

Application of the U.S. QFC Stay Rules to Underwriting and Similar Agreements

The new U.S. “**QFC Stay Rules**”¹ will soon require U.S. global systemically important banking organizations (“**GSIBs**”) and their subsidiaries worldwide, as well as the U.S. subsidiaries, branches and agencies of foreign GSIBs, to include new language in certain of their underwriting agreements and similar agreements.²

Annex A of this document contains a rider that can be inserted into in-scope underwriting agreements to conform the agreement to the requirements of the QFC Stay Rules where a member of the underwriting syndicate is a Covered Entity.³

Certain definitions are listed for reference in Annex B.

1. What are the QFC Stay Rules?

The Board of Governors of the Federal Reserve System (the “**Federal Reserve**”), the Federal Deposit Insurance Corporation (the “**FDIC**”) and the Office of the Comptroller of the Currency (the “**OCC**”) adopted the QFC Stay Rules in 2017 to improve the resolvability and resilience of GSIBs. The QFC Stay Rules require Covered Entities to include contractual stay language in certain of their qualified financial contracts (“**QFCs**”) to mitigate the risk of destabilizing closeouts of Covered Entities’ QFCs, which is a perceived impediment to the orderly resolution of a GSIB.⁴

2. Who is subject to the QFC Stay Rules?

Only “**Covered Entities**” are subject to the QFC Stay Rules. With certain limited exceptions, the term “Covered Entities” includes U.S. GSIBs and their subsidiaries worldwide, as well as the U.S. subsidiaries, U.S. branches and U.S. agencies of foreign GSIBs. For these purposes, a subsidiary generally means a company that is owned or controlled directly or indirectly by the GSIB, using the Bank Holding Company Act definition of “control.”⁵

¹ 12 C.F.R. §§ 252.81 *et seq.* (Federal Reserve), pt. 47 (OCC), pt. 382 (FDIC).

² This document uses the term underwriting agreements to refer to underwriting agreements and similar agreements that a Covered Entity has determined include provisions making the agreement an in-scope QFC, as described in more detail in footnote 7.

³ As described under Question 8 below, the rider in Annex A would not be sufficient to conform all in-scope underwriting agreements to the requirements of the QFC Stay Rules. For instance, additional language beyond what is included in Annex A may be necessary if a Covered Entity is the issuer.

⁴ For more detailed information on the QFC Stay Rules, please see the Davis Polk Visual Memo on the Final QFC Stay Rules at https://www.davispolk.com/files/2017-12-21_final_qfc_stay_rule_visual_memo.pdf.

⁵ 12 U.S.C. §§ 1813(w)(4) (defining subsidiary), 1841(a)(2) (defining control). The definition of control under the Bank Holding Company Act is complex and is relevant to a number of regulatory regimes, such that each Covered Entity has likely already determined the control status of each of its subsidiaries. Inquiries regarding whether a specific subsidiary is “controlled” for these purposes should be made to a Covered Entity’s in-house bank regulatory lawyers.

3. Which agreements will need to include the standardized language?

Only contracts that qualify as “**in-scope QFCs**” need to include the standardized language.⁶ Generally, a contract is an in-scope QFC if it meets the following conditions, each described in greater detail below:

- (1) The contract is a QFC; and
- (2) The contract explicitly either:
 - (a) provides one or more “**default rights**” that may be exercised against a Covered Entity; or
 - (b) includes a “**transfer restriction**” that restricts the transfer of the contract or any interest or obligation in or under, or any property securing, the contract.

4. What contracts qualify as QFCs?

A QFC includes a “**securities contract**,” which is defined to include a contract for the purchase, sale or loan of a security or option on a security. Annex B lists the full statutory definition of a securities contract.⁷

Because an underwriting agreement involves the purchase and sale of an issuer’s securities, it may fall within the definition of a securities contract and therefore be considered a QFC.⁸

5. What is a default right?

The QFC Stay Rules define a “default right” extremely broadly to include, among other things, a right of a party under an agreement to liquidate, terminate, cancel, rescind, or accelerate an

⁶ Covered Entities and their counterparties can also remediate all of their in-scope QFCs to comply with the requirements of the QFC Stay Rules by adhering to the ISDA 2018 U.S. Resolution Stay Protocol (the “**ISDA Protocol**”) to remediate existing QFCs and subsequently incorporating the terms of the ISDA Protocol by reference in their in-scope QFCs entered into after they adhere. This approach is only available if all parties to the QFC have adhered to the ISDA Protocol. For more information regarding the ISDA Protocol, see <https://www.isda.org/protocol/isda-2018-us-resolution-stay-protocol/>. While it is likely that most underwriters will adhere to the ISDA Protocol, many issuers may not. Therefore, while the ISDA Protocol may be a useful means to address certain types of QFCs, including Rider A in underwriting agreements and similar agreements that are in-scope QFCs is likely a more pragmatic approach.

