

BY EMAIL

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Resilience and Resolution Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ
brrd.transposition@hmtreasury.gsi.gov.uk

Ladies and Gentlemen

ISDA comments on HM Treasury's open consultation on transposition of the Bank Recovery and Resolution Directive, published 23 July 2014

The International Swaps and Derivatives Association, Inc. (**ISDA**)¹ is grateful for the opportunity to provide input to HM Treasury's open consultation on the proposed transposition of the Bank Recovery and Resolution Directive published 23 July 2014 (the **Consultation**).

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 direct impact of the proposals on the rights of a market counterparty under its derivative and other financial transactions with a failing firm and under related netting and collateral arrangements. We are aware that a number of other market associations and professional bodies will be responding on some of the broader issues raised by the Consultation.

ISDA supports HM Treasury's proposals for the implementation of the Bank Recovery and Resolution Directive (**BRRD**).

However, we have some concerns with HM Treasury's proposed approach to implementation. In particular, we consider it difficult to provide meaningful input on the questions raised in the consultation without being able to review more detailed drafting of the implementing legislation. We are disappointed that the consultation does not include HM Treasury's proposed approach to the implementation of the power to suspend certain obligations set out in Article 69 of the BRRD. This Article provides for a significant change in the dealings with failing firms by permitting the imposition of a moratorium and we consider

¹ Information regarding ISDA is set out in Annex 1 to this response.

that it would be appropriate for there to be a public consultation on the proposed implementation to allow the industry to provide input on the matter. We are also concerned regarding the HM Treasury's proposed approach to the implementation of the requirements for the contractual recognition of the bail-in tools under Article 55 of the BRRD.

Finally, we note that a number of our [comments](#) dated 9 May 2014 in response to the consultation on HM Treasury's consultation on bail-in published 13 March 2014 remain valid.

We hope that you find our comments useful in your continuing deliberations on the implementation of the BRRD. Please do not hesitate to contact either of the undersigned if we can provide further information about the derivatives market or other information that would assist HM Treasury in its work in relation to the effective implementation of the BRRD requirements.

Yours faithfully

Dr Peter M Werner
Senior Director
pwerner@isda.org

Edward Murray
Chairman, ISDA Financial Law Reform Committee
ed.murray@allenovery.com

Question 1: Do you agree that the powers to remove impediments to resolvability should only extend to mixed-activity holding companies where its subsidiary institutions are not held directly or indirectly by an intermediate financial holding company, with the exception of the power to require a mixed-activity holding company to establish an intermediate financial holding company?

No comment.

Question 2: Do you agree with the proposal to model the right of appeal on s. 55Y of FSMA?

No comment.

Question 3: Should the Bank of England be given a direct enforcement power in relation to resolution?

No comment.

Question 4: Do you have any comments on the features of that enforcement power? Do you agree that it should be modelled on the current enforcement powers of the PRA, FCA and Bank under FSMA?

No comment.

Question 5: Do you agree that the power to require the removal of the senior management should be interpreted as relating to those managers directly accountable to the Board?

No comment.

Question 6: Do you have any comments on the proposed changes to the special resolution objectives?

No comment.

Question 7: Do you have any comments on the proposed changes to the conditions for entry into resolution?

No comment.

Question 8: Do you feel that any changes to the Bank's ability to control an institution under resolution would be useful?

No comment.

Question 9: Do you agree with the proposal to allow for an "onward asset management vehicle"?

No comment.

Question 10: Do you agree that it should be possible to use the Bank Administration Procedure with the Asset Management Vehicle, so that the remainder of the bank that is placed into administration can provide services to the Asset Management Vehicle?

No comment.

Question 11: Do you have any other comments on the suggested approach to transposing the Asset Management Vehicle?

No comment.

Question 12: To the extent that liabilities in relation to pension benefits attributable to variable remuneration must be within scope of the bail-in powers, do you agree that it should be possible for the pension trustee to reduce his liability to the beneficiary accordingly? Do you have any comments on how this could be achieved?

No comment.

Question 13: Do you agree that liabilities with no fixed maturity and which are callable at any point with less than 7 days' notice should fall within the definition of a liability with an original or remaining maturity of less than 7 days?

No comment.

Question 14: Do you have any other comments on the proposed changes to s. 48B?

We note that the definition of 'covered deposit' in the BRRD refers to Directive 2014/49/EU, which includes not only personal deposits, but also deposits made by companies, municipalities, pension schemes and other institutions. The amended wording in s. 48B should address how bail-in applies where a deposit, which is protected from the bail-in, forms part of a netting arrangement with financial contracts.

Question 15: Should the regulators' powers to require the inclusion of a contractual clause regarding recognition of bail-in extend to mixed-activity holding companies where the subsidiary institutions are held by an intermediate financial holding company?

We do not have a comment on this particular question, but are concerned regarding the implementation of the contractual bail-in requirement more generally.

In particular, the point in time at which the relevant liability is issued or entered into is not straightforward when considering derivative contracts documented under industry standard master netting agreements (such as the ISDA Master Agreement) which can only be subject to bail-in after they have been closed out under Article 49 of the BRRD. To illustrate, there may be two transactions entered into under a master agreement: one on 1 January 2012 and the other on 1 February 2015; in the event that the derivatives are subject to bail-in, both of these derivative transactions must be closed-out individually and a net sum determined. The 1 January 2012 transaction is, prima facie, outside of the scope of the Article 55. However, as only the net sum can be subject to the bail-in, recognition must necessarily apply on a master agreement basis. Any new transaction with respect to a pre-

existing master agreement should therefore not be subject to the requirements, as it is effectively an amendment to the terms of a pre-existing liability.

