14 August 2020

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

The International Swaps and Derivatives Association (ISDA) and its members welcome the opportunity to respond to the European Banking Authority's (EBA) consultation on the proposed draft RTS under Article 71a (5) of the Bank Recovery and Resolution Directive (BRRD) (the **RTS**)[1].

ISDA broadly supports the objectives of the consultation to support the effective application of stay powers requirements. Consistent with our mission, we are primarily focusing on the impact of the proposed implementation on the safety and efficiency of the financial markets with respect to derivatives and other financial transactions.

ISDA has been instrumental in supporting international and regional efforts to ensure the cross-border resolvability of financial institutions through contractual recognition. At the request of regulators, ISDA has developed multilateral protocols to achieve effective contractual recognition of resolution stays including:

- the ISDA Universal Stay Protocol, published on November 12, 2015, effectuates amendments to covered master agreements, including ISDA Master Agreements, to contractually recognize stays and other limitations on termination rights and certain other remedies under special resolution regimes applicable to their counterparties in a number of jurisdictions. The recognition ensures that counterparties to foreign-law-governed agreements are on equal footing with counterparties to local-law-governed agreements, and addresses one of the key impediments to an effective cross-border resolution identified after the financial crisis.
- the ISDA Resolution Stay Jurisdictional Modular Protocol (JMP) was introduced to enable all market participants (including buy-side institutions) to comply with regulations or legislation in various jurisdictions. This requires them to transact under terms that provide for cross-border recognition of stays and other limitations on termination rights and other remedies in financial contracts, regardless of the governing law of the applicable agreements. ISDA has currently published Modules to the JMP for the UK, Germany, France, Italy, Switzerland and Japan. ISDA has also published a separate Resolution Stay Protocol for compliance with stay regulations in the US.

[1] https://eba.europa.eu/eba-consults-technical-standards-contractual-recognition-stay-powers-under-brrd

Our assessment is that the EBA draft RTS differs from approaches already implemented in the laws of several EU jurisdictions, goes well beyond the FSB Principles for Cross-border Effectiveness of Resolution Action, and will place undue burdens on EU firms. By way of a high level summary, ISDA's key concerns relate to:

- **The requirement for the contractual recognition clause to be governed by the law of an EU member state**: We do not consider that it is necessary for a term to be subject to the law of a Member State in order for it to be effective and enforceable, and this is supported by the fact that neither the FSB Principles nor the existing Member State legislation regarding contractual stays in resolution include this requirement or any similar requirement. This requirement presents significant concerns and will also make it significantly more likely that non-EU counterparties will challenge inclusion of the contractual recognition clause.
- **Timing for implementation**: ISDA is concerned that the RTS will only be adopted in their final form in December 2020, leaving little time for the industry to develop template clauses and protocols that can be used to amend financial contracts, and to renegotiate contracts with counterparties to include the relevant clauses. These clauses will need to reflect the provisions of national law in each Member State implementing Articles 33a, 68, 69, 70 and 71 BRRD (as amended by BRRD2), but the national implementing law will not be available until 28 December 2020 (and based on previous experience with transposition of Directives, the implementing law in some jurisdictions may not be available until some time after 28 December 2020). In order to address these difficulties, ISDA would respectfully request an implementation period of 12 – 18 months from 28 December 2020.
- **Lack of grandfathering for contracts that already comply with national law requiring contractual recognition of stays in resolution**: We note that the RTS do not provide for grandfathering of financial contracts which already contain contractual recognition of stay clauses. Contractual recognition requirements already exist under the law of a number of EU member states and firms subject to those requirements have already amended existing contracts to implement those requirements (either using the JMP or bilateral amendments). The absence of grandfathering also creates difficulties for firms who need to comply with the existing requirements (e.g., under French, German or Italian law) up until 28 December 2020 and with the new requirements from that date, and who may need to renegotiate agreements shortly after concluding them in order to adapt those agreements for the new requirements of Article 71a.

