

Commissioner Jonathan Hill
European Commission
Rue de la Loi / Wetstraat 200
1049 Brussels
Belgium

2 April 2015

Re: the impact of the Bail-in Tool and the requirement for Bail-in Recognition Clauses under the BRRD on trade finance in the EU

Dear Commissioner Hill:

1. **The ICC**

The International Chamber of Commerce (“ICC”) is the world business organization, whose mission is to promote open trade and investment and help business meet the challenges and opportunities of an increasingly integrated world economy. With interests spanning every sector of private enterprise, ICC’s global network comprises over 6 million companies, chambers of commerce and business associations in more than 130 countries.

The ICC Banking Commission is the largest of ICC’s commissions. With 80 years of experience and more than 600 members in over a hundred countries, the ICC Banking Commission has gained a reputation as the most authoritative voice in the field of trade finance.

The ICC is writing to you to express its concerns as to likely effect and consequences of the Bank Recovery and Resolution Directive (2014/59/EU) (BRRD) on trade finance. In particular, the ICC’s concerns centre on Articles 44 and 55 BRRD.

Trade finance involves a broad range of financial products, such as letters of credit (including their issuance, confirmation and negotiation), bank guarantees and bank trade loans made for the purpose of financing specified underlying trade import or export transactions.

2. **BRRD’s bail-in tool and Bail-in Recognition Clauses**

As you know BRRD directs EU Member States to ensure that the “bail-in tool” may be applied to all liabilities of a bank, with the exception of certain types of liabilities. Exempted liabilities include secured liabilities and certain liabilities with an original maturity of less than seven days.

Article 55 BRRD directs Member States to require that covered entities shall include a contractual clause in all of their agreements under which liabilities can arise (the “**Bail-in Recognition Clause**”). Through such clause counterparties accept the

effects of any possible bail-in.

Such clause will not be required for agreements that are governed by the laws of an EU country or third country which recognises the EU “bail-in tool”. No such third countries have been identified so far.

3. **The ICC’s concerns regarding Bail-in Recognition Clauses**

Almost all trade finance transactions will be affected by the requirement for a Bail-in Recognition Clause. There is no express exemption for a bank’s trade finance liabilities and so far the EBA has not given any indication that trade finance would be exempted by implication.

We should point out that it is not market practice for most trade finance transactions to have an express governing law clause. This makes it difficult to establish what law governs a trade finance transaction. Therefore, most trade finance transactions will not benefit from the rule that no Bail-in Recognition Clauses are required if they are governed by the law of an EU country. Furthermore, where trade finance transactions are in fact expressed to be governed by the laws of a particular country, it is by no means market practice that the country must be the country where the liable party is located.

If banks in the EU were under an obligation to ensure that their trade finance agreements include Bail-in Recognition Clauses, then these banks would meet fierce resistance from non-EU trade finance counterparties. These parties will have no desire to accept in advance the effects of a potential bail-in. This will cause delay in the process of supporting the underlying trade. It is also likely to cause considerable additional costs for EU banks and/or their trade finance customers. It may also result in a situation where the bank’s customer will not have the desired protection against non-payment by their commercial counterparties. It could even lead to a bank being ultimately unable to support its customer for the trade. This can lead to counterparties choosing non-EU banks to facilitate the trade or the trade not taking place at all.

It should be noted that most trade finance is done through standardized documents and electronic message formats used globally between trade finance banks. Changing that practice, these documents and formats will be extremely difficult if not impossible.

For all these reasons industry experts predict that it will be extremely difficult if not impossible to get counterparties in all corners of the world to accept the Bail-in Recognition Clause.

This will create a direct and serious competitive disadvantage for all EU trade finance banks and directly affect access of European manufacturers and service providers to trade finance instruments. It will also weaken their competitiveness in international markets with potential adverse economic effects in the EU. In view of the importance of trade finance instruments for international trade, in particular, for small and medium sized companies, a general exemption for trade finance liabilities from the bail-in tool or from the requirement to have Bail-in Recognition Clauses, should be seriously considered.

4. Is the bail-in tool appropriate for trade finance liabilities?

One can question if a bail-in of trade finance liabilities is actually needed to achieve the loss absorption as intended by the BRRD. A bail-in of a bank's trade finance liabilities will most probably not improve that bank's financial position.

The purpose of a bail-in is to give the debtor relief in the form of more time to pay and/or an actual debt reduction to allow a restructuring or recovery. As the troubled bank's debts exceed its assets, a reduction of its debts can help the bank back on its feet. However, a reduction of those debts that trigger an immediate right to recoup what has or had to be paid –as is typically the case with trade finance debt -, is unnecessary. Trade finance liabilities arise not out of a desire to fund a bank but out of a desire to fund a real trade transaction funded or supported by a bank. Trade finance instruments facilitate an underlying trade. The decision to accept a trade finance exposure on a bank is mainly driven by what is required to support the underlying transaction. Therefore trade finance debt is fundamentally different from most other types of debt that are incurred for funding purposes.

As soon as a bank pays its trade finance debt, it has a right to be reimbursed by another bank or the bank's customer (depending on the bank's role in the trade finance transaction). The immediate benefit of recourse to another party in case of payment of trade finance debt obviates the need for that debt to be subject to a bail-in. In fact, bail-in of trade debt could make matters worse for a bank that relies on another bank for that recourse. A bail-in of the latter's bank's debt could worsen the position of the former bank. It can therefore cause undesirable ripple effects in the trade finance chain frustrating underlying trade transactions without improving the bank's financial position.

