

**MEMO# 29031**

May 27, 2015

# **Bank of England Issues Consultation Paper on Cross-Border Stay of Termination Rights for Certain Financial Contracts**

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TO: DERIVATIVES MARKETS ADVISORY COMMITTEE No. 34-15  
ICI GLOBAL REGULATED FUNDS COMMITTEE No. 25-15  
ICI GLOBAL TRADING & MARKETS COMMITTEE No. 26-15  
INTERNATIONAL COMMITTEE No. 29-15 RE: BANK OF ENGLAND ISSUES CONSULTATION PAPER ON CROSS-BORDER STAY OF TERMINATION RIGHTS FOR CERTAIN FINANCIAL CONTRACTS

Recently, the Bank of England (“BOE”) issued a consultation paper proposing a new rule requiring the contractual adoption of UK resolution stays in certain financial contracts governed by third-country law (i.e., law of a jurisdiction outside the European Union). [\[1\]](#) Specifically, certain regulated entities will be prohibited from entering into new contracts or amending existing financial contracts (e.g., derivatives contracts and securities lending and repurchase agreements) unless the counterparties (e.g., regulated funds) agree to be subject to restrictions on early termination and close-out as if the financial contracts were governed by the laws of the United Kingdom.

Comments in response to the Consultation Paper are due by August 26. ICI expects to comment on the Consultation Paper. If you have specific concerns about the Consultation Paper, please contact Jennifer Choi at [jennifer.choi@ici.org](mailto:jennifer.choi@ici.org) by July 6.

## **Background**

In the aftermath of the financial crisis, international regulators have been concerned about orderly resolution of systemic financial institutions. According to regulators, a key aspect of effective resolution of a systemic financial institution is ensuring that its counterparties in derivatives and other financial contracts cannot terminate and close out their positions solely as a result of the firm’s or a related entity’s entry into resolution. In this regard, the Financial Stability Board (“FSB”) jurisdictions have been adopting special resolution regimes to impose a stay on early termination rights during the resolution of systemically important

financial institutions. In addition, members of the FSB have been working to improve cross-border recognition of resolution stays both through statutory cross-border frameworks and contractual arrangements. [2] Currently, 18 of the world's largest dealer banks have adhered to the International Swaps and Derivatives Association ("ISDA") Resolution Stay Protocol, an example of the contractual solution, into which the stay recognition provisions are incorporated.

In the United Kingdom, the Banking Act of 2009 gives the BOE, as resolution authority, the power to suspend (stay) temporarily the termination rights of a party to a contract with a firm in resolution, provided that the UK institution continues to perform its payment and other substantive obligations under the contract. Although the Bank Recovery and Resolution Directive ("BRRD") would recognize and give effect to a UK stay throughout the European Union, it is unclear whether a contract governed by the law of a non-EU country would be subject to the UK stay. Therefore, the UK authorities are concerned that counterparties under contracts governed by third-country law would potentially be able to exercise early termination rights in resolution while counterparties under contracts governed by UK law or the law of another EU Member State would be prevented from exercising their early termination rights. The proposed new rule is a way to require other counterparties (beyond the G-18 banks) to adhere to a stay under UK law. [3]

## **Proposed Rule**

The proposed rule would apply to Prudential Regulation Authority ("PRA")-authorized UK banks, building societies and PRA-designated UK investment firms as well as their qualifying parents ("Firms") in respect of specified financial contracts governed by the law of a non-EU jurisdiction. The proposed rule would prohibit Firms from creating new obligations or materially amending an existing obligation under such a financial contract without the required counterparty agreement. The counterparty would be required to agree in writing to be subject to similar restrictions on termination, acceleration, close-out, set-off and netting as would apply as a result of the Firm's entry into resolution (or the write down or conversion of the Firm's regulatory capital at the point of non-viability) as if the contract were governed by the laws of the United Kingdom.

Under the proposed rule, Firms also would be required to ensure that their subsidiaries obtain agreement to the stay from their counterparties. The proposed rule would apply to obligations created under: (1) securities contracts; [4] (2) commodities contracts; (3) futures and forwards contracts; (4) swap agreements; (5) all other derivatives; and (6) master agreements for any of the above or for contracts for the sale, purchase, or delivery of a currency.

The proposed rule would apply to obligations created under relevant financial contracts on or after January 1, 2016. The proposed rule would stagger the effective date of the rule by counterparty type as follows: January 1, 2016 for credit institutions and investment firms; July 1, 2016 for asset managers (including funds), insurers and other counterparties that act on an agency basis; and January 1, 2017 for all other counterparties.

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## endnotes

[1] Consultation Paper, CP19/15, Contractual stays in financial contracts governed by third-country laws (May 2015), available at <http://www.bankofengland.co.uk/pr/Pages/publications/cp/2015/cp1915.aspx> (“Consultation Paper”).

[2] In September 2014, the FSB published a consultative document with specific proposals to improve cross-border recognition of resolution actions. For ICI Global’s comment letter in response to the consultation, see ICI Memorandum No. 28540 (Nov. 25, 2014), available at <http://www.iciglobal.org/iciglobal/pubs/memos/memo28540>.

[3] We expect the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation to propose similar rules shortly for certain regulated entities.

[4] Securities contracts would include: contracts for the purchase, sale, or loan of a security or a group or index of securities; options on a security or a group or index of securities; or repo or reverse repo transactions on a security or a group or index of securities.