⁷ A “QFC” also includes other types of agreements, such as swap agreements, repurchase agreements, forward agreements, listed derivatives agreements, and any guarantee, security arrangement or other credit enhancement related to a QFC. The full statutory definition of a QFC can be found at 12 U.S.C. 5390(c)(8)(D).

⁸ Depending upon the terms in each specific contract, other types of agreements that relate to securities offerings may also be QFCs, including, without limitation, agreements among underwriters, purchase agreements (including 144A and Regulation S purchase agreements), medium-term note distribution agreements, at-the-market program agreements, commercial paper dealer agreements, master selected dealer agreements and other distribution agreements. In many cases, a single agreement acts as an umbrella agreement between the issuer and a group of underwriters or brokers governing the terms of future issuances, which is commonly referred to as a master underwriting, program, dealer or distribution agreement. All of these agreements similarly govern the purchases and sales of securities in connection with various types of securities offerings, and therefore may similarly fall within the definition of QFC. Where a Covered Entity has determined that such an agreement contains provisions making the agreement an in-scope QFC, the rider provided in Annex A could be adapted to remediate the agreement.

agreement or transactions thereunder, set off or net amounts owed, exercise remedies in respect of collateral or other credit support, demand payment or delivery, or suspend, delay, or defer payment or performance thereunder. Annex B lists the full regulatory definition of a default right.⁹

Underwriting agreements often include provisions, such as defaulting underwriter provisions, that may be considered default rights under the QFC Stay Rules.

6. What is a transfer restriction?

The term “transfer restriction” is not defined under the QFC Stay Rules but instead broadly refers to any provision that limits the ability of one party to assign its rights or obligations under the agreement (whether by prohibiting all such assignments or allowing the party to assign the agreement only to certain types of entities or only subject to certain conditions) or provides that assignments are subject to the other party’s consent.

Underwriting agreements often include transfer restrictions such as those described above.

7. What exclusions exist?

A QFC does not need to be remediated by a Covered Entity that is an underwriter if both:

- (1) the agreement (a) is governed by the laws of the United States or any state and (b) does not explicitly exclude the applicability of Title II of the Dodd-Frank Act¹⁰ or the Federal Deposit Insurance Act¹¹ (or a broader set of laws that includes these laws); and
- (2) each party to the agreement other than the Covered Entity is (a) an individual domiciled in the United States; (b) a company incorporated in or organized under the laws of the United States or any state of the United States; (c) a company which has its principal place of business in the United States; or (d) a U.S. branch or U.S. agency of a foreign banking organization (each a “**U.S. Entity**”).¹²

As noted under Question 3 above, a QFC that does not include a default right or a transfer restriction also does not need to be remediated under the QFC Stay Rules because such an agreement is not an in-scope QFC under the QFC Stay Rules.

8. When might the rider in Annex A not be sufficient to remediate an underwriting agreement under the QFC Stay Rules?

The rider in Annex A may not be sufficient to remediate an underwriting agreement that a Covered Entity has determined is an in-scope QFC where either:

- (1) the Covered Entity is the issuer; or

⁹ See 12 C.F.R. §§ 252.81 (Federal Reserve), 47.2 (OCC), 382.1 (FDIC).

¹⁰ See 12 U.S.C. §§ 5381 *et seq.*

¹¹ See 12 U.S.C. §§ 1811 *et seq.*

¹² 12 C.F.R. §§ 252.83(a) (Federal Reserve), 47.4(a) (OCC), 382.3(a) (FDIC). A QFC that is eligible for this exclusion may nonetheless be subject to the QFC Stay Rules if it contains a cross-default right against the Covered Entity related, directly or indirectly, to the insolvency of an affiliate of the Covered Entity or restricts the transfer of a guarantee or other credit enhancement provided by an affiliate of the Covered Entity. See 12 C.F.R. §§ 252.84 (Federal Reserve), 47.5 (OCC), 382.4 (FDIC).

- (2) the underwriting agreement either:
- (a) contains a cross-default right against the Covered Entity (i.e., a default right that can be triggered, directly or indirectly, by the insolvency of an affiliate of the Covered Entity); or
 - (b) restricts the transfer of a guarantee or other credit enhancement provided by an affiliate of the Covered Entity.

