Association for Financial Markets in Europe

EBA Draft RTS: Contractual recognition of stay powers

AFME consultation response

14 August 2020

Introduction

The Association for Financial Markets in Europe (AFME)[1] welcomes the opportunity to comment on the European Banking Authority's (EBA's) draft regulatory technical standards (RTS) on the contractual recognition of stay powers under Article 71a(5) of the Bank Recovery and Resolution Directive (BRRD2). We hope that the EBA will find our response of assistance when finalising their proposed RTS.

AFME continues to support the development of an effective recovery and resolution framework in Europe and the ongoing work to enhance resolvability. We recognise the importance of ensuring the effectiveness of resolution tools including appropriate contractual recognition of resolution stays in relevant contracts governed by the law of a third country and have supported the work undertaken to date in this area.

Accordingly, we would like to highlight that there has been a very substantial amount of work already completed in the official sector[2] and the private sector to achieve the objective of putting in place effective contractual recognition of resolution stays in the absence of statutory recognition. We view it as essential that the RTS does not jeopardise the progress which has been made to date.

While Article 71a BRRD2 introduces an EU-wide requirement for contractual recognition of resolution stay powers in financial contracts governed by third country law, a number of jurisdictions have already put in place equivalent requirements which achieve the same objective. Under the encouragement of the official sector and in order to meet existing requirements, including in a number of EU member states, our members have already put in place arrangements for contractual recognition of resolution stays in financial contracts on the basis of standardised recognition clauses, most notably through the ISDA 2015 Universal Resolution stay Protocol[3], and the ISDA Resolution Stay Jurisdictional Modular Protocol[4], which provide stay recognition to address French, German, Italian, UK, Swiss, US and Japanese requirements, amongst others. The Single Resolution Board has also confirmed that adherence to the ISDA protocol is a suitable way to achieve stay recognition for relevant contracts.[5]

Given the very significant amount of work that has already been undertaken to achieve stay recognition under existing requirements, it is vital that the RTS supports progress in recognition of resolution stays without impacting effective recognition which is already in place.

[1] The Association for Financial Markets in Europe (AFME) represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society. AFME is listed on the EU Transparency Register, registration number 65110063986-76.

[2] See for example FSB Principles for Cross-border Effectiveness of Resolution Actions – 3 November 2015 - https://www.fsb.org/wp-content/uploads/Principles-for-Cross-border-Effectiveness-of-Resolution-Actions.pdf

[3] ISDA - https://www.isda.org/protocol/isda-2015-universal-resolution-stay-protocol/

[4] ISDA - https://www.isda.org/protocol/isda-resolution-stay-jurisdictional-modular-protocol/

[5] Principle 2.2, Expectations for Banks, March 2020

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We have reviewed the draft RTS in this context and set out below our views on aspects which should be reviewed in light of this objective, while not affecting the policy objective of ensuring the legal effectiveness of the recognition.

General comments

We have significant concerns with the proposed approach as set out in the draft RTS which we believe should be addressed in the final RTS in order to ensure that the existing contractual stay recognition clauses are not undermined and to ensure a proportionate approach.

The current proposals introduce specific requirements which are not required by the stay recognition requirements that are already in place in a number of large EU Member States. Therefore, if taken forward, we are concerned that they would introduce legal uncertainty over the effectiveness of existing contractual stay recognition clauses and introduce unnecessary burdens and costs for a large number of institutions with no apparent additional benefit.

We are concerned that the proposed additional requirements would necessitate a market-wide repapering exercise, to amend existing financial contracts that already meet national stay recognition requirements which were put in place to implement the international FSB standards. Such an exercise would provide no clear additional legal benefit, but would entail significant costs. This could also undermine global standardisation efforts where an international standard approach to recognition has already been developed for most financial contracts. A common international approach is important to support adherence to the recognition of stay powers by counterparties world-wide.

There does not appear to be a good reason for the EU departing from this approach and we are concerned that an overly prescriptive approach arising from the application of the proposed RTS would adversely impact the effectiveness of existing contractual recognition and also the competitiveness of banks operating in the EU. We have particular concerns with regard to the proposal that the recognition clause is required to be governed by the law of an EU member state and for the reasons set out below this should not be mandated in the final RTS.

We set out below the key aspects of our concerns, following which we address the specific questions raised in the consultation paper.

1. **Alignment with existing EU Member State regimes:** It is important to recognise that the introduction of resolution stay recognition requirements in the EU is not a new concept, and finds itself in EU legislation by virtue of the efforts already undertaken at the global level through the Financial Stability Board (FSB). In particular, following the publication of the FSB's '*Principles for Cross-border Effectiveness of Resolution Actions*'[6], supported by the implementation of national regulatory requirements in many G20 jurisdictions including France, Germany, Italy and the U.K., that pre-date the BRRD2 and have been the subject of very substantial work by both regulators and industry over the past four and a half years.

