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March 24, 2024 (v3)

Ms. Vanessa Countryman
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Mr. Chris Kirkpatrick
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Copy: U.S. Court of Appeals for 2nd Circuit "*In Re Lehman Brothers Special Financing, Inc. v. Branch Banking and Trust Company, et. al., Case Number 18-1079-bk (Lehman Brothers Litigates Flip Clause Enforceability Against the Whole Financial World for 10 Years)*"[1]; Prudential Regulation Authority, Bank of England; Deputy Governor, Financial Stability, Bank of England; Office of Credit Ratings, U.S. Securities and Exchange Commission; Credit Rating Supervision, U.K. Financial Conduct Authority; Supervision of Credit Rating Agencies, European

[1] See for example Fitch Ratings, "U.S. 'Flip Clause' Court Decision a Positive Signal for Structured Finance", *Fitch Wire*, 19 August 2020. **(https://www.fitchratings.com/research/structured-finance/us-flip-clause-court-decision-positive-signal-for-structured-finance-19-08-2020#:~:text=Fitch%20Ratings%2DLondon%2FNew%20York,based%20counterparties%2C%20Fitch%20Ratings%20says.)**.

Securities and Markets Authority; Institute of International Bankers (IIB); International Swaps and Derivatives Association (ISDA); Securities Industry and Financial Markets Association (SIFMA); Fitch Ratings; and S&P Global Ratings

Via Electronic Mail

Re: U.S. Securities and Exchange Commission Petition for Rulemaking "File No. 4-790" ("*I seek a rulemaking by the Commission that prohibits a security-based swap dealer or other entity subject to Commission regulation from predicating a security-based swap or other financial instrument subject to Commission regulation on a flip clause, walk-away, or variable subordination*")[2]
AND
U.S. Securities and Exchange Commission Petition for Rulemaking "File No. 4-799" (*Policy Clarification on Credit Rating Agencies*)[3]
AND
Commodity Futures Trading Commission "§ 13.1 Petition for Rulemaking of May 26, 2020" ("*prohibit a swap dealer . . . from predicating a swap obligation on a flip clause, walkaway, or variable subordination*")[4]
AND
Commodity Futures Trading Commission "Notice of Proposed Order and Request for Comment on an Application for a Capital Comparability Determination Submitted on Behalf of Nonbank Swap Dealers Subject to Capital and Financial Reporting Requirements of the U.K. and Regulated by the U.K. Prudential Regulation Authority (U.K. Swap Dealer Capital Comparability Determination)"[5]
AND
Commodity Futures Trading Commission "Market Risk Advisory Committee"[6]
AND
Moody's Ratings "Moody's Approach to Rating SF CDOs"[7]

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2 (https://www.sec.gov/rules/petitions/2022/petn4-790.pdf).
3 (https://www.sec.gov/rules/petitions/2023/petn4-799.pdf).
4 (https://croataninstitute.org/wp-content/uploads/2022/06/CFTC-WJH-2020-6-26-Sec-13.1-Rulemaking-Petition-Acknowledgment_WJHarrington_06-26-2020.pdf).
5 (https://www.cftc.gov/sites/default/files/2024/02/2024-02070a.pdf)
6 (https://www.cftc.gov/LawRegulation/FederalRegister/final-rules/2024-04070.html).
7 (https://ratings.moodys.com/rmc-documents/416198).

Dear All,

My name is Bill Harrington and I affiliate as Senior Fellow at Croatan Institute, a non-profit research and action institute.[8] I am among the few worldwide who publicly and candidly evaluate needlessly complex finance, most notably credit-rated asset-backed securities (ABS), structured debt, and derivative contracts such as the flip-clause-swap-contract.[9]

I work to boost the sustainability of the U.S. financial system with the dual aims of optimizing economic decision-making and preventing bailouts.[10] Most importantly, I advocate protecting the public interest by establishing robust governance in the financial sector, particularly regarding the capitalization, regulation, and credit ratings of needlessly complex finance.

This letter and the three other documents that the delivering email attach are a joint submission to the U.S. Securities Exchange Commission (SEC), to the Commodity Futures Trading Commission (CFTC), to the Bank of England (BoE), to the U.K. Financial Conduct Authority (FCA), to the European Securities and Markets Authority (ESMA), to Moody's Ratings (NRSRO Moody's), to Fitch Ratings (NRSRO Fitch), and to S&P Global Ratings (NRSRO S&P) regarding each of the seven title-line matters. Please post all four components of today's submission on all applicable sites.

The U.S., U.K., and EU public interests need today's submission with its insights that the SEC, CFTC, BoE, FCA, ESMA, and NRSROs Fitch, Moody's, and S&P have long known and long refused to use. For the same reason—longstanding refusal by the SEC, CFTC, BoE, FCA, ESMA, Fitch, S&P, and Moody's to do the right thing—the U.S., U.K., and EU public interests need *all* my work.

Why have I alone spoken *glaringly obvious truth* about the indefensible flip-clause-swap-contract? Why do the SEC, CFTC, BoE, FCA, ESMA, and NRSROs Fitch, Moody's, and S&P shirk responsibilities to the U.S., U.K., and EU public interests by disregarding the same glaringly obvious truth? What do the SEC, CFTC, BoE, FCA, ESMA, Fitch, Moody's, and S&P fear? The U.S., U.K., and EU are not China or Russia which jail and kill tellers of glaringly obvious truths, at least not yet. But the U.S., U.K., and EU *do* converge with China and Russia as financial regulators and other gatekeepers trash public interests of most people to protect the private interests of a few.

> "*I look forward to public comment on the comparability of the approaches and expect the Commission to publish additional analysis to address concerns raised by commenters as part of any final determination.*"[11]

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8 **(https://croataninstitute.org/).**

9 Harrington, Bill, "Sometimes, Holding the Line *is* Progress", *Croatan Institute View*, November 17, 2022. **(https://croataninstitute.org/2022/11/17/sometimes-holding-the-line-is-progress/).**

10 **(https://croataninstitute.org/2021/05/30/injecting-accountability-into-the-u-s-and-global-financial-systems/) and (https://croataninstitute.org/william-j-harrington/).**

11 CFTC, "Statement of Commissioner Christy Goldsmith Romero: Promoting the Resilience of Swap Dealers in the U.K. through Strong Capital Requirements and Reporting", 24 January 2024. **(https://www.cftc.gov/PressRoom/SpeechesTestimony/romerostatement012424).**

FLIP CLAUSE-SWAP-CONTRACT—THE ULTIMATE "CAPITAL DEPLETING ACTIVITY"

To start, today's joint submission urges five actions regarding the most under-capitalized of needlessly complex, credit-rated finance—namely, the indefensible flip-clause-swap-contract.

(1) The CFTC and the SEC must permanently ban the flip-clause-swap-contract in the U.S.

(2) The CFTC must condition a U.K. Capital Comparability Determination on an outright prohibition against dealers entering the flip-clause-swap-contract.

(3) In assigning credit ratings to U.S. and non-U.S. ABS, re-packaged securities, and all debt that references a second, separate obligor, Fitch Ratings, Moody's Ratings, and S&P Global Ratings must overhaul respective in-use and active criteria / methodologies *to significantly decrease credit ratings where an issuer is party to a flip-clause-swap-contract*. In plain language, debt of an issuer that is party to a flip-clause-swap-contract must always have a lower credit rating than otherwise similar debt of an otherwise similar issuer that is NOT party to a flip-clause-swap-contract.

(4) Fitch Ratings, Moody's Ratings, and S&P Global Ratings must overhaul respective in-use and active criteria / methodologies to track ALL issuers of U.S. and non-U.S. ABS, re-packaged securities, and debt that references a second, separate obligor worldwide that are parties to flip-clause-swap-contracts, and *significantly decrease recovery rates for the associated flip-clause-swap-contract dealers*.

(5) "*Amplifying international comity*" and "*advancing international harmonization"* are two-way streets! For each flip-clause-swap-contact that a regulated entity provides, the BoE Prudential Regulation Authority (BoE PRA) must impose a capital charge >= [100% of mark-to-market contract value plus a volatility add-on].

Today's joint submission urges sixth, seventh, and eighth actions regarding CFTC enactment of demonstrably harmful policies that prioritize tertiary considerations such as "*amplifying international comity*" and "*advancing international harmonization*" rather than the paramount consideration of implementing best-in-world policies that amplify, advance, and protect the U.S. public interest. Chief among best-in-world policies that amplify, advance, and protect the U.S. public interest are the U.S. prudential regulators' swap margin and capital rules.

(6) To protect U.S. persons, U.S. regulated entities, and the U.S. economy, the CFTC must scrap tertiary considerations such as *"amplifying international comity*" and "*advancing international harmonization*" as rationales for enacting policies that harm the U.S. public interest by diverging from U.S. prudential regulator rules.

(7) To protect U.S. persons, U.S. regulated entities, and the U.S. economy, the CFTC must prioritize "*amplifying U.S. regulator comity*" and *"harmonizing with U.S. prudential*

regulators best practice*" in policymaking for the flip-clause-swap-contract such as swap margin and capital rule. *Accordingly, the CFTC must withdraw the U.K. Swap Dealer Capital Comparability Determination Proposal.

(8) In assigning credit ratings to sovereigns, Fitch Ratings, Moody's Ratings, and S&P Global Ratings must overhaul respective criteria / methodologies to *significantly increase credit losses and default probabilities where policymakers prioritize tertiary considerations "amplifying international comity" and "advancing international harmonization" to enact deficient policies that harm their people, regulated entities, economies, and public interest.*

Today's joint submission urges ninth and tenth actions to reconcile the paramount consideration of implementing best-in-world regulation with tertiary considerations "*amplifying international comity*" and "*advancing international harmonization*".

(9) The CFTC must advise the BoE, BoE PRA, and FCA that "*amplifying international comity*" and "*advancing international harmonization*" are two-way streets. Where U.S. regulations such as the prudential regulators' swap margin and capital rules are demonstrably best-in-world, the CFTC must urge U.K. regulators to adopt equally good, best-in-world regulations and not expect the CFTC to dilute its regulations.

(10) The BoE, BoE PRA, and FCA must adopt best-in-world regulation pertaining to the flip-clause-swap-contract and other needlessly complex-finance by harmonizing currently middling-to-poor U.K. regulations with U.S. prudential regulators' superlative swap margin and capital rules.

The immediate impact will be that U.K. dealers stop providing new flip-clause-swap-contracts.

For existing contracts, U.K. regulators must ensure that a dealer is adequately capitalized by doing the following:
-- *Track each flip-clause-swap-contract* that a dealer provides;
-- *Assess all contract terms*;
-- *Assign conservative likelihood of NO NOVATION* to each flip-clause-swap-contract, based on *realistic* evaluation of novation provisions; and
-- *Impose capital charge that assumes 100% correlation of flip clause activation* against a dealer for *ALL* in-the-money flip-clause-swap-contract everywhere in the world.

Today's joint submission urges more CFTC, U.K. regulatory, and NRSRO actions throughout.

"The Big Short" Shortchanged the Flip-Clause-Swap-Contract That Shortchanges the World.

"*There Are None So Blind as Those Who Will Not See*."[12]

"*Partly owing to the outsized losses that the Lehman Brothers Special Financing [LBSF]* ***flip-clause-swap-contract portfolio*** *[emphasis added] incurred, LBSF creditors received lower recoveries than other Lehman creditors.*"[13]

"***The flip clause*** *[emphasis added] is included in a structured finance priority of payments to protect noteholders from effects of a bankruptcy filing by a swap counterparty. Amounts payable by the issuer to a swap counterparty typically take priority over amounts payable to noteholders, except for the swap termination payments resulting from the bankruptcy of the swap counterparty.* ***The court's decision confirmed the issuer's right to terminate the swaps taking into account the payment priority consistent with the relevant flip clauses*** *[emphasis added].*"[14]

"*In funded synthetic SF CDOs, the default of a counterparty may also result in a senior-ranking termination payment that is payable by the issuer. We determine the likelihood of such a payment for each transaction given all relevant factors,* ***including (1) the rating and domicile of the counterparty and (2) the existence and enforceability of the priority of payments (including a 'flip clause' by which payments to the counterparty are to be subordinated following counterparty default)*** *[emphasis added]. . . . If for any transaction, there were a material likelihood that the issuer would be required to make a material senior termination payment following counterparty default, we would likely cap the rating of the transaction to the rating of the counterparty as described in section 4.1.2 for collateral risk.*"[15]

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[12] English proverb that continues "*The most deluded people are those who choose to ignore what they already know.*"

[13] Harrington, William J. "Motion to File Proposed Amicus Curiae Brief to the US 2nd Circuit 'Re: Case No. 18-1079-bk (Lehman vs 250 Financial Entities Re Flip Clause Enforceability)'", 25 June 2019, p22. **(https://croataninstitute.org/wp-content/uploads/2021/06/WJH-Motion-to-File-Amicus-Brief-in-2nd-Circuit-Case-18-1079-bk-Lehman-Brothers-vs-the-World.pdf)**.

[14] Fitch Ratings, "U.S. 'Flip Clause' Court Decision a Positive Signal for Structured Finance", *Fitch Wire*, 19 August 2020. (See Footnote 1 for link).

[15] Moody's Ratings, "Moody's Approach to Rating SF CDOs", *Rating Methodology*, 4 March 2024, p15. **(https://ratings.moodys.com/rmc-documents/416198)**.

Re UK Capital Comparability Determination, the CFTC Must Learn the Following and Repropose:

(1) For dealer credit ratings, does Fitch Ratings incorporate **the full extent** of loss of priority of "*swap termination payments resulting from the bankruptcy of the swap counterparty"*?

(2) Do U.K. swap capital and margin requirements for dealers incorporate **the full material likelihood** of loss of priority of "*swap termination payments resulting from the bankruptcy of the swap counterparty"*?

(3) What "*material likelihood*" does Moody's Ratings assign to a U.K. issuer being "*required to make a material senior termination payment following counterparty default?* For credit ratings of the contract dealer, does Moody's incorporate the reciprocal "*material likelihood*" that the dealer **will not receive** a "*senior termination payment"*?

(4) Do U.K. swap capital and margin requirements for dealers incorporate the **full material likelihood** that a defaulted flip-clause-swap-contract dealer to a U.K. issuer **will not receive** a "*senior termination payment"*?

(5) Does Moody's Ratings recognize that, for a flip-clause-swap-contract, capping "*the rating of the transaction to the rating of the counterparty"* **introduces an infinite loop of interdependence** that requires lowering "*the rating of the counterparty"*, which in turn requires lowering "*rating of the transaction [capped] to the rating of the counterparty"*, and so on, and so on, and so on?

(6) Do U.K. prudential regulators recognize that **credit rating companies inflate credit ratings of both parties to a flip-clause-swap-contract** by many means, including by ignoring the interdependence of issuer and dealer credit ratings on each other?

I made many of the same proposals as on pages 4-5 herein, and posed several of the questions immediately above, in my joint submission to the SEC and the CFTC regarding the CFTC ***EU*** Swap Dealer Capital Comparability Determination and fourteen related matters of August 28, 2023. The entirety of that joint submission supports today's joint submission.[16]

Earlier still, I made many of the same proposals as on pages 4-5 herein, and posed several of the questions immediately above, in my joint submission to the SEC and the CFTC regarding the CFTC ***Japan*** Swap Dealer Capital Comparability Determination and five related matters of October 20, 2022. The entirety of that joint submission supports today's joint submission.[17]

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[16] Harrington, William J., "Joint Submission to the SEC and the CFTC Regarding Fifteen Topics Pertaining to the Flip-Clause-Swap-Contract", August 28, 2023. **(https://www.sec.gov/comments/4-790/4790-271019-653762.pdf).**

[17] Harrington, William J., "Joint Submission to the SEC and the CFTC Regarding Six Topics Pertaining to the Flip-Clause-Swap-Contract", October 20, 2022. **(https://www.sec.gov/comments/4-790/4790-20147063-312602.pdf).**

Today's joint submission irrefutably demonstrates that the flip-clause-swap-contract is, by design, grossly under-capitalized and intrinsically destructive. The contract undermines social compacts around the world by directing investment to sub-optimal uses, by eroding value of ABS and other structured debt, by incentivizing swap dealers to self-sabotage by under-resourcing themselves, and by generating public bail-outs.

Today's joint submission also irrefutably demonstrates that nearly all financial regulators, credit rating staff, and complex-finance practitioners worldwide have ***knowingly and intentionally*** undermined social compacts for decades by mutely going with the flip-clause flow rather than speaking out and applying what they know.

The three additional documents that comprise today's joint submission are:

(1) *Moody's Ratings* Methodology "Moody's Approach to Rating SF CDOs", 4 March 2024
(2) "WJH—CV—Q1 2024"
and
(3) *Moody's* Pre-Sale Report "Elstree Funding No.3 PLC", 9 March 2023.