We address these issues and others in more detail below in our response to the EBA's 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?**

ISDA is concerned that the proposed RTS take a highly prescriptive approach to determining the first paragraph of Article 71a of the BRRD, going well beyond the requirements proposed in the FSB Principles for Cross-border Effectiveness of Resolution Actions as well as the requirements already imposed in EU member states such as France, Germany and Italy (and potentially also going beyond the requirements of Article 71a itself). ISDA is concerned that this may have a number of detrimental consequences, including requiring EU firms that have already included effective contractual recognition clauses in their financial contracts to go through the costly and time consuming process of renegotiating these contracts to make amendments to the relevant provisions that do not change the impact or effectiveness of those clauses in any meaningful way.

The EBA's approach is also likely to result in non-EU counterparties being more reluctant to agree to the inclusion of contractual recognition provisions in their agreements. For non-EU regulated counterparties, it is likely that they and/or their supervisors will be concerned by inclusion of a contractual recognition clause in their agreements, outside of the highly negotiated and standardised clauses that have been developed in accordance with the FSB Principles. For non-EU counterparties that are not subject to resolution regimes, they will be unfamiliar with this requirement in any event and reluctant to commit to a clause that goes so far beyond internationally agreed standards. We have already seen this happen in the context of Article 55 BRRD, and the proposed RTS under Article 71a BRRD go beyond the requirements of Article 55 in a number of respects.

We also consider that some of the additional requirements that the EBA proposes could potentially be addressed in other ways without requiring firms to amend existing agreements that already contain contractual recognition clauses. For example, Article 1(2) of the RTS requires a description of the relevant powers to be included in the contractual provision. While a description of the relevant powers is likely to be useful to non-EU counterparties, it is not clear why this needs to be included in a contractual provision – it seems likely that the EBA's objective could be achieved by a template disclosure document or a central source of information rather than requiring amendment of contracts to meet this requirement.

In other cases the requirement does not appear to be necessary in order to achieve an effective and enforceable contractual recognition clause, and imposing these requirements may go beyond the scope of the EBA's powers under Article 71a. For example, the requirement for the parties to acknowledge that the contractual recognition clause is subject to the law of an EU Member State goes beyond simply detailing provisions for inclusion in a contractual recognition clause (i.e., one that requires recognition of the stays in the resolution regime "as if" the contract were governed by the laws of the jurisdiction for that regime) and involves the EBA imposing additional obligations on firms beyond the scope of Article 71a.

ISDA also has the following general comments regarding the RTS:

- **Timing/Application**: EU member states are required to transpose BRRD2 into national law by 28 December 2020 and ensure that the measures under BRRD apply from the date of entry into force of the relevant national law. As a result, the obligations under Article 71a will apply from 28 December 2020 at the latest. However, we understand that the RTS are not expected to be adopted until December 2020. This is very unlikely to give firms sufficient time to comply, if they are required to reach out to all relevant counterparties and seek to amend in-scope agreements to meet these obligations.

  While firms have been aware for some time that Article 71a would impose a new obligation regarding contractual recognition clauses, we are only now starting to see the detail of what those clauses might look like.

  Even once the final RTS have been adopted, the clause will need to reference the relevant provisions of national law implementing Articles 33a, 68, 69, 70 and 71 of BRRD (as amended by BRRD2). As Member States are only required to transpose BRRD2 into national law by 28 December 2020, it is very likely that we will only know the correct provisions to reference in the clause on or after 28 December 2020. Again, this leaves firms with no time to reach out to their counterparties to renegotiate the relevant agreements before the obligation under Article 71a starts to apply.

  If firms will only have access to the final requirements setting out the detail of these clauses shortly before (or even after) the obligation starts to apply, this gives almost no time for firms to reach out to their counterparties to renegotiate the relevant agreements. ISDA has found the protocol approach to be very effective in reducing the obligation on firms in the context of the contractual recognition requirements already in effect in the UK, France, Germany and Italy (and in fact this approach has been endorsed by the FSB), but it takes time to agree the drafting for a protocol and publicise it so that it is adopted widely, and this work can only begin once the RTS is adopted in its final form and the relevant provisions of national law implementing BRRD (as amended by BRRD2) are transposed.

  It took over six months to agree the original drafting for the ISDA Resolution Stay Jurisdictional Modular Protocol (**ISDA JMP**), even with the benefit of prior resolution protocols, which collectively took several years to produce. It took almost a year to draft the separate U.S. Resolution Stay Protocol even though it, again, was largely based on prior resolution protocols. It is unlikely that ISDA would be able to produce an updated Protocol in the days or weeks between publication of the final version of the RTS and the effective date of the obligation.