We are also concerned regarding the requirement to include a contractual recognition of the bail-in tools as available to the Bank of England in contracts governed by foreign law: Would a foreign court uphold such a contractual recognition when faced with a local claimant that the clause of the contract should be set aside? While international cooperation on this issue may make it more likely that courts in different countries will accept and uphold such clauses, there remains a risk and in the case that a foreign court does not uphold such a clause, a netting arrangement may be disrupted.

We appreciate that the FSMA gives the PRA and FCA powers regarding most aspects of the contractual recognition requirement and we have highlighted our concerns in our responses to the separate BRRD consultations published by the PRA and the FCA, but wanted to bring our concerns to your attention as well.

Question 16: Should the extension of the regulators' powers to require mixed-activity holding companies to include contractual recognition provisions in accordance with Article 55, and the MREL provisions, be delayed until 1 January 2016?

No comment.

Question 17: Do you have any comments on the proposed approach to implementing the requirement that shareholders and creditors must make a contribution to loss absorption and recapitalisation equal to at least 8% of the total liabilities of the firm, including own funds, before alternative resolution financing arrangements can be accessed?

No comment.

Question 18: How should situations with a bank or investment firm where over 92% of its liabilities at the point of resolution are excluded liabilities be dealt with? Do you think that this is a realistic scenario?

No comment.

Question 19: Do you have any comments on the proposed safeguard for protected financial arrangements in bail-in?

No comment.

Question 20: Do you agree with the proposed approach to implementation of the write down and conversion provisions? Do you have any comments on the draft Order?

No comment.

Question 21: Do you agree with the Government's preliminary view that the "No shareholder or creditor worse off" safeguard does not apply in relation to the write-down and/or conversion of capital instruments?

No comment.

Question 22: Do you agree with the proposal not to extend share transfer powers to branches of third country institutions?

No comment.

Question 23: Do you feel that the Bank of England should have the full set of resolution powers (with the exception of share transfer powers) over branches of third country institutions when acting independently to resolve a branch?

No comment.

Question 24: If not, what powers do you feel would be appropriate, in order to ensure that the risks posed by branches of third country institutions can be addressed effectively?

No comment.

Question 25: How should the assets, rights and liabilities of the branch be defined for the purposes of resolution of a branch?

Defining the assets, rights and liabilities of a UK-based branch should not be based on the governing law of the assets, rights and liabilities, as many of the non-UK branches of the bank are also likely to hold assets, rights and liabilities subject to English and Welsh law, especially with regard to financial contracts. For financial contracts, we consider the best approach to be to look to those assets, rights and liabilities which the UK branch holds on its books or which are booked through the UK branch. As those assets, rights and liabilities are usually held in the UK, the Bank of England may also find it easier to exercise resolution powers over them.

Question 26: Should the bank levy be used to meet the ex post funding requirements and replace the initial contributions from the bank levy in the event they are used, or should these be repaid by establishing resolution financing arrangements which follow the Delegated Act on contributions to the resolution financing arrangements?

No comment.

Question 27: Should the contribution of the deposit guarantee scheme should be capped at 50% of the target level of the deposit guarantee scheme, or at a higher level?

No comment.

Question 28: Do you agree that floating charges should rank after secondary preferential debts on insolvency? If not, what characteristics do floating charges have which make them suitable to benefit from higher protection?

No comment.

Question 29: Are you aware of any pre-1997 corporate shareholding members of a building society?

No comment.

Question 30: Should the powers under section 90B of the Building Societies Act 1986 be exercised so that any existing accounts which will not benefit from depositor preference rank pari passu with unsecured creditors?

No comment.

ABOUT ISDA

Since its founding in 1985, the International Swaps and Derivatives Association has worked to make over-the-counter (OTC) derivatives markets safe and efficient.

ISDA's pioneering work in developing the ISDA Master Agreement and a wide range of related documentation materials, and in ensuring the enforceability of their netting and collateral provisions, has helped to significantly reduce credit and legal risk. The Association has been a leader in promoting sound risk management practices and processes, and engages constructively with policymakers and legislators around the world to advance the understanding and treatment of derivatives as a risk management tool.

Today, the Association has more than 850 members from 63 countries on six continents. These members include a broad range of OTC derivatives market participants: global, international and regional banks, asset managers, energy and commodities firms, government and supranational entities, insurers and diversified financial institutions, corporations, law firms, exchanges, clearinghouses and other service providers.

ISDA's work in three key areas – reducing counterparty credit risk, increasing transparency, and improving the industry's operational infrastructure – show the strong commitment of the Association toward its primary goals; to build robust, stable financial markets and a strong financial regulatory framework.

The addresses of our European offices are as follows:

International Swaps and Derivatives Association, Inc.
c/o NCI Park Leopold Business Centre, 4th floor
38/40 Square de Meeûs
Brussels 1000
Belgium
Telephone: +32 (0) 2 401 8758
Fax : +32 (0) 2 401 8762
isdaeurope@isda.org

International Swaps and Derivatives Association, Inc.
One Bishops Square
London E1 6AD
United Kingdom
Telephone: +44 (0) 20 3088 3550
Fax: +44 (0) 20 3088 3555
isdaeurope@isda.org

Our registration number in the relevant EU register is 46643241096-93.

More information about ISDA is available from our website at <http://www.isda.org>, including a list of our members, the address of our head office in New York and other offices throughout the world and details of our various Committees and activities, in particular, our work in relation to financial law and regulatory reform.