

COMMENT LETTER

August 26, 2015

ICI Global Submits Comment Letter in Response to Bank of England's Consultation Paper on Cross-Border Stay of Termination Rights for Certain Financial Contracts (pdf)

August 26, 2015 Andrew Hoffman and Leanne Ingledew Prudential Regulation Authority 20 Moorgate London EC2R 6DA Attention: CP19_15@bankofengland.co.uk Re: Contractual Stays in financial contracts governed by third-country law Dear Mr. Hoffman and Ms. Ingledew: ICI Global¹ appreciates the opportunity to provide comments on the consultation issued by PRA rule requiring the contractual adoption of resolution stays in certain financial contracts governed by third-country law (i.e., the law of a jurisdiction outside the 2 The Proposed Rule is part of the effort by the actions across borders for the orderly resolution of systemically important financial institutions Our members investment companies that are registered under the Investment Company Act of 1940 3 enter into and trade 1 The international arm of the Investment Company Institute, ICI Global serves a fund membership that includes regulated funds publicly offered to investors in jurisdictions worldwide, with combined assets of US\$19.5 trillion. ICI Global seeks to advance the common interests and promote public understanding of regulated investment funds, their managers, and investors. Its policy agenda focuses on issues of significance to funds in the areas of financial stability, cross-border regulation, market structure, and pension provision. ICI Global has offices in London, Hong Kong, and Washington, DC. 2 See Contractual Stays in financial contracts governed by third-country law, CP19/15 (May 2015), available at <http://www.bankofengland.co.uk/prd/Documents/publications/cp/2015/cp1915.pdf> 3 to any fund that is organized or formed under the laws of a nation, is authorized for public sale in the country in which it is organized or formed, and is regulated as a public investment company under the laws of that country. Generally, such funds are regulated to make them eligible for sale to the retail public, even if a particular fund may elect to limit its offering to institutional investors. Such funds typically ICI Global Letter to Andrew Hoffman and Leanne Ingledew August 26, 2015 Page 2 of 7 - 2 - Proposed Rule. As market participants representing tens of millions of investors, ICI Global members recognize financial contracts with other market participants, such as regulated funds. One of the critical issues for regulators to address in preventing contagion risks to the global market from an insolvency of a SIFI is the effective implementation of group-wide resolution plans for cross-border groups. There are, however, currently no means of ensuring that special resolution regimes (such as the Bank Resolution and Recovery Directive (Directive 2014/59/EU)) are

enforceable on a cross-border basis. To give effect to actions under special resolution regimes on a cross-border basis, the FSB and its members have been working to have market participants adopt contractual arrangements under which counterparties resident in different jurisdictions would agree to be bound by specified resolution actions taken pursuant to an established special resolution regime. We understand the for requiring contractual undertakings, which is to ensure equivalent treatment of financial contracts subject to third-country law and those governed by domestic law for purposes of imposition of a temporary stay on early termination. We continue to believe, however, that these contractual approaches should only be an interim solution, as the FSB has indicated previously.⁴ The permanent solution for the orderly resolution of a SIFI with global operations is for FSB members to adopt statutory or regulatory cross-border recognition frameworks to give effect to foreign resolution measures in their respective jurisdictions. This solution provides substantially more certainty and predictability and will make the actions more readily subject to enforcement. Moreover, measures, including regulations, to impose contractual solutions should be narrowly tailored to achieve the intended purpose: for a temporary stay under a special resolution regime, such as the BRRD, to be enforceable equally against transactions governed by third-country law as those under domestic law. As noted in the Consultation Paper, the purpose of the Proposed Rule is to address the concern that the failure of an entity subject to the Proposed Rule would result in financial contracts governed by third-country law being terminated while financial contracts governed by the laws of the United Kingdom or another EU jurisdiction would be stayed. The Proposed Rule therefore should give effect to the temporary stay under the BRRD (and eliminate the uncertainty about its application to cross-border transactions) but should not change the scope of the BRRD. Nor should the Proposed Rule provide for enforcement of a stay that would otherwise not be valid or for the ability for any person to extend the length of the stay, regardless of are subject to substantive regulation in areas such as disclosure, form of organization, custody, minimum capital, valuation, investment restrictions (e.g diversification standards). Examples of such funds include: US investment companies regulated under the Investment 4 See Proposed Rule, supra note 2 could be implemented in the near term to achieve cross-border recognition of particularly critical elements of ICI Global Letter to Andrew Hoffman and Leanne Ingledew August 26, 2015

