EBA EUROPEAN BANKING AUTHORITY

EBA BANKING STAKEHOLDER GROUP

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Consultation Paper - EBA/CP/2020/15

First draft of the response to the EBA Consultation paper (CP) on draft Regulatory Technical Standards on impracticability of contractual recognition of bail-in clause under Article 55(6) of Directive 2014/59/EU and draft Implementing Standards for the notification of impracticability of contractual recognition under Article 55(8) of Directive 2014/59/EU;

The Banking Stakeholder Group (BSG) welcomes the opportunity to express their views on the public consultation on the draft Regulatory Technical Standards (RTS) on impracticability of contractual recognition of bail-in clauses, and on draft Implementing Technical Standards (ITS) for the notification of such impracticability. In this context, we herewith provide you with our responses to the questions listed in the Consultation Paper (CP). We kindly appreciate your consideration about our comments and remain at your disposal for further clarifications in the matter.

Introduction

Pursuant to Article 55(6) of BRRD, the EBA has the mandate to develop draft regulatory technical standards in order to specify:

(a) the conditions under which it would be legally or otherwise impracticable for an institution or entity to include the contractual term referred to in Article 55(1) BRRD in certain categories of liabilities;

(b) the conditions for the resolution authority to require the inclusion of the contractual term pursuant to the third subparagraph of paragraph 2 of Article 55 BRRD;

(c) the reasonable timeframe for the resolution authority to require the inclusion of a contractual term pursuant to the third subparagraph of paragraph 2 of Article 55 BRRD.

Moreover, Article 55(8) of BRRD requires the EBA to develop a draft implementing technical standards to specify uniform formats and templates for the notification to resolution authorities for the purposes of Article 55(2) BRRD.

In what follows, the BSG answers to the proposed questions in the CP.

Q1 - Are there any third country authorities, other than resolution authorities, that might impose instructions not to include the contractual bail-in recognition term?

Unfortunately, the BSG lacks the means and the resources to categorically answer this question.

In the absence of specific information on this point we consider that the EBA should adopt a more prudent approach in terms of the binding nature of the RTS.

Q2. Can you provide concrete examples of instruments, such as letters of guarantee, governed by the law of a third country which are not used in the context of trade finance and which would be subject to conditions of impracticability?

Considering the absence of an exact definition in legal terms of "trade finance", for the avoidance of doubt it would be useful to clarify that condition 1(c) of impracticability includes local letters of credit, letters of guarantee, Standby Letters of Credit, performance bonds or tender bonds or similar local instruments governed by the law of a third country where the party asking for those (i.e., the beneficiary) requires a specific text (that typically does not include a bail-in clause).

It is worth noting that the beneficiary is not the institution/entity's client (as opposed to the applicant) and, therefore, the communication channel between the beneficiary and the institution/entity, as well as the entity's negotiation power vis-à-vis the beneficiary, are in practice non-existent.

Other examples include guarantees issued in favor of public bodies (e.g., where government bodies tender a project, guarantees issued in favor of regulatory authorities, courts, etc.); again, in these cases the terms and conditions are set out by the relevant public body or authority and cannot be modified.

Q3. Do you agree that the categories of liabilities in the above table do not meet the definition of impracticability for the purpose of Article 55(6a)?

With regard to "*Counterparty refusal*", we would like to stress that there is no legal reason why an institution/entity and its client may not agree to amend any contractual terms even those subject to international protocols or standard terms or the guarantees of trade finance operations. Nevertheless, the reason why an entity may not be able in practice to amend a contractual term subject to international standard terms/protocols or the guarantees related to trade finance operations, is the refusal of the client to do so in the context of a global market with different regulatory requirements in place.

Therefore, even if the mere refusal of the client is not a cause of impracticability as such, it is arguable that -as has been recognized by the European Commission per recital 26 of Directive (EU) 2019/879-, under certain circumstances the refusal from the client should be considered a cause of impracticability.

As a result, although it is understandable that a counterparty merely refusing to accept a bail-in clause should not in itself be a reason for impracticability, we believe that it may be under certain circumstances.