The bank's risk in relation to its trade finance liabilities is low. To further prove this point we refer to data collected by the ICC in its 2014 Trade Register Report¹. These demonstrate that the default risk for trade finance instruments is exceptionally low. Therefore, a bail-in of trade finance liabilities appears unnecessary.

If a bank needs help with averting financial difficulty, a more appropriate measure for its trade finance liabilities would be to transfer out those liabilities to a healthy entity. Meddling with the amount or payment terms of the liabilities would not improve the bank's financial position but only damage 'innocent' parties.

The BRRD requires that financial institutions in the scope of the bail-in tool meet the Minimum Requirement for Own Funds and Eligible Liabilities ("**MREL**") and aims to achieve that as many liabilities as possible can be bailed in (and count towards the MREL). However, liabilities with a remaining maturity of less than one year will not be included in the calculation of the MREL. Importantly, as data collected by the ICC in its 2014 Trade Register Report show, trade finance liabilities generally have a remaining tenor of less than one year. The 1-year floor for MREL seems to be in recognition of the fact that a bail-in of short term debt is less useful in terms of improving a bank's financial position.

Trade finance is the lifeblood of international commerce and crucial for a country's economy. For this reason, short term trade finance is often exempted from the restrictions introduced under a country's moratorium. Furthermore, the commercial

¹ <http://www.iccwbo.org/News/Articles/2014/Global-trade-set-to-benefit-from-ICC-report/>

importance of trade finance for a bank in terms of maintaining banking relationships and a continuous flow of business and payments typically would make it less likely that a bank would choose to delay or not pay its trade finance debt should it find itself in financial difficulty. Such a decision would quickly put it out of business and deprive it of income much needed to turn the situation around. Therefore it would not be right to make no distinction between the liabilities of a bank arising from the bank's funding needs and a banks' trade finance liabilities.

Article 44 (3) (c) BRRD provides for the exclusion of certain liabilities where necessary and proportionate to avoid widespread contagion (...) '*which would severely disrupt (...) the financial markets (...) in a manner that could cause a serious disturbance to the economy of a Member State*'. Serious consideration should be given to the effects a write-down of a bank's trade finance liabilities will have on the bank's clients, such as exporters and international traders, and on other trade finance banks in the same country. A bail-in of trade finance related liabilities will primarily affect manufacturers and service providers and the export sector as a whole. Application of the bail-in tool against a bank is likely to have a contagious effect on other banks (and their clients) in the same country. These clients will find it hard to agree payments terms and may either not sell or be forced to agree less safe payments terms. The effect on the country's import and export and therefore its economy would be severe. Excluding trade finance liabilities from the bail-in tool would however have an insulating effect on a country's export and international trade, which would be much needed in these circumstances.

Article 44 (3), paragraph (b) BRRD provides for the exclusion of certain liabilities where necessary and proportionate to '*achieve the continuity of critical functions and core business lines*'. Our argument is that trade finance **is** such a critical function and core business line in much the same way that looking after customers' cash deposits is. Continuity of those critical functions and core business lines would not be achieved by subjecting trade finance exposure to the bail-in tool. On the contrary, it would have the exact opposite effect. If one of the BRRD's main aims is to ensure the continuity of a failing financial institution's critical financial and economic functions then trade finance liabilities should clearly be in the list of excluded liabilities in Article 44 BRRD.

5. **What could be done?**

The BRRD is already in force and we understand that it is not possible to introduce a general exemption for trade finance transactions in the BRRD in the short term. However, we believe it should be possible to ensure that at the very least the Regulatory Technical Standards to be developed by the EBA and currently under discussion (and yet to be adopted by the European Commission) are used to alleviate some of the negative consequences for trade finance transactions, in particular by ensuring that:

- (i) the existing exemptions for secured liabilities and liabilities with a remaining maturity of less than seven days (Article 44 (2) (b) and (f) BRRD) are refined or clarified in such a way that they capture some types of trade finance transactions, and
- (ii) other possibilities are explored to introduce further exemptions in respect of certain types of trade finance transactions within the constraints set by the BRRD.

It seems possible to further define the liabilities excluded from a bail-in. It is not immediately clear from the BRRD if 'liabilities' include contingent liabilities. There has already been some uncertainty amongst industry experts as to the correct interpretation. Similarly, the term 'secured liabilities' as used in Article 44 (2) (b) BRRD leaves room for more than one interpretation. Furthermore, liabilities with an original maturity of less than seven days as referred to in Article 44 (2) (e) BRRD, could be said to include trade finance liabilities that will become payable within 7 days after their conditions for payment are met.

Trade finance supports real underlying trade transactions. Without trade finance services offered by banks international trade would be well nigh impossible. The exposure on banks that arises in trade finance is not the purpose of trade finance, it is rather an inevitable corollary of these services provided to sellers, buyer, traders, exporters and importers. Making the liabilities on banks subject to an EU bail-in tool would make trade finance in the EU and possibly even outside the EU more expensive and less available. It would in general negatively impact trade by companies in the EU with adverse effects on the EU real economy.

We would be grateful for your response and engagement with our concerns and would welcome the opportunity for a dialogue. Naturally we will be available for any clarifications that you may require.

Yours truly



Kah Chye Tan
Chair
On behalf of the Banking Commission of the
ICC

CC:

The European Banking Authority, for the attention of Mr. Andrea Enria

The Economic and Monetary Affairs (ECON) Committee attention of Mr. Gunnar Hoekmark