European Financial
Markets Lawyers Group

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Cc:

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European Banking Authority
Director of Prudential Regulation and Supervisory Policy

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Single Resolution Board
Head of Unit - Resolution planning & Decisions

26 July 2021

Dear Mr. Berrigan

Re: Article 55 BRRD II: Critical issues

In light of the European Banking Authority's ("**EBA**") Final Report on draft regulatory technical standards on impracticability of contractual recognition of the bail in clause under Article 55(6) of Directive 20154/59/EU ("**Draft RTS**") and draft implementing standards for the notification of impracticability of contractual recognition of the bail-in clause under Article 55(8) of Directive 2014/59/EU ("**Draft ITS**") dated 23 December 2020 ("**Final Report**")[1] the members of the European Financial Markets Lawyers Group[2] ("**EFMLG**") took the opportunity to discuss some critical issues in the Final Report and, in general

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1 See EBA's Final Report on Draft regulatory technical standards on impracticability of contractual recognition of the bail-in clause under Article 55(6) of Directive 2014/59/EU and Draft implementing standards for the notification of impracticability of contractual recognition of the bail-in clause under Article 55(8) of Directive 2014/59/EU

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.

in the revised text of Directive 20154/59/EU ("**BRRD**"), with particular focus (i) on the concept of impracticability and (ii) the impracticability notification and assessment process.

The Single Resolution Board ("**SRB**") has recently published, on June 21, 2021, its policy (the "**Policy**") on how banks can notify the authorities when bail-in recognition clauses cannot be added to contracts under third country law, explaining how the SRB will apply, in practice, the rules set out in Article 55(2) BRRD and further detailing in the forthcoming Draft RTS and Draft ITS.

While we welcome the prioritization approach described in the second paragraph, the Policy at the same time confirms that many relevant issues raised in the past, not only by the EFMLG in its letter dated June 12, 2019 (responded by the Commission on August, 30, 2019), but also by the Association for Financial Markets in Europe ("**AFME**")[3], the European Banking Federation ("**EBF**") and the Banking Stakeholder Group ("**BSG**"), have unfortunately not been fully addressed.

We are still of the view that there are several areas of impracticability faced by entities which we do not think are adequately covered by the Draft RTS and that, furthermore, the proposed notification process is complex and unduly burdensome for both the institutions and the SRB's internal resolution teams ("**IRTs**") in comparison with the limited practical advantages it would likely achieve in most of the cases.

Conditions for impracticability

The list of only five conditions for impracticability referred to in Article 1(1) Draft RTS is insufficient. It does not capture all relevant types of liabilities that, in our view, could have a material impact on our business if we could not comply with the bail-in clause requirement due to the counterparty's refusal and albeit the fact that a substantial part of them would not have a material impact in case of resolution. For instance, we refer to contingent liabilities, to low amount or short maturity liabilities and, in general, to those liabilities in respect to which our counterparty refuses to accept the inclusion bail-in clause.

Regarding contingent liabilities, and given the drafting of Recital 26 of the BRRD and the approach taken by certain third country supervisors (such as the UK's Prudential Regulation Authority), we would strongly encourage the European institutions to work towards the inclusion of a condition of impracticability that sufficiently captures, at least, liabilities that are contingent on a breach of contract. The lack of acceptance of standard bail-in clauses for contingent liabilities developed by the industry[4] shows that the idea of using bail-in clause in all contracts potentially giving raise to contingent liabilities does not correspond to prevailing market practice.

A new condition for impracticability would also be useful with respect to purchased receivables, traded loans or other acquired liabilities[5], where institutions are unable to amend documentation that is already

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3 See AFME's response to EBA's consultation

4 The Loan Market Association ("**LMA**") developed a bail-in clause to be used in connection with the standard forms of the LMA Confidentiality Letters (cf. new clause 12 of the LMA Confidentiality Letter (Seller)).

5 See Section 5.2 of the Final Report [Views of the Banking Stakeholder Group], p. 34: "*The BSG argued that 'acquired liabilities' should be a condition of impracticability, offering two examples: one regarding syndicated*

executed[6]. A similar situation is given for syndicated loans where the arranger is not willing to use the standard bail-in clauses developed in the market[7]. Failure to address these matters would restrict the ability of institutions to actively participate in certain products or markets.

With respect to low amount or short maturity liabilities, we acknowledge that the Draft RTS provides for certain thresholds (EUR 20 MM and 6 months) which, if not surpassed, require the bank to only use bail-in clauses if the SRB considers it necessary to ensure resolvability (although the formal notification has to be made in any event). However, such thresholds are cumulative and, therefore, they significantly narrow the possibilities to use them. Being able to apply such thresholds alternatively, instead of cumulatively, would help to ensure the reasonableness of the measures as well as to proportionately address the policy aims.