A reason for impracticability may be that the institution/entity *tries hard* to persuade the counterparty but for some reason fails and then decides that it still wants to enter into the

contract. We should bear in mind that it is not impracticable per se, but very difficult. There must be a reasonable threshold at which a firm is considered to have made sufficient attempt to include the terms, but was unsuccessful. The BSG suggests giving EBA an explicit mandate to define the "reasonable threshold" for considering that an entity has made "sufficient attempts" to persuade a counterparty" to include bail-in terms.

Thus, notwithstanding that the final decision on whether this is a major stumbling block or not must depend on the resolution authorities, there must be a minimum set of common requirements and criteria to determine how big the issue is. Regardless of any threshold, the common requirements must be clear in advance for institutions/entities so as to prevent arbitrariness/or perceived arbitrariness.

With regard to "*Acquired liabilities*", the BSG is of the view that where an institution/entity has acquired a liability, and where it has no power to amend the terms, it is not very realistic to conclude that it can still seek to include a contractual recognition of bail-in in a contract for the acquisition of the instrument.

The contracts for acquisition and certain types of contracts may not be with the counterparty to whom the liability is owed. For example:

(i) an assignment agreement by means of which an existing lender transfers part or all of its position in a syndicated facility agreement to a new lender, in this case -the transfer agreement will be executed by the assignee, the assignor and the facility agent but not by the borrower and the other parties under the facility agreement-, or

(ii) an adherence letter to a non-disclosure agreement (NDA); in this case - it will not be signed by the beneficiary of the underlying NDA but by the original recipient under said document and the new recipient- meaning that the counterparty cannot give the recognition necessary for bail-in.

Similarly, a counterparty may refuse the inclusion of the contractual term as it may consider this as an erosion of its rights under the agreement with a prior party. These cases should fall in the same category as when a counterparty refuses to accept the bail-in clause.

Q4. Do you consider that there is any condition of impracticability that has not been captured in the analysis?

The EBA states *However, BRRD provides that a refusal by the counterparty to agree to be bound by a contractual bail-in recognition clause should not as such be considered a cause of impracticability* The question is what institutions are meant to do in those situations? This should be clarified in the RTS.

It's understandable that a counterparty merely refusing to accept a bail-in clause should not in itself be a reason for impracticability. What should be a reason for impracticability is that the

institution tries hard[1] to persuade the counterparty but for some reason fails and then decides that it still wants to enter into the contract.

Institutions should not be required to give up on transactions in those situations but initially be allowed to make their own assessment as to whether or not the absence of a bail-in clause would negatively affect their MREL or resolvability such that a material impediment to resolvability is created.

Otherwise the EBA RTS may also not cover non-critical loan trading activities, where it would be difficult to negotiate with borrowers or sponsors to require the inclusion of bail-in language. This could restrict EU loan trading business as a result of not allowing for impracticability.

Another criterion for impracticability to which we think the EBA should give due consideration is *liabilities loans*[2] which are governed by English law and that are being changed to EU27 law because of Brexit (English law governed liabilities). An impracticability exemption for these liabilities would be helpful towards building onshore EU presence in line with broader supervisory expectations.

A separate point, but related to the UK´s departure from the EU would like to urge resolution authorities to carry out their assessments on the equivalence and recognition of the write down and conversion powers under English law, as soon as possible, and we to conclude binding agreements in case of a negative outcome, as per art 55(1) of BRRD.

Q5. Do you agree with EBA's approach for developing the draft ITS?

As a general principle, the BSG welcomes the standardization and harmonization provided by ITSs. In this particular case, the BSG follows this principle.

Q6. Do you consider reasonable 3 months for entry into force of the ITS, as allowing enough time to set-up the proper and adequate capabilities to notify with this ITS?

We have experienced in the past that rigid timetables are not suitable in this context as most of the time there is a heavy underlying workload related to contractual recognition. A 3-months period may seem too rigid, and the BSG would support a longer, say 6-month period.

Q7. Do you agree with EBA's proposed conditions of impracticability?