Please make today's joint submission—all four documents—publicly available on the respective sites for the seven title-line matters.

Dealmakers outside the U.S. use the flip-clause-swap-contract to assemble ABS and other structured deals on the cheap.[18] From the get-go, each artificially "cheap" deal with an under-capitalized contract distorts price signals and investment for all types of projects. As in 2008, the deals and contracts can implode and tax everyone with bail-outs, deferred investment, and accelerated social fragmentation.[19]

> "*The flip-clause-swap-contract was a root cause of the 2008 global financial catastrophe. The flip-clause-swap-contract was an integral component of the under-capitalized structured debt that started, fueled, and pro-longed the 2008 financial catastrophe. The flip-clause-swap-contract was a tool that financial institutions such as AIG, Bear Stearns, Lehman Brothers, and many others used to under-capitalize themselves.* ***The flip-clause-swap-contract was a tool that Greece, with the active assistance of Goldman Sachs, used to crash its own economy*** [emphasis added]."[20]

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[18] The following 30 U.K. (blue-shaded) and other swap dealers provided one (or more) *new* flip-clause-swap-contracts during the period October 2022 to May 2023, based on WJH daily review of Moody's Investors Service Pre-Sale Reports and S&P Global Ratings Presales: ABN AMRO (1); ANZ (2); Barclays (1); BMO (1); BNP Paribas (8); BNZ (2); Citi (1); Coventry Building Society (2); Credit Agricole (2); DZ Bank (2); HSBC (1); ING (7); Investec (15); J.P. Morgan (2); Lloyds Bank (3); Merrill Lynch International (1); National Australia Bank (9); Natixis (2); NatWest (1); Nedbank (1); RBC (3); RCI Bank and Services (4); Santander (3); Scotiabank (3); SEB (7); SMBC Group (1); Standard Chartered Bank Korea (1); Toronto Dominion (1); UniCredit (1); and Westpac (1).

[19] "Op. Cit. Harrington Motion to File 'Lehman vs 250 Financial Entities Re Flip Clauses'", in total.

[20] Harrington, William J., "Electronic Letter to U.S. Commodity Futures Trading Commission, European Securities and Markets Authority, DBRS Morningstar, Fitch Ratings, Moody's Investors

"*The flip-clause-swap-contract was central to the EU financial crisis. Even so, EU issuers of RMBS and other ABS use the flip-clause-swap-contact under policy that the US has prudently rejected. As evidence, the US economy habitually outperforms the EU. Also, our social compact rejects bailing out financial companies again, whereas the EU tolerates public support for private entities.*"[21]

Welcome Flip-Clause-Swap-Contract Trainees New and Old, One and All!

"*Does every structured issuer around the world still undercapitalize debt when party to a flip-clause-swap-contract?*

"*Does every provider of a flip-clause-swap-contract around the world still undercapitalize its self-referencing exposure to 100% loss of contract value under each flip clause?*"[22]

I am pleased to add new addressees to my two-decades-and-counting tutorial on the systemically disastrous flip-clause-swap-contract.[23]

Chins up, Newbies! Stay strong though today's submission shows that you degrade the public good day in and decade out. After all, permanent rookies such as Mr. Thomas Smith (CFTC Deputy Director), Mr. Rafael Martinez (CFTC Associate Director), Ms. Sarah Breeden (BoE Deputy Governor, Financial Stability), Ms. Stephanie Webster (General Counsel, IIB), Mr. Steven Kennedy (Global Head of Public Policy, ISDA), Ms. Kyle Brandon (Managing Director, Head of Derivatives

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Service, and S&P Global Ratings 'Re: Deficient Accounting, Capitalization, Credit Ratings, and Regulation of EVERY Party to a Swap Contract with a Flip Clause or Other Walk-Away Provision", December 28, 2020, "Questions for the CFTC, the SEC, the SFA, LSTA, DBRS, Fitch, Moody's, and S&P Global", p3. **(https://croataninstitute.org/wp-content/uploads/2021/09/20201228_Harrington_J_William_Flip_Clause_Questions_to_CFTC-SEC-LSTA-SFA-DBRS-Fitch-Moodys-SP.pdf).**

[21] Harrington, William J, "Proposed Amicus Curiae Brief to the US 2nd Circuit 'Re: Case No. 18-1079-bk (Lehman vs 250 Financial Entities Re Flip Clause Enforceability)'", 25 June 2019, p38. **(https://croataninstitute.org/wp-content/uploads/2021/06/18-1079-bk-WJH-08-08-19-Letter-to-US-Court-of-Appeals-for-Second-Circuit-Proposed-Amicus-Curiae-Brief-Re-Case-No-18-1079.pdf)**.

[22] "Op. Cit. Harrington Electronic Letter to CFTC, ESMA, and Four NRSROs, December 28, 2020", "Questions for the CFTC, the SEC, the SFA, LSTA, DBRS, Fitch, Moody's, and S&P Global" Nos. 2 and 3, p15. **(https://croataninstitute.org/wp-content/uploads/2021/09/20201228_Harrington_J_William_Flip_Clause_Questions_to_CFTC-SEC-LSTA-SFA-DBRS-Fitch-Moodys-SP.pdf).**

[23] "Op. Cit. Harrington Motion to File 'Lehman vs 250 Financial Entities Re Flip Clauses'", in total. Also, Harrington, Bill, "Can Green Bonds Flourish in a Complex-Finance Brownfield?", Croatan Institute *Working Paper*, July 2018, in total. **(https://croataninstitute.org/2018/07/01/can-green-bonds-flourish-in-a-complex-finance-brownfield/).**

Policy, SIFMA), all credit rating addressees, and many, many other practitioners the world over do exactly that, namely degrade the public good day in and decade out![24]

As Mr. Smith, Mr. Martinez, Ms. Breeden, Ms. Webster, Mr. Kennedy, Ms. Brandon, former Moody's chums, their credit rating "competitors", and all reluctant learners can attest, I am among the few worldwide to rigorously assess the proliferation of gaping credit exposures that a flip-clause-swap-contract generates for a U.K. or other non-U.S. ABS or structured debt issuer, for a U.K. or other non-U.S. swap dealer, for a U.K. or other non-U.S. economy, for broader financial systems, and for other sovereigns. Further, I am the *only* one worldwide who publicly posts and disseminates *all* rigorous assessments of the proliferation of gaping credit exposures that a flip-clause-swap-contract generates for a U.K. or other non-U.S. ABS or structured debt issuer, for a U.K. or other non-U.S. swap contract dealer, for a U.K. or other non-U.S. economy, for broader financial systems, and for other sovereigns.[25]

Financial Practitioners Worldwide Honor My Best-Practice Work in the Breach

> "*Since resigning [as Moody's Investors Service senior vice president] in 2010, I have taught myself to be a public-citizen advocate by following financial practitioner leads in speaking to media, co-authoring academic papers and op-eds, and submitting public responses to proposals to regulate and assign credit ratings to complex-finance bonds. However, I break from industry practice in working entirely in the public domain, whereas industry representatives augment public relations with closed-door, off-the-record meetings with policymakers.*"[26]

Almost solely owing to my work, the CFTC, SEC, BoE, NRSROs Fitch, Moody's, S&P, the IIB, ISFA, SIFMA, and many, many, many other entities and people worldwide who should fully appreciate the proliferation of gaping credit exposures that a flip-clause-swap-contract generates for a U.K. or other non-U.S. ABS or structured debt issuer, for a U.K. or other non-U.S. swap contract dealer, for an U.K. or other non-U.S. economy, for broader financial systems, and for other sovereigns ***do*** fully appreciate the proliferation of gaping credit exposures.

Unfortunately for U.K. and other non-U.S. peoples, for U.K. and other non-U.S. economies, for U.K. and other non-U.S. swap contract dealers, for U.K. and other non-U.S. ABS and structured debt issuers, for broader financial systems, and for other sovereigns, the BoE, NRSROs Fitch, Moody's, S&P, the IIB, ISDA, SIFMA, and many, many, many other entities and people worldwide

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[24] Regarding Ms. Sarah Breedon as permanent rookie viz-a-viz the flip-clause-swap-contract, see "WJH and Bank of England Staff -- Flip Clause Meeting and Correspondence -- 31 May 2014 to 26 June 2019". **(https://www.sec.gov/comments/4-790/4790-195119-387602.pdf).**

[25] See Footnote 20.

[26] "Op. Cit. Harrington 'Sometimes, Holding the Line *is* Progress'". **(https://croataninstitute.org/2022/11/17/sometimes-holding-the-line-is-progress/).**

who should and do fully appreciate the proliferation of gaping credit exposures that each flip-clause-swap-contract generates ***will not*** mitigate the exposures, not even by a smidgen.[27]

> "*Among complex-finance practitioners such as accountants, bankers, bond analysts, and legal counsel, the swap-contract-with-flip-clause is an unacknowledged open secret. No financial practitioner does defensible work on the contract because all practitioners that use the contract deliberately ignore deficiencies that stare them in the eye. The global credit rating companies Fitch Ratings, S&P Global Ratings, and my former employer Moody's Investors Service amplify the 'see no evil' approach in posting credit ratings and methodologies for practitioners the world over to exploit. Extending the systemic damage, Fitch, Moody's, and S&P are swamping ESG rating and analyses with the same 'see no evil' methods.*"[28]

Goldman, BoA, and Citi Don't Need *EXEMPTIONS* to Flout U.S. Derivative Rules

> "*This week, the CFTC issued three orders imposing civil monetary penalties of over $50 million combined in actions involving several of the largest financial institutions in our nation and several of the most significant institutions in global swaps markets—**JP Morgan Chase Bank, N.A**. and affiliated entities; **Bank of America, N.A.** and **Merrill Lynch International**; and **Goldman Sachs & Co. LLC."*** [29]
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> "*U.S. regulators have asked Citigroup for urgent changes to the way it measures default risk of its trading partners and the bank's own auditors have found a plan to improve internal oversight to be lacking . . .*
> II
> "*The content of the three Matters Requiring Immediate Attention . . . have deadlines of six months to a year, the source said.* ***They instruct Citi to improve its data and***

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[27] "Op. Cit. Harrington Electronic Letter to CFTC, ESMA, and Four NRSROs, December 28, 2020", "*Financial Sector Apologists, Enablers, Cowering ChurchMice, and Fence-Sitters Also Know All About All the Myriad Flip Clause Problems*", pp7-11. (**https://croataninstitute.org/wp-content/uploads/2021/09/20201228_Harrington_J_William_Flip_Clause_Questions_to_CFTC-SEC-LSTA-SFA-DBRS-Fitch-Moodys-SP.pdf).**

[28] "Op. Cit. Harrington 'Sometimes, Holding the Line *is* Progress'". **(https://croataninstitute.org/2022/11/17/sometimes-holding-the-line-is-progress/).**

[29] CFTC, "Statement of Commissioner Kristin N. Johnson on Mitigating the Systemic Risks of Swap Data Reporting Compliance Failures and Enhancing the Effectiveness of Enforcement Actions", *Public Statements and Remarks*, September 29, 2023. **(https://www.cftc.gov/PressRoom/SpeechesTestimony/johnsonstatement092923b).**

> ***governance around how it sets aside capital to account for counterparty credit risks*** *[emphasis added] . . ."*[30]

To protect U.S. persons, U.S. regulated entities, and the U.S. economy, Commissioner Caroline D. Pham must recuse from voting on the U.K. Capital Comparability Determination considering her seven-plus year history at Citi and the benefits that the determination would provide Citigroup Global Markets Holdings Inc.[31]

To protect U.S. persons, U.S. regulated entities, and the U.S. economy, if Commissioner Caroline D. Pham does not recuse from voting on the U.K. Capital Comparability Determination, the Commission must recuse her from voting on the U.K. Capital Comparability Determination considering her seven-plus year history at Citi and the benefits that the determination would provide Citigroup Global Markets Holdings Inc.

To protect U.S. persons, U.S. regulated entities, and the U.S. economy, the CFTC must withdraw the U.K. Swap Dealer Capital Comparability Determination.

To protect U.S. persons, U.S. regulated entities, and the U.S. economy, the CFTC must prioritize "*amplifying U.S. regulator comity*" and "*harmonizing with U.S. prudential regulators best practice*" in policymaking for swap margin and capital such as that for the flip-clause-swap-contract and the U.K. Swap Dealer Capital Comparability Determination.

To protect U.S. persons, U.S. regulated entities, and the U.S. economy, the CFTC must insist that Goldman Sachs, Citi, Bank of America, and all swap dealers scrupulously respect existing rules for the next few decades.

To protect U.S. persons, U.S. regulated entities, and the U.S. economy, the CFTC must determine that Goldman Sachs, Citi, Bank of America, and all swap dealers *have* scrupulously respected existing rules for the past few decades. Then, and only then, may the CFTC propose policies that depart from prudential regulators' best-practice.

> "*I support this CFTC enforcement case against Goldman Sachs, the fourth case against Goldman in my 18-month tenure at the CFTC. I commend our staff for uncovering the pervasive and persistent violations of the law by Goldman in its over-the-counter derivatives business known as swaps.* ***However, I cannot support the settlement, as it is not strong enough to achieve the goals of law enforcement—justice, accountability, and deterrence*** *[emphasis added].*
>
> **"*Over and Over Again: Goldman's Corporate Culture of Violating Federal Laws, Getting Caught, and Settling Federal Enforcement Cases***

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30 Bautzer, Tatiana, Saeed Azhar, and Lananh Nguyen, "Exclusive: Citi hit by new Fed rebuke, setbacks on consent orders", *Reuters*, 12 February 2024. **(https://www.reuters.com/business/finance/citi-hit-by-new-fed-rebuke-setbacks-consent-orders-2024-02-12/).**

31 **(https://www.linkedin.com/in/carolinedpham/).**

> "*As a longstanding federal enforcement official, I am significantly concerned that Goldman is a repeat defendant in federal enforcement cases. Goldman has a long history of violating federal laws, getting caught, and then settling with federal agencies.*"[32]

ISDA and SIFMA *ENDORSED* WJH Flip-Clause-Swap-Contract Work; *STILL* Push CFTC to OK *MORE* Deficient Complex Finance for BoA, Citi, Goldman Sachs, Morgan Stanley, and 12 Others

> "*Four of the swap dealers who would be able to avail themselves of our determination today are affiliated with the largest Troubled Asset Relief Program recipients. That fact alone is a good reminder of what is at stake in terms of risk. It is not just danger to financial institutions, but also American families and businesses.* ***Under this proposal in addition to the Commission's three prior capital comparability proposals, 16 of 106 registered swap dealers would be eligible to rely on substituted compliance*** *[emphasis added].*"[33]

In 2005-2006, Moody's colleagues and I produced what is to-date the only rigorous, comprehensive credit rating methodology for the flip-clause-swap-contract (Moody's 2006 Hedge Framework). SIFMA and ISDA, which along with the IIB requested the U.K. Capital Comparability Determination, appended Moody's 2006 Hedge Framework to a 2017 amicus curiae brief in major litigation concerning the flip-clause-swap-contract that pitted Lehman Brothers against many major financial entities worldwide.[34],[35]

In short, SIFMA and ISDA argue both sides of the flip-clause coin.

> "*In a closely-related instance of financial practitioners devoting resources to offload CSE [covered swap entity] exposures onto the U.S. public, the IIB, SIFMA, and ISDA urge the CFTC to not only approve a deficient comparability determination for Japan capital rules,*

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[32] CFTC, "Concurring Statement of CFTC Commissioner Christy Goldsmith Romero on CFTC v. Goldman Sachs Over and Over Again", *Public Statements and Remarks*, September 29, 2023. **(https://www.cftc.gov/PressRoom/SpeechesTestimony/romerostatement092923c).**

[33] "Op. Cit. Commissioner Christy Goldsmith Romero: 'Promoting U.K. Swap Dealer Resilience Through Strong Capital Requirements", 24 January 2024.

[34] IIB, ISDA, and SIFMA, "Electronic Submission to the CFTC 'Re: Substituted Compliance Application for U.K. Swap Dealers from CEA Sections 4s(e)–(f) and Rules 23.101 and 23.105(d)–(e), (p)(2) (IIB, ISDA, SIFMA Application)'", 4 May 2021. **(https://www.cftc.gov/PressRoom/PressReleases/8852-24).**

[35] Manchester, Edward, Bill Harrington, and Nicholas Lindstrom, "Framework for De-Linking Hedge Counterparty Risks from Global Structured Finance Cashflow Transactions—Structured Finance Rating Methodology", *Moody's Investors Service*, May 25, 2006, in "Brief of SIFMA and ISDA in Support of Defendants-Appellees and Affirmance Re: U.S. District Court for the Southern District of New York, Case No. 17-cv-1224-LGS, Lehman Brothers Special Financing, Inc. against Bank of America, National Association and all", June 16, 2017, Exhibit A. **(https://www.sifma.org/wp-content/uploads/2017/06/LehmanBrothers061617.pdf)**.

