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European Banking Authority
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Email: mrelreport@eba.europa.eu

Dear Sirs,

European Banking Authority Interim Report on MREL

1. Introduction

The Loan Market Association (**LMA**) has as its key objective improving liquidity, efficiency and transparency in the primary and secondary syndicated loan markets in Europe, the Middle East and Africa. Membership of the LMA currently stands at over 600 organisations across EMEA and consists of banks, non-bank investors, borrowers, law firms, rating agencies and service providers. The production of recommended documentation is one of the LMA's most important activities and we endeavour to keep our documentation under constant review to ensure that it continues to meet the aims and needs of primary and secondary loan markets.

As part of this documentation review, we have produced a model clause for inclusion in our non-EU law governed template facility agreements to assist our members with compliance with Article 55 of the Bank Recovery and Resolution Directive (**BRRD**).

Accordingly, the LMA welcomes the opportunity to comment on Provisional recommendation 6 in the EBA's Interim Report on MREL of 19 July 2016 (the **Interim Report**).

We are concerned that EU financial institutions are required to include the wording required by Article 55 in documents which create liabilities that are not capable of being bailed-in or where a bail-in of the relevant liabilities would not improve an institution's loss absorbing capacity, because of the breadth of interpretation of what would constitute "liabilities" under Article 55. There are significant practical difficulties involved in amending existing documentation or negotiating new documentation to include wording of this sort which we have set out in more detail below and we are concerned that a broad application of Article 55 is not proportionate to achieve the purpose of Article 55.

Accordingly, we would strongly support the Interim Report's Provisional recommendation that the scope of Article 55 be narrowed. In particular, we would support narrowing the scope of Article 55 so that it would apply only to instruments which are eligible for MREL.

We would be happy to discuss this further with you or provide any additional information that you may find useful.

2. Support for narrowing the scope of Article 55 so that it would apply only to instruments which are eligible for MREL

As mentioned above, we strongly support the Interim Report's Provisional recommendation to narrow the scope of Article 55.

In the Interim Report the EBA suggests three possible policy approaches that could be adopted to narrow the scope of the requirement in Article 55:

(a) Introduce additional exemptions;

(b) Introduce a power for resolution authorities to grant waivers from Article 55;

(c) Limit the scope of Article 55 so that it would apply only to instruments which are eligible for MREL.

Our preferred approach would be to limit the scope of Article 55 so that it would apply only to instruments which are eligible for MREL.

While we would welcome the introduction of additional exemptions from the obligation under Article 55 (e.g., including exemptions for CCP membership agreements and defined categories of trade creditors), we would be concerned that this approach may not be sufficiently flexible to address the concerns that the industry has raised regarding the difficulties of including contractual recognition wording in certain types of agreement. In particular, if the intention is to provide exemptions for types of agreements (rather than for types of liabilities), it may be challenging to draft the exemptions with sufficient certainty. However, if this approach is the EBA's preferred option, we would be happy to assist in drafting appropriate wording for an exemption for loan documentation.

We would welcome a power for resolution authorities to grant waivers from Article 55 where this would not create an impediment to resolvability. However, we would be concerned that unless detailed guidance was provided (by the EBA or by the Commission) regarding the types of liability that may be subject to a waiver and the circumstances in which a waiver may be granted, different resolution authorities may take differing approaches to the grant of waivers, potentially resulting in significant differences in the application of Article 55 across the EU. In the case of agreements which are documented using industry standard documentation (such as the LMA documentation), this approach may make it more difficult for firms to develop industry level solutions or templates to assist in compliance with Article 55.

As a result, our preferred approach would be to limit the scope of Article 55 so that it would apply only to instruments which are eligible for MREL. We consider that this approach would be consistent with the FSB's Key Attributes of Effective Resolution Regimes (as discussed in section 3 below) and would also maintain the effectiveness of contractual recognition for MREL liabilities without bringing into scope additional liabilities that may not constitute an impediment to resolvability or even be practically capable of being bailed in.

3. Requiring inclusion of contractual recognition wording in documents creating any liability puts EU firms at a competitive disadvantage in international loan markets

The FSB's Key Attributes of Effective Resolution Regimes recommend introducing contractual recognition approaches to support the cross-border enforceability of resolution action, and state that contractual recognition approaches should, in particular, be considered in order to support the cross-border enforceability of:

(a) temporary restrictions or stays on the exercise of early termination rights (including those resulting from cross-defaults) under financial contracts that are governed by the laws of a jurisdiction other than that of the contracting financial institution that is subject to the resolution regime; and

(b) a write-down, cancellation or conversion of debt instruments in resolution (bail-in) where the instruments are governed by the laws of a jurisdiction other than that of the issuing entity.

