

October 31, 2017

*By Electronic Mail*

The Hon. Steven T. Mnuchin  
Chairman, Financial Stability Oversight Council  
Secretary of the Treasury  
U.S. Department of the Treasury  
1500 Pennsylvania Avenue, N.W.  
Washington, D.C. 20220

**Re: Proposed amendments to EU law affecting global financial stability**

Dear Secretary Mnuchin:

We are writing to alert the Financial Stability Oversight Council to a pending proposal to revise the European Union's legal framework for bank resolution that would reduce financial stability in the United States and globally. Given the FSOC's duty to respond to "emerging threats to the stability of the United States financial system," we request that the FSOC and its member agencies raise this issue at the Financial Stability Board and at the upcoming EU-U.S. regulatory dialogue.

In a significant departure from globally established norms, the European Commission has proposed to amend the European Bank Recovery and Resolution Directive to give EU regulators the power to impose a prolonged form of single-institution "bank holiday." Specifically, EU regulators would be authorized to suspend payment obligations of a bank to its counterparties and customers (including its depositors) for up to twelve business days, and possibly longer.<sup>1</sup> While seemingly arcane, this proposed change, referred to as an extended "payments moratorium," would create serious systemic and economic problems, both in crisis and in normal operations. The potential costs include a significant reduction in cross-border activity, a fragmentation of global financial markets and reduction in opportunities for market participants, including corporates and other end users, to hedge key exposures.

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<sup>1</sup> We understand that proposals are under consideration in Europe to shorten the moratorium period. However, even the proposals that limit the total suspension period to five business days would represent a significant divergence from global norms (more than doubling the current upper limit on the duration of stays) and raise the systemic risk concerns identified throughout this letter.

**First**, the potential for such a lengthy stay would incentivize creditors of EU banks to run even earlier, thereby making failure more likely and more sudden, and making it more likely that such a failure would have systemic consequences in the EU and beyond. Stays on deposit withdrawals, even if limited to wholesale deposits, would incentivize depositors to run at the first sign of trouble – an entirely rational reaction from a financial system dependent on daily access to funding and liquid markets. Further, the imposition of a moratorium at one EU bank (or even the fear thereof) would encourage counterparties to run from other EU banks at even the mere perception of a hint of trouble, thereby precipitating and accelerating precisely the types of liquidity stress and contagion that, even if localized to Europe, can pose substantial risks to global financial stability, including the financial stability of the United States.

**Second**, this standard would create a large and significant inconsistency between EU law and the law in the United States and the rest of the world, with serious systemic and economic consequences. Currently, the Bank Recovery and Resolution Directive allows authorities to suspend payment obligations of a bank in resolution for up to (but not more than) two business days and prevent counterparties from terminating contracts as a consequence. This current approach is consistent with U.S. law and global norms, including the FSB’s “Key Attributes of Effective Resolution Regimes for Financial Institutions.” The proposal would end this consistency.

In particular, the proposed changes to the EU resolution regime would give parties the opportunity – and an incentive – to opt out of the ISDA 2015 Universal Resolution Stay Protocol. This framework was carefully negotiated among regulators, banks and the buy side against the backdrop of a global agreement that stays on derivatives and other contracts should not exceed two days. This achieved a careful balance between the needs of authorities for flexibility in resolution and the needs of counterparties for certainty of either continued performance or timely close out. Breaking this international accord would undermine the effectiveness of a key post-crisis reform supporting the resolvability of internationally active banks—an arrangement the FSB hailed as an “important step towards completion of our comprehensive global reform agenda to end ‘too big to fail’” and which European regulators and resolution authorities helped to facilitate.<sup>2</sup>

This proposal, if adopted, would put derivatives dealers in an untenable position, as a derivative subject to a two-day moratorium cannot be considered as a risk management matter to be a hedge against a derivative subject to a far longer moratorium. A delay in payment on the EU derivative would leave the dealer in an unhedged position.

This enhanced risk would be reflected in U.S. regulatory capital, liquidity and margin regulations, and could make swaps and securities financing transactions with EU banks uneconomic, decreasing liquidity and increasing costs in key markets. Under U.S. law, if a bank’s counterparty is subject to a resolution regime that differs significantly from regimes in the United States, particularly in ways that increase the risks to counterparties, exposures under

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<sup>2</sup> For additional information on how the proposed moratorium would undermine the ISDA resolution stay protocol, see ISDA’s paper [Proposed Moratoria Under the BRRD: A Step Backwards in Efforts to End ‘Too Big To Fail’](#). Also of note, a separate ISDA paper, [Challenges with Expanding BRRD Moratoria Powers](#), identifies the negative financial stability impacts of the proposal. Both papers are available at <https://www2.isda.org/functional-areas/public-policy/financial-law-reform/>.