> *but also to produce 'the same answer in reference to the currently pending capital substituted applications for Mexico, the European Union and the United Kingdom.' Meanwhile, SIFMA and ISDA have also devoted significant resources to advocate that the flip clause impose 100% loss of contact value on a defaulted swap provider. The logical conclusion of the latter SIFMA-ISDA argument supports the entirety of this submission. Every SIFMA and ISDA member that provides the swap contract with flip clause anywhere in the world negligently undercapitalizes itself since no member offsets the 100% loss of mark-to-market asset that each contract imposes."*[36]

The 2017 SIFMA-ISDA brief urged the court to uphold an earlier ruling that imposed losses equal to 100% of mark-to-market on 100% of Lehman Brothers flip-clause-swap-contracts. SIFMA and ISDA freely conceded that dealers continue to under-resource flip-clause-swap-contracts and, by implication, may well wreak Lehman-Brothers-type havoc in the future.

> "*SIFMA's and ISDA's members do not have a uniform financial interest in the outcome of this lawsuit*. ***Indeed, should they one day find themselves in bankruptcy, certain of SIFMA's and ISDA's members might well benefit from rulings in this proceeding favorable to Lehman. SIFMA and ISDA nonetheless submit this brief as amici curiae supporting the position of the Appellees because they and their members seek the certainty, finality and assurances of market stability that the Bankruptcy Code safe harbor provisions were intended to provide*** *[emphasis added]."*[37]

Today, SIFMA, ISDA, and IIB blithely advocate that as many CFTC-regulated entities as possible under-capitalize by providing flip-clause-swap-contracts in the U.K., Japan, the EU, and Mexico and, by implication, wreak Lehman-Brothers-type havoc on the peoples, economies, and public good of the U.K., Japan, the EU and Mexico, and, above all, the U.S.!

> IIB, ISDA, and SIFMA "*believe a similar analysis leads to the same answer in reference to the currently pending capital substituted applications for Japan, Mexico and the EU.*"[38]

To help the CFTC issue a useful U.K. Capital Comparability Determination—as well as a useful Japan Capital Comparability Determination, a useful EU Capital Comparability Determination, and a useful Mexico Capital Comparability Determination—SIFMA, ISDA, and the IIB ***should have***

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[36] "Op. Cit. Harrington Joint SEC and CFTC Submission October 20, 2022", p15. **(https://www.sec.gov/comments/4-790/4790-20147063-312602.pdf).**

[37] "SIFMA and ISDA Op. Cit. 'Proposed Amicus Curiae Brief in Support of Defendants and Affirmance in LBSF vs Bank of America NA et al., (Case No. 17-cv-1224-LGS, Document 87)'", p5.

[38] IIB, ISDA, and SIFMA, "Notice of Proposed Order and Request for Comment on an Application for a Capital Comparability Determination Submitted on Behalf of Nonbank Swap Dealers Subject to Capital and Financial Reporting Requirements of the United Kingdom and Regulated by the United Kingdom Prudential Regulation Authority", p4, 22 March 2024. **(https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=73394&SearchText=).**

reminded the CFTC that a flip-clause-swap-contract acts in direct opposition to Tier 2 capital. To wit, in the event of an entity's insolvency, every single, solitary flip-clause-swap-contract that is an asset to the insolvent entity instantly vaporizes. To help the CFTC issue a useful U.K. Capital Comparability Determination—as well as a useful Japan Capital Comparability Determination, a useful EU Capital Comparability Determination, and a useful Mexico Capital Comparability Determination—SIFMA, ISDA, and the IIB ***should have*** included ***something, anything*** about the flip-clause-swap-contract.[39],[40]

To help itself issue a useful U.K. comparability determination—let alone a useful Japan Capital Comparability Determination, a useful EU Capital Comparability Determination, and a useful Mexico Capital Comparability Determination—the CFTC should have asked SIFMA, ISDA, and the IIB ***something, anything*** about the flip-clause-swap-contract.[41] Likewise, the CFTC should have included ***something, anything*** about the flip-clause-swap-contract in the U.K. Swap Dealer Capital Comparability Determination.[42]

> "*I look forward to public comment on the comparability of the approaches and expect the Commission to publish additional analysis to address concerns raised by commenters as part of any final determination.*"[43]

To help itself, the U.S. people, the U.S. economy, and the U.S. public good, the CFTC must withdraw the U.K. Capital Comparability Determination, the EU Capital Comparability Determination, the Japan Capital Comparability Determination, and the Mexico Capital Comparability Determination, ask more questions, publicize the responses and analyses, and either propose a rigorous capital comparability determination for each domicile or drop the matter altogether and leave regulated entities subject to CFTC capital rules.

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39 "Op. Cit. IIB, ISDA, and SIFMA Application for U.K. Capital Comparability Determination 4 May 2021", See absence of "*flip clause*" throughout. **(https://www.cftc.gov/PressRoom/PressReleases/8852-24).**

40 IIB, ISDA, and SIFMA, "Notice of Proposed Order and Request for Comment on an Application for a Capital Comparability Determination Submitted on Behalf of Nonbank Swap Dealers Subject to Capital and Financial Reporting Requirements of the United Kingdom and Regulated by the United Kingdom Prudential Regulation Authority", 22 March 2024. See absence of "*flip clause*" throughout. **(https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=73383&SearchText=).**

41 SIFMA, "Follow-up Questions: re:, CFTC Staff Questions Regarding Substituted Compliance Application for UK Swap D, "ealers from CEA Sections 4s(e)–(f) and Rules 23.101 and 23.105(d)–(e), (p)(2)", 5 October 23. See absence of "*flip clause*" throughout. **(https://www.cftc.gov/LawRegulation/DoddFrankAct/CDSCP/index.htm).**

42 "Op. Cit. U.K. Swap Dealer Capital Comparability Determination". See absence of "*flip clause*" throughout. **(https://www.cftc.gov/sites/default/files/2024/02/2024-02070a.pdf).**

43 "Op. Cit. Commissioner Christy Goldsmith Romero: 'Promoting U.K. Swap Dealer Resilience Through Strong Capital Requirements'", 24 January 2024.

To start, the CFTC may pose two simple questions to each of the 16 regulated entities that the U.K. Capital Comparability Determination, or the EU Capital Comparability Determination, or the Japan Capital Comparability Determination, or the Mexico Capital Comparability Determination would cover.

1) **How much would the applicable capital comparability determination reduce required capital? What is the existing CFTC capital requirement and what is the requirement under the capital comparability determination?**

2) **How many flip-clause-swap-contracts are booked? Why shouldn't the CFTC condition a capital comparability determination on an outright prohibition on entering a flip-clause-swap-contract?**

<u>Credit Raters Breach Honest Evaluation of Needlessly Complex Finance & Sovereign Enablers</u>

"Credit Rating Companies that Earn from Bad History are Groomed to Repeat It"

Fitch Ratings, Moody's Ratings, and S&P Global Ratings point-blank *refuse* to publicly post rigorous assessments of the proliferation of gaping credit exposures that a flip-clause-swap-contract generates for a U.K. or other ABS or structured debt issuer, for a U.K. or other swap dealer, for U.K. and other economies, for broader financial systems, and for other sovereigns, including the U.S. as ultimate stabilizer of financial systems worldwide. Instead, Fitch, Moody's, and S&P *knowingly and intentionally inflate credit ratings* for ***ALL*** ABS and other structured debt of issuers worldwide that are party to a flip-clause swap-contract, for ***ALL*** contract dealers worldwide, for **ALL** U.K. and non-U.S. sovereigns that enable issuers or dealers to enter the contract, for broader financial systems, and **for other sovereigns, including the U.S.** as ultimate stabilizer of financial systems worldwide.

I resigned as Moody's Investors Service senior vice president in July 2010 after declining an unsolicited offer to join the credit policy group that compels complex-finance analysts to deliver and strictly apply *issuer-friendly* methodologies, including for the flip-clause-swap-contract. Why decline-and-resign? Because Moody's studiously *ignored* the centrality of the flip-clause-swap-contract to the 2008 calamity and just as studiously *refused* to rigorously assess the proliferation of gaping credit exposures that a flip-clause-swap-contract generates for an ABS or structured debt issuer anywhere in the world, for a swap dealer anywhere in the world, for local economies, for broader financial systems, and for sovereigns, especially the U.S. as ultimate financial stabilizer.

In May 2011, NRSRO Moody's refused to rigorously assess the proliferation of gaping credit exposures that a flip-clause-swap-contract generates for a swap dealer.

> "*Thank you for your comments concerning Moody's bank rating methodology [regarding credit exposures that the flip-clause-swap-contract generates]. We appreciate your*

sharing them with us and will give them appropriate consideration. We understand that you have contacted several Moody's employees to provide your comments . . . You are welcome to direct any further comments directly to me, and I will make sure that they are shared with the relevant rating and credit policy personnel."[44]

After scrapping Moody's 2006 Hedge Framework in November 2013 because the framework's comprehensive rigor hurt business, NRSRO Moody's posted increasingly diluted, willfully negligent successor methodologies that minimized the proliferation of gaping credit exposures that each flip-clause-swap-contract generated for an ABS or other structured debt anywhere in the world and *entirely ignored* the gaping credit exposures that each contract generated for a swap dealer anywhere in the world.

In September 2017, Fitch Ratings refused to rigorously assess the proliferation of gaping credit exposures that each flip-clause-swap-contract generated for student loan company Navient, for its ABS, and for its swap contract dealers, including U.K. dealers.

"*Thanks for sending this along. We will look into the issue.*"[45]

In April and in May 2018, S&P Global Ratings refused to acknowledge, let alone rigorously assess, U.S. CLO credit exposures to poor governance when an issuer placed flip clauses in the priorities of payments but provided neither operational capabilities nor financial resources to comply with U.S. swap margin rules.

"*S&P Global Ratings has not rated a new or refinanced US CLO [with a flip clause] that [also] contains a swap during the time that the margin posting rules for uncleared swaps have been effective. Specifically, the ZAIS CLO 8 Ltd./ZAIS CLO 8 LLC transaction you reference in your e-mail was not structured with a swap, and accordingly margin posting was not an analytical consideration when issuing our ratings. If the ZAIS issuer were to enter into a swap, it would be at that time that we would apply our relevant criteria to*

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[44] "Email response of Moody's Investors Service Chief Credit Officer Richard Cantor to Bill Harrington 'Re Recognizing the Market Loss That a Bank Agrees to Bear Under a Swap with a Securitization'", May 16, 2011, in Harrington, William J., "Submission to CFTC 'Re: RIN 3038-AD54 Capital Requirements for Swap Dealers and Major Swap Participants'", May 4, 2017, pp135-136. **(https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61196&SearchText)**. **N.B.,** at least one of today's Moody's Ratings recipients also received my May 12, 2011, email that Cantor brushed off. Cantor, now Moody's Ratings Vice Chairman, was Chief Credit Officer until April 2022, according to his LinkedIn profile on Aug 1, 2023. **(https://www.linkedin.com/in/richard-cantor-b576617/)**.

[45] Meghan Neenan, Managing Director — Financial Institutions, Fitch Ratings, email to Bill Harrington "Re Navient Solvency & Margin Rules for Uncleared Swaps", September 11, 2017. **N.B.,** Ms. Neenan also received today's submission.

assess any impact such a swap would have on our outstanding ratings. We maintain that we abided by our relevant criteria when rating ZAIS CLO 8 Ltd./ZAIS CLO 8 LLC."[46]

"*We did not feel the need to update our counterparty criteria following the introduction of the [U.S.] margin requirements as we continue to stand behind our methodology that incorporates reliance on replacement of counterparties.*
II
"*When a swap counterparty does not replace itself, we would not automatically downgrade our rating on the applicable security. In this case, we would analyze the particular transaction and assess if there are other mitigants that would cover the increased counterparty risk. For example, our cash flow analysis may show that there is sufficient credit enhancement available to cover interest rate risk in the event that the counterparty defaults. Another example would be the counterparty providing us with a detailed action plan outlining their strategy and our determination as to whether this information may give us comfort that there is no immediate need to downgrade the notes."*[47]

C'mon Flip-Clause-Swap-Contract Trainees, Here's Your Chance!

Rip apart the S&P Global Ratings evasion line-by-lying-line. Stymied after 20-years of study? Here's a hint. The S&P response unequivocally shows that the credit rating company, like oligopolistic "competitor" Moody's Ratings, compels complex-finance analysts to deliver and strictly apply *issuer-friendly* methodologies for the flip-clause-swap-contract.

Still blocked, flip-clause-swap-contract trainees? That's fine. I'll do your work yet again for the umpteenth time since 1999.

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[46] Mark Risi, Managing Director / Lead Analytical Director / Structured Finance, S&P Global Ratings email to Bill Harrington "Re NRSRO Ratings of U.S. CLOs with Flip Clauses but No Margin Posting Provisions", April 19, 2018. From WJH return email of April 19, 2018. "*I appreciate your reply, which proves my point. S&P does not abide by its methodologies when assigning ratings to US CLOs with flip clauses in the priorities of payment. II "Most obviously, S&P represents that it conducts a forward-looking analysis on all features of a new deal such as ZAIS CLO 8 Ltd./ZAIS CLO 8 LLC. If so, what forward-looking analysis did S&P conduct with respect to the legal opinion on flip clause enforcement, the business plan to enter into a flip clause swap but not a margin posting swap, and manager quality? II " S&P also represents that it applies applicable rating methodologies consistently across a given asset class. If so, what forward-looking comparisons did S&P conduct between US CLOs that do and do not have flip clauses in the priorities of payment?"*
N.B., at least two of today's S&P Global Ratings recipients also received my February 16, 2018, email that elicited Mr. Risi's email of April 19, 2018.

[47] Katrien Van Acoleyen — Global Structured Finance Head Methodologies, S&P Global Ratings, email to Bill Harrington "Re Your letter to CFTC dated Feb. 2, 2018 Re: CFTC No Action Letter", May 29, 2018.

(1) S&P Global Ratings had no analytical basis to "*continue to stand behind our methodology that incorporates reliance on replacement of counterparties.*"
(2) Regarding the hundreds or more past instances of non-replacement worldwide—namely, *"[w]hen a swap counterparty does not replace itself*"—S&P Global Ratings not only did *"not automatically downgrade our rating on the applicable security" . . .*
(3) S&P also failed to downgrade *any* U.K. or other dealer to reflect ballooning self-exposure to flip clause activation arising from non-replacement and increased probability "*that the counterparty defaults.*"[48]

Why? Well, by this point in today's tutorial, trainees old and new alike should know the answer by heart. All together. S&P Global Ratings optimizes corporate earnings by knowingly and intentionally inflating credit ratings for all ABS and other structured debt of issuers worldwide that are party to a flip-clause swap-contract, for all dealers worldwide that provide the contract, for all U.K. and non-U.S. sovereigns that enable issuers or dealers to enter the contract, for broader financial systems, and for other sovereigns, including the U.S. as ultimate stabilizer of financial systems worldwide.

Dubious? Trainees, consider your own flip-clause-swap-contract malfeasance! Yes, your indefensible perpetuation of the flip-clause-swap-contract degrades the public good day in and decade out! Considering your collective failures, why should S&P alone do the right thing and assign accurate credit ratings to U.K. and other non-U.S. ABS, other structured debt, or flip-clause-swap-contract dealers?

Moreover, your bad history is S&P Global Ratings good side! By September 15, 2008, S&P must have received many Lehman Brothers *"detailed action plan[s] outlining their strategy*" on all fronts, including the immense portfolio of self-sabotaging flip-clause-swap-contracts. Judging by the static S&P rating history for Lehman entities, each successive "*detailed action plan*" convinced S&P "*that there [was] . . . no immediate need to downgrade*" either Lehman Brothers itself or any subsidiary or affiliate. Likewise, S&P discerned "*no immediate need to downgrade the notes*" where Lehman Brothers was counterparty to a flip-clause-swap-contract.

[48] Regarding 25 downgraded swap dealers—including 2 downgraded U.K. swap dealers—that collectively obtained 32 credit rating company permissions to unilaterally disregard replacement and other remedial obligations viz-z-viz 50 U.K. and other ABS and structured debt issuers, see Structured Credit Investors (SCI), "Counterparty Conundrums", 2 August 2013 in Harrington, William J., "Electronic Letter to the U.S. Securities and Exchange Commission and the European Securities and Markets Authority Re Inflated Credit Ratings of ABS and Derivative Product Companies", September 11, 2013, Appendix B, pp17-19. **(https://www.wikirating.com/data/other/20130911_Harrington_J_William_ABS_Losses_Attributable_to_Securitization_Swaps.pdf).**

Moody's: *"Market Interest in Ratings That Exclude Government Support is Currently Low*."[49] On May 11, 2023, NRSRO Moody's cited low "*market interest in ratings that exclude government support*" in doubling-down on refusing to rigorously assess the proliferation of gaping credit exposures that each flip-clause-swap-contract generated for a U.K. or other non-U.S. ABS or structured debt issuer and for a U.K. or other non-U.S. swap dealer. The result? Moody's continues to incentivize all U.K. and other non-U.S. ABS and structured debt issuers, and all U.K. and other non-U.S. swap dealers, to enter flip-clause-swap-contracts by assigning bank credit ratings, counterparty assessments, and counterparty instrument ratings that explicitly assume public support for bank swap dealers.

