protocol may need to be expanded to address this tri-party structure, with an eye toward ensuring that custodians can ascertain when it is appropriate to take action in a resolution context.

## c. Scope of Adherents

In addition, the question of which parties will be required by regulation to adopt contractual solutions to the issues addressed in the Protocol remains open. Although regulators have indicated that they expect to propose regulations relating to cross-border transactions for consultation by mid-2015, the question of whether such regulations would apply only to SIFIs or also to smaller banks with cross-border activity remains to be seen. Similarly, whether home-country regulations will apply to all of a SIFI's subsidiaries around the world, or only to entities in the jurisdiction of the regulation, is not clear. The answer to these questions is likely to vary by jurisdiction, which could undermine the effectiveness of the regulations (and the resulting contractual solutions) in satisfying regulator and industry goals of promoting SIFI resolvability.

## d. Cleared Client Transactions

Industry and regulators will also need to consider how to address cleared client transactions. For example, in some European and Asian markets, where the principal-to-principal model of client clearing prevails, clearing members of central counterparties have amended ISDA Master Agreement documentation with their clients so that it also governs trades that are ultimately submitted for clearing. As such, these contracts would also be subject to the Protocol. Ideally, the treatment of trades between the clearing member and its clients ("CM-Client trades") would mirror how the cleared leg of those trades are treated under applicable law. However, clearing houses, in their capacities as CCPs, are not typically parties to ISDA Master Agreements. As a result, because transactions with CCPs are not governed by ISDA Master Agreements, but rather by the rules of the CCPs, the Protocol does not apply to such transactions.

Under Section 1, CM-Client trades that are documented under an ISDA Master Agreement are treated the same as any uncleared derivative transaction that is within the scope of Section 1, although Section 1 of the Protocol will not apply to a CM-Client trade if its application would violate the rules of a clearing house (*e.g.*, rules governing documentation). Given that clearing houses are not subject to the Protocol, an imbalance regarding how the two legs of the transaction are treated may result.

CM-Client trades that are documented under an ISDA Master Agreement are also subject to Section 2, with certain exceptions to preserve the operation of provisions in documentation for CM-Client trades that provide for termination of the cleared client transaction in the event the clearing house terminates the corresponding transaction with the clearing member. In addition, just as under Section 1, the terms of the Protocol will not apply if its provisions violate the rules of an applicable clearing house.

## e. Transactions with Central Counterparties

The same concerns addressed by the Protocol with respect to over-the-counter bilateral swaps also arise with respect to cleared transactions. For example, default rights of a central counterparty ("CCP") may be triggered by a clearing member's entry into insolvency proceedings. Many CCPs retain broad discretion to cease to act for (and terminate the transactions of) a clearing member for a variety of reasons, many of which would be present in a failure and resolution scenario. As the market moves toward increased reliance on the clearing process, regulators and industry may need to develop approaches that increase the certainty that transactions with CCPs will not be terminated during resolution. Without such approaches, only a portion of the problem posed by the potential termination of financial contracts will have been addressed. Regulators expect to focus on these issues in 2015 and beyond as part of the overall discussion on the relationship of CCPs to bank resolution.

## V. Conclusion

The Protocol was drafted with several goals in mind, including improving resolvability outcomes, protecting creditors' rights by ensuring fairness for all counterparties and avoiding competitive distortions by providing market participants with increased certainty regarding their rights in the cross-border context. While the Protocol has been celebrated by regulators and industry alike, and it has been viewed as being positive for bond creditors of SIFIs from a credit perspective,[63] the new resolution regimes and strategies have yet to be tested in an actual resolution, and it remains to be seen whether they will result in a practical success. In addition, it is vital to recognize that, while the Protocol lays the groundwork for protecting entities that have entered resolution proceedings in a number of ways, it does not force counterparties to continue trading with such entities and, thus, cannot guarantee their continued viability. In order to fully address the concerns that led to the Protocol, concerted action across the market is a necessity, but may prove challenging, given the wide range of views and degrees of understanding of these issues. With the Protocol having laid much of the initial groundwork, 2015 provides an opportunity to address these issues more fully.