transactions must be determined on a gross basis rather than a net basis. In such cases, U.S. banks would be required to hold orders of magnitude more regulatory capital, liquidity and margin in respect of transactions with EU banks. Transatlantic swaps and repo activity would become uneconomic, reducing liquidity in these markets, limiting the ability of U.S. entities to hedge exposures and increasing risks and costs to real-economy end users. Importantly, these effects would begin “day one” from the mere introduction of these powers into EU law, regardless of whether EU regulators ever actually use the stay powers.<sup>3</sup>

**Third**, staying performance to U.S. financial market infrastructures (but not to EU infrastructures) would expose U.S. payment, clearing and settlement systems to greater risk. The proposal would exclude obligations to EU payment, clearing and settlement infrastructures from stays, but there is no such exclusion for obligations to many U.S. and other non-EU financial market infrastructures. In addition to putting non-EU infrastructures at a competitive disadvantage, the proposals would expose the U.S. and other payment, clearing and settlement systems to greater risk, creating a vector for spreading risk from the EU to the U.S. and other markets.

**Fourth**, stays on inter-bank deposits and other wholesale deposits would transmit financial stability risks to the broader economy. No exclusion from the payments moratorium has been proposed for any form of wholesale deposit, meaning access to deposits at EU banks, custodians, and sub-custodians could be interrupted for extended periods in the context of a bank resolution. Freezing deposits used for day-to-day operational services would magnify financial stability risks throughout various sectors of the U.S. economy. For example, regulated investment funds may not be able to fulfill redemption and purchase requests; corporations and governments may not be able to fulfill interest payments on debt obligations; and pension funds may not be able to make regular payments to beneficiaries.

**Fifth**, application of the proposed moratorium powers would be particularly concerning in the context of a resolution of a large international bank, where broader questions of systemic risk are implicated. Indeed, such powers would be directly contrary to one of the key goals of resolving one of these banks—to ensure the bank is able to continue to perform its critical operations even in resolution, thereby minimizing disruption to customers, counterparties and the real economy. In particular, the preferred resolution strategies for the largest international banks work in tandem with new total loss absorbing capacity standards to ensure that these banks can fail safely through a recapitalization strategy (where losses are imposed on equity holders and unsecured long-term bondholders), which allows the recapitalized bank to continue to perform its critical functions and serve its customers – *and do so on an uninterrupted basis*. The proposed extended moratorium powers could impede this strategy because they create the possibility of prolonged (and unnecessary) interruption of the bank’s performance of its obligations. As such, they threaten to accelerate a liquidity run on a distressed firm.

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<sup>3</sup> We have attached our recent paper addressing these issues in greater depth.

We would welcome the opportunity to discuss these issues with you or your staff.

Kind regards,



Greg Baer  
President  
The Clearing House Association



Kenneth E. Bentsen, Jr.  
President and CEO  
SIFMA

cc: Janet L. Yellen  
Chair, Board of Governors of the Federal Reserve System

Keith A. Noreika  
Acting Comptroller of the Currency

Richard Cordray  
Director, Bureau of Consumer Financial Protection

Jay Clayton  
Chair, Securities and Exchange Commission

Martin J. Gruenberg  
Chairman, Federal Deposit Insurance Corporation

J. Christopher Giancarlo  
Chairman, Commodity Futures Trading Commission

Melvin L. Watt  
Director, Federal Housing Finance Agency

J. Mark McWatters  
Chairman, National Credit Union Administration

S. Roy Woodall  
Independent Member with Insurance Expertise, Financial Stability Oversight Council

**Attachment**

**TCH-Sifma Note on Proposed EU Resolution Payment Moratoria  
and Implications under U.S. Regulations and Global Regulatory Initiatives  
(October 2017)**

## **Note on Proposed EU Resolution Payment Moratoria and Implications under U.S. Regulations and Global Regulatory Initiatives**

This note has been prepared to provide background on recent proposed changes to the EU recovery and resolution framework, the Bank Recovery and Resolution Directive (“**BRRD**”). The proposed changes would introduce new powers that would allow resolution authorities to suspend the payment and performance obligations of a distressed financial institution prior to being placed into resolution and would also extend the period of time during resolution that the distressed financial institution’s payment and performance obligations could be suspended. As a result, a distressed financial institution could be excused from performance of a wide variety of obligations (including under derivatives, securities financing transactions and wholesale deposits) for a period of up to 12 days (or potentially even longer). This would represent a clear departure from established global standards and could have severe adverse consequences for financial stability and ongoing cross-border trade.

These payment moratorium provisions would also have consequences for entities subject to U.S. regulation (a “**U.S. Entity**”). Certain aspects of the U.S. capital, liquidity and margin frameworks depend on the characterization of an applicable non-U.S. resolution regime as “substantially similar” to certain U.S. resolution regimes. The duration of the proposed payment moratoria significantly exceeds the 1 business-day temporary stay on the exercise of certain termination rights under the U.S. resolution regimes, and there is no concept under U.S. law of a pre-insolvency or pre-resolution stay on an entity’s general payment or performance obligations.