> "*Moody's Investors Service published on April 5, 2022, a Request for Comment on the proposed introduction of ratings that exclude government support (XG ratings) alongside the existing approach to assigning ratings to banks. The Request for Comment also included the proposed introduction of a Counterparty Risk Assessment Excluding Government Support (XG CR Assessment) that would have applied to the same senior operating obligations and contractual commitments as those for which Moody's already provides Counterparty Risk (CR) Assessments.*
>
> *"Following the closure of the comment period and review of submitted comments, Moody's has decided that it will not update the banks methodology as proposed. . . . Moody's decision reflects its view that market interest in ratings that exclude government support is currently low."*[50]

Reflect a moment. NRSRO Moody's concluded "*that market interest in ratings that exclude government support is currently low*" from just six respondents, including a mousy five who "*requested confidentiality*." In other words, Moody's will continue long-standing practice of developing and strictly applying methodologies for bank credit ratings and counterparty assessments that rest on bailout and other government support assumptions—assumptions that make bailouts and other government support more likely and thereby harm everyone worldwide—to satisfy a handful of likely beneficiaries who won't communicate publicly.[51]

Worse still for all people and economies worldwide, Moody's Ratings exponentially accelerates the bailout doom loop by developing and strictly applying a *sovereign* methodology that pretends bank bailouts and other government support are costless. That's right! Moody's sovereign methodology assumes that the same assumptions of bank bailouts and other government support that inflate bank credit ratings and counterparty assessments have no credit implications

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49 "Moody's concludes proposal on ratings excluding government support for banks methodology, decides not to proceed with proposal", Moody's Investors Service *Methodology RFC Announcement*, May 11, 2023. **(https://www.moodys.com/research/Moodys-concludes-proposal-on-ratings-excluding-government-support-for-banks--PBC_1364275).**

50 "Ibid."

51 "Ibid." "*Moody's received a total of six comments submitted through the Request for Comment page in response to this RFC, for which five respondents requested confidentiality.*"

for affected sovereigns, at least not for Global North sovereigns and especially not for the U.S. as ultimate stabilizer of global financial systems. In tandem, Moody's sovereign and bank methodologies make bank bailouts much more likely and harm everyone worldwide, everyone that is except flip-clause-swap-contract trainees and other credit rating company groomers.

GROSS! 100% Self-Credit-Risk "*UNDERSECURES*" Every Flip-Clause-Swap-Contract Dealer[52]

A flip clause subjects a U.K. or other non-U.S. swap dealer to its own credit risk in addition to the credit risk of an ABS or structured debt issuer. Furthermore, dealer self-exposure is effectively ***gross*** (i.e., simultaneously additive for each contract around the world that may be a mark-to-market asset), rather than the much, much smaller ***netted*** (i.e., where mark-to-market liabilities and assets offset each other and can significantly reduce exposure).

Why effectively gross rather than netted? Two reasons.

(1) By design, each ABS and other structured debt issuer counterparty is a standalone entity with only one or a few flip-clause-swap-contacts. Moreover, where an issuer ***is*** counterparty to more than one contract, each contract is more likely to mirror the others than to offset them.

(2) By design, ***all*** ABS and other structured debt issuers around the world that have out-of-the-money flip-clause-swap-contracts with a dealer that has filed for bankruptcy will quickly and simultaneously activate **all** relevant flip clauses.

"*Each aspect of the proposed model approval process and the computation of the credit risk charges ignores the 100% exposure to itself that a swap dealer bears under a flip clause, walkaway or similar provision in an uncleared swap or an uncleared security-based swap. These provisions enable the counterparty to an uncleared swap or an uncleared security-based swap to write off all payments that would otherwise be due a swap dealer simply because it is bankrupt, insolvent, non-performing or similarly impaired.*

II

"Moreover, the correlation of activation of all flip clauses, walkaways or similar provisions will be 100%, i.e., 100% of counterparties to uncleared swaps and uncleared security-based swaps with these clauses and provisions that are in-the-money to a swap dealer will simultaneously activate them against the swap dealer when it is bankrupt, insolvent, non-performing or similarly impaired."[53]

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[52] "Op. Cit. U.K. Swap Dealer Capital Comparability Determination", footnote 356. *" . . . undersegregated or **undersecured** [emphasis added] condition (i.e., situation where the FCM . . . has insufficient funds set aside for customers trading on non-U.S. markets to meet the FCM's obligations to its customers) . . ."*

[53] "Op. Cit. Harrington CFTC Submission May 4, 2017", p40 and throughout. **(https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61196&SearchText)**.

"*The decision by the United States Bankruptcy Court for the Southern District of New York plainly shows that 100% of the flip clauses in 100% of the 44 CDOs ipso facto modified LBSF's [Lehman Brothers Special Financing] rights by 100%.*

"'The amount of the proceeds of the liquidation of the Collateral was insufficient to make any payment to LBSF under the Waterfall after proceeds 00were paid pursuant to Noteholder Priority."[54]

Credit Ratings: Dealer Default = *NO* Losses for Dealer or Flip-Clause-Swap-Contract Parties

Credit ratings of ABS or structured debt where a U.K. or other non-U.S. issuer is party to a flip-clause-swap-contract assume that the contract, and the flip clause in particular, ***never*** imposes significant losses on an issuer owing to dealer default. Likewise, and incredibly, credit ratings, counterparty assessments, and counterparty instrument ratings of the very same U.K. or other non-U.S. swap dealer assume that it incurs ***no*** significant losses from defaulting, not even from the zero-sum, self-referencing flip clause. To perpetuate non-recognition of contract losses from dealer default, dealers and issuers alike rely on credit rating companies to do the following.

(1) ***Ignore*** the gaping credit exposures that each flip-clause-swap-contract generates for a U.K. or other non-U.S. bank or swap dealer.
(2) ***Minimize*** the gaping credit exposures that each flip-clause-swap-contract generates for credit-rated U.K. or other non-U.S. ABS or structured debt.
(3) ***Pretend*** that the public incurs no costs when U.K. and other sovereigns, not least the U.S. as ultimate stabilizer of global financial systems, bail-out or otherwise support banks, swap dealers, and other financial entities.

Regarding 1), Fitch Ratings, Moody's Ratings, and S&P Global Ratings knowingly post deficient credit rating methodologies for, and knowingly assign inflated credit ratings, counterparty assessments, and counterparty instrument ratings to, U.K. and other non-U.S. banks and swap dealers to accommodate ongoing provision of flip-clause-swap-contracts. Credit ratings, methodologies, and commentary completely and intentionally ignore the idiosyncratic self-sabotage that a U.K. or other non-U.S. bank or dealer self-inflicts in assuming full exposure to itself for full value of each flip-clause-swap-contract that may be an asset. Fitch, Moody's, and S&P should, but categorically will not, assign accurate credit ratings, accurate counterparty assessments, or accurate counterparty instrument ratings to U.K. and other non-U.S. banks and dealers, i.e., credit ratings that incorporate credit-self-exposure equal to 100% loss for 100% of flip-clause-swap contracts that may be in-the-money assets.

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[54] "Op. Cit. Harrington Proposed Amicus Curiae Brief to US 2nd Circuit 'Re: Case No. 18-1079-bk", p47. **(https://croataninstitute.org/wp-content/uploads/2021/06/18-1079-bk-WJH-08-08-19-Letter-to-US-Court-of-Appeals-for-Second-Circuit-Proposed-Amicus-Curiae-Brief-Re-Case-No-18-1079.pdf)**.

Regarding 2), Fitch Ratings, Moody's Ratings, and S&P Global Ratings knowingly post deficient credit rating methodologies for, and knowingly assign inflated credit ratings to, U.K. and other non-U.S. RMBS, ABS, and other structured debt to accommodate issuers that enter flip-clause-swap-contracts.

Regarding 3), Fitch Ratings, Moody's Ratings, and S&P Global Ratings knowingly post deficient methodologies for, and assign inflated credit ratings to, the U.K. and other non-U.S. sovereigns that promote the use of flip-clause-swap-contracts despite the costs of bailing out or otherwise supporting banks and swap dealers. Using the same deficient methodologies, Fitch, Moody's, and S&P knowingly assign inflated credit ratings to the U.S. as ultimate stabilizer of global financial systems. Credit ratings, methodologies, and commentary comprehensively ignore systemic damage that will immediately generate from simultaneous flip clause activation by *all* U.K. and other non-U.S. ABS and structured debt issuers worldwide that are party to an out-of-the-money flip-clause-swap-contract with a defaulted, bankrupt, or otherwise insolvent U.K. or other non-U.S. bank or swap dealer. Fitch, Moody's, and S&P should, but categorically will not, assign accurate credit ratings to the U.K. and all other non-U.S. sovereigns that allow banks and dealers to expose the local economy, broader financial systems, and other sovereign entities to Lehman Brothers havoc. Similarly, Fitch, Moody's, and S&P should, but categorically will not, assign accurate credit ratings to the U.S. that recognize the credit exposures that our Country, and thus the U.S. public, bears as ultimate stabilizer of global financial systems.

LUCKY US (For Now)! CFTC Swap Margin Rule Renders Flip-Clause-Swap-Contact Nonviable

> "***US Congress, markets, and regulators have consigned the flip-clause-swap-contract to the garbage heap of history. There, the contract rots away with aerosol sprays, trans-fats, asbestos tiles, and other toxic synthetics that poisoned users, producers, and our Country.***"[55]
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> "*Fortunately for U.S. persons, our law and regulation render the flip-clause-swap-contract commercially impracticable in the U.S. However, the good fortune is tenuous because financial dealmakers and industry groups periodically push for statutory and regulatory 'relief' to revive the contract. Luckily, my eleven-year-and-counting advocacy has just scored a major win that will at least slow, and might permanently block, contract revival in the U.S.*"[56]

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[55] "Ibid.", p23.

[56] "Op. Cit. Harrington 'Sometimes, Holding the Line *is* Progress'". **(https://croataninstitute.org/2022/11/17/sometimes-holding-the-line-is-progress/).**

Since 2017, U.S. swap margin rules, including the CFTC swap margin rule, have greatly benefited U.S. persons by subduing financial sector credit exposures that might otherwise draw bailouts or other U.S. government support.[57]

Of key importance, U.S. swap margin rules subject innately reckless U.S. ABS issuers, innately reckless U.S. structured debt issuers, innately reckless U.S. banks, and innately reckless U.S. swap dealers to basic self-governance regarding the flip-clause-swap-contract. U.S. swap margin rules, including the CFTC swap margin rule, stop U.S. ABS and other structured debt issuers from entering the flip-clause-swap-contract. Equally beneficially, U.S. swap margin rules, including the CFTC swap margin rule, stop U.S. banks and swap dealers from providing the flip-clause-swap-contract in the U.S. or anywhere else in the world. Sidelined from entering flip-clause-swap-contracts, U.S. ABS issuers, structured debt issuers, banks, and swap dealers have *partially* ceased sabotaging themselves, *partially* ceased undermining the U.S. economy, *partially* ceased distorting the U.S. financial system, and *partially* ceased breaking the U.S. social compact.

UNLUCKY U.K.—Needlessly Complex Finance Hobbles Economy

> "*Since 2008, the US economy has grown at double the rate of the UK economy. Since Covid, the UK is stagnating whilst the US has grown strongly. Despite much faster growth, inflation in the US is dropping fast, whilst the UK seems stuck with high inflation and the worst of both worlds.*"[58]

> "*In the UK, the economy slipped into recession at the end of 2023 and in the euro area, growth remains near zero. In the US, however, consumer spending and wage growth remain robust*."[59]

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57 Regarding *the U.S. prudential regulators'* joint swap margin rule, Harrington, see Bill, "US margin rule for swaps obliges securitization issuers to overhaul structures, add resources, and rethink capital structures", *Debtwire ABS*, 5 November 2015. **(https://www.sec.gov/rules/petitions/2022/petn4-790-ex2.pdf)**. Regarding *the CFTC swap margin rule*, see Harrington, Bill, "CFTC swap margin rule denies relief for ABS; shines light on 'flip clauses'", *Debtwire ABS*, 18 December 2015. **(https://www.sec.gov/files/rules/petitions/2022/petn4-790-ex3.pdf)**.

58 Pettinger, Tejvan, "Why Is the US economy doing so much better than the UK Economy", *Economics Help*, 18 July 2023. **(https://www.economicshelp.org/blog/186814/economics/why-is-the-us-economy-doing-so-much-better-than-the-uk-economy/).**

59 Raithatha, Shaan, "U.K. slips Into recession but U.S. economy still strong", *Vanguard*, 18 Feb 2024. **(https://www.vanguardinvestor.co.uk/articles/latest-thoughts/markets-economy/uk-slips-into-recession-but-us-economy-still-strong).**

The BoE PRA can best fulfill the "*secondary mandate to promote the U.K. economy's international competitiveness and growth*", and ***promote*** the "*safety and soundness of regulated entities*" by ***banning*** the flip-clause-swap-contract![60]

Unfortunately for U.K. and other non-U.S. persons, their respective swap margin rules do the opposite of U.S. swap margin rules. Non-U.S. rules *generate* systemic credit exposures that in turn *increase* the likelihood that banks draw bailouts and other government support.

Deficient U.K. swap margin and capital rules for credit-rated complex finance in general, and for the flip-clause-swap-contract in particular, hobble U.K. economic performance both on an outright basis and viz-a-viz the U.S.

U.K. and other non-U.S. swap margin and capital rules *perpetuate* the flip-clause-swap-contract by allowing ABS issuers, other structured debt issuers, banks, and swap dealers to under-resource respective contract exposures via both exemptions from margin posting and see-no-evil capital rules that treat the contract as "*plain vanilla*". As a result, U.K. and other non-U.S. ABS issuers, structured debt issuers, banks, and swap dealers sabotage themselves, undermine U.K. and other non-U.S. economies, distort financial systems, and break social compacts. Swap margin exemptions may be de-facto or de-jure. A very high threshold for posting variation margin is a common type of de-facto exemption. Lumping ABS and other structured debt issuers with end users that *appropriately* claim margin exemptions provides a standard de-jure exemption.[61]

As corroboration, see the priorities of payment for credit-rated debt of Elstree Funding No.3 Plc or any other U.K. or other non-U.S. ABS or structured debt issuer that is party to a flip-clause-swap-contract. *To spoon feed you, start with the respective priorities of payment in the Elstree Funding No.3 Plc Pre-Sale! The priority of payments does not enable the issuer to post margin to a flip-clause-swap-contract dealer. For more proof, ask the dealer—Natwest Markets Plc—to report the gap between contract mark-to-market and margin exchanged.* Regarding U.K. and other non-U.S. see-no-evil capital rules that treat the flip-clause-swap-contract as *plain vanilla*, ask any U.K. or other non-U.S. dealer to compare two capital amounts, (1) the capital amount for one of its flip-clause-swap-contracts, and (2) the capital amount for an otherwise identical swap contract without a flip clause, respectively.[62]

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60 CFTC, "Statement of Commissioner Christy Goldsmith Romero: Promoting the Resilience of Swap Dealers in the U.K. through Strong Capital Requirements and Reporting", 24 January 2024. **(https://www.cftc.gov/PressRoom/SpeechesTestimony/romerostatement012424).**

61 Latham & Watkin, "US vs EU/UK Margin Rules", Last updated June 2, 2022, p2, "***Permanent Exemptions*** *. . . Hedging swaps related to securitisations (subject to certain conditions)*". **(https://www.lw.com/admin/upload/SiteAttachments/US-EU-UK-margin-rules-reference-guide.pdf).**

62 The following 30 U.K. (yellow-shaded) and other non-U.S. swap dealers provided one (or more) *new* flip-clause-swap-contracts during the period October 2022 to May 2023, based on WJH daily review of Moody's Investors Service Pre-Sale Reports and S&P Global Ratings Presales: ABN AMRO (1); ANZ (2); Barclays (1); BMO (1); BNP Paribas (8); BNZ (2); Citi (1); Coventry Building Society (2);

U.S. Luck Running Out? Tone-Deaf CFTC Strains to "*Harmonize*" with Off-Pitch U.K.