   Very significant effort has been put into ensuring an effective, practicable, and proportionate approach when setting national stay recognition requirements, and substantial resources have been invested by industry participants to support the international work led through the FSB and ensure compliance

[6] FSB – Principles for Cross-border Effectiveness of Resolution Actions – 3 November 2015 - https://www.fsb.org/wp-content/uploads/Principles-for-Cross-border-Effectiveness-of-Resolution-Actions.pdf

with national requirements under the encouragement of resolution authorities. This work has been clearly recognised and welcomed by the official sector.

In this context, it should be ensured that the RTS does not unnecessarily and disproportionately impact the existing effective stay recognition solutions that are already in place.

While we agree with the EBA's proposed approach not to establish a mandatory clause, several of the proposed mandatory elements are not, as drafted, compatible with the existing recognition arrangements already in place. Furthermore, they are not necessary for effective contractual recognition, as evidenced by the requirements already in place within the EU, including, for example, any requirement for the clause to be governed by the law of an EU Member State. We therefore strongly recommend that the EBA seriously reconsiders including mandatory elements which are not aligned with existing contractual recognition arrangements. We consider these elements and possible amendments further below.

Recognising both the EBA's mandate and the shared objective of effective and appropriate stay-recognition, we strongly believe that the EBA's approach should be re-centred on the need for contractual clauses to be legally effective. Any mandatory elements should therefore be kept to the minimum necessary to achieve this, in effect requiring the recognition of the stays implemented under article 71a BRRD2.

Given the nature of the financial contracts within scope, we believe that a focus on legal enforceability under the relevant governing law, providing an appropriate degree of flexibility to the parties on how best to achieve this through specific drafting, would be the correct approach. This would follow the same logic that the EBA already observes in not mandating a specific clause or specific language, as the EBA rightly acknowledges the need for institutions to adopt different terms depending on the counterparty or financial contract in question.

Importantly an approach that focusses on the effectiveness of any contractual recognition clause would not necessarily require the repapering of existing terms in financial contracts. Accordingly, we have proposed amendments to the draft RTS in Annex 1 (below) to seek to achieve this balance and help ensure the focus on effectiveness, and the need for effective clause elements, rather than specific mandatory terms.

In order to safeguard the progress that has already been made in this area, the greatest certainty would come from the EBA's unequivocal confirmation that the requirements stemming from Article 71a BRRD2 and the final RTS would not extend to existing transactions or transactions entered into under existing Master Agreements, or bilateral agreements which already comply with existing national stay-recognition requirements.

2. **Clarity on compliance timelines:** The BRRD2, including Article 71a, has a transposition deadline and generally takes effect as at 28 December 2020. However, the BRRD2 is silent on the deadline for compliance with the requirements for contractual stay recognition. As discussed above, we would welcome the alignment of the BRRD2 requirements with existing requirements to minimise the repapering of existing contracts governing transactions entered into on or after 28 December 2020 and clarification that existing arrangements are sufficient.

   Irrespective of the impact on existing contractual recognition arrangements discussed above, it is also necessary to provide an appropriate period for implementation of the requirements of the final RTS. It would not be feasible to expect institutions to have put in place amended or new stay recognition clauses that would be in line with the EBA's final RTS by 28 December 2020. This is not only due to the expectation that the final RTS would not be available for more than a few weeks before the 28 December date, but also due to the fact that typical timelines for achieving adherence to a new contractual recognition clause normally takes 12 to 18 months to be implemented, not including the additional time it would take to engage in client outreach (a further 6 to 12 month period).

It is also important to note that there are already significant regulatory compliance efforts being undertaken to achieve transition in contracts that currently utilise LIBOR as a benchmark reference rate, the efforts relating to the Single Resolution Board's (SRB) "Expectation for Banks" as well as efforts to review (and amend where necessary) contracts governed by English law in light of the U.K.'s departure from the European Union. These projects have already created a significant resource demand on the teams within institutions that would be required. Further to this, there is unfortunately little to no scope to leverage off such compliance efforts, for example when considering changes to benchmark reference rates, and we believe it would be entirely counterproductive to attempt to do so. It is important to not seek to undermine this work, given counterparties will not have the appetite to look into further issues while prioritising the transition in benchmark rates.

We would, therefore, strongly suggest that the EBA make clear in its final RTS (or, if that is not possible, through another route) that the provisions therein should come into effect at least 24 months from the date of publication of the final RTS in the Official Journal of the European Union. At the very least, the EBA should make clear that authorities need to engage with institutions to ensure that in scope financial contracts comply with the requirements within a realistic and suitable timescale[7].

