TO: European Banking Authority

[Brussels, 13 August 2020]

SUBJECT: EBF response to the EBA consultation on the contractual recognition of stay powers under the Bank Recovery and Resolution Directive (BRRD), Art. 71a.

The European Banking Federation (EBF) welcomes the opportunity to express the views of the European banking industry on the public consultation on the draft Regulatory Technical Standards (RTS) for contractual recognition of stay powers. In this context, we herewith provide you with our general remarks and responses to the questions listed in the Consultation Paper (CP). We appreciate your consideration about our comments and remain at your disposal for further clarifications in the matter.

GENERAL COMMENTS:

Retroactivity issue:

In order to avoid clearly disproportionate burdens for institutions and their counterparties and also considerable disruptions, it is essential that the RTS address the issue of contractual recognition clauses concerning the resolution stays already implemented in existing contractual relationships (legacy agreements). These clauses have been introduced over several years in response to existing national requirements and to the recommendation of the FSB. In this regard, we encourage the EBA to confirm that the new requirements under Art. 71a BRRD do not have any retroactive effect and that, consequently, master agreements or other financial contracts which already contain similar contractual recognition clauses regarding resolution stay powers do not need to be renegotiated (grandfathering). In particular, we would like to underline the importance of the ISDA protocols (and other model clauses /agreements developed for other standard market documentation) which the industry has been using over the past few years and which already provide standardized clauses that are being used to comply with the national regimes.

Without grandfathering for these legacy financial contracts (including master agreements), all the efforts made by the institutions to reach out to their counterparties and to negotiate the inclusion of such clauses over the past years would be invalidated: the relevant institutions would be forced to once again repeat the negotiation and re-papering exercise in relation of the entire population of agreements.

It will be extremely difficult for European institutions to convince their counterparties to accept the adjustment or replacement of these already negotiated clauses - not least, because this would require the relevant counterparty to review the new clauses once again and, in many cases, once again seek legal counsel to assess the legal and regulatory implications of the changes.

In addition, we consider as necessary the establishment of a phase-in period for the implementation of the contractual recognition requirements under Art. 71a BRRD, in view

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of the fact that institutions will need reasonable time to include these clauses in the contracts.

Failure to address the issue that institutions will in some cases not be able to impose the contractual recognition clauses on counterparties:

The experience with Art. 55 BRRD has demonstrated that it will never be possible to impose the required clauses in all contractual agreements/financial contracts falling in the scope of the requirement, regardless of the efforts undertaken by the institutions.

Especially with regard to already existing financial contracts, counterparties may simply reject the inclusion of such clauses, leaving the institution with no means to implement them. The counterparties will have reservations against the inclusion of such clauses since these clauses effectively require a submission to the powers of a foreign regulator and have a significant impact on their contractual rights.

Thus, it has to be expected that institutions will not be able to implement the clauses with respect to every single financial contract or in each case with the exact content as required pursuant to Art. 1 of the draft RTS. However, this cannot be a concern where, and as long as, this does not affect the resolvability of the institutions and where the institutions make this transparent to the relevant regulatory authorities. This point should also be clarified in the draft RTS.

Question1. 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?

This decision to refrain from prescribing a specific contractual recognition clause is to be supported and we fully agree that prescribed contractual recognition clauses would undermine the effectiveness of such a clause. Thus, in principle, we support the alternative approach based on key mandatory elements.

However, we believe that these elements, as proposed, are too detailed and rigid and are also formulated in such a way that they effectively amount to prescribed clauses, or, at least, can be read to set out a very narrow and rigid framework for the drafting of the contractual clauses with very little room for adjustments.

In more detail, the European Banking industry is significantly concerned regarding the impact of the proposed mandatory elements: they are likely to necessitate re-documentation of existing stay recognition arrangements and will potentially undermine the progress which has already been made so far in some national jurisdictions.

Therefore, we urge the EBA to provide for grandfathering of the already existing solutions for the contractual recognition of stay powers, in the form of ISDA protocols as well as model clauses/agreements developed for other standard market documentations. This approach would avoid the necessity to re-negotiate and replace all existing clauses already in place (in the form of protocols or model clauses/agreements). Such a repapering exercise would needlessly divert and strain resources while invalidating the considerable work done so far by institutions across the EU.