> In *"the next two years, the Commission will consider and vote on matters for consideration that . . .* ***amplify international comity*** *[emphasis added]."*[63]
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>
> "*I cannot support the proposed rule.*
> II
> "*The proposed rule discusses the importance of harmonization with global regulation but not U.S. banking regulations.*
> II
> *"I have serious concerns with potentially increasing risks related to uncleared swaps, including risks to financial stability by adopting a definition that harmonizes with global regulation, but not domestic banking regulation."*[64]

Unfortunately for U.S. persons, U.K. and other non-U.S. counterparts who perpetuate the under-capitalization and nonexistent margin posting of needlessly complex finance both generate systemic exposures in local economies and propagate the exposures to the U.S. as the ultimate stabilizer of global financial systems.

Equally unfortunate for the U.S. economy and people, U.K. and other non-U.S. policy makers' disregard of the well-being of their respective peoples and economies supply the CFTC with a seemingly innocuous rationale—namely, to "*amplify international comity*"—to directly propagate systemic exposures to the U.S. by enacting harmful rules such as the U.K. Swap Dealer Capital Comparability Determination.

What harmful policy will the CFTC next propose under the rubrics of *amplifying international comity* and *harmonizing* with non-U.S. regulation? Maybe, reinstating the flip-clause-swap-

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Credit Agricole (2); DZ Bank (2); HSBC (1); ING (7); Investec (15); J.P. Morgan (2); Lloyds Bank (3); Merrill Lynch International (1); National Australia Bank (9); Natixis (2); NatWest (1); Nedbank (1); RBC (3); RCI Bank and Services (4); Santander (3); Scotiabank (3); SEB (7); SMBC Group (1); Standard Chartered Bank Korea (1); Toronto Dominion (1); UniCredit (1); and Westpac (1).

63 CFTC Chair Rostin Behnam, "Testimony Before the Subcommittee on Agriculture, Rural Development, Food and Drug Administration and Related Agencies Committee on Appropriations, U.S. House of Representative", March 28, 2023. Also, "Keynote Address of Chairman Rostin Behnam at the Futures Industry Association Expo 2023, Chicago, Illinois", CFTC *Public Statements and Remarks*, October 2, 2023. "*Since my February remarks, Commission staff have been working nonstop to put forward for Commission review by the end of this year proposed and final rules covering areas such as . . .* ***amplifying international comity*** *[emphasis added] . . .*" **(https://www.cftc.gov/PressRoom/SpeechesTestimony/opabehnam35) AND (https://www.cftc.gov/PressRoom/SpeechesTestimony/opabehnam37),** respectively.

64 "Dissenting Statement of Commissioner Christy Goldsmith Romero on Notice of Proposed Rulemaking for Seeded Funds and Money Market Funds", *Policy Statement and Remark*s, July 16, 2023. **(https://www.cftc.gov/PressRoom/SpeechesTestimony/romerostatement072623e).**

contract for U.S. swap dealers and for all U.S. RMBS, ABS, and structured debt issuers? CFTC failure to post my § 13.1 petition for rulemaking of May 26, 2020, strongly suggests a decision to at least preserve the option of "*amplifying international comity*" and "*harmonizing with non-U.S. regulations*" by reviving the flip-clause-swap-contract in the U.S., rather than eradicate the contract from the U.S. for good.[65]

More broadly, why does the CFTC propose to harm the U.S. people by enlisting them to backstop still more financial sector risk simply to *harmonize* with damaging U.K. policy that hampers the economic prospects for most people apart from flip-clause-swap trainees and other practitioners of needlessly complex finance?

> "*There are proposed deviations from the Commission's bank-based capital requirements that should be closely scrutinized. Some of these deviations are similar to those raised by commenters to other proposed determinations.* ***For example, the Commission proposes to permit compliance with UK capital rules that are not necessarily anchored by a threshold percentage of uncleared swap margin as the CFTC requires. The proposed determination discusses that UK capital rules address liquidity, operational risks, as well as other risks arising from derivatives exposures, through other mechanisms*** *[emphasis added]. I look forward to public comment on the comparability of the approaches and expect the Commission to publish additional analysis to address concerns raised by commenters as part of any final determination.*"[66]

To answer, and directly rebut IIB, ISDA, and SIFMA, the UK Capital Comparability Determination produces an exponentially ***deficient outcome*** in "*permitting compliance with UK capital rules that are not necessarily anchored by a threshold percentage of uncleared swap margin*" because neither U.K. capital nor swap margin rules account for the flip-clause.[67]

1) CFTC capital requirements, in addition to being "*anchored to a threshold percentage of uncleared swap margin*", don't *need to* account for the flip-clause by virtue of the CFTC swap margin rules rendering the contracts commercially untenable.

In Contrast,

2) Poor U.K swap margin rules facilitate and incentivize dealers to enter flip-clause-swap-contracts by de-facto exempting most parties from posting initial or variation margin.
3) UK capital rules facilitate and incentivize dealers to negligently under-capitalize by providing the flip-clause-swap-contract.

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65 "*I seek a rulemaking by the Commission to prohibit a swap dealer, major swap participant, or other regulated entity from predicating a swap obligation on a flip clause, walkaway, or variable subordination.*" **(https://croataninstitute.org/wp-content/uploads/2022/06/CFTC-WJH-2020-6-26-Sec-13.1-Rulemaking-Petition-Acknowledgment_WJHarrington_06-26-2020.pdf).**

66 "Op. Cit. Commissioner Christy Goldsmith Romero: 'Promoting U.K. Swap Dealer Resilience Through Strong Capital Requirements", 24 January 2024.

67 "Op. Cit. IIB, ISDA, and SIFMA, Re U.K. Capital Comparability Determination 22 March 2024", pp1-3.

Credit Rating Methodology Comment – Recoveries for Flip-Clause-Swap-Contract Dealers

NRSRO Moody's Pre-Sale "Elstree Funding No. 3 PLC", 9 March 2023, which comprises part of today's joint submission, details a negligently under-capitalized flip-clause-swap-contract between the credit-rated U.K. RMBS issuer and U.K. dealer NatWest Markets. The negligently under-capitalized flip-clause-swap-contract renders both issuer and dealer under-capitalized, demonstrating why the CFTC must condition the U.K. Capital Comparability Determination on a prohibition against dealers providing the flip-clause-swap-contract. The Elstree Funding No. 3 flip-clause-swap-contract also demonstrates why NRSROs Fitch, Moody's, and S&P must overhaul respective criteria / methodologies *to significantly decrease recoveries for flip-clause-swap-contract dealers*.

"Elstree Funding No. 3 PLC" informs the below comments.

NRSROs Fitch, Moody's, and S&P must update respective credit rating methodologies / criteria to assign lower recoveries and lower governance scores to a bank or swap contract dealer with self-credit-exposure of 100% loss of value under a flip-clause-swap-contract when either following condition applies.

(1) A dealer is party to a huge flip-clause-swap-contract.
(2) A dealer may retain permanent self-exposure to 100% loss of contract value by having no obligation to novate a flip-clause-swap-contract.

Furthermore, and crucially, Fitch, Moody's, and S&P must update respective credit rating methodologies / criteria for financial institutions to accurately assign lower recoveries to a bank or swap contract dealer by doing the following.

(3) Track each flip-clause-swap-contract that a dealer has with an RMBS, ABS, or other structured debt issuer anywhere in the world, regardless of whether Fitch, or Moody's, or S&P, or another credit rating company, or no credit rating company assigns credit ratings to the respective RMBS, ABS, or other structured debt.
(4) Assess all contract terms.
(5) ***Assign plausible likelihood of NO NOVATION*** to each flip-clause-swap-contract based on *realistic* evaluation of novation provisions.
(6) Assume 100% correlation of flip clause activation against a dealer for *ALL* in-the-money flip-clause-swap-contracts with RMBS, ABS, and other structured debt issuers everywhere in the world.

Moreover, the BoE must overhaul U.K. swap capital and margin rules to do the following and ensure that a regulated entity that is party to one or more flip-clause-swap-contracts, and therefore negligently under-capitalized, *becomes* adequately capitalized.

(7) Track each flip-clause-swap-contract that a regulated entity has with an RMBS, ABS, or other structured debt issuer anywhere in the world.
(8) Assess all contract terms.

(9) ***Assign conservative likelihood of NO NOVATION*** to each flip-clause-swap-contract, based on *realistic* evaluation of novation provisions.

(10) Assign capital charge that assumes 100% correlation of flip clause activation against a regulated entity for *ALL* in-the-money flip-clause-swap-contracts everywhere in the world.

(11) Prohibit regulated entities from entering new flip-clause-swap-contracts.

NRSRO Moody's Pre-Sale Report "Elstree Funding No. 3 PLC", 9 March 2023, and "WJH and Bank of England Staff -- Flip Clause Meeting and Correspondence -- 31 May 2014 to 26 June 2019" inform the following comments on U.K. regulation and capitalization of swap dealers.[68]

BoE perpetuation of the flip-clause-swap-contact is a major headache for U.S. people! BoE disregard of the well-being of U.K. people and the U.K. economy supplies U.S. regulators with a seemingly benign rationale—namely, amplifying "*international comity*"—to harm U.S. people and the U.S. economy by proposing to reinstate the flip-clause-swap-contract for U.S. swap dealers and for U.S. RMBS, ABS, and other structured debt issuers.[69]

By 2016 at the latest, U.K. regulators should have already prohibited swap dealers from both entering new flip-clause-swap-contracts anywhere in the world and extending maturities of existing contracts anywhere in the world.

By 2016 at the latest, U.K. regulators should have already obligated swap dealers to immediately post capital equal to 100% of value against every legacy flip-clause-swap-contract anywhere in the world.

Since at least May 31, 2014, I have spoon fed BoE staff and other U.K. financial regulators clear-sighted evidence of economic damage that the flip-clause-swap-contract wreaks. For example, I happily provided copious evidence directly to Ms. Sarah Breeden, now Deputy Governor at BoE for Financial Stability. Her colleague Ms. Allison Parent also relayed my evidence to Ms. Breeden and other BoE staff several times after I met Ms. Parent and her then colleague Mr. Michalis Vasios at BoE headquarters on March 18, 2015. In preparing our meeting, Ms. Parent requested "Efficient, commonsense actions to foster accurate credit ratings" by Norbert J. Gaillard and me.[70]

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68 "WJH and Bank of England Staff -- Flip Clause Meeting and Correspondence -- 31 May 2014 to 26 June 2019" available at: **(https://www.sec.gov/comments/4-790/4790-195119-387602.pdf).**

69 CFTC Chair Rostin Behnam, "Testimony Before the Subcommittee on Agriculture, Rural Development, Food and Drug Administration and Related Agencies Committee on Appropriations, U.S. House of Representative", March 28, 2023. *"[O]ver the next two years, the Commission will consider and vote on matters for consideration that . . . amplify* ***international comity*** *[emphasis added]."* **(https://www.cftc.gov/PressRoom/SpeechesTestimony/opabehnam35).**

70 Gaillard, Norbert J. and William J. Harrington, "Efficient, commonsense actions to foster accurate credit ratings", *Capital Markets Law Journal* 11, no. 1 (2016): 38-59. See "*flip clause*" throughout. **(https://doi.org/10.1093/cmlj/kmv064)**.

"*From: Parent, Allison*

To: wjharrington@yahoo.com
Cc: "Nicola.Anderson@bankofengland.co.uk";
"Andy.Haldane@bankofengland.co.uk";
"Sarah.Breeden@bankofengland.co.uk";
"Lewis.Webber@bankofengland.co.uk";
"Michael.Hume@bankofengland.co.uk";
Alexandra.Ellis@bankofengland.co.uk
Sent: Friday, March 13, 2015 at 12:03:05 PM EDT
Subject: RE: Non-Clearable Swap Contracts with Flip Clauses and No Margin Posting

"*Afternoon Bill,*

"*Thank you for your offer to meet next week. Does next Wednesday, 18th at 4pm still work for you?*

"*Prior to joining the Bank, I worked in the US Congress as General Counsel of Senate Budget Committee focusing on both fiscal and financial services issues. I am familiar with the OTCDs reform having negotiated the text of Title VII of DFA and working with CFTC in the development of their rules. Glad to hear you will be participating at their upcoming roundtable and will be able to share your points with them directly at the event.*

"*The Bank looks forward to learning more about the issues you reference below.* ***Please send along your paper in advance for us to review to help facilitate the dialogue and to share with others who regrettably will be out of the office next week*** *[emphasis added]."*[71]

Why has Ms. Breeden not spurred the BoE to regulate the flip-clause-swap-contract out of existence? The flip-clause-swap-contract poses immense dangers to U.K. bank swap dealers, to the U.K. financial system, to the wider U.K. economy, to BoE prudential regulation, and, most importantly, to the U.K. people. Ms. Breeden's experience indicates that eliminating the flip-clause-swap-contract should be Priority Number 1.

"*She is a member of the Monetary Policy Committee, Financial Policy Committee, Prudential Regulation Committee and the Bank's Court of Directors.*

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[71] Allison Parent email to Bill Harrington "Re Non-Clearable Swap Contracts with Flip Clauses and No Margin Posting", March 13, 2015, in "WJH and Bank of England Staff -- Flip Clause Meeting and Correspondence -- 31 May 2014 to 26 June 2019", p5. **(https://www.sec.gov/comments/4-790/4790-195119-387602.pdf).**

> "*She has specific responsibility within the Bank for financial stability, the supervision of financial market infrastructures, international issues, central bank digital currency and fintech.*
> II
> "*Prior to her current role, Sarah was the Executive Director for Financial Stability Strategy and Risk and a member of the Financial Policy Committee (2021-2023). Previously, she was the Executive Director for UK Deposit Takers Supervision (2019-2021), responsible for the supervision of the UK's banks, building societies and credit unions, and Executive Director for International Banks Supervision (2015-2021), responsible for supervision of the UK operations of international banks.*"[72]

On June 1, 2014, then BoE Chief Economist Andy Haldane introduced me to Sarah Breeden and Niki Anderson in replying to my email of the previous day.

> "*Thanks Bill. I am copying in colleagues here at the Bank leading on this work, Sarah [Breeden] and Niki [Anderson], who I am sure will be interested in your thoughts*."[73]

My thoughts have held firm since well before cold-emailing Andy Haldane on 31 May 2014.

> "*The fatal flaw in the swap contracts most commonly used by ABS issuers is a 'flip clause.' Flip clause risk should be a major concern of the Bank of England, for instance with respect to the bad bank portfolios of swap providers such as RBS and Barclays.*"[74]

Flip-clause-swap-contracts rendered RBS and Barclays "*bad bank portfolios*" much, much badder than even the BoE understood. As damning evidence, my email of 31 May 2014, cited my "*May 29 comment letter to the U.S. SEC that proposes derivative disclosures with respect to securitisations.* ***[https://www.sec.gov/comments/s7-18-11/s71811-84.pdf].***"[75]

> ***"Flip side of a flip clause: A derivative provider's rating should be debited twice***
> *"With respect to the rating of a derivative provider, an NRSRO should apply two (non-zero) debits to the swap contract: a first debit that reflects the credit profile of an ABS issuer and a second, much larger debit that reflects the punitive losses that a derivative provider inflicts upon itself in the event of insolvency. As an alternative to incurring the*

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72 "Sarah Breeden", BoE website, accessed 17 March 2024. **(https://www.bankofengland.co.uk/about/people/sarah-breeden/biography)**.

73 Andy Haldane email to Bill Harrington "Re Improving Securitisation Quality - WJH Comment Letter to U.S. SEC on ABS Ratings", June 1, 2014, in "WJH and Bank of England Staff -- Flip Clause Meeting and Correspondence -- 31 May 2014 to 26 June 2019", p2. **(https://www.sec.gov/comments/4-790/4790-195119-387602.pdf).**

74 Bill Harrington email to Andy Haldane "Re Improving Securitisation Quality - WJH Comment Letter to U.S. SEC on ABS Ratings", May 31, 2014, in "WJH and Bank of England Staff -- Flip Clause Meeting and Correspondence -- 31 May 2014 to 26 June 2019", p1. **(https://www.sec.gov/comments/4-790/4790-195119-387602.pdf).**

75 "Ibid."

second derivative debit, a derivative provider can set aside significant reserves that must be augmented upon being downgraded.

"However, counterparties are unlikely to continue providing swap contracts with flip clauses if required to account for their potential losses in a meaningful way. For example, derivative providers under my supervision while at Moody's (DPCs such as Nomura Derivative Products Inc., Merrill Lynch Derivative Products AG, Lehman Brother Financial Products Inc., and Lehman Brothers Derivative Products Inc.) generally abstained from providing swap contracts with flip clauses after being apprised of their rating implications.