Were a regime found to be not “substantially similar” to applicable U.S. resolution regimes, certain capital, liquidity and margin requirements with respect to transactions with entities subject to the regime would need to be determined on a gross, rather than net, basis, which would significantly increase such requirements. This would have the potential to increase the costs to U.S. Entities of trading with EU counterparties to such prohibitive levels that it could widely disincentivize U.S.-EU trading in derivatives and securities financing transactions, with serious negative effects both for individual institutions and for global markets.

This note begins with an overview of the issues and then provides further background in the following areas:

- U.S. regulations under which capital, liquidity and margin requirements for banking entities transacting with EU counterparties depend on the characterization of the BRRD as “substantially similar” to U.S. resolution regimes;
- The stays provided for under the current BRRD;
- The payment moratoria proposed to be introduced under the BRRD;
- Potential implications of the moratorium for U.S. regulatory purposes and global regulatory initiatives; and
- The status of the EU proposals and industry advocacy.

## 1. Overview

- The European Commission is presently considering amendments to the EU framework for recovery and resolution of failing banks that would expand the stay powers of resolution authorities.
  - Under the BRRD, European authorities may suspend payment and delivery obligations of an institution in resolution for a maximum of two business days.
  - The proposed additional new moratorium powers would permit authorities to suspend nearly all payment and delivery obligations both in advance of resolution, in early intervention and at the commencement of resolution.
  - In aggregate, the moratoria could permit European authorities to excuse an entity in resolution from performing to its counterparties for up to 12 days (or conceivably longer, were the early intervention powers exercised more than once).
- If the proposed moratorium powers were introduced, U.S. regulators and market participants would need to consider whether the BRRD is “substantially similar” to the U.S. special resolution regimes for purposes of U.S. capital, liquidity and margin regulations.<sup>1</sup>
  - For example, such regulations permit a U.S. Entity to recognize exposures under certain financial transactions on a net basis if the bank is able to close-out such transactions on a net basis following an event of default, including insolvency.
  - The regulations permit the exercise of close-out remedies to be subject to stays arising under non-U.S. resolution regimes that are “substantially similar” to those provided under the Federal Deposit Insurance Act (the “**FDI Act**”), Title II of the Dodd-Frank Act and the regime governing certain U.S. “government sponsored enterprises” (collectively, the “**U.S. Resolution Regimes**”).
- The proposed moratorium powers differ significantly from the approach taken under U.S. Resolution Regimes.
  - There is no concept under U.S. law of a pre-insolvency or pre-resolution stay on an entity’s general payment or performance obligations.
  - A moratorium of 12 business days (or even 7 business days) would substantially exceed the stays under the U.S. Resolution Regime.
    - Under the safe harbors for qualified financial contracts (“**QFCs**”) afforded by the U.S. Resolution Regimes, a QFC counterparty would be subject to stays on close-out and netting rights for a maximum of one business day, following which time they could exercise remedies based on a continuing or subsequent performance default.

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<sup>1</sup> As a directive, the BRRD must be implemented under the local law of each European Union member state. The required determinations under U.S. regulations of “substantial similarity” would apply with respect to such member state implementation of the BRRD, and not to BRRD itself. For convenience this paper makes reference to the BRRD itself rather than member state implementation.

- If the BRRD is not “substantially similar” to the U.S. Resolution Regimes, capital, margin and liquidity requirements with respect to transactions between U.S. Entities and entities subject to the BRRD would need to be calculated on a gross rather than net basis, significantly increasing the cost of such transactions.
- Even if a “substantially similar” determination could be achieved, financial stability risks would still be likely to persist, as the cost and risk to counterparties of transacting against the background of the moratoria would remain prohibitive:
  - For U.S. Entities, the possibility of facing a non-performing counterparty for 12 days (or more) may be unacceptable from a risk perspective, and could raise safety and soundness concerns.
  - To address these concerns, U.S. Entities likely would demand significantly more collateral, which EU institutions may be unable or unwilling to provide.
  - Stays with respect to wholesale deposits could have widespread implications for global financial markets, particularly in the context of deposits placed with EU banks in connection with cross-border payment, clearing and settlement activity. These risks are less readily mitigated with collateral.
- The proposed moratorium powers are inconsistent with global norms and regulatory initiatives.
  - The Financial Stability Board’s (“**FSB**”) Key Attributes of Resolution Regimes for Financial Institutions (the “**Key Attributes**”), which the U.S. regulators said they would consider when applying the “substantially similar” test, do not provide for a pre-resolution payment moratorium.
  - The two business-day temporary stay period described in the Key Attributes has become the global standard for the maximum duration of resolution stays.
  - The ISDA 2015 Resolution Stay Protocol (the “**ISDA Protocol**”) permits parties to opt out with respect to resolutions under particular resolution regimes that are amended in a way that materially and adversely affects counterparties, including by lengthening stay periods.