  In order to address these issues and to make it possible for firms to comply with the requirements of Article 71a, ISDA requests that the EBA consider providing an implementation period of 12 – 18 months before the Article 71a requirements start to apply. This period would allow time for ISDA and other trade associations to

develop industry standard protocols and templates and for EU firms to communicate with their counterparties to encourage them to adopt these industry standards either through mechanisms such as the ISDA JMP or through bilateral agreements.

- **Grandfathering / contents of the contractual term to take into account different business models**: We note that the RTS do not provide for grandfathering of financial contracts which already contain contractual recognition of stay clauses.

  As mentioned above, contractual recognition requirements already exist under the law of a number of EU member states and firms subject to those requirements have already amended existing contracts to implement those requirements (either using the ISDA JMP or bilateral amendments). The ISDA JMP was developed with the input of global resolution authorities, including the Single Resolution Board (**SRB**) and national EU resolution authorities. We feel this cooperation creates a justified expectation by the G-SIBs that those industry clauses which are based on the ISDA protocol wording are "fit for purpose" with regard to the requirement for contractual recognition clauses, and that the EBA requirements should not apply retroactively to financial contracts that already contain these clauses.

  The absence of grandfathering also creates difficulties for firms who need to comply with the existing requirements (e.g., under French law) up until 28 December 2020 and with the new requirements from that date, and who may need to renegotiate agreements shortly after concluding them in order to adapt those agreements for the new requirements of Article 71a.

  Although Art 71a requires the EBA to take into account institutions' and entities' different business models when specifying the contents for the contractual term, the EBA has stated that there was no basis to do so. While we welcome the EBA's decision not to vary the contents of the contractual term according to different business models, we consider that this provision does give the EBA the ability to grandfather contracts which already contain a contractual term recognising stays in resolution in accordance with the law of an EU member state. Any grandfathering should be available at the level of the existing master agreement (so new transactions entered into after 28 December 2020 under a master agreement that contains a contractual recognition clause would also benefit from grandfathering).

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?

ISDA and its members have the following concerns regarding EBA's proposed components of the contractual term:

- **Article 1(1) – requirement for the parties to "acknowledge and accept" that the contract may be subject to the exercise of resolution powers**: ISDA

respectfully requests that the EBA clarify that a firm would satisfy the requirements to "acknowledge and accept" or to "recognise" where terms equivalent to these are used (but not necessarily identical terms). For example, a firm may have in its financial contracts a contractual recognition clause which states that the parties "agree" that the contract may be subject to the exercise of resolution powers, or that the parties "acknowledge" that this is the case (but don't "acknowledge and agree"). It is not clear from the RTS that "acknowledge and accept" has a substantially different meaning from "recognise", and these terms do not have a materially different meaning under English law. This clarification would help to avoid a situation where parties already have contractual recognition clauses in relevant financial contracts, but where these clauses do not exactly track the wording of the draft RTS and so the parties may need to undertake the costly and time consuming process of renegotiating existing contracts in order to make changes which are only minor and do not have any real consequence for the ability of resolution authorities to exercise their resolution powers.

ISDA would also request that the Commission clarify the reference to "certain powers by a resolution authority to suspend or restrict rights and obligations arising from such a contract". In order to make this provision acceptable to non-EU counterparties, firms will need to specify which powers their counterparties are required to acknowledge and accept. It would be useful if these could be clarified in the RTS so that firms have certainty that they are complying with the requirements of the RTS and that they have not omitted any relevant power (nor included any additional powers, in the event that the local resolution authority has powers that arise outside of the national law implementing BRRD).

- **Article 1(2) – requirement for the parties to describe the powers of the relevant resolution authority as transposed by the applicable national law**: As mentioned in our response to Question 1, the requirement for firms to describe the relevant resolution powers could be addressed in other ways without requiring firms to amend existing agreements that already contain contractual recognition clauses. While a description of the relevant powers is likely to be useful to non-EU counterparties, it is not clear why this needs to be included in a contractual provision – it seems likely that the EBA's objective could be achieved by a template disclosure document or a central source of information rather than requiring amendment of contracts to meet this requirement.