Page 3 of 7 - 3 - whether an administrator acting under the BRRD ultimately elects to do so. In other words, the Proposed Rule should cover only the entities that would be subject to the BRRD and any stays imposed should be triggered and enforced in the same manner as they would be if both parties to the financial contract were resident in the UK or in another EU jurisdiction. We discuss a number of concerns and questions below to make sure that the Proposed Rule does not go beyond its intended goal and would not result in unintended consequences. Specifically, we have the following concerns with the Proposed Rule: □ The BOE and the PRA should provide more specificity regarding how the Proposed Rule would interact with special resolution regimes in other jurisdictions and the types of financial contracts subject to the Proposed Rule to ensure greater certainty to market participants, including non-EU regulated funds; □ The BOE and the PRA should clarify the provision regarding non-performance to include expressly the obligation of the entities under resolution to return any excess margin and to post additional margin to their counterparties if the transaction becomes out-of-the money to the insolvent entity; □ The BOE and the PRA should confirm that non-compliance with the Proposed Rule would not affect the enforceability of the contract and that there would not be any penalties imposed on counterparties, such as non-EU regulated funds, of entities subject to the Proposed Rule; and □ The BOE and the PRA should provide regulated funds and their managers a 12-month, rather than the 6-month, period of time to comply with the new rule. BOE and PRA Should Provide Greater Specificity regarding the Scope of Proposed Rule To ensure the

orderly resolution of a SIFI, regulators must provide for certainty and establish a transparent and predictable process that allows market participants to understand their rights before the triggering of a resolution.⁵ transparency should enhance the predictability of, and confidence in, resolution regimes and promote the well-functioning of the relevant markets. ⁶ See Key Attributes of Effective Resolution Regimes, available at http://www.financialstabilityboard.org/publications/r_141015.pdf provide for speed and transparency and as much predictability as possible through legal and procedural clarity and advanced pla ⁶ See Consultation Paper, supra note 2, at 7. ICI Global Letter to Andrew Hoffman and Leanne Ingledew August 26, 2015 Page 4 of 7 - 4 - Entities Subject to the Proposed Rule A key component of a transparent resolution process is to make clear to market participants which entities are covered by the Proposed Rule and how the resolution of an entity within a corporate group would affect the termination of transactions of other entities within that group. The Consultation Paper provides that the Proposed Rule would apply to UK banks, building societies, PRA-designated investment firms, and Id require Covered Entities to ensure that certain of their third-country subsidiaries (i.e., credit institutions, investment firms, and financial institutions) obtain agreements from their counterparties to subject themselves to a stay on termination of financial contracts. The Consultation Paper does not discuss, however, how the Proposed Rule would apply if a Covered Entity or its third-country subsidiary were simultaneously subject to the special resolution regime or a regulation similar to the Proposed Rule in another jurisdiction. For example, if a Japanese subsidiary of a UK Covered Entity were being resolved under the Japanese special resolution regime, would the transactions between the Japanese subsidiary and its counterparties be subject to the BRRD or the Japanese special resolution regime? How would the Proposed Rule operate and what resolution regime would apply if a Covered Entity were a UK subsidiary of a US entity that was subject to the special resolution regime in the United States? We strongly believe that the Proposed Rule should provide certainty regarding how the Proposed Rule would interact with other special resolution regimes and their application to entities within a multinational organization. Although questions regarding conflicts of law exist currently, we believe the Proposed Rule, if adopted, would present more opportunities for conflicts that regulators need to consider and clarify. Regulated funds are required by law to evaluate the risks associated with their counterparties and to exercise due care in selecting such counterparties. Evaluation of counterparty risk and careful selection of counterparties depend upon ensuring that regulated funds understand the regulatory schemes to which their counterparties are subject. If transactions with a counterparty could be subject to a stay upon the resolution of the counterparty or its affiliate, that is a relevant risk factor that a regulated fund must evaluate and, potentially, disclose to investors and report to its board of trustees. Similarly, if a stay may apply to some transactions but not others, it would be important for a regulated fund to understand precisely to which transactions the stay would apply. We request that the BOE and the PRA provide the clarification as requested to provide regulated funds and other counterparties the certainty they need to evaluate and mitigate risk and to disclose, if appropriate, such risks to their investors and boards of trustees. Financial Contracts Subject to Proposed Rule with a Covered Entity that is governed by the laws of a third country.⁷ ⁷ See Section 2.1 of the Proposed Rule. ICI Global Letter to Andrew Hoffman and Leanne Ingledew August 26, 2015 Page 5 of 7 - 5 - es of agreements that would be included ⁸ This lack of specificity creates risk both for Covered Entities and their counterparties (such as regulated funds). For example, it is not clear whether a third-country law-governed spot transaction in foreign exchange, an agreement to purchase a bank loan or an agreement to purchase an equity security on an exchange would be within the scope of the Proposed Rule. Regulated funds may be reluctant to engage in these transactions with any UK nexus if there is a lack of certainty regarding the applicability of