The need for this would be reduced (but not avoided) were the EBA to ensure that accommodation is made for the existing approaches that reference the national stay recognition requirements (as highlighted above). Clarity in this area from the EBA would be greatly appreciated and would help to ensure a harmonised approach is taken forward by authorities within the EU.

Aside from these general comments on the draft RTS, we suggest that the EBA should liaise with Member States and resolution authorities to support the effective implementation of Article 71a BRRD2. For example, where Member States already have a national framework for recognition of resolution stays they should be encouraged to transpose the new stay power under Article 33a BRRD2 in a manner which minimises the need for changes to existing protocols for the reasons outlined above.

Responses to questions

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?**

Please see our general comments above. While we agree with the proposal not to mandate a specific clause, we have significant concerns regarding the impact of the proposed mandatory elements which are likely to necessitate repapering/re-documentation of existing contractual stay recognition arrangements. This would potentially undermine the enormous progress which has already been made.

We do not believe that mandatory elements as drafted are necessary to achieve the objective and are therefore disproportionate. However, recognising the mandate that the EBA has been given, to determine the contents of the terms required, we believe that a solution can be found that accommodates for both the variety of language used in existing effective contractual stay recognition terms, and which meets the objective within

[7] Is it notable that requirements put in place at a national level were accompanied by appropriate timescales for implementation, for example in France institutions were provided with 3 years to produce and insert effective contractual stay recognition terms into in scope financial contracts.

the EBA's approach. This, as mentioned above, would be possible were the RTS to be re-focussed on the requirement for terms to have *the effect* of many of the elements suggested, as opposed to the proposed requirement for specific mandatory terms utilising the language as set out in the draft RTS.

In it's consultation paper, the EBA has referenced the international work that has already been undertaken through the FSB. Members of the EU that are also part of the G20 have already taken forward their own national requirements following the finalisation of the FSB's *Principles for Cross-border Effectiveness of Resolution Actions*. However, insufficient consideration appears to have been given to the impact of the proposed mandatory elements on arrangements which have already been put in place in accordance with the existing requirements that apply in the EU's largest Member States, and the international efforts coordinated through the FSB.

The ISDA Stay Modules, for example, have a significant number of adhering parties, including 2,391 for the UK module[8], 316 under the German module[9], 147 for the French module[10], and 43 under the Italian module[11]. Furthermore, the actions taken by the U.S., specifically its recognition of "identified resolution regimes" which includes those in France, Germany and the U.K., has permitted those jurisdictions to utilise the much more widespread U.S. protocol (with 26,004 adhering parties[12]) in certain circumstances (although it is unclear whether this would continue if the underlying framework changes as per the EBA's proposals). As a result, these parties individually may have many thousands of agreements that already include effective and compliant stay recognition clauses by virtue of the applicable Master Agreement, and would represent a very significant number of financial contracts. Further to this, the wording within the existing Stay Modules has already been used in the market to a very wide extent, including by reference in bilateral amendments, as well as independently of formal adherence of the parties to the relevant protocol. The language has also been utilised to amend not only ISDA agreements, but also Global Master Repurchase Agreements (GMRAs) and Global Master Securities Lending Agreements (GMSLAs), representing a further broader scope of financial contracts that already contain compliant recognition clauses.

Beyond these exercises, institutions have also undertaken repapering campaigns not only limited to third country law governed contracts, but also as instructed to by regulators to ensure contract continuity for pre-emptive risk mitigation purposes. This includes targeting English law governed contracts that will become third country law agreements at the end of this year. It should therefore be clear that the number of agreements already repapered to comply with the existing equivalent requirements that apply within key EU Member States, is already very significant.

Having to repeat these exercises would be disproportionately costly in both time and money, and not just from the perspective of banks. Considering the reaction of thousands of counterparties that were approached in past similar exercises and had agreed, sometimes after lengthy negotiations, to amend the agreements in compliance with the elements required in national frameworks, repeating this exercise would be challenging. This would amount to a significant undertaking for institutions that currently meet existing requirements, but importantly would not change the legal relationship in the existing contracts and agreements. There is also no certainty that counterparties to these contracts will agree to new amendments, and may lead to the situation

Note: all references to the number of adhering parties as per footnotes 8 through 12 are as of 31 July 2020.

