

April 1, 2021

To: Ms. Ho Young Lee
Financial Service Commission
Financial Restructuring Division
15F, 209, Sejong-daero, Jongno-gu
Seoul, Korea

VIA EMAIL

Re: Comments on the Proposed Amendments to the 「Enforcement Decree of the Act on the Structural Improvement of the Financial Industry」

The International Swaps and Derivatives Association, Inc. (ISDA)¹ is grateful for the opportunity to provide input to the Enforcement Decree of the Act on the Structural Improvement of the Financial Industry (the “**Proposed Enforcement Decree**”) as announced by the Financial Services Commission (the “**FSC**”) on February 19, 2021. Individual members of ISDA may have their own views on the Proposed Enforcement Decree, and may therefore provide their comments to the FSC directly.

Consistent with our mission, we are primarily concerned in this letter with the impact of the proposed implementation on the safety and efficiency of the financial markets, by considering the impact of the proposals on the obligations of a Systemically Important Financial Institution with respect to Qualified Financial Transactions.

Our membership includes the leading global, regional and national financial institutions as well as leading end-users and many other important financial market participants. Our leading financial institution members are members of the other international financial trade associations, and their views on certain other issues will be represented to you through those associations.

¹ Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 925 member institutions from 75 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association’s website: www.isda.org.

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1. The Financial Services Commission’s authority to implement temporary stay measures with respect to the Qualified Financial Transactions

On February 19, 2021, the FSC issued a public announcement (No. 2021-45) proposing amendments to the Proposed Enforcement Decree. This letter sets forth our comments on the Proposed Enforcement Decree.

Our comments relate to Article 14-9 of the Act on Structural Improvement of the Financial Industry (“Act”) and Article 4-5 of the Proposed Enforcement Decree. We understand that these provisions are the result of the FSC’s efforts to implement the “Key Attributes of Effective Resolution Regimes for Financial Institutions” recommended by the Financial Stability Board on October 15, 2014 (the “FSB Key Attributes”). ISDA, on behalf of its members, appreciates the FSC’s efforts to contribute to the stability of the international financial markets.

In line with the FSB Key Attributes, the FSC is empowered to order temporary stays at its discretion, pursuant to its authority to require timely corrective measures to be undertaken with respect to Qualified Financial Transactions of Systemically Important Financial Institutions (SIFIs), in order to restrict early termination of Qualified Financial Transactions that is triggered solely by the entry into resolution proceeding. However, we are of the view that the Proposed Enforcement Decree fails to clearly specify the “No Cherry Picking Rule”, one of the key conditions that the temporary stay power is subject to, under Annex 5 of the FSB Key Attributes.

2. Necessity of Incorporating “No Cherry Picking Rule” in the Proposed Enforcement Decree

The “No Cherry Picking Rule” prohibits selective transfer of individual transactions out of Qualified Financial Transactions executed under a single master agreement with the same counterparty. As you are aware, pursuant to Article 120, Paragraph (3) of the Debtor Rehabilitation and Bankruptcy Act (the “Insolvency Act”), the termination and settlement of Qualified Financial Transactions executed under a single master agreement shall not be subject to avoidance or termination under the Insolvency Act, and close-out netting of all of such Qualified Financial Transactions is permitted. This right is based on the principle that Qualified Financial Transactions under a single master agreement constitute a single transaction as a whole. However, if only certain transactions executed under a single master agreement are transferred in the process of transfer of contracts, the close-out netting of all of the transactions executed under the same master agreement with a single counterparty would no longer become possible. The validity and enforceability of close-out netting is one of the basic premises of the capital adequacy regulation and the margin requirement regulation applicable to financial institutions. We believe that the selective transfer of Qualified Financial Transactions, if permitted, would clearly undermine the efficacy of these regulations resulting in seriously adverse regulatory consequences including miscalculation of the capital requirement and invalidation in whole or in part of or deficiency in collateral arrangements.

Therefore, Annex 5 of the FSB Key Attributes highlights “No Cherry Picking Rule” as one of the key items under the temporary stay in early termination rights to ensure clear and

unambiguous application of the regulatory framework on early termination rights and close-out netting in the resolution process of a trouble financial institution.

To this end, we believe that it is necessary to make the “No Cherry Picking Rule” clear by adding a new provision expressly specifying it in the Enforcement Decree as recommended by Annex 5 of the FSB Key Attributes. Accordingly, ISDA recommends that a new provision be inserted in the Enforcement Decree to supplement Article 14 (Administrative Disposition), Paragraph (5) of the Act as follows:

Act	<u>(Proposed) Enforcement Decree</u>
<p>Article 14 (Administrative Disposition) (5) Where the Financial Services Commission decides to transfer contracts pursuant to paragraph (2), it shall determine the scope of contracts to be transferred, terms of the transfer, and the financial institution to which contracts are transferred. In such cases, it shall in advance obtain the consent of the board of directors of the financial institution to which the contracts are to be transferred. <Amended as of Mar. 12, 2010></p>	<p><u>Article * (Scope of Contract Transfer)</u> <u>In determining the scope of contracts to be transferred pursuant to Article 14, Paragraph (5) of the Act, all Qualified Financial Transactions entered into under a master agreement with the same counterparty shall be treated as one single contract together with all related agreements.</u></p>

The proposed new provision means that all of the Qualified Financial Transactions executed under a single master agreement with a single counterparty shall be treated as a single agreement at the time of transfer of contracts which shall also include the related credit support agreements and the guarantee agreements.

3. Conclusion

The Proposed Enforcement Decree is not intended to create a new regulatory requirement but to ensure predictability in the application of the Act by clarifying the relevant statutory provisions. Given that ISDA’s proposed new provision discussed above could be viewed to limit the scope of the FSC’s discretionary powers related to the implementation of timely corrective measures, we believe that the inclusion of such provision in the sub-regulation of the Enforcement Decree would not be appropriate and it would be more appropriate to be addressed in the Enforcement Decree. For your reference, similar provisions are also expressly included in the corresponding statutes of the United States² and Europe³, indicating wide recognition that such provisions ensure clarity and predictability in the application of the law.

² **OLA (Orderly Liquidation Law) 12USC5390(c)(9);1821(e)(9):** “If any qualified financial contract with a given counterparty is transferred, All qualified financial contracts between the covered financial company and any particular counterparty must be transferred to the same party (together with all claims, security and credit enhancements relating thereto)”; **NYBL (New York Banking Law) section 618-a2(b):** “any master agreement for qualified financial contracts , together with all supplements thereto, “shall be treated as one qualified financial contract...”

³ **BRRD (Bank Recovery and Resolution Directive) Article 77.1.** “so as to prevent the transfer of some, but not all, of the rights and liabilities “



We sincerely hope that our proposal will be reviewed positively and can contribute to strengthening the Korean financial markets.

We hope you find ISDA's comments and responses informative and useful. Should you have any questions or desire further clarification on any of the matters discussed in this letter, please do not hesitate to contact ISDA via Monica Chiu, Senior Counsel, Asia Pacific (mchiu@isda.org or at +852 2200 5908) or Hyelin Han, Director, Public Policy, Asia Pacific (hhan@isda.org or at +852 2200 5903).

Thank you.

Yours faithfully,

For the **International Swaps and Derivatives Association, Inc.**

A handwritten signature in black ink that reads "Monica Chiu".

Monica Chiu
Senior Counsel, Asia Pacific

A handwritten signature in black ink that reads "Hyelin Han".

Hyelin Han
Director, Public Policy, Asia Pacific