German Banking Industry Committee

Die Deutsche Kreditwirtschaft

Comments

on Draft Regulatory Technical Standards on impracticability of contractual recognition of bail-in clause under Article 55(6) of Directive 2014/59/EU and

Draft Implementing Standards for the notification of impracticability of contractual recognition under Article 55(8) of Directive 2014/59/EU

Register of Interest Representatives
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Comments on EBA consultations on technical standards on impracticability of contractual recognition of bail-in (EBA/CP/2020/15)

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

We are currently not aware of any authorities expressly prohibiting contractual recognition clauses.

We actually believe that it is generally not very likely that authorities will specifically/expressly prohibit counterparties accepting bail-in contractual recognition clauses other than (i) in very exceptional cases, (ii) for very specific capital instruments or (iii) if any third country jurisdiction laws, ordonnances or regulatory rules specifically/ expressly declare such clauses to be illegal or ineffective.

The more likely and practically relevant scenarios are the following:

- The authorities (resolution or other) impose restrictions on the acceptance of contractual recognition (both in respect of Art. 55 and Art. 71a BRRD!) implicitly or informally.
- The clauses are deemed to conflict with or clearly contravene local mandatory laws (such as investor or consumer protection laws) or general legal principles (e.g. governing unfair term), especially in view of their one-sided nature and the fact that the content of the clauses cannot effectively be negotiated by the counterparty.
- Local authorities and/or local laws restrict in some cases or circumstances the extent to which counterparties, especially public entities, are permitted to subject themselves to the powers of a foreign public authority or are allowed to give effect to extraterritorial powers of a foreign authority.

The above potential limitations and restrictions will in most cases not be definitive/clear-cut (sometimes simply because the issue has never been tested in courts) and some are likely to be invoked only in court proceedings against the effects of the eventual resolution actions.

For these reasons we believe that the condition addressed in Art. 1 (1) (a) and (b) of the draft RTS could turn out to be of little practical relevance.

In any event, it should not matter which authority prohibits the acceptance of contractual recognition clauses, since any prohibition would always be an obvious and insurmountable obstacle.

We therefore believe that the provision should be amended to cover any authority which is competent to make such a declaration.

As to the broader need to provide for a more open/flexible approach in order to address the very real situation that institutions will effectively not be able to impose such contractual clauses on their counterparties and that it will be impossible to clearly identify all relevant types of conditions constituting impracticability, see our comments on Question 4 below.

Comments on EBA consultations on technical standards on impracticability of contractual recognition of bail-in (EBA/CP/2020/15)

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

There are many instruments which are not necessarily connected to trade finance transactions but which are, nevertheless, subject to comparable internationally established market practices and customs and/or are concluded in a manner (e.g. by telephone) which make it practically impossible to include the required contractual recognitions clauses: This would include (non-exhaustive list):

- Any contract/agreement which does not cover an outright payment obligation and where the "liability" which could be subject to any bail-in would be only a secondary liability (damage claims or equivalent monetary secondary claims under the laws of the relevant jurisdiction) of an undetermined value/amount. As to the need to clearly exclude such secondary claims from the scope of Art. 55 (limiting the scope to outright/direct/primary payment claims) - see also our comments below on Question 4.

- Deposits/certificates of deposits (concluded / confirmed via telephone or SWIFT-messages on the basis of established market practices and standards and therefore without contractual documentation).

- Interbank guarantees loans/lines of credit (concluded / confirmed via telephone or SWIFT-messages on the basis of established market practices and standards and therefore without contractual documentation).

- Spot transactions in securities or FX (concluded / confirmed via telephone or SWIFT-messages on the basis of established market practices and standards and therefore without a contractual documentation).

- Similar types of transactions where the terms are based on established market practices and are concluded/confirmed via SWIFT-messages or similar services.

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

We do not agree with the assessments made in respect of the following categories listed in the table:

- "contingent liabilities" (at least with mirroring counterclaims)

  Most contingent liabilities should be excluded as they will be completely irrelevant for a bail-in, and it would be unreasonable to burden the institution with the obligation to impose a contractual recognition clause if such clause would not be of any practical relevance.

  This holds particularly true in case of contingent liabilities with mirroring counterclaims: In many cases, the contingent liability vis-à-vis the counterparty is offset by a mirroring counterclaim against a client. Any bail-in into the contingent liability will therefore directly reduce the corresponding counterclaim, resulting in a zero-sum game.

Comments on EBA consultations on technical standards on impracticability of contractual recognition of bail-in (EBA/CP/2020/15)

To impose an obligation to include contractual recognition clauses in contractual agreements or even an obligation to attempt such inclusion will not only be an unnecessary burden but also constitutes a very real and serious competitive disadvantage in the international markets. It has to be taken into account that such clauses, when appearing in a context where they are not common, also pose a considerable burden on the counterparties, since they have to analyse them and may even be forced to obtain legal advice in order to assess the risks and consequences of such clauses. EUinstitutions are likely to be forced to withdraw from certain market segments. (see also our comments on Question 4).