Underwriting agreements typically, however, do not contain cross-defaults to the affiliates of the underwriter, and we have assumed for purposes of drafting the rider in Annex A that the underwriter's obligations are not guaranteed by an affiliate or subject to any other credit enhancement provided by an affiliate of the underwriter.

9. When do Covered Entities' in-scope QFCs need to be conformed to the requirements of the QFC Stay Rules?

The QFC Stay Rules establish three compliance dates for remediating in-scope QFCs – January 1, 2019, July 1, 2019 and January 1, 2020 – depending upon the status of the parties to each QFC.¹³ However, the requirement to conform the terms of new in-scope QFCs, as well as certain pre-existing QFCs, by the applicable compliance date is triggered when a Covered Entity enters into a new QFC on or after January 1, 2019, regardless of counterparty type. For this reason, Covered Entities may wish to consider adding the standardized language to all underwriting agreements by January 1, 2019, or soon thereafter, rather than waiting until the applicable compliance date.

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¹³ In-scope QFCs to which all parties are Covered Entities must be remediated by January 1, 2019; in-scope QFCs to which all parties are either Covered Entities or "financial counterparties," as defined under the QFC Stay Rules, must be remediated by July 1, 2019; and in-scope QFCs to which at least one party is neither a Covered Entity nor a "financial counterparty" must be remediated by January 1, 2020. 12 C.F.R. §§ 252.82(f) (Federal Reserve), 47.3(f) (OCC), 382.2(f) (FDIC); see also 12 C.F.R. §§ 252.81 (Federal Reserve), 47.2 (OCC), 382.1 (FDIC) (defining "financial counterparty"). Annex B lists the full definition of financial counterparty under the QFC Stay Rules.

Annex A:
Rider for Underwriting Agreements¹⁴

(x) Recognition of the U.S. Special Resolution Regimes¹⁵

- (a) In the event that any [Underwriter]¹⁶ that is a Covered Entity becomes subject to a proceeding under a U.S. Special Resolution Regime, the transfer from such [Underwriter] of [this Agreement]¹⁷, 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.
- (b) In the event that any [Underwriter] that is a Covered Entity or a BHC Act Affiliate of such [Underwriter] becomes subject to a proceeding under a U.S. Special Resolution Regime, Default Rights under [this Agreement] that may be exercised against such [Underwriter] 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.

* * *

“BHC Act 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 Federal Deposit Insurance Act and the regulations promulgated thereunder and (ii) Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act and the regulations promulgated thereunder.

¹⁴ [Note: As noted above, this rider is designed to be inserted into an underwriting agreement where a member of the underwriting syndicate is a Covered Entity and not where the issuer is a Covered Entity.]

¹⁵ [Note: As noted above, this rider is not technically required where (1) each party to the agreement other than the Covered Entities is a U.S. Entity, as defined under Question 7 above, and (2) the agreement (a) is governed by the laws of the United States or any state and (b) does not explicitly exclude the applicability of the U.S. Special Resolution Regimes (or a broader set of laws that includes a U.S. Special Resolution Regime).]

¹⁶ [Note: To replace with the relevant defined term throughout.]

¹⁷ [Note: To replace throughout with the relevant defined term.]

Annex B:
Certain Relevant Statutory and Regulatory Definitions

The following definitions are included in this Annex B for reference only. These definitions are not intended to be incorporated into any underwriting agreement or other agreement.

“Affiliate” as defined in 12 U.S.C. § 1841(k) means any company that controls, is controlled by, or is under common control with another company. 12 U.S.C. § 1841(a)(2) states that any company has “control” over a bank or over any company if:

- (a) the company directly or indirectly or acting through one or more other persons owns, controls, or has power to vote 25 per centum or more of any class of voting securities of the bank or company;
- (b) the company controls in any manner the election of a majority of the directors or trustees of the bank or company; or
- (c) the Federal Reserve determines, after notice and opportunity for hearing, that the company directly or indirectly exercises a controlling influence over the management or policies of the bank or company.

“Covered entity” as defined in 12 C.F.R. § 252.81, “covered bank” as defined in 12 C.F.R. § 47.2 and “covered FSI” as defined in 12 C.F.R. § 382.1, generally refer to (with certain exceptions):

- (a) a bank holding company that is identified as a global systemically important bank holding company pursuant to 12 C.F.R. § 217.402;
- (b) a subsidiary of a bank holding company that is identified as a global systemically important bank holding company pursuant to 12 C.F.R. § 217.402; or
- (c) a U.S. subsidiary, U.S. branch or U.S. agency of a top-tier foreign banking organization that is identified as a global systemically important foreign banking organization pursuant to 12 C.F.R. § 252.153(b)(4).

