Response to the EBA Consultation Paper on Draft RTS on the contractual recognition of stay powers under Article 71a

(EBA/CP/2020/04)

Introduction

Intesa Sanpaolo welcomes the opportunity to comment on the European Banking Authority (EBA)'s draft regulatory technical standards (RTS) on the contractual recognition of stay powers under article 71a of BRRD II.

In this response Intesa Sanpaolo would like to suggest further reflection by the EBA on three main issues concerning the draft RTS:

1. While supporting the EBA's efforts to avoid being overly prescriptive, we still consider the level of flexibility of the draft RTS insufficient. Especially given the existence of effective and widely used contractual recognition clauses concerning resolution stays, we do not consider that new mandatory elements, as provided for in the draft RTS, would add to the legal effectiveness of what is the current market practice. Notably the requirements on the governing law of the clause would be particularly disruptive of current market practices.

2. If the EBA's approach is taken forward, there is a high risk of a massive repapering of legacy contracts which are to date fully compliant under current requirements. On top of the legal impediments that any bank would face during such renegotiations, we invite EBA to consider that this would occur in the context of other ongoing and extremely costly repapering exercises. Moreover, a new wave of repapering would affect first and foremost those institutions that have already complied with current regulatory requirements and have repapered their financial contracts accordingly in the past years. Such institutions, despite such proactivity, would find themselves penalized when compared to institutions that have not carried out the same effort to promptly integrate the requested recognition clauses. Therefore, it would be essential to avoid any retroactive effect of the RTS.

3. Finally, we consider it appropriate for the EBA's RTS to make clear the expected timeline for compliance with the requirements of contractual stay recognition. Considering that the final RTS will not be available much in advance with respect to the entry into force of the BRRDII in December 2020 – and that an integration of the amendments should be tailor-made by nationality of the relevant banks and shall have to refer necessarily to legislation with which BRRDII has been transposed in the various jurisdictions and to related national Regulators indications – an adequate phase-in period of at least a year after the entry into force of the directive and the final RTS will be needed for banks to achieve adherence to the new requirements for contractual stay.

Q 1. Do you agree with the approach the EBA has proposed for the purposes of further determining the first paragraph of Article 71a of the BRRD?

Answer:

Intesa Sanpaolo understands that the EBA's approach is intended to be flexible by avoiding the prescription of a fully detailed and mandatory clause. This approach rightly considers that a one-size fits all clause across all jurisdictions and types of contracts would not be proportionate nor effective.

Fully effective contractual clauses already exist

The approach taken by EBA nevertheless crucially fails to account for the work already undertaken in the past years at the international level (through the Financial Stability Board) and extensively at the national level (through the so called ISDA Stay Modules). As a consequence of such work the industry has already addressed the issue of the recognition of stay powers in an extensive number of contracts which are to date fully complaint with the current relevant (European and national) legislation.

Notably, we would like to draw EBA's attention to the fact that the introduction of a new article 33a which sets out additional stay powers, does not *per se* require a modification of the clauses currently adopted by the industry. In fact, while this article does not provide for discretional options at the national level, the transposition into national law will have to take into account the suspension powers already in place in Member States (see also below). Therefore, the way in which the Member States will transpose the provisions of art. 33a cannot be anticipated.

A rigid approach on the concrete features of contractual clauses is also not in line with the provisions of article 71a (4), which expressly states that: "*where an institution or entity does not include the contractual term required in accordance with paragraph 1 of this Article, that shall not prevent the resolution authority from applying the powers referred to in Articles 33a, 68, 69, 70 or 71 in relation to that financial contract*". While we obviously share the need for ensuring adequate safeguards in resolution, we think that the wording of art. 71a should suggest a focus on the concrete effectiveness of contractual clauses and not on mandatory features which may not reflect the realities of counterparties relationships.

