ICMA Note on the U.S. QFC Stay Rules

20 December 2018

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Introduction

The U.S. banking regulators adopted rules (the "QFC Stay Rules") in 2017 to improve the resolvability and resilience of U.S. global systemically important banks ("GSIBs") and their subsidiaries worldwide, as well as the U.S. subsidiaries, branches and agencies of non-U.S. GSIBs (together, "Covered Entities"). The QFC Stay Rules are intended to mitigate the risk of destabilizing terminations of certain contracts, which is a perceived impediment to the orderly resolution of a GSIB. They accomplish this by requiring that those contracts include language establishing that U.S. regulators have the same ability to stay enforcement of termination of such contracts and to transfer such contracts away from a failing GSIB that they would have under U.S. bank insolvency law. This note sets out a summary of the QFC Stay Rules' effects on capital markets documentation for vanilla, non-structured debt securities in primary markets outside the United States. This may include contracts governed by the laws of the United States (e.g. New York law) as well as any other laws (e.g. English law). For more background, please see the document prepared by SIFMA here.

The QFC Stay Rules apply to "qualified financial contracts" ("QFCs"), which include "a contract for the purchase, sale or loan of a security" and a "master agreement that provides for an agreement or transaction" for the purchase, sale or loan of a security. That definition covers a subscription agreement, the ICMA Agreement Among Managers (versions 1 and 2) and a dealer agreement. It does not, however, typically cover other capital markets documents such as a trust deed, agency agreement, deed of covenant or the security instrument itself.

The QFC Stay Rules do not require amendments to all of a Covered Entity's QFCs. Instead, a QFC is only "in-scope" if it restricts the transfer of the contract (or a related interest or obligation) away from a Covered Entity or provides for "default rights" that may be exercised against a Covered Entity.

This note focuses on how to address the QFC Stay Rules' requirements with respect to post-January 1, 2019 "in-scope" QFCs where a *manager* or *dealer* is a Covered Entity. It does not address how QFCs entered into post January 1, 2019 might affect "in-scope" QFCs entered into between the same parties or their affiliates prior to January 1, 2019. In addition, any *issuer* that is a Covered Entity will need to conduct its own analysis of each document it enters into to determine if that document is a QFC and whether it is "in-scope".

The QFC Stay Rules require each Covered Entity to conform the terms of any new "in-scope" QFC it enters into on or after a certain date. That date depends on the identity of the other parties to the contract. The relevant dates are:

- January 1, 2019 if each party to the QFC is a Covered Entity;
- July 1, 2019 if each party to the QFC is a financial counterparty or Covered Entity; and
- January 1, 2020 for all other QFCs.

However, US GSIBs will be seeking to comply with the QFC Stay Rules for all "in-scope" QFCs from January 1, 2019.

ICMA plans to create and update (during the compliance periods) a list of frequently asked questions (FAQs). It will be available on the ICMA website here.

Summary of QFC Stay Rules' impact on typical, vanilla debt capital markets documentation

- **Subscription Agreement for a stand-alone issue**

  Headline: Typically, considered not to be an "in-scope" QFC for managers that are Covered Entities.

  The form of subscription agreement (whether single subscriber/manager or multi-manager) varies by institution and issuer. A subscription agreement is a QFC because it is a contract for the purchase, sale or loan of a security. However, it will only be an "in-scope" QFC if a Covered Entity is a party to it as a manager and it explicitly contains either transfer restrictions or default rights applicable to that Covered Entity. Each subscription agreement will need to be checked individually.

  - As a guideline, typical subscription agreements do not contain restrictions on the managers transferring any of their rights or obligations under the subscription agreement. In addition, although it is very common to include default rights against the issuer in a subscription agreement (for example, termination for reasons of force majeure), it is not common to include such rights against the managers in which case there would be no default rights.
  - If the particular subscription agreement contains a transfer restriction or default rights against a Covered Entity, that Covered Entity will need to include the language set out in Exhibit 1 hereto in that agreement. In these circumstances, lead managers that are not Covered Entities should bear in mind that, if the syndicate is to include a Covered Entity, that language will need to be included.

- **MTN Dealer Agreement**

  Headline: Typically, considered to be an "in-scope" QFC for MTN dealers that are Covered Entities.

  The form of MTN dealer agreement varies by institution and issuer. An MTN dealer agreement will be a QFC because it is a master agreement that provides for an agreement or transaction for the purchase, sale or loan of a security. It will be an "in-scope" QFC if a Covered Entity is (or becomes) a party to it as a dealer and if, as it typically will, it contains transfer restrictions applicable to dealers. Accordingly, dealers may want to include a new provision in their MTN dealer agreement and incorporate the new provision by reference into the form of subscription agreement at the time of the next programme update[1]. Programme arrangers that are not Covered Entities should bear this in mind when updating a programme where one or more of the other dealers is a Covered Entity. Exhibit 1 contains the suggested language for such a provision.

- **MTN Drawdowns**

  Headline: Typically, considered to be an "in-scope" QFC for MTN dealers or managers that are Covered Entities.