NOTES

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1. *See* Financial Stability Board, "Progress and Next Steps Towards Ending 'Too-Big-To-Fail' (TBTF)" (Sept. 2, 2013) 1, *available at* http://www.financialstabilityboard.org/wp-content/uploads/r_130902.pdf?page_moved=1 ("SIFIs are institutions of such size, market importance and interconnectedness that their distress or failure would cause significant dislocation in the financial system and adverse economic consequences. The [TBTF] problem arises when the threatened failure of a SIFI leaves public authorities no option but to bail it out using public funds to avoid financial stability and economic damage. The knowledge that this can happen encourages SIFIs to take excessive risks and represents a large implicit public subsidy of private enterprise.").

2. Some pre-crisis regimes, like the US Federal Deposit Insurance Act ("FDIA"), override in certain circumstances early termination rights upon certain direct defaults but do not address cross defaults.

3. *See* Financial Stability Board, "Key Attributes of Effective Resolution Regimes for Financial Institutions" at 51 (updated Oct. 15, 2014) (hereinafter, "Key Attributes"), *available at* http://www.financialstabilityboard.org/wp-content/uploads/r_141015.pdf ("[T]he termination of large volumes of financial contracts upon entry into resolution could result in a disorderly rush for the exists that creates further market instability and frustrates the implementation of resolution measures aimed at achieving continuity."). According to a filing made by Lehman Brothers, Lehman Brothers Holdings Inc. ("LBHI") and its subsidiaries subject to US bankruptcy proceedings were party to about 930,000 derivatives contracts, about 733,000 of which were terminated, or alleged to have been terminated, by about two months after LBHI's bankruptcy filing. *See* Debtors' Motion for an Order Pursuant to Sections 105 and 365 of the Bankruptcy Code to Establish Procedures for the Settlement or Assumption and Assignment of Prepetition Derivative Contracts at 4, In re Lehman Bros. Holdings Inc., No. 08-13555 (JMP) (Bankr. S.D.N.Y. Nov. 13, 2008).

4. 12 U.S.C. § 5381 *et seq.*

5. *See* Cleary Gottlieb Steen & Hamilton, LLP, "FDIC and Bank of England Signal Significant Cooperation on Resolution Issues in Joint Paper Describing 'Single Point of Entry' Resolution of Cross-border SIFI" (Jan. 2, 2013) (hereinafter, "CGSH Alert Memo of Jan. 2, 2013"), *available at* http://www.cgsh.com/files/News/14201174-9c48-43b4-9e59-83ae7b365cc1/Presentation/NewsAttachment/49cb8ec9-d7d8-4a53-af68-8462d68e7554/CGSH%20Alert%20-%20FDIC%20and%20BoE%20Signal%20Significant%20Cooperation%20on%20Resolution%20Issues.pdf.

6. *See* Key Attributes, *supra* note 3.

7. Key Attributes, *supra* note 3, at 1. Resolution regimes meeting these requirements should allow authorities to "resolve financial institutions in an orderly manner without taxpayer exposure to loss from solvency support, while maintaining continuity of their vital economic functions."

8. *See id.* at 7.

9. *See id.* at 3.

10. *See id.*

11. *See id.* at 4.

12. *See* FSB, "Towards full implementation of the FSB Key Attributes of Effective Resolution Regimes for Financial Institutions" (Nov. 12, 2014), *available at* http://www.financialstabilityboard.org/wp-content/uploads/Resolution-Progress-Report-to-G20.pdf.

13. *See* Articles L. 613-31-1 to L. 613-31-19 and R. 613-28 to R. 613-32 of the French Monetary and Financial Code.