Risks of a massive repapering exercise

In order to assess the full scope of the contracts which would be affected by the new requirements set out by the EBA, it is not enough to just look at the number of adhering parties to the ISDA Stay Modules (42 in the case of the Italian module), as this would not give a complete picture of the impacted contracts. In fact, this would vastly underestimate the amount of agreements which have already been amended by using the wording of the relevant ISDA Jurisdictional Module, as such wording is included in at least two other instances: a) the relevant clauses have been broadly used in the market by reference in bilateral amendments, independently by formal adherence of the parties to the relevant protocol. For instance, Intesa Sanpaolo, itself an adhering party, has amended more than 750 agreements employing this wording, far more than the number of adherents to the Italian Module. b) such clauses can be used to amend not only ISDA agreements, but also, for instance, GMRA and GMSLA agreements, hereby further broadening the number of amended(able) contracts.

Besides, one of the aspects that should probably be better clarified and that immensely broadens the purpose of the repapering exercise already implemented is that many banks have carried out extensive repapering campaigns not only in relation to contracts that were already third-country law agreements (e.g. NY Law agreements) but also – as instructed by the Regulators in order to ensure contract continuity – for pre-emptive risk mitigation purposes, targeting English Law contracts which were potentially due to become third-country law agreements at the end of the Brexit process, without knowing if some kind of political agreement during the Transition Period would have resolved this specific issue.

For the reasons explained above, it can be estimated that the number of agreements already repapered following the described approach is huge and that the cost of re-doing this exercise would be, timely and materially, extremely high and not necessarily feasible. In fact, it must be also taken into consideration the reaction of thousands of counterparties that were approached in the past and had agreed, sometimes after lengthy negotiations, to amend the agreements in compliance with the elements required by national frameworks. A second-wave repapering exercise would inevitably incur into legally or otherwise impracticable obstacles that should be taken into consideration by the Regulator. Moreover, a new wave of repapering would penalize first and foremost proactive institutions that have already complied with current regulatory requirements and have repapered their financial contracts accordingly in the past years.

National requirements must be taken into account

A second issue to consider, is that every EU country has incorporated in the past BRRD rules concerning stay powers in its own legal framework, based on the specific structure of such domestic framework and, therefore, harmonized therewith. Since banks are also under the control of national regulatory authorities, attention has to be paid to the corresponding requirements and indications.

In practice, in the case of Italy, Art. 68 of D.Lgs. 180/2015 has transposed the requirements of Art. 71 BRRD and provides for certain stay powers to be granted to Bank of Italy as resolution authority including the power to require the insertion in third-country law agreements of a dedicated stay clause. Consequently, the Bank of Italy issued in 2018 the "Regulatory measures concerning the temporary suspension of termination rights by the resolution authority in relation to financial contracts governed by the law of a third country" which, in turn, served as a reference for the Italian Jurisdictional Module to the ISDA Resolution Stay Jurisdictional Modular Protocol.

Hence the point is simply that each bank had to comply specifically with requirements which are the national transposition of more general European rules. Since there are in EU 27 different national legal frameworks, a certain level of flexibility to take into account the national specificities appears inevitable.

For all the aforementioned reasons, Intesa Sanpaolo believes that the list of elements proposed in the draft RTS should not be mandatory and should set out only advisable features. This would avoid the risk to render non-compliant innumerable contracts which have in the meanwhile been made fully compliant with the law.

In addition, sufficient time should be given to the market – especially considering the Brexit issue and to avoid a disruption related thereto - to implement/integrate in future master agreements the clauses which will possibly have to be conceived in the future starting from the ones used until now, which should anyhow retain their effectiveness (possibly through the publication of new and updated Protocol Modules).

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In consideration of the fact that any amendment to the existing clauses will have to take into account not only the EBA's final RTS but also the transposition into national law of the provisions of BRRDII and subsequently their implementation by the national resolution authority, we estimate that a least one year will be needed for the industry to adapt their contractual clauses for new contracts to be entered into, without the risk of triggering a market disruption.

Q 2. Do you agree with the approach the EBA has proposed with regard to the components of the contractual term required pursuant to Article 71a of the BRRD?