We are not aware of any other jurisdiction intending to implement this recommendation as broadly as the EU. As an example we understand that the Hong Kong approach to contractual recognition is to apply the contractual recognition requirement to specified liabilities and classes of liabilities only.

This puts EU financial institutions at a significant competitive disadvantage in the international loan markets as non-EU firms are not required to include similar wording in loan documentation and may choose to deal with other non-EU institutions to avoid having to include this wording.

We have set out below in sections 4 and 5 some of the difficulties involved in including this wording in existing loan documentation.

4. Need for a proportionate approach to contractual recognition of bail-in

The term "liabilities" is not defined in BRRD and, as noted in the Interim Report, regulators have taken differing approaches. This has led to some uncertainty, with institutions in some jurisdictions taking a broader view of the liabilities that fall within Article 55 than other EU firms whose regulators have interpreted the term more narrowly.

We do not consider that a broad definition of "liability", encompassing all non-excluded liabilities, is proportionate to achieve the purpose of Article 55. The purpose of Article 55 is to enable resolution authorities to exercise the bail-in power in relation to liabilities governed by the law of a non-EU jurisdiction. However, not all "liabilities" will be capable of being bailed in or (in the event that they are bailed in) of strengthening the loss absorbing capacity of a firm or being eligible for a firm's minimum requirement for own funds and eligible liabilities.

In the context of the syndicated loan markets our concern is that institutions are most often party to syndicated lending documentation, not as borrowers, but as credit providers or in some administrative capacity. Obviously, in the rare case that an institution is party to syndicated lending documentation as a borrower, its borrowing liabilities are clearly capable of being bailed in and, potentially, of strengthening the loss absorbing capacity of a firm or being eligible for a firm's minimum requirement for own funds and eligible liabilities.

However, in the more normal scenario of financial institutions lending to a non-financial institution, a broad definition of "liability" will encompass typical obligations undertaken by financial institutions as credit providers and administrative parties in syndicated lending documentation. The types of obligation undertaken by a financial institution in those capacities under syndicated lending documentation are of 5 broad types:

- *Extension of financial accommodation*: for example the obligation to lend or to issue a letter of credit at the borrower's request.

- *Payment conduit*: administrative parties act as a conduit for payments between the borrower and the lenders and hold amounts on trust in certain circumstances, such as on an enforcement of security.

- *Contingent payment obligations:* such as indemnities against losses suffered by administrative parties. In the ordinary course these obligations would be relevant only in the event of default by the borrower.

- *Commercial restrictions*: such as obligations to safeguard the confidentiality of the borrower's information, or an agreement with the other lenders not to take enforcement action in some circumstances.

- *Administrative obligations*: intended to facilitate the smooth running of a multilateral facility, such as requirements to make prescribed notifications and pass information.

We have set out in the Annex to this letter a more detailed indicative list of the types of obligations that a financial institution would typically take on under syndicated lending documentation in those capacities. We would be happy to discuss any of these obligations further with you if that would be useful.

These obligations would typically only give rise to liabilities where the financial institution (or another party) breaches an obligation, and liabilities arising from breach of these obligations are not capable of being quantified at any given point in time. If a breach of these obligations occurs, the amount of damages or indemnity payment that may be payable as a result would not be known (or be reasonably capable of being known) until a judgment is given. As a result, they are unlikely to be capable of being bailed-in.

Even if a claim has been brought in damages for breach of one of these obligations, any judgment given by the courts of a non-EU jurisdiction would not itself include Article 55 wording and would not be affected by the inclusion of Article 55 wording in the underlying contract. As a result, it is unlikely to be possible to exercise write-down or conversion powers to reduce the amount of any judgment debt.

As a result, we do not consider that inclusion of Article 55 wording in syndicated lending documentation would be likely to have an impact on the resolvability of the parties to the documentation.

5. Difficulty of including Article 55 wording in new documentation

While the LMA has produced a model clause for inclusion in our non-EU law governed template facility agreements, member firms will still need to take steps to incorporate this

model clause in their agreements. For new agreements entered into on or after 1 January 2016, this is an additional point to be negotiated between the parties. This is very rarely straightforward, particularly when the relevant borrower or other parties to the documentation are located outside the EU.