  The contract between the issuer and one or more managers for an MTN drawdown is a QFC because it is a contract for the purchase, sale or loan of a security. It will be an "in-scope" QFC because it will typically incorporate the transfer restrictions from the MTN dealer agreement. Drawdowns under MTN dealer agreements without a QFC Stay Rules provision that involve a Covered Entity as dealer or manager should include a QFC Stay Rules provision in the drawdown contract between the issuer and one or more managers (such as in the dealer confirmation, terms agreement, syndication agreement or subscription agreement) if the transfer restrictions on dealers are incorporated into such documentation or in any dealer accession letter entered into by a Covered Entity. This is not required where a QFC Stay Rules provision is included in the MTN dealer agreement and incorporated into or otherwise made applicable to the relevant drawdown contract.[2] In the case of syndicated drawdowns, lead managers that are not Covered Entities should bear in mind that, if the syndicate is to include a Covered Entity, the language will need to be included in the relevant documentation.

- **ICMA Agreement Among Managers** (versions 1 and 2) (the "AAMs")

  Headline: Considered to be "in-scope" QFCs for managers that are Covered Entities. ICMA has included a QFC Stay Rule provision in the AAMs.

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[1] For more information, see the ICMA FAQ document, which will be available on this ICMA webpage.

[2] This could be the case if, for example, the issuer and the Covered Entity manager(s) adhered to the ISDA 2018 U.S. Resolution Stay Protocol after the date that those parties entered into the MTN dealer agreement.

The AAMs are QFCs because each of them is a contract for the purchase, sale or loan of a security. They are "in-scope" QFCs because of the lead manager's right to adjust the amount of securities to which a manager must subscribe or purchase in the event there is a defaulting manager and the definition of default rights under the QFC Stay Rules includes the right of a party (the lead manager) to modify the obligations of another party (the other managers) thereunder. ICMA has added a new provision to the AAMs that brings them into compliance with the QFC Stay Rules. Exhibit 1 hereto contains the language for that provision, which is broadly consistent with the language for underwriting agreements set out in the SIFMA document referenced above. If there are no Covered Entities as lead manager or manager, the provision will still be included but by its terms will have no effect.

- **ICMA Standard Form ECP Dealer Agreement** (September 2015) (the "ICMA ECP Dealer Agreement")

  Headline: There is an argument that this could be considered not to be an "in-scope" QFC for ECP dealers that are Covered Entities. Currently, ICMA is not intending to amend its standard form.

  The ICMA ECP Dealer Agreement is a QFC because it is either a contract for the purchase, sale or loan of a security or a master agreement that provides for security purchase, sale or loan transactions. This agreement permits the issuer to terminate against an ECP dealer at any time upon 30 days' written notice. A number of affected ECP dealers are taking the view that this right does not bring the ICMA ECP Dealer Agreement within scope, though this remains a topic for discussion. Currently, ICMA is not intending to amend its standard form.

  ECP dealer agreements that do not follow the ICMA standard form will need to be checked individually. In particular, where an ECP dealer agreement contains a transfer restriction applicable to the ECP dealers, then it will be an "in-scope" QFC and ECP dealers that are Covered Entities will need to take steps to remediate the contract. See further the ICMA FAQ document available here.

Exhibit 1

Language for inclusion in the relevant agreement[3]

[ ]. Recognition of the U.S. Special Resolution Regimes

(1) In the event that any Manager that is a Covered Entity becomes subject to a proceeding under a U.S. Special Resolution Regime, the transfer from such Manager of this Agreement, and any interest and obligation in or under this Agreement, will be effective to the same extent as the transfer would be effective under the U.S. Special Resolution Regime if this Agreement, and any such interest and obligation, were governed by the laws of the United States or a state of the United States.

(2) In the event that any Manager that is a Covered Entity or a Covered Affiliate of such Manager becomes subject to a proceeding under a U.S. Special Resolution Regime, Default Rights under this Agreement that may be exercised against such Manager are permitted to be exercised to no greater extent than such Default Rights could be exercised under the U.S. Special Resolution Regime if this Agreement were governed by the laws of the United States or a state of the United States.

"Covered Affiliate" has the meaning assigned to the term "affiliate" in, and shall be interpreted in accordance with, 12 U.S.C. § 1841(k).

"Covered Entity" means any of the following:

(i) a "covered entity" as that term is defined in, and interpreted in accordance with, 12 C.F.R. § 252.82(b);

(ii) a "covered bank" as that term is defined in, and interpreted in accordance with, 12 C.F.R. § 47.3(b); or

(iii) a "covered FSI" as that term is defined in, and interpreted in accordance with, 12 C.F.R. § 382.2(b).

"Default Right" has the meaning assigned to that term in, and shall be interpreted in accordance with, 12 C.F.R. §§ 252.81, 47.2 or 382.1, as applicable.

"U.S. Special Resolution Regime" means each of (i) the U.S. Federal Deposit Insurance Act and the regulations promulgated thereunder and (ii) Title II of the U.S. Dodd-Frank Wall Street Reform and Consumer Protection Act and the regulations promulgated thereunder.

[3] Terms used in this language should be amended to conform to the relevant agreement.