"Without flip clauses that make swap contracts look airtight against a major component of counterparty risk, ABS issuers would be forced to buy options or set aside reserves when bringing new ABS to market, i.e., the ABS industry could no longer offer artificially cheap credit to borrowers across ABS sectors. Some ABS sectors, such as student loan ABS, would grind to a complete halt and other sectors, such as residential mortgage ABS, would not be revived in their earlier form."[76]

I copied Sarah Breeden and other BoE staff in six additional emails pertaining to the flip-clause-swap-contract between June 14, 2014, and June 26, 2019.[77] My email of 12 May 2015, provided a link to an extremely amusing, extremely effective presentation that a former Moody's colleague and I made that day to staff of six U.S. financial regulators—the CFTC and the five prudential regulators the FCA, FDIC, FHFA, FRB, and OCC. The presentation and meeting helped convince the six regulators to adopt best-in-world swap margin rules that regulate the flip-clause-swap-contract out of existence for U.S. swap dealers and for U.S. RMBS, ABS, and other structured debt issuers.[78]

"Attached please find the presentation that I gave today to the teams from the CFTC, FCA, FDIC, FHFA, FRB, and OCC with respect to margin posting by ABS issuers, flip clauses, and clearinghouses.
[https://www.cftc.gov/node/157371
and
dfsubmission_051215_2376_0.pdf (cftc.gov)]."

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[76] Harrington, William J., "Response to U.S. Securities and Exchange Commission Re: 'File Number S7-18-11 Request for Re-proposal Relating to Nationally Recognized Statistical Rating Organizations'", May 29, 2014, pp3-4. **(https://www.sec.gov/comments/s7-18-11/s71811-84.pdf).**

[77] Bill Harrington emails of June 23, 2014, March 8, 2015, March 13, 2015, March 24, 2015, May 12, 2015, and June 10, 2019, respectively, in "WJH and Bank of England Staff -- Flip Clause Meeting and Correspondence -- 31 May 2014 to 26 June 2019", pp3, 4, 6, 7, 9, and 11, respectively. **(https://www.sec.gov/comments/4-790/4790-195119-387602.pdf).**

[78] For summary of the joint prudential regulators' rule, see Harrington, Bill, "US margin rule for swaps obliges securitization issuers to overhaul structures, add resources, and rethink capital structures", *Debtwire ABS*, 5 Nov 2015. **(https://www.sec.gov/rules/petitions/2022/petn4-790-ex2.pdf).**

Additionally, my email of May 12, 2015, also raised the "*UK referendum on remaining in the EU*."

> *"A point that came up in the call is the UK referendum on remaining in the EU. This uncertainty argues that there is no reason to be harmonizing EU and US financial regulations until after the UK status is settled."*[79]

The BoE in the person of Allison Parent summarily dismissed BREXIT referendum concerns and entirely ignored flip-clause-swap-contract concerns. Clearly, The Old Lady of Threadneedle Street always knows what's best for the U.K. financial system, the wider U.K. economy, and, most importantly, the U.K. people. Witness the extremely happy circumstances that a few or even several U.K. people enjoy today, owing to the stellar U.K. economy.

> "*Thank you, Bill for forwarding along to us the presentation you shared with US regulators. We appreciate you keeping us in the loop.*
>
> "*The debate around cross-border regulation for all areas (tax, financial reform, accounting, etc.) will always be a complicated topic for many reasons, including political uncertainty. Thank you for flagging the uncertainty the US regulators see related to the referendum question in regards to cross border derivatives reform."*[80]

I emailed Ms. Breeden directly regarding the flip-clause-swap-contract on June 10, 2019.

> "*I hope that you will discuss the damage that financial catastrophes have on public appetite for climate mitigation at tomorrow's CFTC Market Risk Advisory Committee Meeting.*
> II
> "*As an update, I affiliated as a senior fellow with Croatan Institute in November 2017. The Institute, which actively assesses climate sustainability and finance, posted my Working Paper 'Can Green Bonds Flourish in a Complex-Finance Brownfield?' in July 2018. The Working Paper proposes a financial sustainability score to measure the impact of a financial instrument on the sustainability of the financial system.* ***Unsurprisingly, flip clause swap contracts, including ones in prominent EU 'green' RMBS deals, score among the worst with respect to both a given deal and the swap dealer that assumes walk-away risk to its own credit profile [emphasis added].***
> ***[https://croataninstitute.org/2018/07/01/can-green-bonds-flourish-in-a-complex-finance-brownfield/]***

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79 Bill Harrington email to Allison Parent "Re: Non-Clearable Swap Contracts with Flip Clauses and No Margin Posting", May 12, 2015, in "WJH and Bank of England Staff -- Flip Clause Meeting and Correspondence -- 31 May 2014 to 26 June 2019", p9. **(https://www.sec.gov/comments/4-790/4790-195119-387602.pdf).**

80 Allison Parent email to Bill Harrington "Re: Non-Clearable Swap Contracts with Flip Clauses and No Margin Posting", May 13, 2015, in "WJH and Bank of England Staff -- Flip Clause Meeting and Correspondence -- 31 May 2014 to 26 June 2019", p10. **(https://www.sec.gov/comments/4-790/4790-195119-387602.pdf).**

"*Following is a link to the comment 'Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants (In the Event of No-Deal Brexit)' that I submitted to the CFTC on May 31, 2019.*
https://comments.cftc.gov/PublicComments/CommentList.aspx?id=2960.

"*The comment take-away: 'The CFTC must amend the CFTC No-Deal Brexit Rule to exclude a swap contract with a flip clause, other walkaway provision, or rating agency condition/ confirmation (RAC) that is transferred to an affiliate, branch, or other entity domiciled in the US.'*"[81]

NRSRO Moody's Pre-Sale "Elstree Funding No. 3 PLC", 9 March 2023 details a U.K. RMBS issuance with a fixed-for-floating, predetermined-schedule flip-clause-swap-contract that NatWest Markets provides.

Moody's should, but demonstrably does not, assign lower credit ratings to NatWest Markets that recognize outsized credit exposure to itself under the huge flip-clause-swap-contract that does not obligate NatWest, upon being downgraded, to novate or obtain a guarantee.

Moody's should, but demonstrably does not, assign lower recovery rates to NatWest Markets that recognize outsized credit exposure to itself occasioned by 100% correlation of flip-clause activation by *ALL* RMBS, ABS, and other structured debt issuer counterparties around the world that would have an out-of-the-money flip-clause-swap-contract should NatWest default, enter bankruptcy, or become insolvent.

The BoE should, but demonstrably does not, assign capital charges to NatWest Markets that recognize outsized credit exposure to itself occasioned by 100% correlation of flip-clause activation by *ALL* RMBS, ABS, and other structured debt issuer counterparties around the world that would have an out-of-the-money flip-clause-swap-contract should NatWest default, enter bankruptcy, or become insolvent.

Moody's should, but demonstrably does not, assign lower governance scores to NatWest Markets that recognize disastrous governance in providing the flip-clause-swap-contract.

"Flow of funds, Allocation of payments/pre-accelerated revenue waterfall", Steps 2 and 16, page 17 constitute the flip clause.

The Elstree Funding No. 3 Plc flip-clause-swap-contract is HUGE because 95% of residential mortgage loans are initially fixed-rate. The contract is "**not balance guaranteed**." See page 20.

"*[A]bout 95.3% of the loans in the pool are fixed-rate mortgages, which will revert to West One's SVR or BBR plus a margin between December 2023 and October 2029*.

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[81] Bill Harrington email to Sarah Breeden "Re: CFTC MRAC June 12 2019 + 'Improving Securitisation Quality - WJH Comment Letter to U.S. SEC on ABS Ratings'", June 10, 2019, in "WJH and Bank of England Staff -- Flip Clause Meeting and Correspondence -- 31 May 2014 to 26 June 2019", pp11-12. **(https://www.sec.gov/comments/4-790/4790-195119-387602.pdf).**

II

"*The swap notional follows a predetermined schedule and does not reference the actual outstanding amount of loans being hedged during each period. This feature has in recent years become more common in other UK RMBS transactions . . .*"

The issuer moderately mitigated poor governance in entering the flip-clause-swap-contract by eliminating a balance-guaranteed component sometime after soliciting credit ratings from S&P Global Ratings. From the S&P Presale "Elstree Funding No. 3 PLC", 9 March 2023.[82]

"*The transaction no longer features a balance-guaranteed swap and instead the notional for the swap follows a schedule.*"

Unfortunately, the issuer and NatWest Markets each enacted a massive governance failure by omitting a hard transfer obligation (*replacement*) from the flip-clause-swap-contract. See Moody's Pre-Sale, page 20.

"*However, there is no transfer trigger in the swap definition and swap counterparty must post collateral or transfer rights.*"

NatWest ability to avoid either transferring the flip-clause-swap-contract or obtaining a guarantee by instead merely posting collateral even if approaching default, bankruptcy, or insolvency increases the expected losses of Elstree Funding No. 3 Plc RMBS today. The lack of hard transfer obligation all but ensures that a defaulted, bankrupt, or insolvent NatWest will remain counterparty to the contract and expose the issuer to outsize losses 100% of the time, i.e., both when the contract is in-the-money to the issuer and when the contract is out-of-the-money.

Likewise, NatWest ability to avoid transferring the flip-clause-swap-contract by merely posting collateral even if approaching default, bankruptcy, or insolvency increases NatWest expected losses today. The lack of hard transfer obligation all but ensures that a defaulted, bankrupt, or insolvent NatWest will remain counterparty to the contract and, if in-the-money, lose 100% of contract value owing to flip-clause activation.

The Elstree Funding No. 3 Plc issuer exposes its RMBS to an extremely high governance risk, i.e., well above already very high governance risk that is the U.K. RMBS baseline! Most U.K. RMBS are exposed to high governance risk because most issuers are party to flip-clause-swap-contracts. Moody's Pre-Sale describes eight "*other transactions by the same originator and comparable transactions*." Each has a "*hedge in place*" that is a "*fixed-floating swap*" and all such swaps are, with 100% certainty, flip-clause-swap-contracts. See page 20.

[82] **(https://www.spglobal.com/ratings/en/research/pdf-articles/230309-presale-elstree-funding-no-3-plc-12584847).**

NRSRO Moody's fails its own self-governance by setting governance benchmarks that *willfully ignore* the outsized expected losses incurred by each U.K. and other non-U.S. RMBS, ABS, and other structured debt issuer that is party to a flip-swap-contract. The following re-work of Moody's Pre-Sale, page 3, is more accurate.

> "*UK RMBS sector governance risk is high, based on issuers' pervasive use of flip-clause-swap-contracts, many of which are disproportionately huge.*
> II
> "*Governance: Governance risks for this transaction are high based on the presence of a huge flip-clause-swap-contract with no hard obligation for a downgraded NatWest Markets to transfer or obtain a guarantee."*

Likewise, the following re-work of Moody's Pre-Sale, pages 21-22, is more accurate.

> "***ESG - Governance considerations***
>
> *"Strong RMBS governance relates to transaction features that promote the integrity of the operations of the transaction for the benefit of investors, as well as the data provided to investors. The following are some of the governance considerations related to the transaction:*
>
> *"**» Absence of flip-clause-swap-contract.***
>
> " ***…"***

25 Outcomes Under U.K. Capital Comparability Determination *THAT AIN'T COMPARABLE* to Outcomes Under CFTC Or SEC Or U.S. Prudential Regulator Capital and Swap Margin Rules

> "*The concern with capital adequacy is well founded. During the financial crisis of 2007-09, we saw failures or near-failures of major banks and non-banks, which contributed to market turmoil and a recession in the real economy. Within a short period of time, a cascade of liquidity crises quickly followed the collapse or failure of Bear Stearns, Lehman Brothers, and Merrill Lynch and the conversion of Goldman Sachs' and Morgan Stanley's investments banks into bank holding companies to access funding from the Federal Reserve.*"[83]

During the financial crisis of 2007-09 . . . Bear Stearns, Lehman Brothers, and Merrill Lynch and . . . Goldman Sachs each finally acknowledged that it had long been negligently under-capitalized owing in large part to negligent provision of flip-clause-swap-contracts.[84] U.S. people paid the price by picking up the flip-clause-swap-contract tab via myriad direct and indirect bailouts.

To convincingly demonstrate that the BoE PRA "*capital and financial reporting requirements achieve comparable outcomes to the corresponding CFTC requirements*", the CFTC must first propose a new determination that prohibits swap dealers from providing the flip-clause-swap-contract. Alternatively, the CFTC may simply deny the application for a U.K. comparability determination and obligate jointly regulated swap dealers to keep on keeping on, i.e., continue conforming to CFTC capital rules.[85]

A "*holistic*" approach to comparing CFTC and BoE PRA capital rules must recognize that the latter allows swap dealers to negligently under-capitalize by providing the flip-clause-swap-contract. A useful capital comparability determination must prevent a swap dealer from doing exactly that, namely negligently under-capitalizing by providing a flip-clause-swap-contract.

> "*I look forward to public comment on the comparability of the approaches and expect the Commission to publish additional analysis to address concerns raised by commenters as part of any final determination.*"[86]

The UK Capital Comparability Determination needs a 26th condition.

"An Entity Using the Determination Must Not Be Party to a Flip-Clause-Swap-Contract."

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83 CFTC, "Statement of Commissioner Kristin N. Johnson: Combatting Systemic Risk and Fostering Integrity of the Global Financial System Through Rigorous Standards and International Comity", 24 January 2024. **(https://www.cftc.gov/PressRoom/SpeechesTestimony/johnsonstatement012424).**

84 Search "*Bear Stearns*" and "*Lehman Brothers*" and "*Merrill Lynch*" and "*Goldman Sachs*" throughout today's joint submission, including herein and in each "WJH—CV—Q1 2024" entry.

85 "Op. Cit. U.K. Swap Dealer Capital Comparability Determination", p8.

86 CFTC, "Statement of Commissioner Christy Goldsmith Romero: Promoting the Resilience of Swap Dealers in the U.K. through Strong Capital Requirements and Reporting", 24 January 2024. **(https://www.cftc.gov/PressRoom/SpeechesTestimony/romerostatement012424).**

Alternatively, the CFTC must re-propose the determination and add the following to each condition.

". . . and Is Not Party To a Flip-Clause-Swap-Contract."

As example, Condition 8 may be amended as follows.

> "*The PRA-designated UK nonbank SD has filed with the Commission a notice stating its intention to comply with the UK PRA Capital Rules and the UK PRA Financial Reporting Rules in lieu of the CFTC Capital Rules and the CFTC Financial Reporting Rules* ***and furthermore, that it is not and will not be party to a flip-clause-swap-contract****. The notice of intent must include the PRA-designated UK nonbank SD's representation that the firm is organized and domiciled in the UK, is a licensed investment firm designated for prudential supervision by the PRA, and is subject to, and complies with, the UK PRA Capital Rules and UK PRA Financial Reporting Rules* ***and furthermore, that it is is not and will not be party to a flip-clause-swap-contract****. A PRA-designated UK nonbank SD may not rely on this Capital Comparability Determination Order until it receives confirmation from Commission staff, acting pursuant to authority delegated by the Commission, that the PRA-designated UK nonbank SD may comply with the applicable UK PRA Capital Rules and UK PRA Financial Reporting Rules in lieu of the CFTC Capital Rules and CFTC Reporting Rules* ***and furthermore, that it is not and will not be party to a flip-clause-swap-contract****. Each notice filed pursuant to this condition must be submitted to the Commission via email to the following address: MPDFinancialRequirements@cftc.gov;*"

Each of the 25 conditions follows in sequence with explanation why the condition individually and collectively fails to achieve *comparability*.[87]

1) **U.S. prudential regulator swap margin rules de-facto preclude an SD** "*subject to regulation by a prudential regulator defined in Section 1a(39) of the CEA (7 U.S.C. 1a(39))*" **from entering a flip-clause-swap-contract.**

In Contrast,

2) **Weak U.K. swap margin rules incentivize an SD that is** "*organized under the laws of the UK and is domiciled in the UK*" **to negligently under-capitalize by entering a flip-clause-swap-contract**.

3) **Weak U.K. swap margin rules incentivize an SD that is** "*licensed as an investment firm in the UK and is designated for prudential supervision by the PRA (PRA-designated UK nonbank SD)*" **to negligently under-capitalize by entering a flip-clause-swap-contract**.

[87] "Op. Cit. U.K. Swap Dealer Capital Comparability Determination", pp131-140.

4) **A PRA-designated UK nonbank SD that** "*is subject to and complies with: Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and amending Regulation (EU) No 648/2012 as restated and applicable in the UK (UK CRR), the provisions implementing the Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (CRD), including Capital Requirements Regulations 2013 and Capital Requirements (Capital Buffers and Macro-prudential Measures) Regulations 2014, Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 to supplement Regulation (EU) No 575/2013 of the European Parliament and the Council with regard to liquidity coverage requirement for Credit Institutions (Liquidity Coverage Delegated Regulation), the Banking Act 2009 and its secondary legislation, and the rules of the PRA as reflected in the PRA Rulebook (collectively the UK PRA Capital Rules)*" **may negligently under-capitalize by entering a flip-clause-swap-contract**.