Some situations where inclusion of Article 55 wording has proved almost impossible and other examples where difficulties arise are set out below.

- **Transactions involving Export Credit Agencies / Development Finance Institutions**

A number of lending transactions, particularly those in the asset or project finance field, are carried out in conjunction with export credit agencies and / or development finance institutions. These types of institutions are often quasi-governmental bodies which are fundamental to the transaction and contract on standard terms which they are often unwilling to alter. We understand that there is some reluctance on the part of export credit agencies and development finance institutions to include Article 55 wording meaning that the practical reality is that BRRD firms are unlikely to be able to include Article 55 wording in these arrangements given the structural importance and unique position of these institutions.

- **Agreed form documents under pre-existing agreements**

In some cases pre-existing agreements contain an agreed form of document to be entered into or issued under the agreement (e.g., agreed form bank guarantees or letters of credit). A BRRD firm will be contractually required to execute the relevant document in its agreed form and unless it reopens negotiations with all the other parties to these documents it is unlikely that the BRRD firm will be able to include Article 55 wording in those documents when they are entered into or issued.

- **No opportunity to negotiate**

A number of lending transactions involve BRRD firms entering into contracts which they have no chance to negotiate and into which a BRRD firm enters in order to benefit from the contractual relationship between two other parties. An example would be of insurance or warranty arrangements where the BRRD firm is often made party to the arrangement between the insurer and the borrower in order to benefit from the insurance on a borrower default. The nature of such arrangements is that there is no opportunity for a BRRD firm to control the terms of the contract or to obtain inclusion of Article 55 wording.

Other lending transactions involve BRRD firms issuing a form of bank guarantee or letter of credit that is required to be in a form specified by the beneficiary of that bank guarantee or letter of credit. Such beneficiaries are often governmental or quasi-governmental authorities or large corporations which will refuse to accept any changes to the form of bank guarantee or letter of credit.

6. Difficulty of including Article 55 wording in pre-existing documentation

Agreements that were executed prior to 1 January 2016 (or after 1 January 2016 but which were originally entered into solely by non-EU financial institutions) are particularly problematic. This is because the documentation has already been negotiated and agreed between all parties, and amending the documents to include Article 55 wording will require

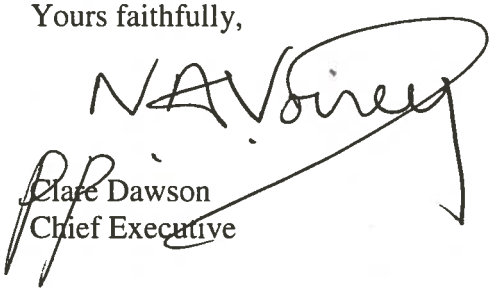
the agreement of all parties. In some cases, this could mean that an EU financial institution would need to obtain the agreement of tens or, in some cases hundreds, of other parties in order to amend the documents to include Article 55 wording. This raises difficulties in terms of the timing for obtaining all relevant consents, as well as difficulties in seeking to amend documentation that has previously been agreed between all parties. We understand that firms have encountered (and it is likely will continue to encounter) significant commercial resistance to such amendments.

The main situation in which it may be necessary for an EU financial institution to seek to include Article 55 wording in a facility agreement executed prior to 1 January 2016 (or after 1 January 2016 but which was originally entered into solely by non-EU financial institutions) is where an EU financial institution transfers in as a new lender under that facility agreement. Such a facility agreement will not contain Article 55 wording and when a new lender wants to transfer in they will do so using a standard form of adherence agreement that has already been agreed as part of the suite of original documentation. Transferring in would trigger a requirement on the EU financial institution to include Article 55 wording in the documentation but the facility agreement is not re-negotiated between the parties as part of the transfer process, and the adherence of a new lender does not present an opportunity for amending the suite of documentation that has already been agreed between the parties. The only way to insert Article 55 wording is to renegotiate the documentation between all parties. This has proved to be extremely difficult to achieve commercially.

We would also note that we are aware that these difficulties are having a significant negative effect on liquidity in the loan markets and risk impairing the ability of EU financial institutions to manage their risk portfolios (as they will be less able to sell their interests in loans which were in existence prior to 1 January 2016).

