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BRRD responses

DeAnna Green and Slawek Kozdras

Prudential Regulation Authority

20 Moorgate

London

EC2R 6DA

BRRD_CP_13_14@bankofengland.co.uk

BY E-MAIL

Ladies and Gentlemen

ISDA comments on the Prudential Regulation Authority's Consultation Paper CP13/14 on implementing the Bank Recovery and Resolution Directive, published July 2014

The International Swaps and Derivatives Association, Inc. (ISDA)¹ is grateful for the opportunity to provide input to the Prudential Regulation Authority's (PRA's) Consultation Paper (CP13/14) on the implementation of the Bank Recovery and Resolution Directive (BRRD), published 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 obligations of firms with respect to derivatives and other financial transactions, and the consequential impact on market counterparties to such financial transactions in the event that a firm goes in to resolution. 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 the PRA's proposals for the implementation of the BRRD.

However, in common with other stakeholders, we have some concerns with the PRA's proposed approach to implementation of requirements for contractual recognition of bail (i.e. Article 55 of the BRRD).

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

Given ISDA's remit we limit our response to Chapter 6 of the Consultation (contractual recognition of the bail-in tool):

The interpretation of Article 55 of the BRRD poses a number of difficult questions for affected firms. In particular, for parties to derivatives contracts, which are ordinarily documented under industry standard master netting agreements (such as the ISDA Master Agreement) and which, under Article 49 of the BRRD, can only be subject to bail-in after they have been closed out, the point in time at which the relevant liability is issued or entered into is not straightforward. To illustrate, a master agreement may have one derivative contract entered into on 1 January 2012, and a second on 1 February 2015; in the event that the derivatives are to be bailed-in, derivatives contracts one and two must each be closed-out and a single net sum determined. This first derivative contract is, prima facie, outside of the scope of Article 55. However, given that only the net sum can be bailed in, it would seem odd for recognition to be required on a contract by contract, and not on a master agreement, basis. These questions, and others, are being considered by the European Banking Authority (the EBA) in detail as they develop the regulatory technical standard (RTS) required by Article 55(3) of the BRRD.

Without any further guidance, whether in the form of the EBA RTS or (in advance of such RTS) PRA guidance, there is a risk that different firms will take considerably different approaches to the interpretation of Article 55, and proposed PRA Notification Rule 8.2 (the Proposed Rule).

ISDA therefore supports a two stage introduction process for the Proposed Rule, on the basis of its understanding that derivatives liabilities would fall into the second category of financial contracts, such that the Proposed Rule would not apply to derivatives contracts until 1 January 2016 (by which stage it is assumed that the EBA RTS will be in force).

In respect of the first category of financial contracts, ISDA notes that several debt market instruments issued during the course of 2014 and governed by non-EEA Member State laws (e.g. New York law) have included provisions which seek to meet the requirements of Article 55. However, others are better placed to respond to the impact of the PRA's proposals on such financial contracts.

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 the PRA in its work in relation to the effective implementation of the BRRD requirements.

Yours faithfully

Dr Peter M Werner
Senior Director
pwerner@isda.org

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
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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.