14. *See* Restructuring and Resolution Act (*Sanierungs- und Abwicklungsgesetz*) & Credit Institutions Reorganization Act (*Kreditinstitute-Reorganisationsgesetz*).

15. *See* Deposit Insurance Act (Act No. 34 of 1971, as amended).

16. *See* Art. 24 and section eleven (*Massnahmen bei Insolvenzgefahr*) of the Swiss Federal Law on Banks and Savings Banks of 8 November 1934 (*Bundesgesetz über die Banken und Sparkassen; SR 952.0*) and Ordinance of the Swiss Financial Market Supervisory Authority on the Insolvency of Banks and Securities Dealers of 30 August 2012 (*Verordnung der Eidgenössischen Finanzmarktaufsicht über die Insolvenz von Banken und Effektenhändlern; SR 952.05*).

17. *See* Part I, Banking Act 2009, as amended.

18. *See supra* note 5.

19. *See* Directive 2014/59/EU of the European Parliament and the Council of 15 May 2014, *available at* http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0059&from=

EN. (BRRD requires that EU member states, among other things, implement special resolution regimes that comply with the requirements established in BRRD.)

20. *See* Notice of Report of Activities Through January 15, 2010 of the Official Representatives and Other Participating Affiliates Pursuant to the Cross-Border Insolvency Protocol, In re Lehman Bros. Holdings Inc., No 08-13555 at 3 (Feb. 2, 2010); LBHI, International Protocol Proposal (Feb. 11, 2009), *available at* http://dm.epiq11.com/LBH/Document/GetDocument/1131024.
21. Much of the business of LBHI's US registered broker-dealer subsidiary Lehman Brothers Inc. was sold to Barclays Capital Inc. pursuant to an agreement executed shortly after LBHI's bankruptcy filing, *see* Barclays Capital Inc. v. Giddens (In re Lehman Bros. Holdings Inc.), 761 F.3d 303, 306 (2d Cir. 2014), and portions of its Asian and English operations were sold to Nomura, *see* Nomura Holdings, Inc., Acquisition of Former Lehman Brothers Operations (Oct. 2008), *available at* http://www.nomuraholdings.com/investor/summary/financial/data/2009_2q_leh.pdf.
22. CGSH Alert Memo of Jan. 2, 2013, *supra* note 6.
23. *See* FSB, "Recovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Developing Effective Resolution Strategies" at 17 (July 16, 2013) (hereinafter, "FSB July 2013"), *available at* http://www.financialstabilityboard.org/wp-content/uploads/r_130716b.pdf?page_moved=1.
24. *See id.* at 13.
25. *See* Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy, 78 Fed. Reg. 76614 (Dec. 18, 2013) (hereinafter, "FDIC Notice"), *available at* http://www.gpo.gov/fdsys/pkg/FR-2013-12-18/pdf/2013-30057.pdf. *See also* Cleary Gottlieb Steen & Hamilton LLP, "FDIC's Notice on 'Single Point of Entry Strategy' Provides Additional Details While Raising Important Issues for Future Clarification" (Dec. 18, 2013) (hereinafter, "CGSH Alert Memo of Dec. 18, 2013"), *available at* https://clients.clearygottlieb.com/rs/alertmemos/125.-2013.pdf.
26. *See* FDIC Notice, *supra* note 25; *see also* CGSH Alert Memo of Dec. 18, 2013, *supra* note 25.
27. *See* FDIC Notice, *supra* note 25; *see also* CGSH Alert Memo of Dec. 18, 2013, *supra* note 25.