the stay under the Proposed Rule. Uncertainty of the scope of coverage of the Proposed Rule, as mentioned above, would not promote predictability that is critical during a resolution process. We recommend that the Proposed Rule include a list of agreements that would be covered under the Proposed Rule. 9 8 the types of agreements that would qualify. 9 -country law unless the counterparty to such UK entity has agreed in writing to be subject to similar restrictions on termination, acceleration, close-out, set-off and netting as would apply where the relevant firm is not a credit institution or investment firm, as though it were a credit institution or investment firm. ICI Global Letter to Andrew Hoffman and Leanne Ingledew August 26, 2015 Page 6 of 7 - 6 - Enforceability of Non-Compliant Contracts Implementation Period The effective date of the Proposed Rule would depend on the type of counterparty, and for regulated funds, the Proposed Rule would become effective on July 1, 2016. We agree with the BOE and the PRA that the effective date should be staggered according to the type of counterparty rather than by product type. We also agree that regulated funds and their asset managers should have more time than credit institutions and investment firms to comply with the new rules. We request that regulated funds and their managers be given a 12-month, rather than the 6-month, period of time to evaluate and sign contracts with the new provisions. As noted in the Consultation Paper, asset managers will need time to discuss these issues with all of their clients (including regulated funds), which will necessarily take time. Conclusion ICI Global appreciates that, to reduce systemic risk, regulators globally are seeking to administer efficiently and in an orderly manner the resolution of SIFIs. Cross-border recognition of stays supports this goal of regulators to resolve these institutions in an orderly fashion and to avoid market contagion. The Proposed Rule would prohibit Covered Entities from engaging in new or amending existing transactions with non-EU counterparties unless they agree to abide by a temporary stay under the BRRD. We believe, however, the Proposed Rule should be narrowly tailored to enforce the essential provisions of the BRRD and not change the reach of the BRRD. * * * ICI Global Letter to Andrew Hoffman and Leanne Ingledew August 26, 2015 Page 7 of 7 - 7 - /s/ Dan Waters Managing Director ICI Global +44 (0) 207 961 0831 cc: Lauren Anderson, Bank of England Ann Battle, Federal Deposit Insurance Corporation Felton Booker, Federal Reserve Board