

EBA/CP/2020/04

15 May 2020

Consultation Paper

Draft Regulatory Technical Standards on the contractual recognition of stay powers under Article 71a(5) of Directive 2014/59/EU

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Responding to this consultation

The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in the last part of this document.

Comments are most helpful if they:

- respond to the questions stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by 15.08.2020. Please note that comments submitted after this deadline, or submitted via other means may not be processed.

Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EU) 2018/1725 of the European Parliament and of the Council on the protection of individuals with regard to the processing of personal data by the Union institutions and bodies, offices and agencies and on the free movement of such data, and repealing Regulation (EC) No 45/2001 and Decision No 1247/2002/EC ('EUDPR') as implemented by the EBA in its implementing rules adopted by its Management Board. Further information on data protection can be found under the Legal notice section of the EBA website.

Executive Summary

Pursuant to Article 71a(1) of Directive 2014/59/EU (BRRD) Member States shall require institutions and entities referred to in points (b), (c) and (d) of Article 1(1) of that Directive to include in any financial contract which they enter into and which is governed by third-country law, terms by which the parties recognise that the financial contract may be subject to the exercise of powers by the resolution authority to suspend or restrict rights and obligations under Articles 33a, 69, 70, and 71 of BRRD and recognise that they are bound by the requirements of Article 68 of BRRD.

Where an institution or entity does not include the contractual term required, that shall not prevent the resolution authority from applying the powers referred to in Articles 33a, 68, 69, 70 or 71 in relation to that financial contract.

Article 71a(5) of the BRRD requires the EBA to develop draft regulatory technical standards (RTS) in order to further determine the contents of the term required in that paragraph, taking into account banks' different business models.

This Consultation Paper includes the EBA's proposal for the draft RTS and explains the approach the EBA has taken in relation to the proposal.

Consistent with its mandate under Article 71a(5) of the BRRD, the EBA has proposed in the draft RTS a list of mandatory components which must be present in the contractual term required in the financial contracts. These include provisions specifying the acknowledgement, description of the powers and recognition of the parties that they are bound by the powers to suspend certain obligations and restrictions of some rights and that they are bound by the requirements of article 68 of BRRD. In addition, the parties acknowledge that no other contractual term impairs the effective and enforceability of this clause.

This approach is intended to strike a balance between the need to achieve an appropriate level of convergence whilst ensuring that differences in legal systems of third countries as well as other differences arising from different forms of financial contracts can be taken into account by resolution authorities, institutions and relevant entities through the addition of further elements if necessary to achieve the policy goal of ensuring that the powers to suspend or restrict rights and obligations can be applied effectively in relation to financial contracts governed by the law of a third country.

Background and rationale

Objective

Directive 2014/59/EU (BRRD) requires Member States to confer on their resolution authorities a number of powers including the powers to suspend or restrict rights and obligations under Articles 33a, 69, 70, and 71 of BRRD.

Member States must ensure that such powers may be applied to all financial contracts where an institution or entity is a party.

Financial contracts, to which an institution or relevant entity is party, may be governed by the law of a Member State, in which case the application of the resolution powers would be effective as a matter of law.

However, some financial contracts may be governed by the law of a third country. In the absence of a legal framework (either under the local law of the relevant third country or pursuant to an international standard agreement) that secures the effectiveness of the application of the suspension and restrictions powers by a Member State resolution authority, it is possible that a third country court may not recognise the effect of the application of the powers by that resolution authority.

For this reason, Article 71a(1) of the BRRD requires Member States to require institutions and entities to include in any financial contract, governed by the laws of a third country, a contractual term by which the parties recognise that the financial contract may be subject to the exercise of powers to suspend or restrict rights and obligations by the exercise of those powers by a Member State resolution authority.

'Financial contracts' are defined in Article 2(100) of the BRRD.

Content

Article 71a(5) of the BRRD requires the EBA to develop draft RTS in order to determine the contents of the contractual term to be required to be included in relevant financial contracts, taking into account institutions' and entities' different business models.

The EBA's proposal for the draft RTS is set out in the next chapter of the Consultation Paper. An overview of each part of the draft RTS is set out below.