[8] ISDA UK (PRA Rule) Jurisdictional Module to the ISDA Resolution Stay Jurisdictional Modular Protocol - https://www.isda.org/protocol/isda-uk-pra-rule-jurisdictional-module-to-the-isda-resolution-stay-jurisdictional-modular-protocol/adhering-parties

[9] ISDA German Jurisdictional Module to the ISDA Resolution Stay Jurisdictional Modular Protocol - https://www.isda.org/protocol/isda-german-jurisdictional-module-to-the-isda-resolution-stay-jurisdictional-modular-protocol/adhering-parties

[10] ISDA French Jurisdictional Module to the ISDA Resolution Stay Jurisdictional Modular Protocol - https://www.isda.org/protocol/isda-french-jurisdictional-module-to-the-isda-resolution-stay-jurisdictional-modular-protocol/adhering-parties

[11] ISDA Italian Jurisdictional Module to the ISDA Resolution Stay Jurisdictional Modular Protocol - https://www.isda.org/protocol/isda-italian-jurisdictional-module-to-the-isda-resolution-stay-jurisdictional-modular-protocol/adhering-parties

[12] ISDA 2018 U.S. Resolution stay Protocol - https://www.isda.org/protocol/isda-2018-us-resolution-stay-protocol/adhering-parties

where previously compliant financial contracts that contain contractual clauses that give recognition to stay powers, become non-compliant despite remaining legally effective. Such an unintended outcome would be regressive and sub-optimal given the objective of the provisions within Article 71a BRRD2 and would also undermine the progress made to date in this area.

As discussed above, it is very important to acknowledge the existing stay recognition frameworks, and the significant effort that industry has expended to implement these when finalising the RTS. The EBA should revise its approach such that it is aligned with stay recognition requirements already present across multiple large EU Member States to avoid an unnecessary, burdensome, and potentially regressive repapering exercise. One way of achieving this, as we set out in this response and propose in Annex 1, is to re-focus the RTS such that the requirement is for contractual recognition terms to give *effect* to most of the elements already proposed, rather than to explicitly include terms utilising the language described in the EBA's proposal.

The final RTS should not jeopardise the validity of existing stay recognition, and we would therefore strongly suggest that the greatest certainty would be provided if the EBA made clear in its final approach that existing contractual recognition arrangements would be deemed to meet the EBA's proposed mandatory elements including in relation to new transactions under existing Master Agreements. We have proposed some additional wording for inclusion in the draft RTS which seeks to give effect to this in Annex 2.

As suggested above, an appropriate solution that may minimise the need for repapering, but also ensure the objective of effective contractual recognition is met, would be to amend the proposed RTS such that they focus on ensuring any terms had the *effect* of several of the elements proposed. This would permit more flexible solutions to be accommodated with greater probability of counterparty adherence, and not require the parties to include specific wording as described within the proposed mandatory elements. As currently written the draft RTS gives rise to a very narrow set of language that could be used to meet the proposed mandatory elements. The focus on the effectiveness of the terms and providing greater flexibility would be consistent with the EBA's own logic when assessing its policy options (as set out in the consultation paper). In the same vein as not mandating the language in the clause itself, not mandating specific terms, but instead the effect of any contractual terms, gives greater breadth to the possible effective language within clauses. This would in several areas encompass existing language used to meet national stay recognition requirements that otherwise would not meet the requirements as set out in the draft RTS. We also believe that this approach would be proportionate to the objective of Article 71a. We have provided suggested amendments to this end in Annex 1.

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?**
3. **Do you believe that having the Article 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 Article 1(5) of the draft RTS?

In addition to our comments above, we do not agree with the proposed mandatory components of the contractual term as currently prescribed. We address each of the proposed mandatory elements below and have set out our proposed amendments in Annex 1.

Article 1(1) – Express acknowledgement: While we understand the objective behind this element, there is an issue with specifically mandating 'acknowledgment' from counterparties as part of the contractual recognition of stay powers. In particular, existing stay recognition clauses do not strictly include expressions of acknowledgement, but rather counterparties adhere to terms that permit them to exercise their termination rights, or their right to enforce a security interest, to the extent they are entitled to do so under the regimes to which stay powers apply. This difference in approach is a nuanced one, and does not change the effectiveness of the clause or the legal standing of the parties adhering to it, but does represent a difference in the language that delivers that legal relationship. As such, mandating acknowledgement and agreement could give rise to uncertainty regarding the means that have already been used to attain such an agreement that gives recognition to the stay powers. It is for this reason that the EBA's proposed approach to mandate 'acknowledgment' would represent a concerning divergence that may render existing stay recognition non-compliant.

Further to this there is the need to understand what additional benefit is derived from contract counterparties' 'acknowledgement' when compared to the proposed Article 1(3) (recognition that powers are binding). When entering into an agreement with a counterparty such differences would need to be explained, and minimising the language and number of elements necessary in this regard would also minimise the risk of issues arising that may lead to counterparty rejection. Therefore, the most efficient means of obtaining counterparty acceptance, and ultimately the recognition of stay powers, is to minimise the number of elements necessary.