- Low value contract/liability (materiality threshold)

  A materiality/value threshold would be an extremely useful feature/criterion to reduce unnecessary burdens and allow institutions and also resolution authorities to concentrate their efforts on the practically relevant liabilities/instruments. In the event of a bail-in, the resolution authorities would – in the interest of efficiency - necessarily focus their efforts on higher-value liabilities and would not pursue individual liabilities of low value based on contractual recognition clauses which would have to be enforced against counterparties in third countries simply because the cost would significantly outweigh the benefits. This, of course, would not preclude the authority from simply applying the bail-in to such low-value/smaller liabilities based on its resolution powers and without resorting to contractual recognition.

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

Yes:

First and foremost, and as already indicated above, it is important to recognise that it will not be possible to identify all potential conditions of impracticability. It also needs to be recognised that the impracticability can result from a combination of circumstances which cannot be easily categorised or reduced to specific predetermined types of conditions or cases.

In this context it is necessary to take into account that experience over recent years has clearly demonstrated the difficulties EU institutions have had with such clauses and the very considerable competitive disadvantages they face in the international markets because of this requirement (particular in view of the still extremely broad scope which is much broader than that of any other jurisdiction). A too restrictive application of the newly introduced possibility to waive the need to introduce contractual recognition clauses will force EU institutions to withdraw from certain markets or transactions with third country counterparties. It is difficult to see how such an effect is supposed to be justified in the name of a formal improvement of the resolvability, especially since the absence of a contractual recognition clause does not preclude the authorities from applying the bail-in tool.

Against this background we would suggest a much more flexible and open approach regarding the specification of conditions which indicate a legal or other impracticability.

This could best be achieved by setting out a list of non-exhaustive examples of such conditions. This would actually enable the resolution authorities - together with institutions - to better take into account developments and practical experience.

At the very least, we believe it is necessary to set out more clearly that the listed conditions do not preclude an institution from referring to other conditions indicating such other legal impracticability.

As regards the specific conditions suggested in the draft RTS and as already indicated in some of our responses to the above questions, we believe that the following should also be considered as conditions indicating impracticability:

- Contingent liability with a corresponding/mirroring counterclaim
- Low-value contract/liability (we do note, however, that this at least been taken into account on a secondary level)

In this context - and as already indicated above - we strongly believe that it is essential to expressly clarify that liabilities/contracts which are not direct/primary contractual payment obligations and where the value/amount will regularly be undetermined, are – as such - not captured by the Art. 55 requirements. Anything else would require institutions to notify such liabilities/contracts, which would clearly result in unnecessary burdens for both institutions and the authorities receiving these notifications.

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

We refer to our responses to Questions 6, 13 and 14.

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

No:

Depending on the specific circumstances and the composition of the portfolio of liabilities, three months is likely to be very challenging. In this context, it has to be taken into account that institutions are currently facing numerous challenges requiring far-reaching operative changes and adjustments to existing procedures and contractual arrangements, including the ongoing benchmark-replacement projects, the imminent coming into force of Brexit and the parallel implementation projects in respect of Art. 71a BRRD. We therefore see the need for a longer implementation period, ideally combined with a more flexible/staggered approach allowing for a risk-based implementation by institutions. Of course, clarifications clearly limiting the scope of potentially affected contracts/liabilities (such as the suggested clarification concerning the exclusion of indirect /secondary payment obligations) would greatly help the implementation process.

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

As to our general concerns regarding the approach, see our responses to Questions 4, 5 and 10.

As to the conditions set out in the draft RTS we have the following comments:

- (a)/(b) Breach of the law / explicit and binding instruction

Comments on EBA consultations on technical standards on impracticability of contractual recognition of bail-in (EBA/CP/2020/15)

As already indicated in our response to Question 1 we believe that the two situations addressed under (a) and (b) will not be of much practical relevance: the more probable and practically relevant situation will be that the imposition of contractual recognition clauses on counterparties is likely to conflict with local investor (or consumer) protection rules or mandatory legal principles concerning clauses which are deemed unfair / unilaterally imposed (without allowing for any meaningful negotiations) and intended to extend an extraterritorial effect on measures by foreign public authorities.

In many cases, it will therefore not be possible to determine with certainty whether the clauses can be effectively implemented or not. At best, it will be possible to conclude that it is more likely than not that the clauses will be effective, or, conversely, that it there is a considerable risk that the clauses can be successfully. However, there will never be absolute legal certainty.