## 2. Background on U.S. regulatory capital, liquidity and margin requirements

- With regard to U.S. regulations:
  - Under the U.S. risk-based capital regulations, the amount of capital that a U.S. Entity must maintain in respect of a financial transaction depends in significant part on the bank's exposure under that transaction. The higher the exposure, the more capital a bank is generally required to maintain.
  - Under the U.S. liquidity regulations, U.S. Entities' liquidity coverage or buffer depends in significant part on inflows and outflows of liquidity under the relevant transactions. The higher the short-term net outflow, the more liquid assets the bank is generally required to maintain.
  - Similarly, U.S. regulations mandating the transfer of margin under uncleared swaps tie the margin requirement to the exposure under the relevant swap.
- Consistent with the frameworks set out by the Basel Committee on Banking Supervision, the U.S. capital, liquidity and margin rules permit U.S. Entities to recognize exposures or liquidity needs under certain types of financial contracts as net of the counterparty's collateral and/or deliverables from that counterparty, provided certain requirements are satisfied.<sup>2</sup>
- The regulations require banks to be able to close out on a net basis the transactions with the counterparty and to liquidate or set-off collateral "promptly" upon an event of default, including receivership, insolvency or a similar proceeding in respect of the counterparty.
  - Until recently, the only exception to this requirement was for stays under the U.S. Resolution Regimes.
- In December 2014, the Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency (the "OCC") and Federal Deposit Insurance Corporation (the "Agencies") amended their capital regulations (and subsequently liquidity and margin requirements) to permit a bank's exercise of close-out rights to be subject to stays under the "laws of foreign jurisdictions that are substantially similar" to the U.S. Resolution Regimes.
  - These amendments were prompted by the upcoming transposition into local law of BRRD and the advent of the ISDA 2014 Resolution Stay Protocol, under which adherents contractually agree to the application of certain foreign resolution regimes.
- The Agencies did not define "substantially similar" but said that the length of stays under the resolution regime is a relevant factor and that they would expect any stays under a "substantially similar" resolution regime to be consistent with the Key Attributes.
- The Agencies indicated they expected the resolution regimes in France, Germany and the United Kingdom (each of which had transposed the BRRD into local law) to be substantially similar to the U.S. Resolution Regimes.
  - The Agencies noted that "the BRRD contains special resolution powers, including a limited stay on certain financial contracts that is similar to the stays provided under

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<sup>2</sup> The provisions permitting U.S. Entities to recognize exposures or liquidity needs as net depend on the particular type of transaction. Appendix I below provides excerpts of key U.S. capital, liquidity and margin regulations.

Title II of the Dodd-Frank Act and the FDI Act.” The guidance also emphasizes that “the BRRD is generally designed to be consistent with the Key Attributes.” 79 Fed. Reg. 78287 (Dec. 30, 2014).

- At the time of these amendments, the moratoria described below were not contemplated.
- Both the U.S. Resolution Regimes and the Key Attributes significantly limit the stays that may be applied to QFC counterparties.
  - Under the U.S. Resolution Regimes, counterparties to the entity in resolution would be stayed from exercising close-out rights for a period of up to one business day.
    - QFC counterparties not transferred during the stay period to a successor of the entity in resolution would be able to close out their transactions on a net basis and exercise remedies against collateral upon the expiration of the stay.
    - QFC counterparties transferred to a successor would be able to exercise close-out rights based on any continuing or subsequent performance default by the successor.
  - The Key Attributes state that “entry into resolution and the exercise of any resolution powers should not trigger statutory or contractual set-off rights, or constitute an event that entitles any counterparty of the firm in resolution to exercise contractual acceleration or early termination rights provided the substantive obligations under the contract continue to be performed.” Key Attribute 4.2, emphasis added.
    - The Key Attributes provide that if such rights are to be stayed, any stay should be “strictly limited in time (for example, for a period not exceeding 2 business days).”
- Neither the U.S. Resolution Regimes nor the Key Attributes provide for a general suspension of payment obligations prior to the initiation of resolution proceedings.

### 3. Stays under the BRRD

- The BRRD was implemented in 2014. It established a comprehensive recovery and resolution regime for EU banks and certain “investment firms” (broker-dealers and asset managers with permission to hold client assets/money) (collectively, “institutions”).
- Like Title II of the Dodd–Frank Act, the BRRD introduced tools and powers designed to enable regulators and resolution authorities to deal effectively with failing institutions (including on a cross-border basis), while minimizing negative consequences to taxpayers and the real economy. As an EU directive, the BRRD establishes an EU-wide framework of requirements to be implemented under local law.<sup>3</sup>
- Among other things, the BRRD contains:
  - A framework for early intervention in distressed institutions, which enables supervisors to demand changes to institutions’ business strategy, funding structure, operations and/or management, or to take other specified actions (including implementing specific recovery plan options); and
  - Resolution tools and powers for failing institutions, which facilitate a range of possible resolution outcomes, including:
    - A sale of all or part of the business to another institution;
    - The separation and transfer of the failing institution’s assets to an interim “bridge bank” and/or asset management vehicle (or “bad bank”);
    - The temporary public ownership of the failing institution; and/or
    - A “recapitalization” of a failing institution through a write-down or conversion of liabilities (a “bail-in”).
- The BRRD contains certain powers that support the exercise by resolution authorities of the resolution powers described above.
- These powers include the automatic override of resolution-based default rights, which prohibit a failing institution’s creditors and counterparties from exercising any termination, suspension, modification, netting or set-off rights or enforcing any security under applicable contracts based on the exercise of early intervention or resolution powers under the BRRD (BRRD Article 68).
  - This prohibition applies both to counterparties of the institution in resolution and to counterparties of its subsidiaries and affiliates (e.g. under contracts with “cross-defaults”).
  - The override applies only if the institution in resolution continues to satisfy its payment, delivery and collateral obligations.