In any event, the RTS should provide for an adequate degree of flexibility/discretion regarding the specific content and structure of a clause so that any revised and updated protocol and model clauses/agreement, reflecting the introduction of Art. 71a BRRD, can continue to be relied upon by market participants in a format which corresponds as much as possible to already existing protocols (ISDA) and model clauses/agreements, as this would greatly enhance market acceptance.

Additionally, we would consider it more beneficial for the universal implementation of the requirements of Article 71a BRRD, if the draft RTS would not employ specific legal terminology in order to achieve its aim. This is because specific legal terminology is always connected to the respective jurisdiction only and is not known or might even not be enforceable in another jurisdiction. It seems to be that the proposed text is, in general, based on English law background. Whereas it might be useful to name proper legal concepts of a widely known jurisdiction such as English law in order to better explain to the institutions how the requirements of Art. 71a(1) should be implemented, the draft RTS should leave room for the use of other legal ways to validly and effectively reach the contractual recognition. We have commented in this respect on every element of Article 1 separately below.

Question 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?

As mentioned before, we generally agree on the approach followed by the EBA with regard to the proposed content for the contractual recognition of the stay powers, based on the listing of the key mandatory elements of the term.

However, the major concern of the European banking industry is that the EBA's approach will not give enough consideration to the already existing stay recognition frameworks as well as to the effort deployed so far by the industry by means of the ISDA protocols (and other model clauses /agreements developed for other standard market documentation). Additionally, we signal that the draft RTS includes proposed mandatory elements that are not deemed necessary under different existing national regimes and significantly diverges from what is already required to be effective in practice.

All our concerns on the different elements of article 1 are explained below.

Art.1(1): We believe that it is not constructive to require to utilise specific legal terminology, such as "acknowledgement" and "acceptance", in order to establish an agreement on the recognition and binding effect of resolution powers. In some jurisdictions an "undertaking" or a "confirmation" or an "agreement" or a "submission to powers" might be the proper means in order to validly achieve this aim. Although the delegated regulation will be available in all languages of the EU, the contracts where the clause needs to be included may be concluded in non-EU language. Because the terms used in Art. 1(1) of the draft RTS are obviously exclusive, it would be difficult to adhere to the requirements of Art. 71a if another language must be used when the requirement includes legal terminology.

Considering the above, we would welcome if Art. 1(1) of the draft RTS would be rephrased as follows:

"(1) the agreement of the parties to the effect that they recognise that the contract may be subject to the exercise of certain powers by a resolution authority to suspend or restrict rights and obligations arising from such contract;"

alternatively, if the exemplary reference to specific legal terms is considered helpful:

"(1) the acknowledgement and acceptance or another proper type of agreement by the parties to the effect that they recognise that the contract may be subject to the exercise of certain powers by a resolution authority to suspend or restrict rights and obligations arising from such contract;".

Art. 1(2): We see the requirement to include a description of the respective resolution powers in the contract as very onerous. In our opinion, this would raise several issues in connection with the full implementation of Art. 71a(1) and the enforceability of the clause as such.

Art. 71a(1) BRRD requires a contractual recognition of the respective resolution powers as these are set out in the BRRD and not as they are (or will be) described in the respective contract. In this respect, we signal that describing the powers in the contract might be considered as limiting the recognition of the resolution powers by the counterparty to what has been described in the contract. Also, a description of the resolution powers to the full extent would not only include a description (or a verbatim reproduction) of the implementing provisions of Articles 33a, 69, 70 and 71 BRRD, but must inevitably also include description of the background as to under which conditions these powers may be employed and which, if any, discretion the resolution authority has when deciding whether to exercise the powers. This would make the clause very lengthy without a visible benefit for the purpose of Art. 71a BRRD, still being under the risk of the recognition only being enforceable to the extent of the powers that were described in the clause.

Additionally, we signal that current national regimes in relevant EU Member States do not require a description of the powers that are being recognized. Doing so would, in our opinion, be deemed unusual to current market practice.

Art. 1(3)(a): We do not see any reason for requiring both sub-section (1) and sub-section (3) as explicitly separate provisions. It is confusing to require a separate and explicit "recognition" by the parties that (obviously as a result of having agreed that their contract may be subject to resolution powers) they are bound by the effects of such powers, if these are exercised.