The need under the EBA's proposed approach for both an explicit 'acknowledgement' and a recognition that stay powers are binding would in our view be duplicative and may also render obtaining counterparty adherence even harder than had been the case previously. Were the requirement under the RTS to be that terms had the necessary effect, this could be more easily achieved through one single clause, thus meeting the objectives of the RTS but without separate mandated elements.

Article 1(2) – Description of powers: Current national regimes in relevant EU Member States and other jurisdictions do not require a description of the powers that are being recognised. Not only would this be deemed an unusual practice (observed elsewhere only in the recognition of bail-in powers under Article 55 BRRD – and to which a great many cases of impracticability have been observed), but it would also represent a further element within the terms that would require explanation and negotiation, and in any event is not necessary for a counterparty to adhere to and recognise stay powers in a legally effective manner.

Counterparties should, and do, undertake their own due diligence. Almost all counterparties to relevant contracts will be sophisticated financial market participants with access to professional legal advice, who would already rely on their own counsel to analyse the stay powers that are applicable. Therefore, the description of such powers by the institution would be largely duplicative and unnecessary.

Whilst a description of the powers may be helpful to aid understanding, it should not be mandated as a part of the contractual term itself. A description of the powers may be better and more appropriately provided through other means, such as reference to another document outside the contract, for example a summary provided by the relevant resolution authority.

Mandating this requirement would also represent a divergence from existing practice and if taken forward in the final RTS could force institutions to undertake a repapering exercise, whilst not being necessary in of itself to achieve the policy objective. It would therefore be disproportionate to mandate its inclusion. Accordingly, we propose that the final RTS accommodate for a reference to the relevant powers to also be permitted.

Article 1(3) – Parties' recognition that powers are binding: Similarly this proposed mandatory element is not required under existing national regimes, and again represents an unnecessary additional requirement that, if taken forward, would trigger the potential need for repapering of 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. Again, the legal relationship that is achieved through the current approach would not be changed through the inclusion of this proposed mandatory element and we are concerned that mandating it is likely to make it more challenging to achieve counterparty adherence.

Of similar concern is the proposal that could be interpreted to mean that institutions and their counterparties are undertaking in the contract to assist resolution authorities in the exercise of a stay power, which would be completely unacceptable to most counterparties. Ensuring recognition by parties of the application of the stay powers is perfectly consistent with the level 1 legislation and the internationally agreed objectives to support resolution. However, asking institutions and the adhering counterparty to "*endeavour to ensure the effective application of these powers*" has never been within the scope of the legislation and is clearly beyond the capabilities of institutions and their counterparties. Requiring recognition by counterparties to not only be bound by the effect of an application of the powers but also to endeavour to ensure their effective application results in a very high burden on the parties to the contract, akin to a covenant to assist a third country public authority as opposed to recognition. The interpretation of this language, and the burden it places on both institutions would in all likelihood lead to a rejection of the proposed contractual term by the counterparty, and fuel cases of impracticability to comply with the requirements.

Given the current national approaches that exist in the EU on stay recognition do not require this element or the particular language referred to above to be deemed both effective and enforceable, again we do not believe that it is necessary or proportionate to mandate it. For this reason we propose this language be removed.

Article 1(4) – No other overriding contractual term: Again this element is not required under existing national regimes for the recognition of stay powers, and again represents an additional requirement that, if taken forward, would trigger the potential need for repapering. Current market practice has shown that even absent this form of contractual element, it has not prevented the development of clauses that are effective, and which are not adversely affected by any other contractual terms. In the first instance we would recommend that it is not necessary to mandate this, but that if the EBA considers that this element should be retained, the requirement should be for contracts to have this effect, not necessarily including such specific terms. This would enable flexibility in the language used to meet the requirement whilst still having the intended effect.

Article 1(5) – Contractual term is to be subject to the law of an EU Member State: We consider this proposed mandatory element to be the most concerning put forward by the EBA under the draft RTS. It is firstly not required by existing national stay recognition regimes and would clearly represent a material divergence from current requirements. As such it is not deemed necessary to ensure effective contractual recognition of stay powers. It would clearly require substantial remediation between institutions and counterparties and would lead to a very costly exercise, not just for institutions but also their counterparties who would need to seek legal advice on the applicable EU Member State governing law as well as the law governing the contract. This increase in the cost of doing business would undermine the competitiveness of EU banks operating in international markets, and would in all likelihood lead to counterparties seeking alternative suppliers which are not subject to this requirement. It would be extremely difficult to agree with counterparties as a concept.

This proposed requirement would also introduce an increased amount of complexity to the financial contract. On a practical level some courts have less experience of applying foreign law than others and this feature may lead to difficulties in the effective application of the stay power itself. This would run against the policy intention of this requirement, potentially reducing the certainty and effectiveness of the clause.