28. Under Dodd-Frank, the priority of claims is as follows: (1) administrative expenses of the receiver; (2) amounts owed to the United States; (3) certain limited employee salary and benefit claims; (4) other general or senior unsecured creditor claims; (5) subordinated debt holder claims; (6) wage and benefit claims of senior officers and directors; (7) shareholder claims. *See* 12 U.S.C. § 5390(b).
29. *See*, *e.g.*, ISDA, "Netting Legislation – Status", *available at* http://www.isda.org/docproj/stat_of_net_leg.html (describing the status of statutory protections in different jurisdictions).
30. The Key Attributes do not specifically refer to stays on early termination rights arising from cross defaults.
31. *See* 12 U.S.C. § 5390(c)(16). *See generally*, Cleary Gottlieb Steen & Hamilton LLP, "FDIC Finalizes Rule on Nullification of Subsidiary and Affiliate Cross-Defaults under OLA" (Oct. 17, 2012), *available at* http://www.cgsh.com/files/News/44a3a67f-bcd4-401e-beb8-e9d9d1a0b79c/Presentation/NewsAttachment/9fcac6a8-659f-4728-b464-eaa50a773b99/Alert%20Memo%20-%20FDIC%20Finalizes%20Rule%20on%20Nullification%20of%20Subsidiary%20and%20Affiliate%20Cross-Defaults%20und.pdf.
32. *See* Key Attributes, *supra* note 3, at 13 (Key Attribute 7.5).
33. FSB, "Cross-border recognition of resolution action (Consultative Document)" (Sept. 29, 2014) (hereinafter, "FSB Consultation of Sept. 2014"), *available at* http://www.financialstabilityboard.org/wp-content/uploads/c_140929.pdf?page_moved=1.
34. *Id.* Specifically, the FSB "agreed to pursue the rapid implementation of contractual solutions in regard to two particular cases where achieving cross-border recognition is a critical prerequisite for orderly resolution: (i) temporary restrictions or stays on early termination rights (including with respect to cross defaults) in financial contracts; and (ii) write-down, cancellation or conversion of debt instruments in resolution ('bail-in') where the instruments are governed by the laws of a jurisdiction other than that of the issuing entity." *Id.* at 1.
35. Even absent statutory recognition regimes, courts could recognize and enforce foreign law, including stays. In the United States, under general principles of comity, courts may grant deference to foreign insolvency proceedings. Pursuant to the doctrine of comity, a court may recognize and enforce actions taken under foreign insolvency regimes so long as they comport with US notions of due process and fundamental fairness, regardless of the citizenship of the party whose rights are affected or whether the parties have chosen non-US law to govern their contract and submitted to non-US jurisdiction. A long-standing principle underlying this doctrine, at least in the United States, is efficiency—that "equitable and orderly distribution of a debtor's property requires assembling all claims against the limited assets in a single proceeding." *See* Finanz AG Zurich v. Banco Economico S.A., 192 F.3d 240, 246 (2d Cir. 1999). In addition, parties should expect to be subject