Article 1: The contents of the contractual term required by Article 71a(1) of Directive 2014/59/EU

The EBA is tasked with determining the ‘contents’ of the contractual term required to be included pursuant to Article 71a(1) of the BRRD.

The EBA has considered whether to propose in the draft RTS a specific clause or a list of mandatory components to be included in the term.

The specification of an actual clause instead of clause components is in principle a preferable option, since it enhances the harmonization in the implementation of the RTS, also cross border. However, the EBA does not consider it appropriate to specify a clause as this may not be effective in all jurisdictions - also taking into account the need to capture in an RTS the various national transpositions of the stay powers – and it may not take into account the or suitable for all forms of liability falling within the scope of Article 71a(1) of the BRRD. Rather the EBA considers that listing the key mandatory elements of the term strikes the right balance between securing an appropriate level of convergence whilst ensuring that differences in legal systems of third countries as well as other differences arising from different forms of financial contracts can be taken into account by Member State resolution authorities, institutions and relevant entities.

Accordingly, it is proposed that the draft RTS include a list of mandatory components which must be present in the contractual term required pursuant to Article 71a(1) of the BRRD. These include provisions specifying the express acknowledgement, a description of the powers, the parties’ recognition that they are bound by the effect of an application of the powers by the requirements of Article 68 of Directive 2014/59/EU as transposed by national law. In addition, the parties should acknowledge that no other contractual term impairs the effectiveness and enforceability of the clause, and that the contractual term is exhaustive on the matters described therein to the exclusion of any other agreements, arrangements or understandings between the counterparties relating to the subject matter of the relevant agreement. Further, it is required that the parties acknowledge that such contractual term is subject to the law of a Member State.

The mandate under Art.71a(5) BRRD requires for the EBA to “take into account institutions' and entities' different business models when determining the contents of the contractual term”.

The type of transactions or contracts institutions engage into is potentially a more relevant dimension than business model. As a potential relevant dimension is also the way (occasional or not) through which institutions engage in contracts governed by a third country law. However, as the BRRD clearly imposes the requirement to include the contractual term in any financial contract governed by third country law, no reasoning was found to support approaches differentiated based on these two dimensions.

Ongoing international work in this area

The EBA is aware of ongoing international work in relation to statutory and contractual approaches to the recognition of the exercise of resolution powers. In particular, the EBA notes the Financial Stability



Board's (FSB) *Principles for Cross-border Effectiveness of Resolution Actions* published on 3 November 2015¹ and has sought to align its proposals with the FSB's proposals insofar as compatible with the BRRD and otherwise appropriate.

Question for the Public Consultation: 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?

¹ <https://www.fsb.org/wp-content/uploads/Principles-for-Cross-border-Effectiveness-of-Resolution-Actions.pdf>



Draft regulatory technical standards

COMMISSION DELEGATED REGULATION (EU) .../..
of XXX

supplementing Directive 2014/59/EU of the European Parliament and of the Council
with regard to regulatory technical standards to determine the contents of the
contractual term for the recognition of stay powers

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012 of the European Parliament and of the Council, and in particular Article 71(a)(5) thereof,

Whereas:

- (1) In line with the relevant international standards for cross-border effectiveness of resolution actions such as the Financial Stability Board's 'Key Attributes of Effective Resolution Regimes for Financial Institutions', and 'Principles for Cross-border Effectiveness of Resolution Actions' published on 3 November 2015, Directive (EU) 2019/879 of the European Parliament and of the Council of 20 May 2019 amended Directive 2014/59/EU by introducing, amongst other things, certain safeguards in order to enhance effective resolution execution in relation to financial contracts subject to third-country law in the absence of a statutory cross-border recognition framework (as indicated in recital 31 of Directive (EU) 2019/879). As resolution authorities' stay powers might not be effective when applied to financial contracts under third-country law, institutions and entities subject to Directive 2014/59/EU are required by Article 71a(1) of that Directive to include contractual recognition of these stay powers in their financial contracts.
- (2) Article 68 of Directive 2014/59/EU provides, in the interest of an efficient resolution, that crisis prevention measures or crisis management measures, as defined in Directive 2014/59/EU and including events directly linked to them, should not be deemed enforcement events nor insolvency proceedings. In addition, under Article 68 of Directive 2014/59/EU such measures should not entitle contracting counterparties in relevant contracts to exercise certain contractual rights, solely as a result of the application of such measures. The parties' acceptance to be bound by these requirements



should be included in the contents of the contractual term to be determined under this Regulation, in accordance with Article 71(a)(1) of the Directive 2014/59/EU.