We would be pleased to discuss any aspect of the above with you in more detail. If we can be of any further assistance, please do not hesitate to contact me by email at clare.dawson@lma.eu.com or on +44 (0)20 7006 6007. We would also be pleased to meet to further discuss the above at your convenience.

Yours faithfully,



Clare Dawson
Chief Executive

Annex

Part 1
Typical contractual obligations of financial institutions in syndicated loans

Lenders

1. ***Extension of financial accommodation***

Obligation to lend to borrowers

2. ***Contingent payment obligations***

(a) *Indemnities*

(i) Indemnity given to facility agent against liability incurred by the facility agent in acting as such

(ii) Counter-indemnity to issuing bank in respect of drawings on a letter of credit which a borrower fails to repay

(b) *Other payment obligations*

(i) Obligation to provide cash collateral to issuing bank for letter of credit indemnity obligations if downgraded beyond a trigger point

(ii) Obligation to make payments to other lenders to facilitate *pro rata* sharing of recoveries / exposures under the loan among the lending syndicate in certain circumstances

(iii) Obligation to pay tax credits to borrower in certain circumstances

(iv) Obligation to pay any applicable VAT on amounts payable

3. ***Commercial restrictions***

(a) Obligation to keep confidential information relating to the borrower; to notify borrower of breach of confidentiality; and not to use that information for any unlawful purpose

(b) Obligation to consult with the borrower / obtain borrower's consent before transferring lender's participation in the facility

(c) Obligation to transfer its participation in the facility as directed by the borrower in certain circumstances.

(d) Obligation to mitigate circumstances that might lead to a lender making a claim for repayment under illegality protection or indemnification / gross-up under tax or increased costs indemnities provided by borrower

(e) Obligation to cooperate with borrower in making necessary filings under double-taxation treaties

(f) Obligation not to provide ancillary facilities in excess of lending commitment

4. ***Administrative obligations***

Obligation to notify the facility agent / borrower / other lenders of:

(a) illegality affecting the lender

(b) lender's tax position; application of any gross-up obligations; VAT position and information

(c) amount (and existence) of any claim by the lender under tax, increased costs and break funding indemnities provided by borrower

(d) secondary debt transactions undertaken by the lender with parties related to the borrower

(e) ratings downgrade in some circumstances

(f) information relating to the operation of its ancillary facilities

Facility Agent

1. ***Payment conduit***

Obligation to collect and distribute payments owing from lenders / borrower and distribute to the lenders / borrowers to whom they are due

2. ***Contingent payment obligations***

Obligation to pay any applicable VAT on amounts payable

3. ***Commercial restrictions***

(a) Obligation to act generally on the instructions of the specified lender group

(b) Obligation to keep confidential information relating to the borrower; to notify borrower of breach of confidentiality; and not to use that information for any unlawful purpose

(c) Obligation to keep confidential any quotes given by an institution of its cost of funding the loan; to notify the relevant institution of breach of confidentiality; and not to use that information for any unlawful purpose

(d) Obligation to enter into negotiations with borrower if loan falls to be priced on the basis of individual lenders' costs of funds

4. ***Administrative obligations***

(a) Obligation to notify:

(i) lenders and borrowers of applicable rates of interest

(ii) lenders of the borrower's intention to borrow each lenders' participations in that borrowing

(iii) lenders of borrower's intention to prepay a facility

(iv) borrower of application of provisions requiring a loan to be priced on the basis of individual lenders' cost of funds

(v) lenders of specified borrower defaults of which it is aware

(vi) borrower and lenders of details of lending syndicate in some circumstances

(vii) borrower and lenders upon satisfaction by borrower of conditions precedent to lending

(b) Obligation to revalue multicurrency drawings on a regular basis by reference to the underlying currency of the facility

(c) Obligation to act as a conduit for information / communications between lenders and borrowers (and to notify parties of changes to its contact details)

(d) Obligation to bring about transfers of lenders' participations and accession and resignation of borrowers and guarantors by executing otherwise duly executed transfer / accession and resignation documentation

(e) Obligation to provide assistance to successor facility agents

(f) Obligation to resign as facility agent when requested to do so by specified lender group

Issuing Bank

1. ***Extension of financial accommodation***

Obligation to issue letters of credit or guarantees to counterparties identified by the borrower

Upon issuance thereof: contingent payment obligations

2. ***Administrative obligations***

(a) Obligation to notify facility agent and borrower of:

(i) any reduction in face value of a letter of credit

(ii) expiry of any letter of credit

(iii) failure by a lender to provider cash collateral when required to do so

(iv) illegality affecting the issuing bank

(b) Obligation to revalue multicurrency letters of credit on a regular basis by reference to the underlying currency of the facility

Part 2
Typical contractual obligations of financial institutions in intercreditor documentation

Creditors (lenders, hedge counterparties etc)

1. ***Contingent payment obligations***

(a) Obligation to hold any recoveries made from the borrower in certain specified circumstances on trust for (and to pay to) the security agent for distribution by the security agent to creditors in order of priority

(b) Obligation to return amounts distributed to it by the security agent if original recovery is clawed back.

(c) Obligation to pay proceeds of any claim against a third party report provider (e.g. law firm due diligence report) to the borrower, or, if the borrower is in distressed circumstances, to the security agent for distribution to creditors in agreed order of priority.

(d) Obligation to make payments to other creditors of the same ranking to facilitate *pro rata* sharing of recoveries from the borrower among those creditors in certain circumstances

(e) Indemnity given to security agent against liability incurred by the security agent in acting as such.

2. ***Commercial restrictions***

(a) Obligation to direct any insolvency officer to pay that creditors recoveries against the borrower to security agent for distribution by the security agent to creditors in order of priority

(b) Obligation to facilitate security agent making insolvency recoveries on the relevant creditor's behalf

(c) Restriction on exercising any applicable rights of subrogation

(d) Obligation to vote as directed by security agent in borrower's insolvency / rehabilitation proceedings

(e) Obligation to facilitate releases / transfers of the relevant creditor's rights against borrower on a restructuring / enforcement

(f) Restrictions on:

(i) amending facility / hedging documentation

(ii) receiving or taking further security

(iii) taking enforcement action against the borrower

(iv) ability to transfer rights and obligations under the document

(g) Requirement to:

(i) Take enforcement action in certain circumstances on the request of other specified creditors

(ii) Ensure facility / hedging documentation complies with prescribed terms

(iii) Co-operate in ensuring that notional amounts hedged do not exceed a specified limit

(iv) Facilitate a refinancing in full of senior lenders (within prescribed limits) by taking necessary actions to give the refinancing lenders equivalent rights to those of the exiting lenders under the transaction security and intercreditor package

(h) Requirement for senior creditors to transfer their participations in the facility / hedging to junior creditors (on their request) at par when borrower is in distress

3. ***Administrative obligations***

(a) Obligation to provide information to security agent to facilitate its role as such

(b) Requirement to communicate with security agent through any relevant facility agent

(c) Obligations to notify:

(i) security agent of the extent to which it is able to receive proceeds of enforcement / asset disposal in non-cash format

(ii) Other creditors and security agent of the occurrence of specified events (e.g. borrower default / distress, taking of enforcement action, waivers of mandatory prepayments, reduction of debt)

Security Agent

1. ***Payment conduit***

(a) Obligation to hold all amounts received from enforcement of security and / or paid to it by a creditor on trust and distribute to the creditors in the prescribed priority in discharge of amounts owing by the borrower to the creditors

(b) Obligation to hold the transaction security and resulting proceeds on trust for the creditors

2. ***Commercial restrictions***

(a) Obligation to act generally on the instructions of the specified lender group and in the interests of a specified lender group in the absence of instructions

(b) Obligation to enforce security at the times, and in the manner, directed by the specified group of creditors

(c) Obligation to obtain fair value for the relevant asset when enforcing security or requiring the borrower to make a disposal in distressed circumstances

(d) Obligation to notify creditors before distributing proceeds of enforcement / asset disposal in non-cash format

(e) Obligation to hold any non-cash proceeds for any creditor unable to receive non-cash proceeds and deal with those non-cash proceeds on the instructions of that creditor

3. ***Administrative obligations***

(a) Obligation to notify:

(i) creditors of specified borrower defaults of which it is aware

(ii) creditors of its spot rate of exchange in some circumstances

(b) Obligation to act as a conduit for information / communications between creditors and borrower (and to notify parties of changes to its contact details)

(c) Obligation to bring about accession of creditors and borrowers and guarantors by executing otherwise duly executed accession documentation

(d) Obligation to provide assistance to successor security agents

(e) Obligation to resign as security agent when requested to do so by specified creditor group