Regulators in some other jurisdictions are also extremely resistant to contractual recognition of bail-in in agreements either governed by their law, and/or involving an entity incorporated in their country and we anticipate similar issues would arise if an EU bank has to seek to introduce stay recognition clauses governed by the law of an EU Member State. In mandating this element the EBA would remove the possibility of a stay recognition clause being developed and introduced that is agreeable in such jurisdictions, whereby the entire contract may need to be governed by the law of that (third) country, thereby introducing a barrier to compliance and fuelling cases of impracticability.

In mandating that the contractual term be governed in this way we also fear that is may not only threaten the execution of a relevant stay power, but it may also lead to greater risk of litigation than would otherwise be the case. As a result, it would be extremely difficult for institutions to obtain a supporting legal opinion as to the effectiveness of the recognition clause.

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 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. On 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.

One further consideration that would need to be made by the EBA is the impact this requirement may have on Master Agreements used for regulatory netting purposes under the Capital Requirements Regulation (CRR). 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 "a new type of netting agreement" to the relevant Joint Supervisory Team[13]. The impact of introducing a contractual recognition with this split-governing law feature, would therefore in the 'interim' render the relevant contract non-nettable, which is particularly concerning for Master Agreements. This would subsequently result in a spike in regulatory capital requirements, as contracts deemed non-nettable would lead to the underlying exposures needing to be calculated on a gross basis. This would remain the case until both a new positive legal opinion and an ECB notification is received. Given the aforementioned difficulties this mandatory element would introduce in producing said positive legal opinion, this could result in significant long-term capital impacts that are currently not accounted for in the EBA's own analysis. Even where a positive legal opinion is possible, this would introduce unnecessary volatility into an institution's capital requirements.

The disadvantages to taking forward this approach not only include the undermining of the effectiveness of the stay power, but also the increased legal complexity that would be introduced, the resultant higher compliance costs for both institutions and their counterparties, the subsequent impact on EU banks' competitiveness globally, the creation of a cause for refusals and therefore impracticability, but also the possibility of a sustained significant increases in capital requirements by virtue of the loss of netting and at the very least unnecessary volatility in capital requirements.

Given these concerns, we see several material disadvantages to the EBA taking forward this proposal as a mandatory element, including that this particular requirement would significantly undermine the

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

effectiveness of the very stay powers which the contractual clause is meant to recognise. As such there is no clear advantage in including such a requirement, and we strongly recommend that it be removed from the RTS.

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)?

As highlighted above, existing Master Agreements that include protocols, terms or attached modules that fulfil national requirements within large EU Member States would be largely utilised to fulfil stay recognition requirements. However, were the EBA's proposed approach to be taken forward these would need to be amended or entirely new agreements produced. This process and the subsequent adherence and repapering exercises, as well as the necessary client outreach that would be required would likely take at least 18-30 months if not more depending on counterparties and their willingness to accept a change in terms.

Master Agreements differ across financial contracts, be that for derivatives (ISDA Master Agreements), repos (GMRAs), and securities lending (GMSLAs), however the specific clauses for stay power recognition are broadly constructed to be as universally acceptable as possible. This is to a large extent to promote a market standard, and to reduce incidences of counterparty refusals. This is also a key driver for the approach taken and the language used in the terms already utilised across the different product markets.

5. Do you agree with the draft Impact Assessment?

Given the implications to the current approach to complying with stay recognition requirements we do not agree with the EBA's draft impact assessment. In our view the impact assessment does not accurately estimate '*the potential related costs and benefits*' on "in scope" institutions implementing the proposed approach, and does not realistically take into account the costs of any repapering exercises that may be required, nor the impact on capital that may occur through a loss of netting.

The Impact Assessment instead states that '*given the nature of the study, the IA is high-level and qualitative in nature*'. The proposed RTS are technical and legal in nature, which necessitates the work of technical experts in institutions, including in-house and/or external counsel. These resources are high cost and are quantifiable. We therefore propose that the EBA conduct a survey on the basis of their final RTS to fulfil their requirements as per Article 10(1) of the EBA regulation (Regulation (EU) No 1093/2010), as well as the potential cost to firms of complying given the capital impact reference above. It is hoped that this would set out and highlight the costs of taking forward the EBA's approach and allow these to be compared against any benefits arising from a change in the existing contractual terms that give recognition of stay powers.

The impact assessment instead focusses on the benefits of harmonisation and costs of divergence in regard to approaches to solve the policy problem identified. This does not however consider the existing reality that some Member States already require stay recognition, and the cost of changing such requirements in relation to the EBA's own proposals. The assessment considers the policy options available to the EBA and compares these without assessing the costs of any option, but seeks instead to explain the EBA's thought process in arriving at their proposed RTS. This, whilst helpful in of itself, is not an impact assessment but a description of the considerations made in the policy design process.