This proposed mandatory element is not required under existing national regimes and represents a divergence that, if taken forward, would trigger the potential need for repapering existing master agreements or amended bilateral financial contracts. Existing stay recognition clauses do not strictly or expressly include recognition that the powers are binding, but rather involve counterparties adhering to terms that permit them to exercise their termination rights, or their right to enforce a security interest, to the extent that they are entitled to do so under the regimes to which stay powers apply.

Further, it is not quite clear what should be achieved (in addition to the acknowledgement, acceptance and recognition of being bound by the effects of the application of the powers) by the agreement that the parties "shall endeavour to ensure the effective application of these powers". The decision on the most effective application of the powers must remain with the resolution authorities. The counterparty can only be bound by the decision of the resolution authority to exercise its powers in the manner set out in the decision. The parties to a financial contract cannot and should not be obliged contractually to endeavour to go beyond the decision of the authorities to ensure the effective application of such powers. This requirements goes beyond Art. 71a(1) of the BRRD and should therefore be deleted.

Finally, we note that the list of powers in Art. 1(3)(i)-(iv) is duplicative to the requirements of the description of these same powers in the immediately preceding sub-paragraph. The same risks for the institutions are inherent in this list as we described above with respect to Art. 1(2).

Art. 1 (4): requirement to acknowledge and accept that no other contractual term impairs the effectiveness and enforceability of the contractual term, and that the agreement is exhaustive.

As to the understanding of the term "acknowledgment and acceptance", the comments on Art. 1 (1) apply correspondingly. Furthermore, we would like to point out that the provision required is primarily of a declaratory nature and thus necessarily of limited practical relevance: the clause would not prevent any subsequent further agreement negating or contradicting this declaration (which, of course, would be a breach of regulatory requirements on the part of the institution subject to the BRRD).

The requirement in Art. 1(4) has therefore no added value, is largely redundant and would not justify a change in the market standard clauses already in use.

Again, we would like to signal that such element is not required under existing national regimes for the recognition of stay powers and thus represents a divergence that, if taken forward, would trigger the potential need for repapering. Moreover, and as the current market practice has shown, the ISDA standardized clauses have not been adversely affected by any other contractual term in practice.

Notwithstanding the foregoing, we deem relevant to set out as an additional section of this article 1, that additional features to the wording could be included if parties so agree (for instance, entities may be willing to specify that the stay powers listed in any of the relevant articles can be enforced only once and that their effects are limited to the midnight of the business day following its enforcement. We believe that this may make the provision easier to be accepted by third country entities that are not familiar with these stay powers).

Question 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?

1. The EBF encourages the deletion of the requirement of having the Art.71a BRRD clause governed by the laws of an EU jurisdiction.

The split of choice of governing law could lead to problems for master agreements used for regulatory netting purposes under CRR (regulatory capital, large exposure, leverage ratio). According to the European Central Bank, the governing law of a netting agreement used for regulatory purposes is a core provision, whose amendment would require: (i) the obtention of a new legal opinion on the enforceability of the netting provisions, to satisfy the requirements of Article 296 CRR and also (ii) the notification of each master agreement to the ECB as a "new type of netting agreement". The risk of having to make such new notifications to the ECB and to seek new legal opinions should absolutely be avoided.

2. Moreover, we believe that having the Art. 71a BRRD clause governed by the laws of an EU jurisdiction would not improve the likelihood that it would be effective and enforceable before the courts of the relevant third country jurisdiction for the following reasons:

First, this requirement would cause a split choice of law (dépeçage), meaning that, whereas the other terms of the contract are governed by the laws of a third country jurisdiction, the Art. 71a BRRD clause is governed by the laws of a Member State. Although it might be recognised in a number of third countries, the recognition has commonly its

limits where the aim of the dépeçage is to make an otherwise invalid and unenforceable clause valid and enforceable. In particular, this applies where the respective clause breaches the public policy of the jurisdiction of the court.

Second, it causes a situation where courts in a third country have to decide upon the validity of the Art. 71a BRRD clause governed by the laws of another country, because agreeing on the governing law does not affect the choice of courts by the parties or the general place of jurisdiction of the parties, in cases where no courts have been chosen. Commonly, in a financial contract parties would submit all disputes arising out of such contract to the jurisdiction of the courts located in the jurisdiction of the law applicable to such financial contract. One aim of this practice is to avoid a situation where courts of one jurisdiction would have to decide upon a matter governed by the laws of another jurisdiction, because this would lead to unpredictable court decisions. The same argument would apply with respect to Art. 71a BRRD.