- (3) In addition, under Articles 33a, 69, 70, 71 resolution authorities may, for a limited period of time, suspend contractual payment or delivery obligations due under a contract with an institution or an entity referred to in points (b), (c) and (d) of Article 1(1) of Directive 2014/59/EU under resolution or in certain circumstances before resolution, restrict the enforcement of security interests and suspend certain rights of counterparties to, for instance, close-out, net gross obligations, accelerate future payments or otherwise terminate financial contracts.
- (4) In order to allow for an appropriate level of convergence whilst ensuring that differences in legal systems or those arising from the particular contractual form or structure can be taken into account by resolution authorities, institutions and entities referred to in points (b), (c) and (d) of Article 1(1) of Directive 2014/59/EU, it is appropriate to lay down the mandatory contents for the contractual term required under Article 71a. In this vein, as mandated under Article 71a(5) of that Directive, the contents of the contractual term should take into account institutions' and entities' different business models. However, as the scope of the mandate covers entities with financial contracts in relation to international transactions, there is no basis for creating different contents for contractual recognition clauses.
- (5) This Regulation is based on the draft regulatory technical standards submitted by the European Supervisory Authority (European Banking Authority) (EBA) to the Commission.
- (6) The EBA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010².

HAS ADOPTED THIS REGULATION:

Article 1 - Contents of the contractual term

The contractual term in a relevant financial contract governed by third country law shall include all of the following terms:

- (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 OJ L 331, 15.12.2010, p. 12.



(2) a 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 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 contractual term impairs the effectiveness and enforceability of the contractual term as specified in this article, and that the contractual 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.

Questions for the Public Consultation:

1. 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?

2. Do you believe that having the art.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 art 1(5) of the draft RTS?

3. 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)?



Article 2 - Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, []

For the Commission
The President

On behalf of the President

[Position]

Accompanying documents

Draft cost-benefit analysis / impact assessment

1. Article 71a(5) of the Directive (EU) 2019/879 of the European Parliament and of the Council (from now on BRRD) amending Directive 2014/59/EU as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms and Directive 98/26/EC mandated the EBA to develop regulatory technical standards to further determine the contents of the term that shall be included in financial contracts governed by third-country laws to recognise that the contract may be subject to the exercise of stay powers, taking into account institutions' and entities' different business models.
2. The current RTS aims to answer to this mandate.
3. As per Article 10(1) of the EBA regulation (Regulation (EU) No 1093/2010 of the European Parliament and of the Council), any RTS developed by the EBA shall be accompanied by an Impact Assessment (IA) annex which analyses 'the potential related costs and benefits' before submitting to the European Commission. Such annex shall provide the reader with an overview of the findings as regards the problem identification, the options identified to remove the problem and their potential impacts.
4. For the purposes of the IA section of the Consultation Paper, the EBA prepared the IA with cost-benefit analysis of the policy options included in the regulatory technical standards described in this Consultation Paper. Given the nature of the study, the IA is high-level and qualitative in nature.

A. Problem identification

5. Financial contracts of an institution or an entity referred to in points (b), (c) and (d) of Article 1(1) of the Directive may be governed by the law of a Member State, in which case the application of the powers by resolution authorities to suspend or restrict rights and obligations under Articles 33a, 69, 70 and 71 and the bounding by the requirements of Article 68 would be effective as a matter of law.
6. However, some financial contracts where an institution or relevant entity is a party may be governed by the law of a third country. In the absence of a statutory cross-border recognition framework, for financial contracts governed by the law of a third country, for which these requirements do not apply directly, it is possible that a third country court may not recognise the effect of the application of the powers by that resolution authority. A refusal to recognise the application of the powers could undermine the effectiveness of actions on the part of a Union resolution authority to restore the financial condition of an institution or relevant entity



for the purposes of addressing a threat to financial stability and/or the interests of depositors and clients.