One way to address this would be to take this situation into account, if not as a condition which directly implies unconditional impracticability, then at least as a relevant criterion for the assessment that the non-inclusion of the clauses does not adversely affect resolvability.

- (c) - liability arising out of instruments or agreements concluded in accordance with, and governed by, internationally standardised terms or protocols which the institution or entity is unable to amend.

  The condition addresses the highly pertinent situation that existing and established standard terms and practices in the relevant market effectively preclude institutions from including contractual recognition clauses into the applicable terms of the agreement. However, in order to ensure that this condition does not become redundant in practice, the additional condition that the institution was unable to amend these terms cannot be interpreted too rigidly and should not cover a purely theoretical possibility to amend terms: In general, transactions on the basis of established terms and practices, such as ICC rules for guarantees and letters of credit (but not limited to these!), allow for some level of individual amendments. However, market participants are - in practical terms - not able to unilaterally impose clauses where these are not customary in this market, especially when they concern issues other than purely commercial terms. The additional condition should therefore be deleted.

- (d) liability governed by contractual terms to which the institution is bound pursuant to its membership of, or participation in, a non-Union body, including financial market infrastructures, and which contractual terms the institution or entity is in practice unable to amend

  The comments to (c) apply correspondingly.

- (e) liability is owed either to a commercial or trade creditor and relates to goods or services that, while not critical, are used for daily operational functioning and where the institution or entity is in practice unable to amend the terms of the agreement concluded on standard terms.

  The condition is too rigid and restrictive: First, as already mentioned in other responses, it should be clarified that contracts/liabilities which are not direct/primary payment obligations are excluded as such: The contractual recognition requirement can apply only to agreements which provide for payment obligations and cannot apply to any secondary /indirect monetary obligations which may or may not arise out of, or in connection with, the relevant agreement and where the value/amount is

not even known. Anything else would effectively mean that any legal agreement or even non-contractual, yet contract-like relations (depending on the applicable law) would fall within the scope of Art. 55 BRRD. This would be a clear and unnecessary overreach and also result in considerable uncertainty.

Second, and in addition and as in the above cases, the further condition of an inability of the institution to amend the terms is particularly unnecessary in the context of these agreements/contracts: It simply cannot be expected that institutions need to demonstrate that they tried to include contractual recognition clauses in types of agreements where it was already unclear whether a liability would ever exist.

- Para. (2)

The requirements established under para. (2) determining when an institution can be deemed to be unable to amend an agreement are far too restrictive and unhelpful. As already pointed out in our comments on (c) to (e) above, this additional condition is unhelpful and should be deleted. Experience has shown that institutions face great difficulty in unilaterally imposing contractual recognition clauses on counterparties where this is not customary in the relevant market and for the relevant products. These difficulties are not limited to cases where the counterparties set the terms. Rather, it also applies to all cases where the terms are based on customs and market practices.

Para. (2) should therefore be deleted.

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

As to the need to expressly/clearly exclude non-payment liabilities, see our comments above 1and our responses to Questions 3 and 4 above.

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

We refer to our responses to Questions 7 and 8.

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

As to our central concerns regarding the scope of Art. 55 and the need for a more flexible approach, see our above response to Question 4.

We understand the proposal regarding Art. 2 of the RTS in cases where the resolution authorities have to or may require institutions to include contractual recognition clauses – together with Art. 1 of the RTS to effectively provide for the following avenues for institutions to address the issue that they will not be able to impose these contractual recognition clauses on their counterparties.

The draft RTS set out two different avenues regarding the permissibility for the non-inclusion of contractual recognition clauses:

- The first one is based on Art. 1 of the draft RTS, in the form of a positive determination of impracticability which automatically and irrefutable makes it permissible for institutions to omit the inclusion of contractual recognition clauses.

- The second one is based on Art. 2 of the draft RTS setting out criteria under which the authorities either have to or can require an institution to include the contractual recognition clauses. Under this second approach, an institution is effectively allowed to omit the inclusion of the contractual recognitions clauses until/unless the authorities require them to do so on the basis of the criteria set out in Art. 2 of the draft RTS. This Art. 2 approach distinguishes between two sets of circumstances which effectively means the following for institutions:

    - Art. 2 (1) as currently drafted would effectively preclude institutions from omitting contractual recognition clauses in case of liabilities in an amount of EUR 20 million or more or a maturity of more than six months (which would effectively mean that a liability with a longer maturity than 6 months regardless of the amount in questions or in an amount of EUR 20 million or more (regardless of the maturity) would always be subject to the contractual recognition requirement).

    - Art. 2 (2) would effectively allow an institution to omit the contractual recognition clauses in case of liabilities below the thresholds of Art. 2 (1) of the draft RTS except where the resolution authorities determine that omitting the clauses would significantly affect the resolvability of the institution.