Answer:

As said above, Intesa Sanpaolo does not agree with the mandatory nature of the elements set out in the draft RTS. Most of these elements are in fact redundant, not in line with the features of national requirements nor necessary to ensure the effectiveness of the clause.

In short, touching on the single elements:

- Article 1(1): we do not believe that there is any need in the clause for provisions specifying the express acknowledgement; this would be redundant as the parties are already clearly bound by the terms of the financial contract;
- Article 1(2): we also note that a description of powers is currently not included in the standard clauses used by the industry. We do not see how this would add to the effectiveness of the clause;
- Article 1(3): we want to stress that ensuring the effective application of these powers does not fully fall into the abilities of the parties especially whenever local law applies;
- Article 1(4): this element as well could give place to some conflict of law issues in any circumstance requiring the application of the local law;
- Article 1(5): we do not see any added value in subjecting the clause to the law of a Member State. Please see more extensive comments below.

Q 3. Do you believe that having the art.71a BRRD clause governed by the laws of an EU jurisdiction would improve the likelihood that it would be effective and enforceable before the courts of the relevant third country jurisdiction? Please provide your reasons for this view. Further, what do you consider to be the advantages or the disadvantages of using the provision proposed under art 1(5) of the draft RTS?

Answer:

Intesa Sanpaolo does not believe that inserting a clause governed by the law of an EU jurisdiction would improve the likelihood that the clause would become effective and enforceable before the courts of the relevant third country. As a matter of fact, pursuant to conflicts of law principles, irrespective of a chosen governing law of e.g. an ISDA Master Agreement in place between the parties, mandatory provisions of local law should apply if there are "relevant" elements which are connected with the country of that specific local law (e.g. the Stay Clause).

The "characteristic performance" principle should also help to secure legal certainty as regards the law applicable to certain provisions. With this purpose such principle/rationale is further stressed under para 6 of Art. 68 of BRRD I, where it is stated that the provisions contained under Article 68 (which embeds certain suspensions restrictions under Arts. 69, 70 or 71), shall be considered to be overriding mandatory provisions within the meaning of Article 9 of Regulation (EC) No 593/2008 of the European Parliament and of the Council.

The split governing law could lead to problems for master agreements used for regulatory netting purposes under the CRR (regulatory capital, large exposure, leverage ratio). The governing law of a netting agreement used for regulatory purposes is seen by the European Central Bank as so essential a contractual term that not only would additional legal opinion coverage be needed to satisfy the requirements of Article 296 CRR but also the notification as "new type of netting agreement" to the relevant Joint Supervisory Team[1].

Q 4. What are the standard clauses you are likely to use for your financial contracts pursuant to this requirement? Will the clause differ for various types of financial contracts (please detail if yes)?

Answer:

As far as ISDA, GMRA and GMSLA standards are concerned Intesa Sanpaolo currently makes sure they are fully compliant with the related Bank of Italy regulatory measures, by using the wording of the Italian Stay Module of the ISDA Resolution Stay Jurisdictional Modular Protocol. This has resulted in standard clauses which have proven effective and are well known and accepted by the market.

Q 5. Do you agree with the draft Impact Assessment?

Answer:

No, the impact assessment is unsatisfactory as it does not estimate the costs for institutions in implementing the proposed approach, it does not consider the burdens of any additional repapering exercises that may well be triggered by the RTS and it does not take into account the additional disruption effect related to English-law agreements becoming third-country law agreements after Brexit. Particular attention should also be paid to the likely legal impediments that would arise due to the implementation of the EBA's RTS.

In terms of the estimation of benefits related to the EBA's approach, the impact assessment also fails to clarify how the draft RTS would increase the effectiveness of the recognition of stay powers compared to the regime already existing in several Member States and in relation to the current practice of the industry.

[1] See FAQs on the notification process for the recognition of netting agreements, available at: https://www.bankingsupervision.europa.eu/press/letterstobanks/html/netting_agreement_FAQs.en.html.