7. For this reason, Article 71a of the BRRD requires Member States to require institutions and relevant entities to include a contractual term in financial contracts governed by a third country law. By this contractual term parties shall recognize that the financial contract might be subject to the suspension of certain payment and delivery obligations, the restriction of the enforcement of security interests or to temporarily suspension of termination rights and to be bound by the conditions for the exclusion of certain contractual terms in early intervention and resolution.
8. The inclusion of the contractual term may cause a number of problems if no specification about its contents is defined:
 - a. Ineffectiveness of the resolution power in the third countries: the lack of definition of the mandatory contents of the contractual term may lead to reduce the effectiveness of the inclusion of the term as regards financial instruments governed by the law of a third country, for example where a Union resolution authority has determined that a contractual term is sufficient but it does not, in fact, secure the effective application of stay powers. This could lead to financial stability implications in the Member State concerned and in the Union as a whole.
 - b. Absence of an appropriate level of convergence and uneven playing field between institutions: an heterogeneous application of the requirement to include the contractual term could lead to a situation where the contractual term is generally effective in some jurisdictions but it is not effective in others. This situation would have an impact on the availability and cost of funding for institutions and relevant entities.

B. Policy objectives

9. The main objective of this RTS is to answer the mandate established in article 71a(5) of the BRRD.
10. As a result, the general objective is to determine the contents of the contractual term in order to allow for an appropriate level of convergence whilst ensuring that differences in legal systems or those arising from the particular contractual form or structure can be taken into account by resolution authorities.

C. Baseline scenario

11. As noted above, in the absence of Union action there is a risk of divergences between the Member States as to the interpretation of the contents of the contractual term which could lead to the aforementioned problems.

D. Options considered

12. When drafting the present RTS, the EBA considered several policy options under two main areas:

1. The flexibility of the content of the contractual term:
 - a. Option A: the specification of the mandatory contents with no flexibility for institutions and relevant entities to supplement these components.
 - b. Option B: the specification of mandatory contents with flexibility for institutions and relevant entities to supplement the clause with additional components from a closed list set out in the RTS.
 - c. Option C: the specification of mandatory contents with flexibility for institutions and relevant entities to supplement these components with additional components (i.e. no closed list).
2. The inclusion of wording referring to the fact that the counterparty should be bound by the contractual term:
 - a. Option A: Not to include this specific mention as article 71 does not specifically refer to it.
 - b. Option B: To include this specific mention even if article 71 does not specifically refer to it.

E. Assessment of the options and the preferred option(s)

13. Regarding the flexibility of the content of the contractual term, under Option A, the contents of the contractual term would be developed with no flexibility for institutions and relevant entities to supplement these components. This option would secure a very high degree of consistency as regards the approach of the Member States, institutions and entities to the contents of the contractual term. However, this option would not enable institutions and relevant entities to supplement these contents as necessary to take account of any specificities arising in relation to a particular type of financial contract or a specific third country law.

14. Option B would offer a greater degree of flexibility while keeping the mandatory components. This option would also promote a high degree of convergence, but, in addition, it would enable some specificities arising in relation to a particular type of financial contract or a specific third country law to be taken into account. However, it does not appear feasible to anticipate in advance all potential issues that may be identified with regard to a particular type of financial contract or a specific third country law.

15. Option C aims to find a balance between the need for harmonisation and the need for flexibility. Under this option the mandatory contents are set out in the RTS, but there are no limits on the ability of institutions and relevant entities to supplement the contents to take into account issues arising in relation to a particular type of financial contract or a specific third country law. For these reasons, the preferred option is Option C.



16. Regarding the inclusion of wording referring to the fact that the counterparty should be bound by the contractual term, article 71a does specifically refer to the bounding obligation only for the power recognized in article 68. For other stay powers (in articles 33a, 69, 70, and 71) only the recognition of the contractual term is requested but not the bounding obligation. Nevertheless, the counterparty should be formally bound by the contractual term to adequately ensure the application of state powers. In order to ensure an adequate framework for the application of the stay powers, the preferred option is Option B: the inclusion of wording referring to the fact that the counterparty should be bound by the contractual term.

Question for the Public Consultation: Do you agree with the draft Impact Assessment?

Overview of questions for consultation

Respondents are invited to comment in particular the following 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?**

- 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 art.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 art 1(5) of the draft 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)?**

- 5. Do you agree with the draft Impact Assessment?**