August 26, 2015

By electronic submission

Andrew Hoffman and Leanne Ingledew
Prudential Regulation Authority
20 Moorgate
London, U.K. EC2R 6DA

Re: Prudential Regulation Authority Consultation Paper on Contractual Stays in Financial Contracts Governed by Third-Country Law (CP19/15)

Ladies and Gentlemen:

The Clearing House Association L.L.C. ("**The Clearing House**")[1] welcomes the opportunity to provide comments to the Prudential Regulation Authority of the Bank of England (the "**PRA**") with regard to its Consultation Paper CP19/15, entitled *Contractual stays in financial contracts governed by third-country law* and published on the Bank of England's website on May 26, 2015 (the "**PRA Proposal**" or the "**Consultation Paper**").[2] The PRA Proposal would introduce a new rule into the PRA Rulebook requiring the contractual adoption of resolution stays in certain financial contracts governed by third-country law (that is, the law of a jurisdiction outside the European Economic Area (the "**EEA**")).

The Consultation Paper indicates that the PRA Proposal is intended to reduce the risk of contagion from the failure of a relevant firm and support its orderly resolution by ensuring that resolution action taken against the firm would not immediately lead to the termination of its financial contracts governed by third-country law.[3] A solution to this issue endorsed by the Bank of England and other Financial Stability Board-member jurisdictions has been to implement contractual approaches to the recognition of critical elements of resolution, including restrictions or "stays" on early termination rights in financial contracts.[4] The International Swaps and Derivatives Association ("**ISDA**") 2014 Resolution Stay Protocol (the "**ISDA Protocol**") is an industry initiative cited in the PRA Proposal as an example of a contractual mechanism that achieves the policy goals of the Bank of England

[1] *See* Annex A for a description of The Clearing House.

[2] Prudential Regulation Authority Consultation Paper CP19/15 May 26, 2015 – www.bankofengland.co.uk/pra/Documents/publications/cp/2015/cp1915.pdf

[3] *Id.* at Overview 1.2

[4] *Id.* at Overview 1.11

and the PRA in this respect.[5] As the Bank of England and the PRA have indicated in the PRA Proposal, the Proposal Paper should be viewed as part of a coordinated effort among regulatory and resolution authorities in Europe, the United States, and elsewhere to require banks and other financial institutions to incorporate recognition of domestic stay regimes into their financial contracts where these are governed by foreign law.[6]

The Clearing House broadly supports the PRA Proposal's goal of incorporating contractual recognition of limitations on termination rights in financial contracts governed by third-country law, and believes that the framework presented in the Consultation Paper is a constructive step toward achieving the stated policy objectives. In particular, The Clearing House believes that if the PRA Proposal can be coordinated and harmonized with similar regulations in other key jurisdictions it will promote consistent implementation of contractual limitations on termination rights in financial contracts across the industry and facilitate the orderly resolution of covered firms under home country resolution regimes. However, we believe that there are a several key areas where the Consultation could be improved or clarified in order to more fully achieve its goals.

A. Statement as to Scope of Statutory Stays

We would encourage the PRA to state in the preamble of the final rule that the stays of termination rights in resolution under the provisions of the Banking Act of 2009 are applicable to the financial arrangements intended to be covered by the Consultation Paper, regardless of governing law or when such transactions were entered into, that the failure of any party to observe the provisions of such stays would be in violation of English law, and that the regulations are intended to ensure compliance with such mandatory rules of English law by promoting acknowledgment of such restrictions. Such a recital will remind market participants that they are stayed by operation of law and that the contractual amendments required by the rule are intended merely to assure uniformity of compliance regardless of the governing law of the contract, and to reduce disputes.

B. Amendment of Existing Transactions

The Clearing House would encourage the adoption of a more robust framework requiring the amendment of existing transactions. As the PRA is aware, both existing transactions and new transactions give rise to similar resolution concerns, which is why the Banking Act's limitations on termination rights apply with respect to existing transactions as well as new transactions. We believe that the policy goals of the Consultation Paper would be best served by support for contractual recognition of limitations on termination rights that are coextensive with those under English law for the financial arrangements covered by the Consultation Paper.

---

[5] *Id.* at Overview 1.12

[6] *Id.* at Overview 1.13

The PRA Proposal would appear, however, to allow counterparties to continue trading with a covered firm while leaving existing transactions unaffected (for example, by engage in future transactions under a new master agreement that contains the required contractual provisions, while leaving existing transactions under an unmodified legacy agreement, resulting in a "split book"). While some market participants may as a practical matter choose voluntarily to amend their existing transactions if future transactions with covered firms must be addressed, it cannot be assumed that all market participants will choose to do so.

