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EACB comments on EBA Consultation Paper

Draft Regulatory Technical Standards on impracticability of contractual recognition of bail-in clause under Article 55(6) of Directive 2014/59/EU and Draft Implementing Standards for the notification of impracticability of contractual recognition under Article 55(8) of Directive 2014/59/EU

(EBA/CP/2020/15)

General comments

The EACB welcomes the opportunity to comment on the EBA Consultation Paper Draft Regulatory Technical Standards on impracticability of contractual recognition of bail-in clause under Article 55(6) of Directive 2014/59/EU and Draft Implementing Standards for the notification of impracticability of contractual recognition under Article 55(8) of Directive 2014/59/EU.

The approach provided in the draft RTS in terms of proposed conditions of impracticability is currently too prescriptive and risks missing the actual cases of non-recognition of bail in when these may occur in practice as a result of combination of circumstances which cannot be easily categorised or reduced to specify predetermined types of conditions or cases.

Having regard to the experience with contractual recognition clauses and the competitive disadvantages they pose in the international markets, a too restrictive application of the newly introduced possibility to waive the need to introduce contractual recognition clauses will force EU institutions to withdraw from certain markets or transactions with third country counterparties. Therefore, we would suggest EBA to adopt a more flexible and open approach regarding the specification of conditions which indicate a legal or other impracticability.

Moreover, we suggest EBA to consider a more flexible and risk-based approach in determining the time needed for inclusion of the contractual recognition clause.

Answers to specific questions

1. Are there any third country authorities, other than resolution authorities, that might impose instructions not to include the contractual bail-in recognition term?

First, members have not reported of any third country authorities which would explicitly prohibit contractual clauses.

We think that it is rather unlikely that authorities will specifically prohibit counterparties from accepting bail-in contractual recognition clauses. The impracticability of recognition of bail-in clauses is more likely to occur in specific situations or for very specific capital instruments, or where a third country jurisdiction mandatory or local laws specifically consider such clauses to be illegal or ineffective.

Therefore, we think that the conditions included under Art. 1 (1) (a) and (b) of the draft RTS might in fact result redundant.

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Further to this, we think that it is impossible to define all relevant types of conditions constituting impracticability which could in fact occur in practice. In order to better address those situations, we think that the approach envisaged should be more flexible in order to anticipate other likely scenarios. We suggest amending this provision in such a way that it covers any authority which is competent to impose also implicitly or informally such a prohibition/restriction (both in respect of Art. 55 and Art. 71a)

2. Can you provide concrete examples of instruments, such as letters of guarantee, governed by the law of a third country which are not used in the context of trade finance and which would be subject to conditions of impracticability?

Examples of instruments which are not necessarily used in the context of trade finance and which could be subject to conditions of impracticability (i.e. especially, those instruments which are concluded/confirmed by telephone or SWIFT messages without a contractual documentation):

- Any contract/agreement which does not cover an outright payment obligation and where the "liability" which could be subject to any bail-in would only be a secondary liability (damage claims or equivalent monetary secondary claims under the laws of the relevant jurisdiction) of an undetermined value/amount.
- Deposits/certificates of deposits; Interbank guarantees loans/lines of credit; Spot transactions in securities or FX which are concluded / confirmed via telephone or SWIFT-messages on the basis of established market practices and standards and therefore without a contractual documentation.
- Similar types of transactions where the terms are based on established market practices and are concluded/confirmed via SWIFT-messages or similar services.

3. Do you agree that the categories of liabilities in the above table do not meet the definition of impracticability for the purpose of Article 55(6)a)?

We do not agree with the reasoning for non-inclusion within the scope of the RTS of "contingent liabilities" (at least with mirroring counterclaims) and low value contracts/liabilities (materiality threshold). We think that in particular contingent liabilities with mirroring counterclaims, but also low value contract/liability should also be considered as conditions indicating impracticability.

A materiality/value threshold would be an extremely useful instrument to reduce unnecessary burdens and allow institutions and also resolution authorities to concentrate their efforts on the practically relevant liabilities/instruments.

To impose an obligation to include contractual recognition clauses in the contractual agreements or even an obligation to attempt such inclusion will not only be an unnecessary burden (including a considerable burden on the counterparties since they have to analyse them and may even be forced to obtain legal advice in order to assess the risks and consequences of such clauses) but also constitutes a very real and serious competitive disadvantage in the international markets.

4. Do you consider that there is any condition of impracticability that has not been captured in the analysis?

Yes, see our answer to question 3.

As stated above, it will not be possible to identify all potential conditions of impracticability (owing to complexity of market situations such conditions cannot be categorised in a direct manner).