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<sup>3</sup> In practice, the BRRD applies throughout the European Economic Area, which comprises the 28 Member States of the EU, together with Iceland, Norway and Liechtenstein. The term “EU” is however used for simplicity.

- These powers also include discretionary powers (the “**temporary stays**”) that permit resolution authorities, subject to certain requirements, to suspend until midnight on the business day following their announcement:
  - The payment or delivery obligations of the institution in resolution (BRRD Article 69);
    - The suspended obligations become due upon the expiration of the suspension period;
  - The ability of a secured creditor to enforce its security interest against such an institution (BRRD Article 70); or
  - The rights of counterparties to terminate contracts to which the institution (and, subject to certain conditions, its subsidiaries) are a party (BRRD Article 71).
- Both the automatic override and temporary stays apply with respect to all contracts and payment obligations of the institution, including swaps, derivatives, repos, securities lending agreements and other collateralized obligations, subject to carve-outs for insured deposits, liabilities arising under clearing and settlement arrangements with certain financial market infrastructure providers, and liabilities to certain investor compensation schemes.

#### **4. EU proposal to introduce payment moratorium powers**

- In November 2016, the European Commission published proposals to amend the BRRD and the related EU prudential frameworks, to implement various global and EU reforms, including the global FSB standards for total loss-absorbing capacity and EU-driven proposals for third country banking groups to establish EU intermediate holding companies.
- The proposed amendments would also significantly expand the discretionary powers available to EU supervisors under the BRRD to suspend payment and delivery obligations by introducing two new moratoria:
  - A pre-resolution moratorium exercisable before an institution has been placed into insolvency or resolution proceedings, which could be exercised in circumstances where authorities regard the suspension as necessary to determine whether the failing institution meets the conditions for resolution under the BRRD and, if so, which resolution powers should be used; and
  - An in-resolution moratorium, which could be exercised where the resolution authority determines it necessary for the effective application of the resolution tools.
- Each of the moratoria would have a maximum duration of five business days. Thus, if EU authorities were to exercise the pre-resolution moratorium and, following the initiation of resolution proceedings, the in-resolution moratorium, followed by the temporary stays described in section 3 above, the institution in resolution would be excused from performing to its counterparties for a period of up to 12 business days. It is also not clear that the pre-resolution moratorium power could not be exercised on multiple consecutive occasions, suspending payment and delivery obligations for over 12 days.
- Given that the proposed moratorium powers cover wholesale deposits, it is notable that:
  - There is no exclusion for intragroup transactions; and
  - There is no exclusion for “operational deposits,” which are deposits generated from clearing, custody, and cash management activities.
- As discussed further in section 6, ongoing discussion of these proposals at the EU level has resulted in proposed alternative formulations of these powers, with proposals ranging from increasing the length of the total stay period to abandoning the pre-resolution moratorium altogether.

## 5. Potential implications of the proposed payment moratorium powers

### a. Considerations regarding analysis of “substantial similarity” between the BRRD and U.S. Resolution Regimes

- The U.S. capital, liquidity and margin regulations require that banking entities have a “well-founded” basis for believing they could promptly close out following an event of default, subject to any permitted limitations. This generally means obtaining opinion-level comfort that the requirements can be satisfied.
  - Absent a determination by the Agencies that the BRRD remains “substantially similar” to the U.S. Resolution Regimes notwithstanding the introduction of any payment moratoria, it is not clear that banking entities would be able to obtain sufficient comfort that the BRRD is “substantially similar” to the U.S. Resolution Regimes.
- The U.S. regulations that rely on a “substantially similar” determination include those listed below, each of which is included in Appendix I.
  - Capital: The definitions of “collateral agreement,” “eligible margin loan,” “qualifying master netting agreement” and “repo-style transaction” under the regulatory capital provisions of Regulation Q. 12 CFR 217.2.
  - Liquidity: The definition of “qualifying master netting agreement” under the liquidity coverage ratio provisions of Regulation WW. 12 CFR 249.3.
  - Margin: The definition of “eligible master netting arrangement” under the swaps margin provisions of Regulation KK. 12 CFR 237.2.
- If the BRRD cannot be determined to be “substantially similar” to the U.S. Resolution Regimes, certain exposures to entities subject to the BRRD would need to be treated on a gross basis, rather than a net basis, for purposes of determining applicable capital, liquidity and margin levels as the netting agreements governing these transactions would no longer be considered “qualifying” or “eligible” under applicable regulations.
- From a regulatory capital perspective, determining exposures on a gross basis, and without recognizing the credit-risk mitigating benefit of collateral, would result in significant increases in capital requirements for derivatives transactions and securities financing transactions, including repurchase agreements, reverse repurchase agreements, securities borrowing and lending agreements and margin loans with EU institution counterparties, making these transactions significantly more expensive for U.S. Entities.
- From a margin perspective, under the margin rules for uncleared swaps and security-based swaps, if a swap dealer is unable to conclude that an agreement is an eligible master netting arrangement, it is required to collect margin from its counterparty on a gross basis, increasing the cost of covered transactions for EU institution counterparties.
- The significantly increased capital, margin and liquidity costs associated with cross-border transactions between U.S. Entities and EU institutions would strongly disincentivize this activity, with negative implications not just for European financial markets but also for the safety of the U.S. financial system, U.S. competitiveness and the U.S. economy as a whole.