Finally, we would like to stress that this split governing law requirement is not foreseen or even suggested in art. 71a BRRD and that there is no similar requirement for the contractual recognition of the bail-in, either in the BRRD or in the Commission Delegated Regulation (EU) 2016/1075. If a third country counterparty refuses to subject the terms of a contractual agreement to the law of an EU Member State, it is foreseeable that they will be also highly reluctant to accept the subjection of one specific provision to it. Therefore, this requirement would make the contractual recognition of the stay even more burdensome and difficult to be accepted by third country counterparties than the contractual recognition of the bail-in. In this respect, we consider it relevant to highlight the hardships and the competitive disadvantages that the imposition of the contractual recognition of the bail-in has posed to the EU firms.

As to the advantages and disadvantages of requiring the Art. 71a BRRD clause to be governed by the laws of a Member State, we would like to highlight that, according to our previous experience in negotiating resolution stay clauses with counterparties in third countries, this requirement would constitute a high burden for the counterparties. This applies in particular to non-financial counterparties. These counterparties are accustomed to the contractual agreements used for the financial contracts in question and their relevant governing law (e.g. English, New York law or Swiss law). Being faced with a clause governed by a jurisdiction which is different from the law applicable to the financial contract would cause hesitation, raise additional questions and may also require them to seek legal counsel for a further, unknown jurisdiction. All this would affect the willingness of the counterparties to accept such clauses.

We do not see any advantage in having the Art. 71a BRRD clause governed by the laws of a member state. The clause should be governed by the laws governing the financial contract.

Question 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)?

Banks shall determine the specific wordings that will be used, once the standard wordings of the main industry associations have been published. We consider important that such provisions are as aligned as possible with the industry standards (taking into account the particularities of each entity and jurisdiction), in order to make them easier to be assessed and accepted by other third country entities, to the extent that such counterparties are likely to be more familiar with such standards.

As stressed before, the current market practice of relying on standardized clauses deployed through the relevant ISDA protocols or in the form of model clauses/agreements developed for other standard market documentations represents our favourable solution as it ensures the highest level of acceptance in the market and also represents the most efficient manner in which such clauses can be implemented. Consequently, it is of paramount importance that the existing protocols and model clauses/agreements already in place are grandfathered.

In any event, the EBA RTS should strive to minimize as much as possible the need to revise or replace already existing solutions enacted via protocols or model clauses/agreements (see already response to question 1 and the general comments).

Such approach could be implemented as follows:

- Keeping Article 1(1) as mandatory element in the stay recognition clause to respond to the level-1 requirement;
- Possibly keeping something that achieves the effect of article 1(4);
- Avoiding all the remaining elements proposed by the draft RTS.

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

Item 6: While we believe that contractual recognition clauses can support the implementation of resolution measures, it needs to be acknowledged that they – as any contractual instrument – can never ensure that resolutions measures will be recognised in every jurisdiction under all circumstances: a residual risk of challenges will always remain. The only instrument which would provide the desired legal certainty are international agreements on the reciprocal recognition of resolution measures. We therefore reiterate once again our urgent call to intensify the efforts to conclude such intergovernmental agreements, as envisaged by Article 93 and 97 BRRD.

Items 8 to 16: We believe that the impact assessment, on the one hand, significantly overstates the risks associated with less uniform approaches to the contractual clauses and the advantages of uniformity/convergence and, on the other hand, does not sufficiently take into account the clear disadvantages of too rigid/formalistic requirements. The experience over that past years with such clause, both from the perspective of the party having to impose them on the other party as well as being the counterparty on which it is being imposed, has clearly demonstrated that institutions and industry associations need to focus on developing clauses tailored to the contractual agreements and counterparties involved by addressing the core elements we described in our response to question 1, and also taking into account the need to make the clauses easily understandable, operable and acceptable to the counterparties. As mentioned above, the specification of the content of the required clause should not include any legal concepts, as these will always derive from one legal system, but should state the intended result that the clause is to accomplish.

The last point cannot be stressed enough: in order to ensure greater acceptance and effectiveness, the contractual recognition clauses need to be designed taking into account also the perspective and legitimate interests of the counterparties.