We therefore think that a more flexible and open approach regarding the specification of conditions which indicate a legal or other impracticability should be applied for instance by setting out a list of non-exhaustive examples of such conditions and by setting out more clearly that the listed conditions do not preclude an institution to refer to other conditions indicating such legal other impracticability. If a too restrictive approach is applied, EU Institutions are likely to be forced to withdraw from certain markets or transactions with third country counterparties.

We believe that it is essential to expressly clarify that liabilities/contracts which are not direct/primary contractual payment obligations and where the value/amount will regularly be undetermined, are not covered by the Article 55 requirements. Provisions requiring institutions to notify such liabilities/contracts would imply redundant burdens for both institutions and the authorities receiving these notifications.

5. Do you agree with EBA's approach for developing the draft ITS?

Compare our answer to Questions 6, 13 and 14.

6. Do you consider reasonable 3 months for entry into force of the ITS, as allowing enough time to set-up the proper and adequate capabilities to notify with this ITS?

No, three months does not seem to be reasonable taking into account the current context posing numerous difficulties for banks in terms of far-reaching operative changes and adjustments to existing procedures and contractual arrangements, including the ongoing benchmark-replacement projects, Brexit and the parallel implementation projects in respect of BRRD2.

We therefore suggest providing for a longer implementation period and a more flexible approach allowing for a risk-based implementation by institutions.

Moreover, the scope of potentially affected contracts/liabilities should be limited, and it should be clarified that indirect /secondary payment obligations are excluded.

7. Do you agree with EBA's proposed conditions of impracticability?

- *(a)/(b) Breach of the law / explicit and binding instruction*

  Regarding the two conditions addressed under points (a) and (b), we believe that they will in fact have a little practical relevance.

  As stated above, we believe that the more likely and practically relevant scenarios are where the imposed contractual recognition clause is likely to conflict with the domestic investor (or consumer) protection rules or mandatory legal principles concerning clauses which are deemed unfair / unilaterally imposed (without allowing for any meaningful negotiations) and intend extend extraterritorial effect to measures by foreign public authorities.

  In practice, it will therefore be very challenging to determine with certainty whether the contractual recognition clauses can effectively be implemented or not. We therefore suggest taking the above described scenario into account, as a condition which directly implies unconditional impracticability, or least as a relevant criterion for the assessment that the non-inclusion of the clauses does not adversely affect the resolvability.

- (c) - *liability arising out of instruments or agreements concluded in accordance with and governed by internationally standardised terms or protocols which the institution or entity is unable to amend*

We see the risk that this condition may also become practically redundant, especially when the additional condition that the institution was unable to amend these terms is interpreted too strictly and if it refers to a purely theoretical possibility to amend terms (we would like to stress that typically, in general transactions on the basis of established terms and practices (e.g. ICC rules for guarantees and letters of credit the market participants are - in practical terms - not able to unilaterally impose clauses where these are not customary in this market). We therefore suggest deleting this additional condition .

- (d) *liability governed by contractual terms to which the institution is bound pursuant to its membership of, or participation in, a non-Union body, including financial market infrastructures, and which the institution or entity is in practice unable to amend*

  See the comments to lit. (c) .

- (e) *liability is owed either to a commercial or trade creditor and relates to goods or services that, while not critical, are used for daily operational functioning and where the institution or entity is in practice unable to amend the terms of the agreement concluded on standard terms*

  We find this condition too restrictive and possibly leading to legal uncertainty, while it should be explicitly clarified that contracts/liabilities which are not direct/primary payment obligations are excluded as such from the contractual recognition requirement.

  It should be clear that secondary/indirect monetary obligations are not captured by Article 55 BRRD. Moreover, as above, we suggest removing the additional condition of an inability of the institution to amend the terms; as it is not justified in case of agreements where it was already unclear whether a liability would ever exist.

- Para. (2) *For the purposes of paragraph 1, points (c) and (d) and (e) , an institution or entity shall be deemed to be unable to amend the instruments or agreements or contractual terms where the instrument, agreements or contractual terms can only be concluded under the terms set by the counterparty or counterparties or by the applicable standard terms or protocol.*

  Considering that in general, institutions experience great difficulties in imposing unilaterally contractual recognition clauses on counterparties where this is not standard behaviour under the relevant market conditions and for the relevant products, we find para. (2) too restrictive and unhelpful. The difficulties are common in cases where the parties set the terms but also in all other situations where the terms are grounded on customs and well-established market practices.

  We therefore suggest deleting para. (2).