With regards to condition 1.(c) (i.e., "the liability arises out of instruments or agreements concluded in accordance with and governed by internationally standardized terms or protocols which the institution or entity is unable to amend;"), for comprehensive and clarification purposes it would be useful to add an explicit reference to

[1] Trying hard is difficult to prove and in general particularly in business situations, trying hard is not trying harder.
[2] A clarification is needed. Is it "all" liabilities loans under UK law, or only the ones that are "bail-inable" under the spirit of BRRD (ie sub debt)?

(i) guarantees, counter-guarantees, letters of credit or other trade finance instruments as done in other sections of the consultation paper (e.g., in the third bullet point of section 3.4.1; in recital (2) of the draft RTS; or in paragraph 17 of section 6.1, etc.); and

(ii) to local guarantees governed by the law of a third country as explained in Q2 above (to which we refer to avoid duplication).

In addition, in general transactions on the basis of established terms and practices, ICC rules for guarantees and letters of credit (but not limited to these) allow for individual amendments. However, market participants are - in practical terms - not able to unilaterally impose clauses where these are market custom, especially when they concern issues other than purely commercial terms. The additional condition should therefore be deleted.

Q8. Can you provide examples of instruments or contracts for which it would be impracticable to include the contractual recognition which are not captured by the above proposed conditions?

See comments under Q1, Q2, Q3, and Q4.

Q9. Are the proposed conditions of impracticability clear and meeting their purpose?

In general terms, the BSG considers the conditions clear. Nevertheless, as Q1 indicates a flexible approach in terms of the binding nature of the RTS it would be desired to ensure any third countries' authorities and standards are taken into account.

Q10. Is the article providing the conditions for the Resolution Authority to require inclusion clear?

The BSG considers that some criteria could be clarified to grant - institutions and resolution authorities- the necessary flexibility to ensure contractual recognition requirements under Art. 55 BRRD without jeopardise resolvability.

Q11. Do you agree with EBA's proposal for the conditions for the resolution authority to require the inclusion of the contractual term?

Some BSG members believe that the proposed thresholds (on maturity and value) could unduly restrict the ability of the resolution authority to make decisions in a flexible and efficient way. Therefore, it may potentially lead to situations where it could end up requiring the inclusion of the clause, when the actual impact on the resolvability of the institution would not have been impaired. In view of this opinion, these thresholds might create an unlevel-playing field among EU banks. For example, large banks might end up being penalised as they own a large amount of high-value contracts.

Other BSG members concur to the view that thresholds, on the contrary, by applying common rules do re-instate a level-playing field among EU banks.

Q12. What is the likely amount of the liabilities to be notified under article 55 BRRD, as average per liability and as expected maximum per liability? What is the expected average maturity of the liabilities to be notified under article 55 BRRD?

Unfortunately, the BSG lacks the means and the resources to categorically answer this question.

Q13. Do you agree with EBA's proposal for the reasonable timeframe for the resolution authority to require the inclusion of the contractual term?

Irrespective of the chosen timeframe, in the event that a counterparty refuses the inclusion of a contractual term after the fact, an institution/entity will have no legal tool at its disposal to force the counterparty to accept such inclusion.

In this event the bank should notify the resolution authority without delay so that the impact of that impracticability can be assessed and resolvability is maintained at all times.

Q14. How much time do you need to implement the technical specifications provided in this ITS?

According to BSG consultations to the financial industry the timeframe expected to implement technical specifications in this ITS would not take less than 6 months at its minimum.

Q15. Do you consider the draft ITS comprehensive for submitting a notification of impracticability?

The BSG is of the view that some very limited flexibility should be allowed for. It considers the prescribed tables and formats as somewhat too rigid. For instance, in the current drafts the possibilities for notifications are closely mapped to the cases of impracticability included in the draft RTS; it is not possible to include other options (see our response to Q1).

Q16. Do you consider the templates and instructions clear?

In our view, in general terms, the instructions are clear.

Q17. Do you have any suggestions or proposals in relation to the draft ITS template and the instructions to fill it in?

No further suggestions.

Q18. Do you find any specific piece of information required in the template as hard to provide or unclear how to fill in?

See comments under Q15

Q19. Do you agree with the draft Impact Assessment? Can you provide any numerical data to further inform the Impact Assessment?

The BSG lacks the means and the resources to answer this question.