5) **A PRA-designated UK nonbank SD that** "*satisfies at all times applicable capital ratio and leverage ratio requirements set forth in Article 92 of UK CRR and the rules in PRA Rulebook, CRR Firms, Leverage Ratio – Capital Requirements and Buffers Part, Chapter 3 Minimum Leverage Ratio, the capital conservation buffer requirements set forth in PRA Rulebook, CRR Firms, Capital Buffers Part, and applicable liquidity requirements set forth in PRA Rulebook, CRR Firms, Liquidity Coverage Requirement – UK Designated Investment Firms Part and PRA Rulebook, CRR Firms, Liquidity (CRR) Part, and otherwise complies with the requirements to maintain a liquidity risk management program as required under PRA Rulebook, CRR Firms, Internal Liquidity Adequacy Assessment Part*" **may negligently under-capitalize by entering a flip-clause-swap-contract**.

6) **A PRA-designated UK nonbank SD that is** "*subject to and complies with: Reporting (CRR) and Regulatory Reporting parts of the PRA Rulebook and the Companies Act 2006, Parts 15 and 16 (collectively and together with UK CRR, the UK PRA Financial Reporting Rules)*" **may negligently under-capitalize by entering a flip-clause-swap-contract**.

7) **A PRA-designated UK nonbank SD that** "*maintains at all times an amount of regulatory capital in the form of common equity tier 1 capital as defined in Article 26 of UK CRR, equal to or in excess of the equivalent of $20 million in United States dollars*" **may negligently under-capitalize by entering a flip-clause-swap-contract**.

8) **A PRA-designated UK nonbank SD that** *"has filed with the Commission a notice stating its intention to comply with the UK PRA Capital Rules and the UK PRA Financial Reporting Rules in lieu of the CFTC Capital Rules and the CFTC Financial Reporting Rules*" **may negligently under-capitalize by entering a flip-clause-swap-contract**.

9) **A PRA-designated UK nonbank SD that** "*prepares and keeps current ledgers and other similar records in accordance with the PRA Rulebook, General Organisational Requirements Part, Rule 2.2 and Record Keeping Part, Rule 2.1 and 2.2, and conforming with the applicable accounting principles*" **may negligently under-capitalize by entering a flip-clause-swap-contract**.

10) **A PRA-designated UK nonbank SD that** "*files with the Commission and with the National Futures Association (NFA) a copy of templates 1.1 (Balance Sheet Statement: assets), 1.2 (Balance Sheet Statement: liabilities), 1.3 (Balance Sheet Statement: equity), and 2 (Statement of profit or loss) of the financial reports (FINREP) that PRA-designated UK nonbank SDs are required to submit pursuant to PRA Rulebook, CRR Firms, Regulatory Reporting Part, Chapter 9 Regulatory Activity Group 3, Rule 9.2, and templates 1 (Own Funds), 2 (Own Funds Requirements) and 3 (Capital Ratios) of the common reports ("COREP") that PRA-designated UK nonbank SDs are required to submit pursuant to PRA Rulebook, CRR Firms, Reporting (CRR) Part, Chapter 4 Reporting (Part Seven A CRR), Article 430 Reporting on Prudential Requirements and Financial Information, Rule 1*" **may negligently under-capitalize by entering a flip-clause-swap-contract**.

Likewise, a PRA-designated UK nonbank SD that is "*registered as security-based swap dealers (SBSDs) with the SEC*" and that files "*with the Commission and NFA a copy of Form X-17A-5 (FOCUS Report) that the PRA-designated UK nonbank SD is required to file with the SEC or its designee pursuant to an order granting conditional substituted compliance with respect to Securities Exchange Act of 1934 Rule 18a-7*" **may negligently under-capitalize by entering a flip-clause-swap-contract**.

11) **A PRA-designated UK nonbank SD that** "*files with the Commission and with NFA a copy of its annual audited accounts and strategic report (together, annual audited financial report) that are required to be prepared and published pursuant to Parts 15 and 16 of Companies Act 2006*" **may negligently under-capitalize by entering a flip-clause-swap-contract**.

12) **A PRA-designated UK nonbank SD that files** "*Schedule 1 of Appendix B to Subpart E of Part 23 of the CFTC's regulations (17 CFR 23 Subpart E – Appendix B) with the Commission and NFA on a monthly basis*" **may negligently under-capitalize by entering a flip-clause-swap-contract**.

13) **A PRA-designated UK nonbank SD that** *"submits with each set of FINREP and COREP templates, annual audited financial report, and Schedule 1 of Appendix B to Subpart E of Part 23 of the CFTC's regulations, a statement by an authorized representative or representatives of the PRA-designated UK nonbank SD that to the best knowledge and belief of the representative or representatives, the information contained in the reports, including the conversion of balances in the reports to U.S. dollars, is true and correct*" **may negligently under-capitalize by entering a flip-clause-swap-contract**.

14) **A PRA-designated UK nonbank SD that** "*files a margin report containing the information specified in Commission Regulation 23.105(m) (17 CFR 23.105(m)) with the Commission and with NFA within 35 calendar days of the end of each month*" **may negligently under-capitalize by entering a flip-clause-swap-contract**.

15) **A PRA-designated UK nonbank SD that is party to one or more flip-clause-swap-contracts and** "*files a notice with the Commission and NFA within 24 hours of being informed by the PRA that the firm is not in compliance with any component of the UK PRA Capital Rules or the UK PRA Financial Reporting Rules*" **is much further "not in compliance" with the "PRA Capital Rules or the UK PRA Financial Reporting Rules" than the PRA realizes, may already be insolvent, and faces impending flip-clause activation.**

16) **A PRA-designated UK nonbank SD that is party to one or more flip-clause-swap-contracts and** "*files a notice within 24 hours with the Commission and NFA if it fails to maintain regulatory capital in the form of common equity tier 1 capital as defined in Article 26 of UK CRR, equal to or in excess of the U.S. dollar equivalent of $20 million*" **has even less common equity tier 1 capital than reported, may already be insolvent, and faces impending flip-clause activation.**

17) **A PRA-designated UK nonbank SD that is party to one or more flip-clause-swap-contracts and** "*provides the Commission and NFA with notice within 24 hours of filing a capital conservation plan with the PRA pursuant to PRA Rulebook, CRR Firms, Capital Buffers Part, Chapter 4 Capital Conservation Measures, Rule 4.4, indicating that the firm has breached its combined capital buffer requirement*" **has filed an insufficient capital conservation plan because the SD has breached its combined capital buffer requirements by more than reported, may already be insolvent, and faces impending flip-clause activation.**

18) **A PRA-designated UK nonbank SD that is party to one or more flip-clause-swap-contracts and** "*provides the Commission and NFA with notice within 24 hours if it is required by the PRA to maintain additional capital or additional liquidity requirements, or to restrict its business operations, or to comply with other requirements pursuant to Financial Services and Markets Act 2000, Part 4A or the Capital Requirements Regulation 2013, Regulation 35B*" **may already be insolvent, and moreover may remain insolvent after maintaining additional capital or additional liquidity requirements, or restricting business operations, or complying with other requirements pursuant to Financial Services and Markets Act 2000, Part 4A or the Capital Requirements Regulation 2013, Regulation 35B because the PRA ignores under-capitalization that a flip-clause-swap-contract creates.**

19) **A PRA-designated UK nonbank SD that is party to one or more flip-clause-swap-contracts and** "*files a notice with the Commission and NFA within 24 hours if it fails to maintain its minimum requirement for own funds and eligible liabilities (MREL), if the PRA-*

designated UK nonbank SD is subject to such requirement as set forth by the Bank of England pursuant to the Banking Act 2009, Section 3A and the Bank Recovery and Resolution (No. 2) Order 2014, Part 9" **has filed too late and may be insolvent, owing to MREL not incorporating impending loss of flip-clause-swap-contract assets, which is entirely ignored under requirements "as set forth by the Bank of England pursuant to the Banking Act 2009, Section 3A and the Bank Recovery and Resolution (No. 2) Order 2014, Part 9".**

20) **A PRA-designated UK nonbank SD that is party to one or more flip-clause-swap-contracts and "***files a notice with the Commission and NFA within 24 hours of when the firm knew or should have known that its regulatory capital fell below 120 percent of its minimum capital requirement, comprised of the firm's core capital requirements and any applicable capital buffer requirements*" ("*For purposes of the calculation, the 20 percent excess capital must be in the form of common equity tier 1 capital*") **has filed too late and may be insolvent, owing to regulatory capital not incorporating impending loss of flip-clause-swap-contract assets. To be clear, a firm's "core capital requirements and any applicable capital buffer requirements" and "common equity tier 1 capital" entirely ignore under-capitalization of the flip-clause-swap-contract.**

21) **A PRA-designated UK nonbank SD that is party to one or more flip-clause-swap-contracts and "***files a notice with the Commission and NFA within 24 hours if it fails to make or keep current the financial books and records*" **has recklessly and negligently lost the ability to discover the extent of under-capitalization attributable to one or more flip-clause-swap-contracts, may already be insolvent, and faces impending flip-clause activation.**

22) **A PRA-designated UK nonbank SD that is party to one or more flip-clause-swap-contracts and "***files a notice with the Commission and NFA within 24 hours of the occurrence of any of the following: (i) a single counterparty, or group of counterparties under common ownership or control, fails to post required initial margin or pay required variation margin on uncleared swap and non-cleared security-based swap positions that, in the aggregate, exceeds 25 percent of the PRA-designated UK nonbank SD's minimum capital requirement; (ii) counterparties fail to post required initial margin or pay required variation margin to the PRA-designated UK nonbank SD for uncleared swap and non-cleared security-based swap positions that, in the aggregate, exceeds 50 percent of the PRA-designated UK nonbank SD's minimum capital requirement; (iii) the PRA-designated UK nonbank SD fails to post required initial margin or pay required variation margin for uncleared swap and non-cleared security-based swap positions to a single counterparty or group of counterparties under common ownership and control that, in the aggregate, exceeds 25 percent of the PRA-designated UK nonbank SD's minimum capital requirement; or (iv) the PRA-designated UK nonbank SD fails to post required initial margin or pay required variation margin to counterparties for uncleared swap and non-*

cleared security-based swap positions that, in the aggregate, exceeds 50 percent of the PRA-designated UK nonbank SD's minimum capital requirement" **has filed too late, may be insolvent, is flying blind, and may face impending flip-clause activation because U.K. swap margin rules LARGELY EXCLUDE the flip-clause-swap-contract. U.K. swap margin rules exempt almost all SDs and flip-clause-swap-contract counterparties from posting any initial or variation margin. Moreover, a "PRA-designated UK nonbank SD's minimum capital requirement" entirely ignores the under-capitalization of a flip-clause-swap-contract.**

23) A PRA-designated UK nonbank SD that is party to one or more flip-clause-swap-contracts and "*files a notice with the Commission and NFA of a change in its fiscal year-end approved or permitted to go into effect by the PRA*" **has not, by merely doing so, rectified contract under-capitalization.**

24) A PRA-designated UK nonbank SD that is party to one or more flip-clause-swap-contracts or an entity acting on its behalf that "*notifies the Commission of any material changes to the information submitted in the application for capital comparability determination, including, but not limited to, material changes to the UK PRA Capital Rules or UK PRA Financial Reporting Rules imposed on PRA-designated UK nonbank SDs, the PRA's supervisory authority or supervisory regime over PRA-designated UK nonbank SDs, and proposed or final material changes to the UK PRA Capital Rules or UK PRA Financial Reporting Rules as they apply to PRA-designated UK nonbank SDs*" **may negligently under-capitalize by entering a flip-clause-swap-contract until the "UK PRA Capital Rules or UK PRA Financial Reporting Rules imposed on PRA-designated UK nonbank SDs, the PRA's supervisory authority or supervisory regime over PRA-designated UK nonbank SDs, and proposed or final material changes to the UK PRA Capital Rules or UK PRA Financial Reporting Rules as they apply to PRA-designated UK nonbank SDs" obligate an SD to fully capitalize self-referencing credit risk posed by each flip-clause-swap-contract.**

25) **A PRA-designated UK nonbank SD that is party to one or more flip-clause-swap-contracts that** "*submits electronically*" those "*reports, notices, and other statements required to be filed by the PRA-designated UK nonbank SD with the Commission and NFA pursuant to the conditions of this Capital Comparability Determination Order*" **may negligently under-capitalize by entering a flip-clause-swap-contract.**

Nineteen SIFMA Confirmations That Outcomes Under U.K. Capital Comparability Determination *AIN'T COMPARABLE* to Outcomes Under CFTC Or SEC Or U.S. Prudential Regulator Capital and Swap Margin Rules

> "*I look forward to public comment on the comparability of the approaches and expect the Commission to publish additional analysis to address concerns raised by commenters as part of any final determination.*"[88]

1) A PRA-designated UK nonbank SD that provides a flip-clause-swap-contract requires significantly higher "*loss-absorbing capacity*" than BoE PRA capital rules prescribe for each flip-clause-swap-contract. Moreover, the BoE PRA cannot access the systemic risk buffer, or the O-SII buffer, or the G-SII buffer to rectify the SD's negligent under-capitalization of each contract.

> "***[T]he systemic risk buffer does not apply to PRA-designated investment firms*** *[emphasis added].*"[89]
>
> ---
>
> " . . . ***The O-SII buffer, however, can only be applied to ring-fenced banks and building societies, and therefore is not relevant to the six firms*** *[emphasis added].*
>
> "***There are no relevant G-SIIs, and therefore the G-SII buffer is not currently relevant*** *[emphasis added].*"[90]

2) The EU Capital Requirements Regulation (CRR), "*converted into domestic UK law and UK legislation implementing EU directives*", by entirely ignoring dealer-self-exposure to the flip-clause-swap-contract, **incentivizes a dealer to negligently under-capitalize by entering a flip-clause-swap-contract**."[91]

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88 "Op. Cit. Commissioner Christy Goldsmith Romero: 'Promoting U.K. Swap Dealer Resilience Through Strong Capital Requirements", 24 January 2024.

89 SIFMA, "Follow-up Questions: re:, CFTC Staff Questions Regarding Substituted Compliance Application for UK Swap Dealers from CEA Sections 4s(e)–(f) and Rules 23.101 and 23.105(d)–(e), (p)(2)", p3. **(https://www.cftc.gov/LawRegulation/DoddFrankAct/CDSCP/index.htm).**

90 "Ibid.", p4. "*There are two firm-specific buffers that can be applied at the discretion of the PRA to systemically important banks or to address systemic risks. These are the global systemically important institutions ("G-SII") and other systemically important institutions ("O-SII") buffers.*"

91 "Ibid.", p1.

3) "*Counterparty Credit Risk (CCR)*" requirement, by entirely ignoring dealer-self-exposure to the flip-clause-swap-contract, **incentivizes a dealer to negligently under-capitalize by entering a flip-clause-swap-contract**."[92]

4) The "*leverage ratio floor*", by entirely omitting dealer-self-exposure to the flip-clause-swap-contract, **incentivizes a dealer to negligently under-capitalize by entering a flip-clause-swap-contract**."[93]

5) The BoE will not clean up post-default flip-clause-swap-contract messes such as the mess that Lehman Brothers created for a PRA-designated UK nonbank SD.