b. Considerations for adherents to the ISDA Protocol

- The ISDA Protocol was adhered to by most global systemically important banks as a means of mutually enhancing the resolvability of the adhering parties.
  - Under Section 1 of the ISDA Protocol, the parties agree to be bound by stays on early termination rights that may be imposed in the context of a resolution of one of the adhering parties (or one of their affiliates), notwithstanding that the law of the jurisdiction of the resolution regime may differ from the law governing contracts with such parties.
- The ISDA Protocol allows adhering parties to opt out of Section 1 with respect to parties subject to resolution under a particular resolution regime if that regime is amended in a manner that “materially and adversely affects” the rights of parties to exercise early termination rights.
  - The ISDA Protocol specifically identifies an increase in the length of stays on early termination rights as one of the types of amendments that may give parties the right to opt out.
  - Whether the opt out conditions have been satisfied is a question of contractual interpretation among the parties and, ultimately, the courts and is not subject to determinations made by ISDA or regulatory authorities.
- If the BRRD is amended to include the proposed payment moratorium powers, adhering parties to the ISDA Protocol would need to consider whether the amendment is of the type that permits them to opt out with respect to adhering parties subject to the BRRD and, if so, whether to exercise such rights.

c. Effects on liquidity and funding flows during stress and resolution

- Imposing a payment moratorium on the EU subsidiaries of U.S. banking groups (or other non-EU groups) could increase the risk of uncoordinated host regulatory actions precipitating or complicating global recovery and resolution efforts.

## **6. Current status of the EU proposals and industry advocacy**

- While the proposed moratoria have proved politically divisive and are not unanimously supported by EU Member States, the European Commission and European Central Bank, together with a minority of Member States, continue to express strong support for payment moratorium powers.
- As part of the ongoing EU level negotiations, discussion papers from the official sector on potential alternatives to the proposed moratoria have been put forward. These papers have suggested a variety of alternatives, including the elimination of the proposed moratoria, a more flexible discretionary power that could result in a maximum aggregate stay period of 27 working days or (depending on how the drafting is interpreted) expanding the moratoria to a potentially indefinite period.
- Various advocacy efforts have been made or are in progress from key industry bodies such as AFME, IIF, ISDA and the SIFMA Asset Management Group, warning of the severe adverse impacts on global consistency and financial stability and the more specific negative implications for regulatory capital and liquidity treatment, particularly in connection with derivatives.
  - The Clearing House strongly supports the arguments put forward in the recent papers produced by these industry associations. We agree that if the BRRD were to diverge substantially from established global resolution standards, this would be a retrograde step that could have severely disruptive consequences for financial institutions and global markets. These financial stability risks could arise both in a specific resolution scenario and on a business-as-usual basis, due to the significant financial implications for ongoing cross-border trading relationships discussed in this paper and in the other papers highlighted above.

## Appendix I

### Capital (Regulation Q, 12 CFR 217.2)

*Collateral agreement* means a legal contract that specifies the time when, and circumstances under which, a counterparty is required to pledge collateral to a Board-regulated institution for a single financial contract or for all financial contracts in a netting set and confers upon the Board-regulated institution a perfected, first-priority security interest (notwithstanding the prior security interest of any custodial agent), or the legal equivalent thereof, in the collateral posted by the counterparty under the agreement. This security interest must provide the Board-regulated institution with a right to close-out the financial positions and liquidate the collateral upon an event of default of, or failure to perform by, the counterparty under the collateral agreement. A contract would not satisfy this requirement if the Board-regulated institution's exercise of rights under the agreement may be stayed or avoided:

- (1) Under applicable law in the relevant jurisdictions, other than:
  - (i) In receivership, conservatorship, or resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs, or laws of foreign jurisdictions that are substantially similar<sup>4</sup> to the U.S. laws referenced in this paragraph (1)(i) in order to facilitate the orderly resolution of the defaulting counterparty;
  - (ii) Where the agreement is subject by its terms to, or incorporates, any of the laws referenced in paragraph (1)(i) of this definition; or
- (2) Other than to the extent necessary for the counterparty to comply with the requirements of subpart I of the Board's Regulation YY, part 47 of this title, or part 382 of this title, as applicable.

