

RESOLUTION STAY PROTOCOL – BACKGROUND

The Resolution Stay Protocol is a major component of a regulatory and industry initiative to address the too-big-to-fail issue by improving the effectiveness of cross-border resolution actions against a big bank – therefore ensuring taxpayer money is never again needed to prop up a failing institution.

Issues

- Under an ISDA Master Agreement, the insolvency of a derivatives counterparty, or the start of resolution actions against it, can trigger certain close-out rights – including termination of the swap, foreclosure on collateral and claim for payments.
- Regulators had expressed concern that the simultaneous close-out of derivatives transactions during the resolution of a large, cross-border bank could hamper resolution efforts and destabilise markets.
- This is being addressed in certain countries through the development of statutory resolution regimes – for instance, Title II of the Dodd-Frank Act and the EU Bank Recovery and Resolution Directive – which impose a stay on termination rights in the event a bank is subject to resolution action in its jurisdiction. If the resolution is successful, then counterparties would face a creditworthy institution and no longer have the right to terminate their transactions.
- The problem is that these statutory regimes don't typically contain provisions that recognise the resolution regimes of other jurisdictions. In other words, cross-border trades may end up falling between the cracks.
- That could potentially be a big problem for regulators trying to resolve a big globally active bank with multiple overseas subsidiaries. There is a question as to whether stays on termination rights under a particular resolution regime would be enforceable against all swap counterparties of the banking group, which would likely be located in different jurisdictions and transacting under the laws of a variety of jurisdictions

Project

- Dealing with the too-big-to-fail issue is a major focus for regulators, as spelt out in the recent Financial Stability Board report on cross-border resolution (September 29, 2014: http://www.financialstabilityboard.org/publications/c_140929.pdf).

- The introduction of temporary stays within statutory resolution regimes in multiple countries shows how determined policy-makers and regulators are to tackle the issue.
- In early 2013, ISDA was asked by prudential regulators to explore a contractual solution to support existing statutory regimes and work alongside longer-term regulatory efforts to develop cross-border recognition of statutory resolution frameworks.
- Specifically, regulators wanted the industry to consider the development of a Protocol – essentially, a means of amending ISDA Master Agreements to incorporate contractual recognition of stays under various statutory resolution regimes.
- The Protocol contractually opts adhering parties into provisions within certain qualifying special resolution regimes that limit the exercise of termination rights.
- US regulators also asked ISDA to incorporate contractual stays on cross-default rights (but not on direct default rights) that would apply in the context of proceedings under the US Bankruptcy Code and would replicate some of the types of stays found in the statutory resolution regimes.

Timing

The first wave of banks will adopt the Protocol before the G-20 meeting in Brisbane in November. This wave involves 18 major banks and certain of their affiliates. They will adhere to the protocol on a voluntary basis by early November 2014. The protocol will become effective for those firms on January 1, 2015 – except for the US bankruptcy related provisions, which become effective only upon relevant regulations being issued by US regulators.

- The special resolution regime opt-in within the Protocol will come into effect for the 18 banks on January 1, 2015.
- Buy-side firms are not included in the first phase. These institutions are unable to voluntarily adopt the protocol due to fiduciary responsibilities to their clients. By voluntarily giving up advantageous contractual rights, they potentially leave themselves open to lawsuits. The FSB has recognised this issue, and FSB members have committed to encourage broader adoption of the protocol by imposing new regulations in their jurisdictions throughout 2015.