> "*None of the six firms have been designated as a resolution entity.*"[94]

6) Both the CRR requirement and the "*total loss absorbing capacity (TLAC)*" requirement, by entirely ignoring dealer-self-exposure to the flip-clause-swap-contract, **incentivize a dealer to negligently under-capitalize by entering a flip-clause-swap-contract**."[95]

7) The "*common reporting framework (COREP)*", by entirely ignoring dealer-self-exposure to the flip-clause-swap-contract, **incentivizes a dealer to negligently under-capitalize by entering a flip-clause-swap-contract**."[96]

8) The "*Regulatory Reporting Part of the PRA Rulebook*" and the "*FINREP reports (templates 1- 3)*", by entirely ignoring dealer-self-exposure to the flip-clause-swap-contract, **incentivizes a dealer to negligently under-capitalize by entering a flip-clause-swap-contract**."[97]

9) (Although not relevant to the UK Capital Comparability Determination, it is important to note that the '*FINREP template 10 (Derivatives – Trading and economic hedges*)')", by entirely ignoring dealer-self-exposure to the flip-clause-swap-contract, **incentivizes a dealer to negligently under-capitalize by entering a flip-clause-swap-contract**."[98])

10) SEC reporting, by entirely ignoring dealer-self-exposure to the flip-clause-swap-contract, **incentivizes a dealer to negligently under-capitalize by entering a flip-clause-swap-contract**.[99]

11) *"[R]esponsible individuals' status from the ICAEW (Institute of Chartered Accountants in England and Wales)*" **does not obligate** "*audit partners/directors . . . [who] . . . sign*

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92 "Ibid.", pp1 and 10.
93 "Ibid.", p4.
94 "Ibid.", p5.
95 "Ibid.", p5.
96 "Ibid.", pp6-7.
97 "Ibid.", p6.
98 "Ibid.", p7.
99 "Ibid.", p7.

accounts in the UK" **to recognize dealer-self-exposure to the flip-clause-swap-contract.**[100]

12) The PRA Rulebook should, but does not, designate the flip-clause-swap-contract as among the most toxic "*capital depleting activities*" in recognition of 100% dealer-self-exposure. Indeed, by the time a contract provider needs a "*capital conservation plan*", **the impending activation of flip-clauses will have already consigned the provider into an irreversible doom loop to bankruptcy, default, insolvency, or other extreme credit impairment.**

> "*The Capital Buffers part of the PRA Rulebook does not directly grant the PRA powers to set additional requirements should they reject a capital conservation plan. The direct impact is limited to the continued prohibition on certain capital depleting actions specified in that part of the rulebook.*"[101]

13) "*PRA, The Prudential Regulation Authority's approach to banking supervision*", by entirely ignoring dealer-self-exposure to the flip-clause-swap-contract, **incentivizes a dealer to negligently under-capitalize by entering a flip-clause-swap-contract**."[102]

14) "*Reg 35B(1)(g) of The Capital Requirements Regulations 2013 (2013 Regulations)"*, by entirely ignoring dealer-self-exposure to the flip-clause-swap-contract, **incentivizes a dealer to negligently under-capitalize by entering a flip-clause-swap-contract**."[103]

15) "*Reg 35B(1)(b) of the 2013 Regulations*", by entirely ignoring dealer-self-exposure to the flip-clause-swap-contract, **incentivizes a dealer to negligently under-capitalize by entering a flip-clause-swap-contract**."[104]

16) "*Reg 35B(1)(d) of the 2013 Regulations*", by entirely ignoring dealer-self-exposure to the flip-clause-swap-contract, **incentivizes a dealer to negligently under-capitalize by entering a flip-clause-swap-contract**.[105]

17) "*Reg 35B(1)(d) of the 2013 Regulations*", by entirely ignoring dealer-self-exposure to the flip-clause-swap-contract, **incentivizes a dealer to negligently under-capitalize by entering a flip-clause-swap-contract**."[106]

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100 "Ibid.", p8.
101 "Ibid.", p9.
102 "Ibid.", p9.
103 "Ibid.", p11.
104 "Ibid.", p11.
105 "Ibid.", p11.
106 "Ibid.", p11.

18) *Reg 35B(1)(i) of the 2013 Regulations*", by entirely ignoring dealer-self-exposure to the flip-clause-swap-contract, **incentivizes a dealer to negligently under-capitalize by entering a flip-clause-swap-contract**."[107]

19) "*Reg 35B(1)(j) of the 2013 Regulations*", by entirely ignoring dealer-self-exposure to the flip-clause-swap-contract, **incentivizes a dealer to negligently under-capitalize by entering a flip-clause-swap-contract**."[108]

Eight WJH Corrections to IIB/ISDA/SIFMA "*Suggestions*" for U.K. Capital Comparability Determination *TO MAKE OUTCOMES COMPARABLE* to Outcomes Under CFTC and SEC and, Best-of-All, U.S. Prudential Regulator Capital and Swap Margin Rules

> "*I look forward to public comment on the comparability of the approaches and expect the Commission to publish additional analysis to address concerns raised by commenters as part of any final determination.*"[109]

Following are corrections to each of the seven corrections that IIB, ISDA, and SIFMA propose for the U.K. Capital Comparability Determination, and also a correction to the one condition to the Mexico Capital Comparability Determination that IIB, ISDA, and SIFMA cite.[110]

N.B. Each WJH correction omits all language strike-outs that IIB, ISDA, and SIFMA suggested.

1) **U.K. Condition 4—**"*The PRA-designated UK nonbank SD* ***that is not party to a flip-clause-swap-contract*** *is subject to and complies with: . . . the Banking Act 2009 and its secondary legislation with regard to minimum requirements for own funds and eligible liabilities, . . . (collectively, UK PRA Capital Rules).*"

   For an SD that is party to a flip-clause-swap-contract, both the original proposal and the IIB/ISDA/SIFMA suggestion produce a deficiently sub-par outcome because an SD that merely complies with "the Banking Act 2009 and its secondary legislation with regard to minimum requirements for own funds and eligible liabilities" may negligently under-capitalize by entering a flip-clause-swap-contract.

2) **Mexico Condition 15—"***The Mexican nonbank SD* ***that is not party to a flip-clause-swap-contract*** *files a notice with the Commission and NFA within 24 hours of when it knows that its regulatory capital is below 120 percent of the minimum capital requirement under the Mexican Capital Rules. The Notice must be prepared in the English language.*"

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107 "Ibid.", p11.

108 "Ibid.", p11.

109 "Op. Cit. Commissioner Christy Goldsmith Romero: 'Promoting U.K. Swap Dealer Resilience Through Strong Capital Requirements", 24 January 2024.

110 "Op. Cit. IIB, ISDA, and SIFMA, Re U.K. Capital Comparability Determination 22 March 2024", pp4-8.

For an SD that is party to a flip-clause-swap-contract, both the original proposal and the IIB/ISDA/SIFMA suggestion produce a deficiently sub-par outcome because the SD has regulatory capital even further below 120 percent of the minimum capital requirement under the Mexican Capital Rules than either the SD or Mexican regulator realizes, may already be insolvent, and faces impending flip-clause activation.

3) **U.K. Condition 19—**"*The PRA-designated UK nonbank SD* ***that is not a party to a flip-clause-swap-contract*** *files a notice with the Commission and NFA within 24 hours if it fails to maintain its minimum requirement for own funds and eligible liabilities (MREL), if the PRA-designated nonbank SD is subject to such requirement as set for the by the Bank of England pursuant to the Banking Act 20009, Section 3A and the Bank Recovery and Resolution (No. 2) Order 2014, Part 9;*"

For an SD that is party to a flip-clause-swap-contract, both the original proposal and the IIB/ISDA/SIFMA suggestion produce a deficiently sub-par outcome because the SD has filed too late and may be insolvent, owing to MREL not incorporating impending loss of flip-clause-swap-contract assets, which is entirely ignored under requirements "as set forth by the Bank of England pursuant to the Banking Act 2009, Section 3A and the Bank Recovery and Resolution (No. 2) Order 2014, Part 9".

4) **U.K. Condition 20—**"*The PRA-designated UK nonbank SD* ***that is not party to a flip-clause-swap-contract*** *files a notice with the Commission and NFA within 24 hours of when the firm knew or should have known that its regulatory capital fell below 120 percent of its minimum capital requirement, comprised of the firm's core capital requirements and any applicable capital buffer requirements. For purposes of the calculation, the 20 percent excess capital must be in the form of common equity tier 1 capital.*"

For an SD that is party to a flip-clause-swap-contract, both the original proposal and the IIB/ISDA/SIFMA suggestion produce a deficiently sub-par outcome because the SD has filed too late and may be insolvent, owing to regulatory capital not incorporating impending loss of flip-clause-swap-contract assets. To be clear, a firm's "core capital requirements and any applicable capital buffer requirements" and "common equity tier 1 capital" entirely ignore under-capitalization of the flip-clause-swap-contract.

N.B. Preserve this correction and entirely disregard the SECOND IIB, ISDA, and SIFMA correction to U.K. Capital Comparability Determination Condition 20 in 6), further below.

5) **U.K. Condition 21—**"*The PRA-designated UK nonbank SD* ***that is not a party to a flip-clause-swap-contract*** *files a notice with the Commission and NFA within 24 hours if it fails to make or keep current the financial books and records.*"

For an SD that is party to a flip-clause-swap-contract, both the original proposal and the IIB/ISDA/SIFMA suggestion produce a deficiently sub-par outcome because the SD has recklessly and negligently lost the ability to discover the extent of under-capitalization attributable to one or more flip-clause-swap-contracts, may already be insolvent, and faces impending flip-clause activation.

6) **BACK to U.K. Condition 20, AGAIN—The CFTC must entirely disregard this IIB/ISDA/SIFMA correction!**

See correction to initial IIB/ISDA/SIFMA correction of U.K. Capital Comparability Determintion Condition 20 in 4), further above.

7) **U.K. Condition 22—"***The PRA-designated UK nonbank SD* ***that is not party to a flip-clause-swap-contract*** *files a notice with the Commission and NFA within 24 hours of the occurrence of any of the following: (i) a single counterparty, or group of counterparties under common ownership or control, fails to post required initial margin or pay required variation margin on uncleared swap and non-cleared security-based swap positions that, in the aggregate, exceeds 25 percent of the PRAdesignated UK nonbank SD's minimum total capital requirement; (ii) counterparties fail to post required initial margin or pay required variation margin to the PRA designated UK nonbank SD for uncleared swap and non-cleared security based swap positions that, in the aggregate, exceeds 50 percent of the PRA-designated UK nonbank SD's minimum total capital requirement; (iii) the PRA-designated UK nonbank SD fails to post required initial margin or pay required variation margin for uncleared swap and non-cleared security-based swap positions to a single counterparty or group of counterparties under common ownership and control that, in the aggregate, exceeds 25 percent of the PRA-designated UK nonbank SD's minimum total capital requirement; or (iv) the PRA-designated UK nonbank SD fails to post required initial margin or pay required variation margin to counterparties for uncleared swap and non-cleared security-based swap positions that, in the aggregate, exceeds 50 percent of the PRA-designated UK nonbank SD's minimum total capital requirement;*"

For an SD that is party to a flip-clause-swap-contract, both the original proposal and the IIB/ISDA/SIFMA suggestion produce a deficiently sub-par outcome because the SD has filed too late, may be insolvent, is flying blind, and may face impending flip-clause activation because U.K. swap margin rules LARGELY EXCLUDE the flip-clause-swap-

contract. U.K. swap margin rules exempt almost all SDs and flip-clause-swap-contract counterparties from posting any initial or variation margin. Moreover, a "PRA-designated UK nonbank SD's minimum capital requirement" entirely ignores the under-capitalization of a flip-clauseswap-contract.

8) **U.K. Condition 24—"***The PRA-designated UK nonbank SD* ***that is not party to a flip-clause-swap-contract*** *or an entity acting on its behalf notifies the Commission of any material changes to the information submitted in the application for capital comparability determination, including, but not limited to, material changes to the UK PRA Capital Rules or UK PRA Financial Reporting Rules imposed on PRA-designated UK nonbank SDs, or the PRA's supervisory authority or supervisory regime over PRA-designated UK nonbank SDs, and proposed or final material changes to the UK PRA Capital Rules or UK PRA Financial Reporting Rules as they apply to PRA-designated UK nonbank SDs*;"

For an SD that is party to a flip-clause-swap-contract, both the original proposal and the IIB/ISDA/SIFMA suggestion produce a deficiently sub-par outcome because the SD may negligently under-capitalize by entering a flip-clause-swap-contract until the "UK PRA Capital Rules or UK PRA Financial Reporting Rules imposed on PRA-designated UK nonbank SDs, the PRA's supervisory authority or supervisory regime over PRA-designated UK nonbank SDs, and proposed or final material changes to the UK PRA Capital Rules or UK PRA Financial Reporting Rules as they apply to PRA-designated UK nonbank SDs" obligate an SD to fully capitalize self-referencing credit risk posed by each flip-clause-swapcontract.

2024 To-Do: Shoo Flip-Clause-Swap-Contract Chickens Home to Roost!

1) Request Commissioner Caroline D. Pham to recuse from voting on the U.K. Capital Comparability Determination considering her seven-plus year history at Citi and the benefits that the determination would provide Citigroup Global Markets Holdings Inc.
   - https://www.linkedin.com/in/carolinedpham/
   - Exclusive: Citi hit by new Fed rebuke, setbacks on consent orders | Reuters

2) If Commissioner Caroline D. Pham does not recuse from voting on the U.K. Capital Comparability Determination considering her seven-plus year history at Citi, request that the Commission recuse Pham from voting on the determination considering the benefits it would provide Citigroup Global Markets Holdings Inc.

3) Submit complaint to CFTC Office of Inspector General that the CFTC violates publicly stated policy by failing to post Code of Federal Regulations (CFR), Title 17, Chapter 1, Section 13.1 petitions for rulemakings and associated exhibits and comments.
   - https://www.ecfr.gov/current/title-17/chapter-I/part-13
     "*Any person may file a petition with the Secretariat of the Commission, by mail or electronically through the Commission website, for the issuance, amendment or repeal of a rule of general application. The petition shall . . . set forth the text of any final rule or amendment or shall specify the rule the repeal of which is sought. The petition shall further state the nature of the petitioner's interest and may state arguments in support of the issuance, amendment or repeal of the rule. The Secretariat shall acknowledge receipt of the petition, refer it to the Commission for such action as the Commission deems appropriate, and notify the petitioner of the action taken by the Commission. Except in affirming a prior denial or when the denial is self-explanatory, notice of a denial in whole or in part of a petition shall be accompanied by a brief statement of the grounds of denial.*"
   - https://www.cftc.gov/LawRegulation/FederalRegister/finalrules/2019-27103.html
     "*The Commission is adopting a change in proposed regulation Sec. 13.1 to allow the electronic submission of petitions through the Commission's website, as recommended.* ***Furthermore, it will be the Commission's policy to post the petitions for rulemaking on the Commission's website*** *[emphasis added]. The electronic submissions of petitions will facilitate the submission of petitions for rulemaking and thereby the public's engagement in the Commission's rulemaking process.*"

The CFTC *reluctantly* acknowledged my Section 13.1 petition to ban the flip clause of May 26, 2020 a month later on June 26, 2020 after I *embarrassed* it into doing so.

- https://croataninstitute.org/wp-content/uploads/2022/06/CFTC-WJH-2020-6-26-Sec-13.1-Rulemaking-Petition-Acknowledgment_WJHarrington_06-26-2020.pdf

The CFTC *unavoidably* makes my Section 13.1 petition to ban the flip clause of May 26, 2020, publicly available because it was part of a joint submission regarding three additional CFTC matters, as well.

- https://comments.cftc.gov/PublicComments/CommentList.aspx?id=3106

My Section 13.1 petition to ban the flip clause of May 26, 2020, does NOT "*contain confidential information (e.g., trade secrets, CEA section 8 material) and abusive or inappropriate language.*"

> " *\13\ The Commission will retain its discretion whether to post petitions that contain confidential information (e.g., trade secrets, CEA section 8 material) and abusive or inappropriate language."*

However, the CFTC neither posts my petition on a dedicated site for all petitions, nor posts supporting materials that I have submitted after May 26, 2020. Does the CFTC outsource posting petitions to the SEC? The analogous SEC site for rulemaking petitions contains my petition for a parallel SEC rulemaking to ban the flip clause of July 21, 2022, and associated materials that I have submitted since then, including today's submission.

- https://www.sec.gov/files/rules/petitions/2022/petn4-790.pdf
- https://www.sec.gov/comments/4-790/4-790.htm

4) Submit a Freedom of Information Act (FOIA) request to obtain all Section 13.1 petitions submitted since 1976.

- FOIA | CFTC

5) Update the CFTC top-secret, publicly unavailable file for my Section 13.1 petition to ban the flip clause, and the SEC public site for comments on my parallel petition to ban the flip clause, and a second SEC public site for comments on a petition for clarification on policy for credit rating agencies of January 13, 2023, by submitting all materials pertaining to the flip-clause-swap-contract that I have produced since 2011.

- https://www.sec.gov/files/rules/petitions/2022/petn4-790.pdf
- https://www.sec.gov/comments/4-790/4-790.htm
- https://www.sec.gov/files/rules/petitions/2023/petn4-799.pdf
- https://www.sec.gov/comments/4-799/4-799.htm

6) File complaint with SEC Office of Credit Ratings, ESMA, Financial Conduct Authority, Fitch Ratings, Moody's Ratings, and S&P Global Ratings, respectively, that each of the three credit rating companies violates its respective internal procedures by failing to post critiques of existing credit rating methodologies / criteria on applicable sites.

Fitch Ratings, Rating Criteria tab

- https://www.fitchratings.com/criteria

Moody's Ratings, Request for Comment Page

- https://ratings.moodys.com/request-for-comment

S&P Global Ratings, Ratings Criteria and Models

- https://disclosure.spglobal.com/ratings/en/regulatory/ratings-criteria

7) Prepare book proposal that describes how one U.S. person may pursue public advocacy to influence policy in any field, using my experiences as a template.

Best regards,

Bill Harrington

cc: Mr. Rostin Behnam, Chairman
Ms. Kristin N. Johnson, Commissioner
Ms. Christy Goldsmith Romero, Commissioner
Ms. Summer K. Mersinger, Commissioner
Ms. Caroline D. Pham, Commissioner
Ms. Amanda Olear, Director, Market Participants Division
Mr. Thomas Smith, Deputy Director
Mr. Rafael Martinez, Associate Director
Ms. Liliya Bozhanova, Special Counsel