*Eligible margin loan* means:

- (1) An extension of credit where:
  - (i) The extension of credit is collateralized exclusively by liquid and readily marketable debt or equity securities, or gold;
  - (ii) The collateral is marked-to-fair value daily, and the transaction is subject to daily margin maintenance requirements; and
  - (iii) The extension of credit is conducted under an agreement that provides the Board-regulated institution the right to accelerate and terminate the extension of credit and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, insolvency, liquidation, conservatorship, or similar proceeding, of the counterparty, provided that, in any such case,
    - (A) Any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than

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<sup>4</sup> The Board expects to evaluate jointly with the OCC and Federal Deposit Insurance Corporation whether foreign special resolution regimes meet the requirements of this paragraph.

(1) In receivership, conservatorship, or resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs,<sup>5</sup> or laws of foreign jurisdictions that are substantially similar<sup>6</sup> to the U.S. laws referenced in this paragraph (1)(iii)(A)(1) in order to facilitate the orderly resolution of the defaulting counterparty; or

(2) Where the agreement is subject by its terms to, or incorporates, any of the laws references in paragraph (1)(iii)(A)(1) of this definition; and

(B) The agreement may limit the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default of the counterparty to the extent necessary for the counterparty to comply with the requirements of subpart I of the Board's Regulation YY, part 47 of this title, or part 382 of this title, as applicable.

(2) In order to recognize an exposure as an eligible margin loan for purposes of this subpart, a Board-regulated institution must comply with the requirements of §217.3(b) with respect to that exposure.

*Qualifying master netting agreement* means a written, legally enforceable agreement provided that:

(1) The agreement creates a single legal obligation for all individual transactions covered by the agreement upon an event of default following any stay permitted by paragraph (2) of this definition, including upon an event of receivership, conservatorship, insolvency, liquidation, or similar proceeding, of the counterparty;

(2) The agreement provides the Board-regulated institution the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, conservatorship, insolvency, liquidation, or similar proceeding, of the counterparty, provided that, in any such case,

(i) Any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than:

(A) In receivership, conservatorship, or resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs, or laws of foreign jurisdictions that are

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<sup>5</sup> This requirement is met where all transactions under the agreement are (i) executed under U.S. law and (ii) constitute "securities contracts" under section 555 of the Bankruptcy Code (11 U.S.C. 555), qualified financial contracts under section 11(e)(8) of the Federal Deposit Insurance Act, or netting contracts between or among financial institutions under sections 401–407 of the Federal Deposit Insurance Corporation Improvement Act or the Federal Reserve Board's Regulation EE (12 CFR part 231).

<sup>6</sup> The Board expects to evaluate jointly with the OCC and Federal Deposit Insurance Corporation whether foreign special resolution regimes meet the requirements of this paragraph.

substantially similar<sup>7</sup> to the U.S. laws referenced in this paragraph (2)(i)(A) in order to facilitate the orderly resolution of the defaulting counterparty; or

(B) Where the agreement is subject by its terms to, or incorporates, any of the laws referenced in paragraph (2)(i)(A) of this definition; and

(ii) The agreement may limit the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default of the counterparty to the extent necessary for the counterparty to comply with the requirements of subpart I of the Board's Regulation YY, part 47 of this title, or part 382 of this title, as applicable;

(3) The agreement does not contain a walkaway clause (that is, a provision that permits a non-defaulting counterparty to make a lower payment than it otherwise would make under the agreement, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the agreement); and

(4) In order to recognize an agreement as a qualifying master netting agreement for purposes of this subpart, a Board-regulated institution must comply with the requirements of §217.3(d) with respect to that agreement.

*Repo-style transaction* means a repurchase or reverse repurchase transaction, or a securities borrowing or securities lending transaction, including a transaction in which the Board-regulated institution acts as agent for a customer and indemnifies the customer against loss, provided that:

(1) The transaction is based solely on liquid and readily marketable securities, cash, or gold;

(2) The transaction is marked-to-fair value daily and subject to daily margin maintenance requirements;

(3)

(i) The transaction is a "securities contract" or "repurchase agreement" under section 555 or 559, respectively, of the Bankruptcy Code (11 U.S.C. 555 or 559), a qualified financial contract under section 11(e)(8) of the Federal Deposit Insurance Act, or a netting contract between or among financial institutions under sections 401-407 of the Federal Deposit Insurance Corporation Improvement Act or the Federal Reserve Board's Regulation EE (12 CFR part 231); or

(ii) If the transaction does not meet the criteria set forth in paragraph (3)(i) of this definition, then either:

(A) The transaction is executed under an agreement that provides the Board-regulated institution the right to accelerate, terminate, and close-out the transaction on a net basis and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, insolvency,

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<sup>7</sup> The Board expects to evaluate jointly with the OCC and Federal Deposit Insurance Corporation whether foreign special resolution regimes meet the requirements of this paragraph.

liquidation, or similar proceeding, of the counterparty, provided that, in any such case,