We therefore strongly believe that the EBA impact assessment should be revisited in a way which assesses the actual impact of the proposals (or final RTS) on "in scope" firms.

Additional Comments

Scope of stay powers recognition requirements: We note that under the level 1 legislation, Article 71a requires contractual recognition of stay powers with counterparties to in scope financial contracts which provide for the exercise of one or more termination rights or rights to enforce security interests, to which a stay power under the BRRD2 would apply (if it were governed by the law of a Member State). This directly translates the scope of the stay powers themselves onto the requirement to put in place the appropriate contractual recognition language for financial contracts governed by third country law.

However, the scope that applies to the stay powers themselves, following amendments under BRRD2 to Articles 69, 70 and 71, and the scope of Article 68 itself, is of great concern when also considering the need to obtain counterparty agreement to contractual terms recognising the applicable stay powers. This is largely informed by the existing difficulties faced by institutions in obtaining contractual recognition for bail-in powers under Article 55 – for which the cases of impracticability have been acknowledged by legislators as per the BRRD2's introduction of an impracticability waiver.

Particular concern surrounds the need to obtain contractual recognition from EU designated settlement systems, EU central counterparties (CCPs) and third country CCPs recognised by ESMA and central banks, which are excluded under Articles 33a, 69, 70 and 71, but not under Article 68. In addition, third country Financial Market Infrastructures (FMIs) and central governments are not excluded from the scope of the stay powers.

As already acknowledged in the area of bail-in recognition, most FMIs have standard terms and conditions which are non-negotiable, and in-scope firms would face significant difficulty in obtaining counterparty agreement on the recognition of resolution stay powers and explicit consent not to exercise early termination rights from them. Therefore, if these counterparties were not explicitly excluded from the requirement's scope, institutions would have to undertake significant remediation work with those counterparties to continue to use their services, and as already experienced, would unlikely be able to obtain their acceptance to necessary recognition terms. As such, strict adherence to Art. 71a could lead to unintended consequences for the market, such as reduced transactions via third country FMIs from EU entities, and more bilateral transactions. Moreover, EU banks would also face difficulty in accessing certain third country markets and carrying out transactions with central governments.

In our view, this is an adverse outcome given the objective of the cross-border resolution regime to maintain financial stability. In particular it will carry negative implications for the broader objectives of improving resolvability through seeking to ensure continuity of access to FMIs during a resolution event. Given this is a key expectation within the SRB's Expectations for Banks[14], and an area the FSB has issued guidance[15] on and highlighted within its annexes to the Key Attributes[16], we would expect and encourage the EBA to set out its view on the appropriate scope of stays and associated contractual recognition requirements.

This issue also has implications for the global competitiveness of EU banks, and the issue of fragmentation. International regimes elsewhere grant full exemption to the counterparties outlined above.

Due to the broader scope of the applicable stay powers, and the requirement to insert contractual clauses recognising these powers, contracts are at risk of becoming inconsistent depending on the host jurisdiction (e.g. EU v. U.S.). This is particularly undesirable as it creates additional complexity in what should be standardised documentation, which otherwise complicates the process of negotiating with clients. It also

[14] SRB Expectations for Banks – March 2020 (page 30) - https://srb.europa.eu/sites/srbsite/files/efb_main_doc_final_web_0.pdf

[15] FSB - Guidance on Continuity of Access to Financial Market Infrastructures for a Firm in Resolution – July 2017 - https://www.fsb.org/wp-content/uploads/P060717-2.pdf

[16] FSB – Annex to the Key Attributes of Effective Resolution Regimes for Financial Institutions: I-Annex 5: Temporary stay on early termination rights – October 2014 - https://www.fsb.org/wp-content/uploads/I-Annex-5-Temporary-stay-on-early-termination-rights.pdf

places EU firms at a competitive disadvantage because additional rights (for the resolution authority) will come with additional costs. Furthermore, it is inconsistent with the FSB principles which were specifically aimed at early termination rights. As such, we would urge the EBA to consider additional flexibility in the mandatory contractual terms and scope of counterparties, as well as ensure that that they are proportionate to facilitate the public policy objective.

We would therefore encourage the EBA to expand the scope of exclusions on the recognition of resolution stay powers to include, at the very least, EU designated settlement systems, third country FMIs and sovereign/quasi sovereign counterparties (e.g. central governments).