to the laws and proceedings of foreign nations when engaging in dealings with foreign corporations. *See* Canada S. Ry. v. Gebhard, 109 U.S. 527, 537 (1883); The Argo Fund Ltd. v. Bd. of Directors of Telecom Argentina, S.A. (In re Bd. of Directors of Telecom Argentina, S.A.), 528 F.3d 162, 755 (2d Cir. 2008) (citing *Canada S. Ry.*); Remington Rand Corp.-Del. v. Bus. Sys. Inc., 830 F.2d 1260, 1268 (3d Cir. 1987) (same). While a court might enforce a stay under a foreign resolution regime under principles of comity, such enforcement could not be ensured in advance and is subject to exceptions.

36. *See* Key Attributes, *supra* note 3, at 13 (Key Attribute 7.5). Key Attribute 7.5 qualifies this requirement by noting that "[r]ecognition or support of foreign measures should be provisional on the equitable treatment of creditors in the foreign resolution proceeding." *Id.*
37. *See id.*
38. BRRD at art. 94.
39. Article 95 of BRRD enumerates the circumstances under which recognition need not be granted by the EU resolution authority. BRRD at art. 95.
40. *See* FSB Consultation of Sept. 2014, *supra* note 33, at 11.
41. *See* Letter from Bank of England, Bundesanstalt für Finanzdienstleistungsaufsicht, FDIC, Swiss Financial Market Supervisory Authority to ISDA (Nov. 5, 2013), *available at* https://www.fdic.gov/news/news/press/2013/pr13099.html.
42. *See* FAQs, ISDA 2014 Resolution Stay Protocol, http://www2.isda.org/functional-areas/protocol-management/faq/20.
43. The amendments would apply to any contracts traded pursuant to ISDA Master Agreements, which typically includes over-the-counter derivatives, *i.e.*, derivatives not subject to centralized clearing.
44. The first wave of adhering firms included the following banks and certain of their subsidiaries: Bank of America Merrill Lynch, Bank of Tokyo-Mitsubishi UFJ, Barclays, BNP Paribas, Citigroup, Crédit Agricole, Crédit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JP Morgan Chase, Mizuho Financial Group, Morgan Stanley, Nomura, Royal Bank of Scotland, Société Générale, Sumitomo Mitsui Financial Group and UBS. *See* Adhering Parties, ISDA 2014 Resolution Stay Protocol, http://www2.isda.org/functional-areas/protocol-management/protocol-adherence/20.
45. *See* ISDA, Latest News, "Major Banks Agree to Sign ISDA Resolution Stay Protocol" (Oct. 11, 2014), http://www2.isda.org/news/major-banks-agree-to-sign-isda-resolution-stay-protocol (hereinafter, "ISDA Press Release"). This figure includes (i) transactions with all counterparties of such dealer banks that would be subject to stays upon resolution because of the governing law of their agreements and (ii) transactions with the other adhering dealer banks.
46. Under the Protocol, a "related entity" is any affiliate, including any parent of an adhering party, a "Credit Enhancement Provider" or a "Specified Entity," whose failure gives rise to default rights. The Protocol uses the term "Credit Enhancement Provider" as a broad concept to capture the full range of parties providing credit support with respect to the applicable ISDA Master Agreement. Such credit support may take a variety of forms, including, for example, a guaranty, a credit support deed, collateral arrangements, a letter of credit, a transfer of margin or other similar arrangements.
47. "Specified Entity," a term used in the ISDA Master Agreements, refer to entities whose default under certain agreements or insolvency give rise to early termination rights. "Credit Support Provider," a term used in the ISDA Master Agreements, refers to an entity, such as a guarantor, that provides credit support for a direct party to an ISDA Master Agreement.
48. "Default rights" are defined in the Protocol as rights or contractual provisions that permit a non-defaulting party to liquidate, terminate or accelerate, or set off or net amounts owing under, the applicable ISDA Master Agreement or related credit support document; foreclose on collateral; demand payment or delivery; suspend payment or performance; call for stepped-up margin; and other similar rights to take action that are premised on the default of an entity.
49. The Protocol refers to such jurisdictions as "Protocol-eligible Jurisdictions." These jurisdictions consist of each FSB member jurisdiction, as of January 1, 2014, other than the six jurisdictions that already have qualifying SRRs in place (*i.e.*, France, Germany, Japan, Switzerland, the United Kingdom and the United States). The Protocol-eligible Jurisdictions are Argentina, Australia, Brazil, Canada, China, Hong Kong, India, Indonesia, Italy, Mexico, the Netherlands, the Republic of Korea, Russia, Saudi Arabia, Singapore, South Africa, Spain and Turkey. The United States is also included in this list, but only with respect to the Bankruptcy Code, in the event it is amended in the future to satisfy the requirements under the Protocol to become a qualifying regime.
50. Regimes must satisfy all of these requirements in order to be considered a "Protocol-eligible Regime" under the Protocol. In resolutions under Protocol-eligible Regimes, these creditor protections must also be satisfied by the actions taken by the resolution authority. This

"second look" ensures not only that the regime has creditor protections, but also that they are respected by the resolution authority during resolution.

