JONES DAY

COMMENTARY

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QFC Resolution Stay Regulations: Not Just For Derivatives

IN SHORT

The Situation: Banking regulators in the United States have issued the so-called "Resolution Stay Regulations," which require "global, systemically-important banks" ("GSIBs") to amend a broad variety of "qualified financial contracts" ("QFCs"), including spot and forward physical commodity contracts, securities underwritings, and other offerings.

The Result: GSIBs are required to bring all QFCs transacted on or after January 1, 2019 with "financial" counterparties into compliance by July 1, 2019 and with corporate clients by January 1, 2020.

Looking Ahead: Although often equated with derivatives, corporate counterparties and issuers of securities are starting to see "QFC resolution stay" provisions being proposed for insertion into QFCs in potentially unexpected circumstances, including in overseas offerings that have no connection with the U.S.

The Resolution Stay Regulations require GSIBs to amend or otherwise remediate a wide range of financial contracts and are reaching into potentially unexpected corners of the markets. QFCs are often equated with derivatives and "repo" agreements, but they also include spot and forward physical commodity contracts and "contract[s] for the purchase, sale, or loan of a security" and accordingly capture ordinary capital markets activities in which securities are purchased directly from the issuer for the purpose of re-sale to investors. Corporate clients in the U.S. and overseas are seeing "resolution stay" provisions being proposed for insertion into derivatives, physical commodity contracts and syndication agreements.

The resolution stay regulations are complex, and this short introduction must necessarily omit many important details and qualifications. Corporate counterparties and issuers are urged to seek detailed and individualized advice from competent counsel concerning the applicability of the Resolution Stay Regulations to their own circumstances.

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THREE KEY TAKEAWAYS

1. The broad definition of QFC under the Resolution Stay Regulations reaches well beyond derivatives and includes transactions such as spot and forward physical commodity contracts and off-shore sales of securities to a U.S. GSIB affiliate underwriter. If they haven't already, corporate counterparties and issuers should expect to receive proposals to amend QFCs to meet the January 1, 2020 compliance date for GSIBs to remediate their QFCs with non-financial

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counterparties. The risk of failing to do so rests entirely on the relevant GSIB, but a remediated QFC will in effect be a condition to doing business with all in-scope GSIBs.

2. Although they are complex, the Resolution Stay Regulations seek to facilitate a Resolution Transfer for a GSIB by means of two conceptually straightforward agreements on the part of counterparties: to observe the stay-and-transfer provisions under FDIC Receiverships and to disable cross-defaults and Transfer Restrictions on credit enhancements when insolvency proceedings are commenced for an Insolvent Affiliate.

3. Two methods exist for GSIBs to bring their QFCs into compliance with the Resolution Stay regulations: bilateral amendment, in which case the amendment must adhere strictly to the Resolution Stay Regulations, and ISDA protocol adherence, which contains certain dispensations from the Resolution Stay Regulations and is a "one-stop shop" for affiliated groups of counterparties to amend all QFCs between them but is also an instrument that may be excessively broad for specific circumstances.

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