- **Article 1(3) – requirement for the parties to recognise that they are bound by the relevant requirements**: We have a similar concern here to the one raised in relation to Article 1(1) above. It is unclear what the distinction is between "acknowledge and agree" and "recognise", and requiring firms to use the specific words referenced in the RTS is likely to result in firms that already have contractual recognition clauses in their financial contracts having to renegotiate these contracts in order to make amendments that have no real consequence.

- **Article 1(3)(a) - requirement for the parties to recognise "that they shall endeavour to ensure the effective application" of the resolution stay powers**: It is unclear why this requirement would be necessary, given that Article 71a(4) provides that where the contractual term is not included, that shall not prevent the resolution authority from applying the powers referred to in Articles 33a, 68, 69, 70 or 71 in relation to the relevant contract. However, even if the EBA does consider it to be necessary, we are concerned that it is unclear what parties are expected to do in order to "ensure effective application" or that it would be within the power of the parties to "ensure effective application". The requirement to "ensure" effective application sets a high threshold for compliance (without clarifying what steps are required for compliance or what the consequences for non-compliance would be). As a result, it seems that requiring this provision makes it significantly more likely that non-EU counterparties will challenge inclusion of the contractual recognition clause.

  This requirement also goes well beyond what is required for contractual recognition of stays and seems to seek to impose additional requirements on in-scope firms and their counterparties. We are concerned that this may go beyond the scope of the EBA's powers to make RTS under Article 71a, as this goes beyond simply determining the contents of a contractual recognition clause and in fact requires parties to comply with additional obligations.

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?**

   No, ISDA does not consider that having the Art 71a BRRA 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.

   We do not consider that it is necessary for a term to be subject to the law of a Member State in order for it to be effective and enforceable, and this is supported by the fact that neither the FSB Principles nor the existing Member State legislation regarding contractual stays in resolution include this requirement or any similar requirement.

   This requirement presents significant concerns and will also make it significantly more likely that non-EU counterparties will challenge inclusion of the contractual recognition clause. In particular, some counterparties may only be permitted to contract under local law, meaning that they would be unable to accept a clause on the basis and so EU counterparties would not be able to continue to deal with them, introducing a new barrier to cross border trade and putting EU counterparties at a disadvantage compared to firms

from jurisdictions that take an approach more closely aligned with the in the FSB Principles for Cross-border Effectiveness of Resolution Actions (**FSB Principles**) (i.e., a requirement for the parties to recognise the relevant stay provisions *as if* the contract were subject to the law of the relevant resolution regime).

This requirement may also require firms to obtain new legal opinions in order to comply with obligations to obtain legal opinions (e.g., regarding enforceability of contracts or specific terms, or regarding effectiveness of certain provisions under their contracts) in "all relevant jurisdictions", and in some cases these opinions may not be favourable.

We are also concerned that imposing this requirement goes beyond the scope of the EBA's powers to make RTS under Article 71a. Article 71a(5) provides that the EBA shall develop draft regulatory technical standards "in order to further determine the contents of the term required in paragraph 1". This provision would appear to give the EBA the power only to determine the content of the contractual recognition clause, not to impose additional requirements regarding the governing law of the relevant contract.

If the EBA determines that this change in governing law is essential and that the benefits to resolution of imposing this obligation would outweigh the significant negative effects, ISDA would welcome confirmation that this change in governing law would not trigger a requirement for firms to notify the ECB of a new type of netting agreement. The ECB's letter to significant institutions of 10 October 2019 makes it clear that such institutions are only permitted to treat contractual netting agreements as risk-reducing if they notify these agreements to the ECB. One of the triggers for notification listed by the ECB is a change in the governing law of an already recognised type of netting agreement. As a result, if compliance with Article 71a would be considered to involve a change in governing law for these purposes, significant institutions may no longer be able to treat affected contracts as risk-reducing until they have notified the EBA.

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)?**

ISDA has published the ISDA Resolution Stay Jurisdictional Modular Protocol (**ISDA JMP**), which enables parties to amend the terms of Protocol Covered Agreements to aid compliance with requirements for contractual recognition of stays in resolution under the laws of various jurisdictions. The ISDA JMP is composed of boilerplate provisions and jurisdictional modules with respect to stay regulations in particular jurisdictions. Parties may choose to adhere to one or more of these modules.