51. *See* Title I of the Dodd-Frank Act, at § 165(d); *see also* FDIC Notice, *supra* note 25, at 76615.
52. *See supra* note 47.
53. *See id*.
54. In addition to performance default rights, discussed below, the non-defaulting party can exercise its default rights if the direct counterparty defaults to another, similarly situated party under the Protocol and fails to pay a close-out amount and the debtor does not satisfy its credit support obligations to such counterparty per the terms of such obligation (*i.e.*, a failure by the debtor to pay any stayed party a close-out amount under a guarantee reinstates the rights to close out of all other stayed parties benefiting from guarantees of the debtor).
55. The Protocol overrides certain direct default rights that arise, directly or indirectly, because of the entry of an affiliate into insolvency proceedings (*e.g.*, a default right based on the counterparty's loss of rating, where the loss of rating was caused by the affiliate's bankruptcy). However, Section 2 of the Protocol never overrides default rights that arise due to a direct counterparty's insolvency or failure to satisfy a payment or delivery obligation, or that are unrelated to an affiliate's entry into proceedings. In preserving these direct default rights, Section 2 also preserves the operation of the safe harbors in the Bankruptcy Code. These safe harbors protect the exercise of contractual rights, including under certain "swap agreements", to cause the termination of such agreements and to offset or net termination values, payment amounts or other transfer obligations upon a direct counterparty's commencement of bankruptcy proceedings. *See* 11 U.S.C. §§ 362(b)(17) and 560.
56. *See* Press Release, FSB, "FSB welcomes industry initiative to remove cross-border close-out risk" (Oct. 11, 2014), *available at* http://www.financialstabilityboard.org/wp-content/uploads/pr_141011.pdf.
57. *See* ISDA Press Release, *supra* note 45.
58. *See* "Regulatory Capital Rules, Liquidity Coverage Ratio: Interim Final Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions," 79 Fed. Reg. 78287 (Dec. 30, 2014), *available at* http://www.gpo.gov/fdsys/pkg/FR-2014-12-30/pdf/2014-30218.pdf; see also Press Release, Bd. of Governors of Fed. Reserve Sys. & Off. of the Comptroller of the Currency, "Agencies Announce Rules to Reflect ISDA Protocol in Regulatory Capital and Liquidity Coverage Ratio Rules" (Dec. 16, 2014), http://www.federalreserve.gov/newsevents/press/bcreg/20141216a.htm.
59. Specifically, if a party does not become subject to regulations with respect to (a) one of the six jurisdictions that already has a qualifying SRR in place (*i.e.*, France, Germany, Japan, Switzerland, the United Kingdom and the United States) by January 1, 2018 or (ii) a newly-qualifying FSB jurisdiction regime by the later of January 1, 2018 or 18 months following the effective date of that FSB regime, other adhering parties can opt out of such party's resolution under the applicable SRR.
60. *See* ISDA Press Release, *supra* note 45.
61. *See* 17 C.F.R. §§ 23.701-23.703.
62. *See* European Banking Authority, European Insurance and Occupational Pensions Authority & European Securities and Markets Authority, Consultation Paper: Draft Regulatory Technical Standards on Risk-Mitigation Techniques for OTC-Derivative Contracts Not Cleared by a CCP under Article 11(15) of Regulation (EU) No 648/2012 (Apr. 14, 2014), *available at* http://www.eba.europa.eu/documents/10180/655149/JC+CP+2014+03+%28CP+on+risk+mitigation+for+OTC+derivatives%29.pdf.
63. *See* Ana Arsov & Megan Snyder, ISDA Stay Protocol for Derivatives is Credit Positive for Large Banks, Moody's Credit Outlook at 10 (Oct. 16, 2014) ("The [Protocol] is credit positive for the senior creditors of the largest global banks with greatest derivative exposures … . Agreement to the [Protocol] helps establish an orderly cross-border resolution of large systemically important banks, which could result in greater recoveries than in a disorderly bankruptcy.").