Reminder of stay power application: It is in our view important to stress that whilst we agree with the objectives of the requirements put forward under Article 71a BRRD2, and as already applicable under national regimes in place within several large EU Member States, it remains important to note that the power to apply the relevant stays to in scope financial contracts is not affected by the contractual recognition of such stays. We suggest that this is referenced expressly in the recitals to the RTS. The level 1 text provides a sound statutory basis for the application of the relevant stay powers, as reinforced by Article 71a(4). Whilst contractual recognition can act to reduce the risk of litigation and strengthen enforceability (where properly crafted), contractual recognition in of itself should be viewed as a temporary solution given the long-term intention for the mutual recognition of cross-border resolution actions, as set out and agreed to in the FSB's *Principles for Cross-border Effectiveness of Resolution Actions*. We certainly recognise that these are yet to be proposed, let alone implemented, but would like to take this opportunity to further encourage work in this area to give the greatest certainty possible to the enforceability of such resolution actions.

Differentiating the requirements for financial contracts of third country subsidiaries: European headquartered banks with subsidiaries in third countries that enter into financial contracts governed by the law of a third country may be subject to the requirements under Article 71a(2). Here requirements may be placed on firms that are more targeted, in particular around the need to recognise that the exercise of the power of the resolution authority to suspend or restrict rights and obligations of the Union parent undertaking does not constitute valid grounds for the early termination, suspension, modification, netting, exercise of set-off rights or enforcement of security interests on those contracts. The EBA's draft RTS does not set out any differentiation between the requirements under Article 71a(1) or Article 71a(2) in this regard. We would recommend that the EBA consider the limited need for the proposed mandatory elements for the requirements under Article 71a(2), and instead simply require that terms with the effect of such recognition should be necessary.

We welcome any questions or views you may have on this response and we are very happy to discuss these issues further.

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Annex 1: Proposed amendments to the draft RTS under Art. 71a

Article 1 - Contents of the contractual term

The contractual **recognition** term in a relevant financial contract governed by third country law shall **give effect to** ~~***include***~~ all of the following ~~***terms***~~ **requirements**:

(1) the acknowledgement and acceptance by the parties 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 a contract.

(2) a **reference to or other** description of the powers of the relevant resolution authority set out in Articles 33a, 69, 70, and 71 of Directive 2014/59/EU as transposed by the applicable national law governing the resolution of the institution of entity concerned, and a **reference to or other** description of the requirements of Article 68 of Directive 2014/59/EU as transposed by the applicable national law.

(3) the recognition by the parties:

(a) that they are bound by the effect of an application of the powers referred to in point (2) ~~***and that they shall endeavour to ensure the effective application of these powers***~~, which include:

- (i) the suspension of any payment or delivery obligation in accordance with Article 33a of Directive 2014/59/EU as transposed by the applicable national law;
- (ii) the suspension of any payment or delivery obligation in accordance with Article 69 of Directive 2014/59/EU as transposed by the applicable national law;
- (iii) the restriction of enforcement of any security interest in accordance with Article 70 of Directive 2014/59/EU as transposed by the applicable national law;
- (iv) the suspension of any termination right under the contract, in accordance with Article 71 of Directive 2014/59/EU as transposed by the applicable national law;

(b) that they are bound by the requirements of Article 68 of Directive 2014/59/EU as transposed by the applicable national law;

(4) the acknowledgement and acceptance by the parties that ~~***no other***~~ **the** contractual **recognition** term **takes precedence over any existing** ~~***impairs the effectiveness and enforceability of the***~~ contractual term **to the contrary** ~~***as specified in this article***~~, and that the contractual **recognition** term is exhaustive on the matters described therein notwithstanding any other agreements, arrangements or understandings between the counterparties relating to the subject matter of the relevant agreement.

~~***(5) the acknowledgement of the parties that such contractual term is subject to the law of a Member State.***~~

Annex 2: Proposed amendments to the draft RTS under Art. 71a

New Article 2 to be inserted:

Article 2

Where an institution has - before the entry into force of the applicable national law of the institution or entity concerned that will transpose the powers set out in Articles 33a, 69, 70, and 71 of Directive 2014/59/EU and of the requirements of Article 68 of Directive 2014/59EU (as amended by Directive 2019/879/EU) – already included in a relevant financial contract or master agreement relating to a financial contract governed by third country law a contractual term giving legal effect to the acknowledgement and acceptance by the parties 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, based on stay powers pursuant to applicable national laws of the institution or entity concerned in force at the time, such contractual recognition shall remain valid and binding and shall be deemed to be compliant with the contents of the contractual term pursuant to Article 1 for the purposes of the relevant financial contract including, where applicable, any transactions under an existing master agreement entered into before or after the entry into force of this regulation.

Note: In the time available we have not been able to verify this wording with legal counsel but have included the above wording to provide an example of the type of approach that could be adopted, i.e. deeming existing recognition to meet the requirements of the RTS. We would be very happy to work with the EBA to develop a final clause to give effect to the objective discussed above.