The ISDA JMP is open to ISDA members and to non-members, and can be used to amend the terms of ISDA documentation as well as other non-ISDA agreements between adhering parties. The ISDA JMP does not differ for various types of financial contracts.

The ISDA JMP currently provides jurisdictional modules in relation to the stay regulations under French, German, Italian, Japanese, Swiss and UK[2] law. If ISDA members would find this helpful, ISDA would propose to develop jurisdictional modules to support implementation of the national law implementing Article 71a in the remaining EU member states (and amend the jurisdictional modules for France, Germany, Italy and the UK as necessary).

As mentioned in our response to question 1 above, ISDA has found the protocol approach to be very effective in reducing the obligation on firms in the context of the contractual recognition requirements already in effect in a number of EU jurisdictions, but it takes time to agree the drafting for a protocol and publicise it so that it is adopted widely, and this work can only begin once the RTS is adopted in its final form. It took over six months to agree the original drafting for the Jurisdictional Modular Protocol, even with the benefit of prior resolution protocols, which collectively took several years to produce. It took almost a year to draft the separate U.S. Resolution Stay Protocol even though it, again, was largely based on prior resolution protocols. It is unlikely that ISDA would be able to produce an updated Protocol in the days or weeks between publication of the final version of the RTS and the effective date of the obligation.

5. Do you agree with the draft impact assessment?

ISDA has the following comments on the draft impact assessment. In particular, we are concerned that the impact assessment does not address the potential impact of the proposed RTS on firms subject to the Article 71a obligation and on firms who have already included contractual recognition wording in their financial contracts in compliance with existing obligations regarding contractual recognition of stays in resolution.

Flexibility of the contractual term: We agree with the policy option selected by the EBA in relation to the flexibility of the content of the contractual term (i.e., that the RTS should specify mandatory contents with flexibility for firms to supplement these components as they consider appropriate, with no closed list). However, as discussed in our responses to the questions above, we consider that the mandatory contents of the clause should be streamlined and clarified further.

Requirement for the counterparty to be bound by the contractual term: As mentioned in the impact assessment, Article 71a only requires the contractual term to provide that the parties recognise that they are bound by the requirements of Article 68 BRRD. The requirement proposed in the RTS that the parties should also recognise that

[2] Under the Stays in Resolution Part of the PRA Rulebook

they are bound by the effect of the application of the powers under Articles 33a, 69, 70 and 71, and that the parties shall endeavour to ensure the effective application of these powers is not mentioned at all in BRRD and goes significantly beyond the requirements of Article 71a. This is problematic for the reasons discussed in our response to question 2 above, and the impact assessment does not actually assess the impact of these additional obligations on firms subject to Article 71a.

Scope of the obligation under Article 71a: While we recognise that the scope of the obligation under Article 71a is set out in BRRD itself, we are concerned by the lack of a general exclusion from the obligation with respect to contracts entered into with third country financial market infrastructure (**FMIs**), third country governments and central banks. This is not consistent with international principles on contractual recognition of stays, and is likely to give rise to significant difficulties including:

- Impracticability of obtaining the required counterparty acknowledgement from EU designated settlement systems, third-country FMIs and central banks: as already acknowledged by the exclusions available elsewhere under BRRD2, most FMIs have standard terms and conditions which are non-negotiable, and in-scope firms would face significant difficulty in obtaining counterparty agreement on the recognition of resolution stay powers and explicit consent not to exercise early termination rights from them. Therefore, if the exclusions were not expanded also to take into account EU settlement systems and third country FMIs, firms would have to undertake significant remediation work with those counterparties to continue to use their services.
- Unintended consequences for market structure and access: strict adherence to Art. 71a could lead to unintended consequences for the market, such as reduced transactions via third country FMIs from EU entities and more bilateral transactions. Moreover, EU banks would also face difficulty in accessing certain third-country markets and carrying out transactions with central governments. In our view, this is an adverse outcome given the objective of the cross-border resolution regime to maintain financial stability.
- Level playing field / Fragmentation: international principles grant full exemption to the counterparties mentioned above. A strict adherence to Art. 71a with no equivalent exemptions would negatively impact the Single Point of Entry resolution strategy for international banks.

About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 925 member institutions from 75 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter, LinkedIn, Facebook and YouTube.