For these purposes, a “subsidiary” generally means a company that is owned or controlled directly or indirectly by another company, and “control” has the same definition as listed in the definition of “affiliate” above.

“Default Right” as defined in 12 C.F.R. §§ 252.81, 47.2 or 382.1, as applicable, means, with respect to a QFC, any:

- (a) right of a party, whether contractual or otherwise (including, without limitation, rights incorporated by reference to any other contract, agreement, or document, and rights afforded by statute, civil code, regulation, and common law), to liquidate, terminate, cancel, rescind, or accelerate such agreement or transactions thereunder, set off or net amounts owing in respect thereto (except rights related to same-day payment netting), exercise remedies in respect of collateral or other credit support or property related thereto (including the purchase and sale of property), demand payment or delivery thereunder or in respect thereof (other than a right of operation of a contractual provision arising solely from a change in the value of collateral or margin or a change in the amount of an



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economic exposure), suspend, delay, or defer payment or performance thereunder, or modify the obligations of a party thereunder, or any similar rights; and

- (b) right or contractual provision that alters the amount of collateral or margin that must be provided with respect to an exposure thereunder, including by altering any initial amount, threshold amount, variation margin, minimum transfer amount, the margin value of collateral, or any similar amount, that entitles a party to demand the return of any collateral or margin transferred by it to the other party or a custodian or that modifies a transferee's right to reuse collateral or margin (if such right previously existed), or any similar rights, in each case, other than a right or operation of a contractual provision arising solely from a change in the value of collateral or margin or a change in the amount of an economic exposure.

“Financial counterparty” as defined in 12 C.F.R. §§ 252.81, 47.2 and 382.1 means:

- (a) a bank holding company or an affiliate thereof; a savings and loan holding company as defined in section 10(n) of the Home Owners' Loan Act (12 U.S.C. § 1467a(n)); a U.S. intermediate holding company that is established or designated for purposes of compliance with 12 C.F.R. § 252.153; or a nonbank financial company supervised by the Federal Reserve under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. § 5323);
- (b) a depository institution as defined in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. § 1813(c)); an organization that is organized under the laws of a foreign country and that engages directly in the business of banking outside the United States; a Federal credit union or State credit union as defined in section 2 of the Federal Credit Union Act (12 U.S.C. §§ 1752(1), (6)); an institution that functions solely in a trust or fiduciary capacity as described in section 2(c)(2)(D) of the Bank Holding Company Act (12 U.S.C. § 1841(c)(2)(D)); an industrial loan company, an industrial bank, or other similar institution described in section 2(c)(2)(H) of the Bank Holding Company Act (12 U.S.C. § 1841(c)(2)(H));
- (c) an entity that is state-licensed or registered as:
 - (i) a credit or lending entity, including a finance company; money lender; installment lender; consumer lender or lending company; mortgage lender, broker, or bank; motor vehicle title pledge lender; payday or deferred deposit lender; premium finance company; commercial finance or lending company; or commercial mortgage company; except entities registered or licensed solely on account of financing the entity's direct sales of goods or services to customers; or
 - (ii) a money services business, including a check casher; money transmitter; currency dealer or exchange; or money order or traveler's check issuer;
- (d) a regulated entity as defined in section 1303(20) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, as amended (12 U.S.C. § 4502(20)) or any entity for which the Federal Housing Finance Agency or its successor is the primary federal regulator;
- (e) any institution chartered in accordance with the Farm Credit Act of 1971, as amended, 12 U.S.C. §§ 2002 et seq., that is regulated by the Farm Credit Administration;



