

- THE VICE- CHAIR -

Jonathan Hill
Commissioner
Financial Stability, Financial Services and Capital Markets Union
European Commission

28 December 2015

Dear Commissioner Hill,

Article 55 of the European Bank Recovery and Resolution Directive

As you are aware, the European banking industry is currently discussing various issues concerning the interpretation of the Bank Recovery and Resolution Directive (BRRD)¹ and its implementation into national law. One issue is Article 55 of the BRRD ("Article 55") concerning the contractual recognition of bail-in of liabilities governed by the law of a third country. The European Financial Markets Lawyers Group (EFMLG)² would like to contribute to this discussion by pleading for a coordinated action at Union level to address the potential disparities in the interpretation and implementation of Article 55.

Article 55 introduces a requirement that European institutions within its scope include contractual terms in a wide range of agreements governed by the law of a third country recognizing the possibility that the liability may be subject to bail-in powers exercised by the relevant resolution authorities and agreeing to be bound by such bail-in. The requirement applies from 1 January 2016. Article 55 also specifies that the requirement does not apply to a limited list of excluded liabilities including, among others, secured liabilities (up to the extent of the security), liabilities under deposits to individuals and SMEs, liabilities under covered bonds and fiduciary arrangements, certain liabilities with an original maturity of less than seven days.

Several issues have been raised regarding the scope of Article 55 and the bail-in recognition clause. While Article 55 expressly excludes specific type of liabilities, the remaining obligations subject to the bail-in recognition clause are not clearly defined. In particular, notwithstanding the spirit and goal of the bail-in tool, and the position of the Financial Stability Board (FSB) in this matter³, the current drafting of Article 55 may be interpreted as an obligation to include the contractual recognition clause in every contract creating any kind of liability for the European institution, and not only in debt instruments.

1 Directive 2014/59/EU of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms.

2 The European Financial Markets Lawyers Group is a group of senior legal experts from the EU banking sector dedicated to undertaking analyses and initiatives intended to foster the harmonization of laws and market practices and facilitate the integration of financial markets in Europe. The Group is hosted by the European Central Bank. More information about the EFMLG and its activities is available on its website at www.efmlg.org

3 Please see page 7 of the Financial Stability Board's principles for cross-border effectiveness of resolution actions dated of 3 November 2015, available at <http://www.financialstabilityboard.org/wp-content/uploads/Principles-for-Cross-border-Effectiveness-of-Resolution-Actions.pdf>

Various industry bodies, including AFME, the BBA, the ICC, ISDA, and the FBF have repeatedly highlighted that although their members are working hard to comply with the requirement, they struggle with the implementation of Article 55, the scope of which extends the requirement significantly beyond the recent FSB Principles for Cross-Border Effectiveness of Resolution Actions³ (“FSB Principles”).

The publication of these FSB Principles in November 2015 clarifies that statutory approaches remain the preferred solution to address cross-border recognition of resolution actions, and the development of contractual recognition clauses must be considered with respect to the cross-border enforceability of bail-in of debt instruments⁴. This narrower scope ensures that only liabilities that may contribute significantly to the loss absorbing capacity of the European institution are of such a nature that may meet the objectives and goals sought in the development of effective resolution regimes.

Furthermore, in light of the objectives of resolution and scope of bail-in as stated in Article 43 (2) and (3) of the BRRD, the current drafting of Article 55, which clearly exceeds such stated objectives and gives rise to uncertainty and concern across the market, should not be interpreted on a stand-alone basis. Further, the current drafting of Article 55 creates a competitive disadvantage for European institutions against other entities pertaining to jurisdiction with a legislation based on FSB Principles.

Some of the issues identified are set out below.

Breadth of scope

Article 55 applies to a broad range of liabilities, arising in a variety of contexts which are not always purely financial transactions or documented in the same way. European institutions subject to the BRRD may find that they are unable to enter into certain contracts which are exclusively orally concluded, via electronic communications (e.g., S.W.I.F.T.) or which are governed by standard terms and conditions that may not be negotiated.

Trade finance

It was pointed out by the BBA⁵ in its letter on Article 55 and Trade Finance that it is practically impossible for banks to add contractual bail-in terms to certain types of trade finance liabilities due to various reasons, such as the use of international standard documentation and rules, the practice of having no express choice of governing law of contracts, the legal nature of certain trade finance liabilities, and the inability to impose unilateral changes to a contract because of the dominant bargaining position of non-customers (overseas counterparties and beneficiaries) in many trade finance transactions.

The ICC⁶ further stressed that the Article 55 requirements will create a direct and serious competitive disadvantage for all European trade finance banks and will directly affect access of European manufacturers and service providers to trade finance instruments. It also insisted that the contractual

³ Financial Stability Board's principles for cross-border effectiveness of resolution actions dated of 3 November 2015, available at <http://www.financialstabilityboard.org/wp-content/uploads/Principles-for-Cross-border-Effectiveness-of-Resolution-Actions.pdf>

⁴ Please see page 7 of the FSB Principles for cross-border effectiveness of resolution actions dated of 3 November 2015.