While the PRA could attempt to impose requirements regarding existing contracts with covered firms on a firm-by-firm basis utilizing their informal supervisory authority, there is no assurance that unregulated market participants will agree with covered firms to amend existing transactions based on unpublished supervisory requirements. Even if market participants are willing to consider conforming some existing contracts to such supervisory requirements when requested, there is a risk that the market participants will elect to comply with respect to only a subset of covered firms or products.

Although we understand that there may be concerns under English law regarding published regulations that have retroactive effect, we believe broader regulations can be fashioned that have only a prospective effect by prohibiting covered firms from engaging in future dealings in *any* covered financial contract (or materially modifying any existing covered financial contract) with market participants unless *all* covered financial contracts (whether under the same master agreement or different master agreements or of the same type or different type of financial contract) between relevant entities in the covered firm's corporate group and such market participants have been amended. A counterparty could elect to retain its existing terms on outstanding transactions with a covered firm, but the covered firm would be barred from future dealings in all financial contracts with that counterparty. We see no reason why such a requirement should be imposed on a firm-by-firm basis through an informal process that is likely to be less effective in achieving regulatory goals.

C. Coordination with Other Regulators

We note that many of the firms covered by the PRA Proposal are global businesses with global clients, subject to regulation in various jurisdictions designed to promote contractual recognition of limitations on termination rights. The Clearing House and its members are particularly concerned that regulations in the U.K. and the U.S. be implemented in a manner that fosters consistency and efficiency by allowing firms to engage with their clients at the same time with regard to the amendments to financial contracts required by both jurisdictions in a coordinated manner that will streamline the administrative process of amending contracts and minimize the burden on clients. For this reason, we strongly urge that the timing of implementation of the final rule be coordinated with anticipated regulations in the U.S. For the same reason, we would also encourage alignment between implementation of the PRA requirements for contractual recognition of bail-in and compliance with the final rule.

D. Certain Coverage and Interpretive Issues

The Clearing House believes that the scope of contracts required to be amended under the PRA Proposal and the content of such amendments should be clarified in two key respects.

First, the PRA Proposal requires contractual recognition of limitations on the exercise of "termination rights" but it does not call for similar recognition of limitations on the exercise of enforcement rights with respect to collateral,[7] even though the Bank Recovery and Resolution Directive of 2015 as transposed into the Banking Act of 2009 provides for a stay as to both termination rights and enforcement rights with respect to collateral. To promote consistency with the treatment of counterparties under EU-law governed contracts, as well as with the provisions of the ISDA Protocol, we would encourage the PRA to address the exercise of enforcement rights with respect to collateral in the final rule.

Second, the scope of contracts required to be amended under the PRA Proposal is not entirely clear. The term "financial arrangement" is very broadly defined in the PRA Proposal and could potentially cover contract types that do not typically contain termination rights (or enforcement rights with respect to collateral) that would be stayed under the relevant provisions of the Banking Act of 2009. We would encourage refinement of the final rule to make it clear that references to "financial arrangements" within the meaning of the rule are limited to financial contracts that raise systemic concerns and contain a termination clause or enforcement rights with respect to collateral that would be stayed under the relevant provisions of English law, and that no amendments are required in respect of contracts that do not contain such provisions.

In addition, The Clearing House encourages the PRA to clarify its expectations regarding the information that firms are expected to be able to provide about their financial contracts as discussed in section 3.3 of the preamble to the Consultation Paper. In particular, The Clearing House would encourage the PRA to provide clarification regarding the specific types of information firms are expected to provide, and on what timeframe.

* * * * * * *

[7] *Id.* at Annex 1.4

The Clearing House thanks the PRA for the opportunity to respond to the PRA's Consultation Paper. If you have any questions, please do not hesitate to call John Court at +1 202-649-4628 (email: john.court@theclearinghouse.org).

Respectfully Submitted,

John Court
Managing Director and Deputy General Counsel
The Clearing House

cc: Andrew Gracie
Bank of England

Lauren Anderson
Bank of England

Donald S. Bernstein
Davis Polk & Wardwell LLP

Erika D. White
Davis Polk & Wardwell LLP

Annex A

The Clearing House. Established in 1853, The Clearing House is the oldest banking association and payments company in the United States. It is owned by the world's largest commercial banks, which collectively hold more than half of all U.S. deposits and which employ over one million people in the United States and more than two million people worldwide. The Clearing House Association L.L.C. is a nonpartisan advocacy organization that represents the interests of its owner banks by developing and promoting policies to support a safe, sound and competitive banking system that serves customers and communities. Its affiliate, The Clearing House Payments Company L.L.C., which is regulated as a systemically important financial market utility, owns and operates payments technology infrastructure that provides safe and efficient payment, clearing and settlement services to financial institutions, and leads innovation and thought leadership activities for the next generation of payments. It clears almost $2 trillion each day, representing nearly half of all automated clearing house, funds transfer and check-image payments made in the United States. *See* The Clearing House's web page at www.theclearinghouse.org.