  Please see also our response to Question 4, 5 and 10.

8. Can you provide examples of instruments or contracts for which it would be impracticable to include the contractual recognition which are not captured by the above proposed conditions?

Please see our answer to Questions 3 and 4 above.

9. Are the proposed conditions of impracticability clear and meeting their purpose?

Please refer to our answer to Questions 7 and 8.

10. Is the article providing the conditions for the Resolution Authority to require inclusion clear?

We think that the framework resulting from Article 2(1) and 2(2) of the draft RTS for institutions is too restrictive and owing to practical limitations it will actually not address real and important problems which institutions are confronting.

In line with the current draft, the scope excludes imposing the contractual clauses to liabilities below EUR 20 million with a maturity of less than six months, but implicitly covers - all other types of liabilities with longer or unclear maturities, which may be nevertheless irrelevant for a bail-in and/or where the failure to include contractual recognition clauses does not adversely affect the resolvability an any meaningful way. The liabilities even if with longer maturities but practically irrelevant will be subject to the contractual recognition requirements.

This framework seems to be too burdensome for institutions and not reasonable from the perspective of resolvability of institutions as it also implies competitive disadvantages for EU institutions in international markets by for example impeding the access of EU institutions to essential international markets or even requiring a withdrawal from such market.

Therefore, we suggest adopting a more flexible and open approach where the real impact on the resolvability is properly reflected. i.e. by providing a non-exhaustive list of conditions/examples of impracticability under Art. 1 of the draft RTS, by refraining from the additional limitation of a maturity of less than six months in Art. 2 (1) and (2) of the draft RTS, in general by providing the authorities and the institutions the necessary flexibility to ensure that the contractual recognition requirements under Art. 55 BRRD do not result in unreasonable burdens for institutions, authorities and the counterparties without actually improving the resolvability.

11. Do you agree with EBA's proposal for the conditions for the resolution authority to require the inclusion of the contractual term?

Please refer to our answer to Questions10 and for the general concerns please see responses to Questions 4 and 5.

12. What is the likely amount of the liabilities to be notified under article 55 BRRD, as average per liability and as expected maximum per liability? What is the expected average maturity of the liabilities to be notified under article 55 BRRD?

It is difficult to give any indication from the association perspective given that members may have different balance sheet structures.

13. Do you agree with EBA's proposal for the reasonable timeframe for the resolution authority to require the inclusion of the contractual term?

We do not agree with the EBA's proposal to rigidly define the "reasonable timeframe" as three months/or exceptionally 6 months. These timeframes can be very demanding in certain situations; we therefore suggest EBA to consider a more flexible and risk-based approach in determining the time needed for inclusion of the contractual recognition clause (such inclusion normally is very problematic and time-consuming for the parties).

14. How much time do you need to implement the technical specifications provided in this ITS?

As such three months for implementation seems to be too short and too demanding. See also our answers to Q13 and Q6.

15. Do you consider the draft ITS comprehensive for submitting a notification of impracticability?

First, we think that the tables should reflect the possibility to notify also other conditions of impracticability besides the conditions listed in the draft (0130). As stated above the list of the conditions suggested in the draft seems to be too narrow and to a large extent of little practical relevance (especially conditions under Article 1(a) and (b) of the RTS).

Second, regarding the individual ID for liabilities (0010), having regard to the broad scope of Article 55, we think it would be rather difficult for institutions to identify all of the liabilities captured and covered by the condition of impracticability individually and use for them an individual notification template.

Third, regarding the notification of a material amendment (0020), the draft template suggests that all types of amendments should be notified. While in our view, it should be clarified that it applies to only those amendments which substantially increase the amount of the liability, otherwise the notification becomes unreasonably burdensome.

Finally, regarding the notification cell for legal opinions (0160), this may indicate that the institutions will sometimes request legal opinions confirming the impracticability. However, it should be clarified that the conditions of impracticability are not of a legal nature and can thus not be addressed by a legal opinion, except for the conditions the under Art. 1 (1) lit. (a) and (b). The more relevant from the practical point view might be in fact the reference to the legal analysis resulting in an inconclusive assessment identifying existing legal risks and uncertainties.

16. Do you consider the templates and instructions clear?

Please refer to our answer to Question 15.

17. Do you have any suggestions or proposals in relation to the draft ITS template and the instructions to fill it in?

Please refer to our answer to Question 15.

18. Do you find any specific piece of information required in the template as hard to develop or unclear how to fill in?

Please refer to our answer to Question 15.

19. Do you agree with the draft Impact Assessment? Can you provide any numerical data to further inform the Impact Assessment?

NA

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