(1) Any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than:

(i) In receivership, conservatorship, or resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or jurisdictions that are substantially similar<sup>8</sup> to the U.S. laws referenced in this paragraph (3)(ii)(A)(1)(i) in order to facilitate the orderly resolution of the defaulting counterparty;

(ii) Where the agreement is subject by its terms to, or incorporates, any of the laws referenced in paragraph (3)(ii)(A)(1)(i) of this definition; and

(2) The agreement may limit the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default of the counterparty to the extent necessary for the counterparty to comply with the requirements of subpart I of the Board's Regulation YY, part 47 of this title, or part 382 of this title, as applicable;

or

(B) The transaction is:

(1) Either overnight or unconditionally cancelable at any time by the Board-regulated institution; and

(2) Executed under an agreement that provides the Board-regulated institution the right to accelerate, terminate, and close-out the transaction on a net basis and to liquidate or set-off collateral promptly upon an event of counterparty default; and

(4) In order to recognize an exposure as a repo-style transaction for purposes of this subpart, a Board-regulated institution must comply with the requirements of §217.3(e) of this part with respect to that exposure.

**Liquidity (Regulation WW, 12 CFR 249.3)**

*Qualifying master netting agreement* means a written, legally enforceable agreement provided that:

(1) The agreement creates a single legal obligation for all individual transactions covered by the agreement upon an event of default following any stay permitted by paragraph (2) of this definition, including upon an event of receivership, conservatorship, insolvency, liquidation, or similar proceeding, of the counterparty;

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<sup>8</sup> The Board expects to evaluate jointly with the OCC and Federal Deposit Insurance Corporation whether foreign special resolution regimes meet the requirements of this paragraph.

- (2) The agreement provides the Board-regulated institution the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, conservatorship, insolvency, liquidation, or similar proceeding, of the counterparty, provided that, in any such case,
- (i) Any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than:
- (A) In receivership, conservatorship, or resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs, or laws of foreign jurisdictions that are substantially similar<sup>9</sup> to the U.S. laws referenced in this paragraph (2)(i)(A) in order to facilitate the orderly resolution of the defaulting counterparty;
- (B) Where the agreement is subject by its terms to, or incorporates, any of the laws referenced in paragraph (2)(i)(A) of this definition; and
- (ii) The agreement may limit the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default of the counterparty to the extent necessary for the counterparty to comply with the requirements of subpart I of the Board's Regulation YY, part 47 of this title, or part 382 of this title, as applicable;
- (3) The agreement does not contain a walkaway clause (that is, a provision that permits a non-defaulting counterparty to make a lower payment than it otherwise would make under the agreement, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the agreement); and
- (4) In order to recognize an agreement as a qualifying master netting agreement for purposes of this subpart, a Board-regulated institution must comply with the requirements of §249.4(a) with respect to that agreement.

**Margin (Regulation KK, 12 CFR 237.2)**

*Eligible master netting agreement* means a written, legally enforceable agreement provided that:

- (1) The agreement creates a single legal obligation for all individual transactions covered by the agreement upon an event of default following any stay permitted by paragraph (2) of this definition, including upon an event of receivership, conservatorship, insolvency, liquidation, or similar proceeding, of the counterparty;
- (2) The agreement provides the covered swap entity the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, conservatorship, insolvency, liquidation, or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the

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<sup>9</sup> The Board expects to evaluate jointly with the OCC and Federal Deposit Insurance Corporation whether foreign special resolution regimes meet the requirements of this paragraph.

agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than:

- (i) In receivership, conservatorship, or resolution under the Federal Deposit Insurance Act (12 U.S.C. 1811 *et seq.*), Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5381 *et seq.*), the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, as amended (12 U.S.C. 4617), or the Farm Credit Act of 1971, as amended (12 U.S.C. 2183 and 2279cc), or laws of foreign jurisdictions that are substantially similar to the U.S. laws referenced in this paragraph (2)(i) in order to facilitate the orderly resolution of the defaulting counterparty; or
  - (ii) Where the agreement is subject by its terms to, or incorporates, any of the laws referenced in paragraph (2)(i) of this definition;
- (3) The agreement does not contain a walkaway clause (that is, a provision that permits a non-defaulting counterparty to make a lower payment than it otherwise would make under the agreement, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the agreement); and
- (4) A covered swap entity that relies on the agreement for purposes of calculating the margin required by this part must:
- (i) Conduct sufficient legal review to conclude with a well-founded basis (and maintain sufficient written documentation of that legal review) that:
    - (A) The agreement meets the requirements of paragraph (2) of this definition; and
    - (B) In the event of a legal challenge (including one resulting from default or from receivership, conservatorship, insolvency, liquidation, or similar proceeding), the relevant court and administrative authorities would find the agreement to be legal, valid, binding, and enforceable under the law of the relevant jurisdictions; and
  - (ii) Establish and maintain written procedures to monitor possible changes in relevant law and to ensure that the agreement continues to satisfy the requirements of this definition.