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- (f) any entity registered with the Commodity Futures Trading Commission as a swap dealer or major swap participant pursuant to the Commodity Exchange Act of 1936 (7 U.S.C. §§ 1 et seq.), or an entity that is registered with the U.S. Securities and Exchange Commission as a security-based swap dealer or a major security-based swap participant pursuant to the Securities Exchange Act of 1934 (15 U.S.C. §§ 78a et seq.);
- (g) a securities holding company, with the meaning specified in section 618 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. § 1850a); a broker or dealer as defined in sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934 (15 U.S.C. §§ 78c(a)(4)–(5)); an investment adviser as defined in section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. § 80b-2(a)); an investment company registered with the U.S. Securities and Exchange Commission under the Investment Company Act of 1940 (15 U.S.C. §§ 80a-1 et seq.); or a company that has elected to be regulated as a business development company pursuant to section 54(a) of the Investment Company Act of 1940 (15 U.S.C. § 80a-53(a));
- (h) a private fund as defined in section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. § 80b-2(a)); an entity that would be an investment company under section 3 of the Investment Company Act of 1940 (15 U.S.C. § 80a-3) but for section 3(c)(5)(C); or an entity that is deemed not to be an investment company under section 3 of the Investment Company Act of 1940 pursuant to Investment Company Act Rule 3a-7 (17 C.F.R. § 270.3a-7) of the U.S. Securities and Exchange Commission;
- (i) a commodity pool, a commodity pool operator, or a commodity trading advisor as defined, respectively, in sections 1a(10), 1a(11), and 1a(12) of the Commodity Exchange Act of 1936 (7 U.S.C. §§ 1a(10), 1a(11), and 1a(12)); a floor broker, a floor trader, or introducing broker as defined, respectively, in sections 1a(22), 1a(23) and 1a(31) of the Commodity Exchange Act of 1936 (7 U.S.C. §§ 1a(22), 1a(23), and 1a(31)); or a futures commission merchant as defined in section 1a(28) of the Commodity Exchange Act of 1936 (7 U.S.C. § 1a(28));
- (j) an employee benefit plan as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income and Security Act of 1974 (29 U.S.C. § 1002);
- (k) an entity that is organized as an insurance company, primarily engaged in writing insurance or reinsuring risks underwritten by insurance companies, or is subject to supervision as such by a State insurance regulator or foreign insurance regulator; or
- (l) an entity that would be a financial counterparty described in paragraphs (a)–(k) of this definition, if the entity were organized under the laws of the United States or any state thereof.

The term “financial counterparty” does not include any counterparty that is:

- (a) a sovereign entity;
- (b) a multilateral development bank; or
- (c) the Bank for International Settlements.

“**Qualified Financial Contract**” or “**QFC**” is defined to include any securities contract, as well as certain other contracts. Copied below is the statutory definition of the term “securities contract.” The full statutory definition of a “qualified financial contract” or “QFC”, including the full definition of other types of contracts that qualify as QFCs, can be found at 12 U.S.C. § 5390(c)(8)(D).



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- (a) Securities contract: The term “securities contract”—
- (I) means a contract for the purchase, sale, or loan of a security, a certificate of deposit, a mortgage loan, any interest in a mortgage loan, a group or index of securities, certificates of deposit, or mortgage loans or interests therein (including any interest therein or based on the value thereof), or any option on any of the foregoing, including any option to purchase or sell any such security, certificate of deposit, mortgage loan, interest, group or index, or option, and including any repurchase or reverse repurchase transaction on any such security, certificate of deposit, mortgage loan, interest, group or index, or option (whether or not such repurchase or reverse repurchase transaction is a “repurchase agreement”, as defined in clause (v));
 - (II) does not include any purchase, sale, or repurchase obligation under a participation in a commercial mortgage loan unless the Corporation determines by regulation, resolution, or order to include any such agreement within the meaning of such term;
 - (III) means any option entered into on a national securities exchange relating to foreign currencies;
 - (IV) means the guarantee (including by novation) by or to any securities clearing agency of any settlement of cash, securities, certificates of deposit, mortgage loans or interests therein, group or index of securities, certificates of deposit or mortgage loans or interests therein (including any interest therein or based on the value thereof) or an option on any of the foregoing, including any option to purchase or sell any such security, certificate of deposit, mortgage loan, interest, group or index, or option (whether or not such settlement is in connection with any agreement or transaction referred to in subclauses (I) through (XII) (other than subclause (II)));
 - (V) means any margin loan;
 - (VI) means any extension of credit for the clearance or settlement of securities transactions;
 - (VII) means any loan transaction coupled with a securities collar transaction, any prepaid securities forward transaction, or any total return swap transaction coupled with a securities sale transaction;
 - (VIII) means any other agreement or transaction that is similar to any agreement or transaction referred to in this clause;
 - (IX) means any combination of the agreements or transactions referred to in this clause;
 - (X) means any option to enter into any agreement or transaction referred to in this clause;
 - (XI) means a master agreement that provides for an agreement or transaction referred to in any of subclauses (I) through (X), other than subclause (II), together with all supplements to any such master agreement, without regard to whether the master agreement provides for an agreement or transaction that is not a securities contract under this clause, except that the master agreement shall be considered to be a securities contract under this clause only with respect to each agreement or transaction under the master agreement that is referred to in any of subclauses (I) through (X), other than subclause (II); and
 - (XII) means any security agreement or arrangement or other credit enhancement related to any agreement or transaction referred to in this clause, including any guarantee or reimbursement obligation in connection with any agreement or transaction referred to in this clause.