Another type of liabilities that concerns institutions are those arising under agreements (e.g. credit facilities or non secured master agreements for financial contracts) that are governed by English law and that have been entered into before the withdrawal of the United Kingdom from the Union (**Brexit**) became effective. In practice, there is no real possibility to amend the relevant agreements[8]. We may consider that some of them are instruments or agreements concluded in accordance with international standardized terms of protocols that the bank is unable to amend, as per Article 1(1)(c) Draft RTS (e.g.non secured master agreements for financial contracts developed by the International Swaps and Derivatives Association ("**ISDA**") or the EBF), although many of them are not included in the categories referred to in Article 55(7) BRRD, and thus, in the best case scenario (i.e. in case they can be concluded because they fall within one of the defined conditions for impracticability), require a notification per transaction, which would be unduly burdensome, not only for the notifying institution, but also for the corresponding resolution authorities. In any event, we strongly encourage resolution authorities to carry out their assessment on the equivalence and recognition of the write down and conversion powers under English law as soon as possible.

Finally, and in general, with respect to those liabilities in which our counterparty refuses to accept the inclusion bail-in clause, we believe that the fact that institutions or entities are in practice unable to amend

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facility agreements, where a lender transfers its position to a new lender, and one regarding adherence to non-disclosure agreements"

6 A reasonable approach (which could serve as a model) has been taken by the EBA Guidelines on loan origination and monitoring of 29 May 2020 ("**EBA/GL/2020/06**"). Paragraph 19 of the EBA/GL/2020/06 provides the Section 5 on loan origination practices (namely on the assessment of the borrower's creditworthiness) will apply to existing loans and advances only if their terms and conditions have been changed, provided that such changes followed a specific credit decision approval and their implementation required a new loan agreement or addendum to the existing loan agreement.

7 The Loan Syndications and Trading Association ("**LSTA**") has developed a bail-in clause with the express intent that it be incorporated into US loan documentation, particularly credit agreements governed by New York law.

8 See Section 5.2 of the Final Report [Views of the Banking Stakeholder Group], p. 34: "*Furthermore, the BSG discussed situations of impracticability potentially linked to Brexit.*"

the contractual terms imposed by the counterparty, after having tried it (and being able to evidence it), should be a valid condition of impracticability, regardless of the counterparty-type, or the contract/instrument used as long as this does not relate to capital or MREL instruments. In light of the applicable civil law principles of contractual freedom as well as the absence of any trading ban or other express sanction in respect of non-Union law governed contracts without bail-in clause, being required to amend the terms of the contracts despite clients' refusal under the conditions outlined above would amount to EU law demanding the legally impossible.

EU banking institutions are of the view that failure to address these points would likely result in a material damage to their business with third-country clients, and in the setting of an uneven playing filed with their third-country competitors, without the corresponding additional protection to the EU economy.

The impracticability notification and assessment process

We believe the impracticability notification and assessment process entails significant charges for the institutions and, in certain cases, risks.

As already highlighted in previous communications (e.g. that of AFME dated 23 October 2020), the number and type of data to be provided when sending notifications (including but not limited to notifications per liability in form N 01.01) is very complex. We insist in urging the EBA to reconsider the simplification of the notification format or, at least, to allow for voluntary disclosure in most of the required fields.

Timing on the required notifications and responses by the SRB also poses a significant challenge; Institutions are required to send notifications solely on a quarterly - per liability – or on a semi-annual basis - per category - (ad hoc notifications may lead to longer processing times, as indicated by the Policy). Considering that the obligation to include the bail-in recognition clause is only suspended from the date of notification the institution would not to be adequately covered from the date in which it assumes the liability until the date of its notification, as it is not realistic to think that a notification on a forward looking basis can be done in a significant part of the cases.

Furthermore, if the SRB does not assess the inclusion of the clause as impracticable, either in case of a "per liability" notification, or a "per category" notification (e.g. in a category not included in the list referred to by the SRB in the Policy), it may require the institution to include the bail-in clause several months after the relevant contract has been concluded. In that case, the counterparty would likely not accept the novation of the agreement to include the clause (if it was the case, the clause would have been included from the outset of the relevant transaction), resulting in a second impracticability issue in practice. It is understood that notification on a forward looking-basis as described on p. 3 of the Policy is supposed to address that issue but the approach of notifying future contracts is not feasible.

We acknowledge that many of the issues mentioned in this letter have already been raised by the industry in the last years/months, and that have already been taken into account by the Commission, the EBA and the SRB. However, when analyzing the Draft RTS, the Draft ITS and the Policy, we still consider that the way this issue is likely to be finally addressed is going to cause EU institutions, not only a potential loss of

their business (especially the non-EU related) due to the fact that they will not be able to enter into certain type of transactions because of the counterparty's refusal, but also the need to invest in tools and implementation procedures in order to be able to comply with the notification process established.

We believe that the implementation of these rules may result in a severe loss of competitiveness of European banks, without resulting in a proportionated rise in the resolvability of those institutions, unless an approach is explored that is more closely related to the aim of the BRRD. That is why we encourage the European Commission, the EBA and the SRB to reconsider lightening up the obligations derived from the application of Article 55 BRRD for the institutions.

Yours faithfully,

Fernando Conlledo
EFMLG
Vice-Chairman