While we understand the approach, we believe that the resulting framework for institutions is far too restrictive and formalistic and will not resolve the very real and considerable problems institutions are facing.

By narrowing down the scope of liabilities which may effectively benefit from Art. 2 of the draft RTS and the possibility to omit contractual clauses for liabilities below EUR 20 million with a maturity of less than six months, a significant portion of other types of liabilities with longer or unclear maturities, which are irrelevant for a bail-in and/or where the failure to include contractual recognition clauses does not adversely affect the resolvability in any meaningful way, will continue to be subject to the contractual recognition requirements.

As already indicated in our responses to other questions, this would be an unreasonable consequence, not only because of the resulting considerable burdens and competitive disadvantages for EU institutions in international markets but also because impeding the access of EU institutions to essential international markets or even requiring a withdrawal from such markets will not improve the resolvability of institutions in any way.

As already indicated in our responses to Question 4 and 5 above, we therefore believe that a more flexible and open approach which focusses on the actual impact on resolvability would be the only reasonable and appropriate way.

One element could be – as already suggested in responses to earlier questions – a non-exhaustive list of conditions/examples of impracticability under Art. 1 of the draft RTS.

In addition, the criteria in Art. 2 (1) and (2) of the draft RTS should also be more open and flexible. At the very least, the additional limitation of a maturity of less than six months should be deleted in both para. 1 (1) and (2) so that the mandatory requirement to include contractual recognition clauses arises only in the case of liabilities with an amount of EUR 20 million and that, conversely, resolution authorities may determine that is permissible to omit the contractual recognition clauses in respect of liabilities with amounts below this threshold regardless of the maturity.

A clearer focus on the impact on the resolvability is essential to grant the authorities and institutions the necessary flexibility to ensure that the contractual recognition requirements under Art. 55 BRRD do not result in unreasonable burdens for institutions, authorities and counterparties without actually improving resolvability.

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

We refer to our comments on Question 10 and the general concerns we raised in the responses to Questions 4 and 5.

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

Considering the extent of the scope of liabilities governed by Art. 55, it is impossible to give any helpful indication.

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

No: Experience has shown that the imposition of the contractual recognition clauses is very burdensome and time-consuming (and for both parties). Rigid timetables would not be helpful in this context. We therefore strongly urge the EBA to consider a significantly more flexible and risk-based approach.

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

As already indicated above, we believe that a three-month period is likely to be too demanding.

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

We have the following concerns:

- Notifications

  The tables imply that institutions may only notify cases of impracticability which can be connected with any of the listed conditions. As we already indicated in our responses to the previous questions, the

conditions suggested in the draft are too narrow and/or of little practical relevance. It is therefore necessary to allow for notification of other conditions. This needs to be reflected in the tables.

- Individual ID for liabilities

  The proposal assumes that at least some liabilities will and can be notified on an individual basis. Considering the very broad scope of Art. 55, which captures a vast array of liabilities (even if one - as strongly urged – excludes agreements which do not provide for direct/primary payment obligations), many will need to be notified as it will be impossible for institutions to include contractual recognition clauses. It would be extremely difficult to identify all of these liabilities individually. It is thus unlikely that institutions will make regular use of individual notification.

- Material amendment

  The purpose of a notification of a material amendment is not clear: As long as the amendments do not change the liability in such a way that the original assessment no longer applies (primarily if the amount of the liability is changed and now breaches the thresholds because of the change), amendments will be irrelevant and a requirement to notify amendments - except in these exceptional cases - would be clearly unreasonably burdensome. This should be clarified, e.g., by confirming that material amendments for the purposes of the notification requirements are only amendments which substantially increase the amount of the liability.

- Legal opinions

  The proposal assumes that the institutions will at least in some cases obtain legal opinions confirming the impracticability: This will, however, normally not be the case.

  Legal opinions are, of course, an important instrument to establish the effectuality and enforceability of standard agreements and clauses used by institutions. However, in this context the opinions make little sense: Most of the conditions of impracticability are not of a legal nature and thus cannot be addressed by a legal opinion. To the extent the obstacle is indeed a legal one (Art. 1 (1) lit. (a) and (b)) this would, however, have to be negative opinion (confirming the illegality/ineffectuality of a clause).

  As already indicated above, only in very rare cases will a clause be inadmissible/illegal/prohibited as such. The more relevant case will be that the legal analysis results in an inconclusive assessment, merely identifying existing legal risks and uncertainties.

16. Do you consider the templates and instructions clear?

See our above comments on Question 15

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

See or comments above.

Comments on EBA consultations on technical standards on impracticability of contractual recognition of bail-in (EBA/CP/2020/15)

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

See our comments above.

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

NA