⁵ Letter prepared by the BBA on Article 55 & trade finance dated 28 October 2015.

⁶ Letter prepared by the ICC addressed to Commissioner Hill dated 2 April 2015.

recognition requirement will weaken EU trade finance banks' competitiveness in international markets with potential adverse economic effects in the EU.

In its technical advice issued on 6 March 2015⁷, EBA identified contingent liabilities like off-balance sheet items or undrawn commitments as obligations the amount of which might be difficult to determine within a reasonable time. The statement implies that it may be justified to exempt those contingent liabilities from bail-in, on a case by case basis, in accordance with Article 44 (3) (a) of the BRRD. The EFMLG would appreciate if the EBA would clarify that at least contingent liabilities stemming from trade finance activities (e.g., letters of credits, guarantees) should be exempted from bail-in and, hence, also from the Article 55 requirement.

Financial Market Infrastructures

Liabilities to the operators or participants of financial market infrastructures (FMI) organized in third countries are not excluded under Article 44(2)(f) of the BRRD. It is uncertain whether foreign FMIs would need to rewrite their rules to accommodate the contractual recognition requirement in order for European institutions to be able to continue their membership. It is unlikely that those foreign FMIs will make such changes.

Other obligations potentially subject to the bail-in recognition clause

Additionally, there are other groups of liabilities or potential liabilities which may be included in the scope of the bail-in recognition scope, but for which the implementation would be impracticable and absolutely against the proportionality principle. This is the case of all kind of all contracts including an indemnity clause (i.e.: inter-creditor agreements, underwriting agreements, custody agreements, etc.) or a fee to be paid by the European institution (e.g., license agreements, trade associations subscriptions).

The above examples are not exhaustive, but illustrate that the scope of Article 55 is too wide and includes liabilities that may be very difficult to subject to the bail-in tool or be inappropriate for this purpose, and for which in some circumstances, the use of bail-in could even be counterproductive.

While European banking industry progresses with their due diligence and the development of model clauses, there is still no clarity on the final requirements of Article 55, as the Regulatory Technical Standards (RTS) have not been adopted⁸. Without these rules, the model clauses cannot be finalized and there is insufficient time for European institution to meet the requirements by 1 January 2016, even if the RTS was endorsed as of today. A reasonable amount of time to interpret it, analyse it and prepare the corresponding contractual clauses should be considered.

Further, the RTS will likely create more legal uncertainty than it solves. Article 2(1)(b) of the RTS clarify that an obligation can be viewed as "fully collateralized" if it is subject to margining mechanism that complies with regulatory requirements of Union law or of an equivalent third country law. What the RTS does not account for is that the regulatory margin requirements established under Article 11 (3) of the

⁷ EBA Technical advice on the delegated acts on the circumstances when exclusions from the bail-in tool are necessary (EBA/Op/2015/07) dated 6 March 2015.

⁸ EBA, final draft Regulatory Technical Standards on the contractual recognition of write-down and conversion powers under Article 55(3) of Directive 2014/59/EU (EBA/RTS/2015/06) dated 3 July 2015.

Regulation (EU) No 648/2012 (EMIR) do not apply yet and that they do not cover a broad spectrum of financial contracts, which are also subject to comprehensive margin requirements, especially exchange-traded derivatives and repurchase, securities lending and margin lending transactions.

Finally, the above-mentioned uncertainties have led resolution authorities in certain Member States to implement measures to avoid its negative impacts. On 25 November 2015 the Prudential Regulation Authority (PRA) published a “waiver by consent” in relation to the bail-in recognition clause requirements. In particular, this waiver affects such contracts that should be out of the scope of Article 55 pursuant to FSB Principles (trade finance, operational liabilities, liabilities to non-EU FMIs, etc.).

The Federal Agency for Financial Market Stabilisation (FMSA) indicated recently that in Germany, where the national law implementing Article 55 applies since 1 January 2015, being non-compliant with the Article 55 requirement will be viewed as potential impediment for the resolvability of a German institution and will therefore be discussed in the resolution planning process established for such institution. When analysing the impact of non-compliance, the FMSA will take into account whether the liabilities governed by the law of a third country are relevant for the resolution of the institution, especially whether they should contribute to the minimum requirement for own funds and eligible liabilities (MREL). Other national resolution authorities may take a similar approach. These local initiatives may create an unlevel playing field for European institutions.

We therefore would welcome a coordinated action at Union level to address the implementation issues and challenges associated with the Article 55 requirements, and prevent fragmented national solutions. We kindly request the European Commission to consider whether there is a means to clarify the scope of the said Article 55 to make it consistent with the FSB position, by issuing a public position paper or by using the forthcoming delegated acts, and contribute to enhancing clarity on this relevant issue across the Union.

Yours sincerely,



Holger Hartenfels

The Vice-Chair

CC: Isabelle Vaillant, Director of Regulation, European Banking Authority