afme/ Finance for Europe

Association for Financial Markets in Europe

EBA Consultation: Impracticability of contractual recognition of bail-in

AFME consultation response

23 October 2020

Introduction

The Association for Financial Markets in Europe (AFME)[1] welcomes the opportunity to comment on the European Banking Authority's (EBA's) draft Regulatory Technical Standards (RTS) and Implementing Technical Standards (ITS) as laid down under Article 55 of the Bank Recovery and Resolution Directive (BRRD2). Specifically, regarding the impracticability of contractual recognition of write-down and conversion powers and related notifications. We hope that the EBA will find our response of assistance when finalising their proposed technical standards.

AFME continues to support the development of an effective recovery and resolution framework in Europe and the ongoing work to enhance resolvability. We recognise the importance of ensuring the effectiveness of resolution tools including appropriate contractual recognition of resolution powers in relevant contracts governed by the law of a third country and have supported the work undertaken to date in this area, including through providing model clauses to achieve this[2]. Our members have gone to very significant efforts to implement the existing requirements.

Nevertheless, as has become evident through the implementation of the original BRRD, there remain a number of cases where it is not possible or practicable for institutions to insert such clauses into contracts that fall within the scope of the requirement. This has been formally recognised by the co-legislators, resulting in the provision of a new Article 55 under the BRRD2. A key part of the new Article 55 is the provision for the use of a waiver of the requirement where there is a legal (or other) impracticability.

It is important that this waiver is able to cover cases where impracticability has been observed, to the extent that its use and the exclusion of any such recognition clause does not create a substantive impediment to resolvability. For this reason, we strongly believe that the waiver should not be unduly restricted in its use, especially given the residual power of the resolution authority under Article 17 to address any impediments to resolvability. Accordingly, the existence of a sufficiently wide waiver will not deprive the resolution authorities of their ability to ensure there is no impediment to resolvability.

We would therefore encourage the EBA to ensure that the use of the waiver, and specifically the scope of conditions that permit its use, not be narrowly defined. To do so would undermine the intention of the co-legislators to remedy the issues with the original requirement under Article 55. We have therefore reviewed the draft RTS and ITS in this context and provide our detailed views in response to the specific questions below. Should you have any question on any aspect of our response, please do not hesitate to get in touch with us.

[1] The Association for Financial Markets in Europe (AFME) represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society. AFME is listed on the EU Transparency Register, registration number 65110063986-76.

[2] See AFME: Model clauses for the contractual recognition of bail-in under Article 55 BRRD – August 2016 - https://www.afme.eu/Portals/0/globalassets/downloads/standard-forms-and-documents/afme-model-clauses-for-contractual-recognition-of-bail-in.pdf?ver=2019-09-24-164450-453

Responses to 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?**

We strongly believe that the definition of third country authorities in the final RTS should be sufficiently broad to capture the relevant authorities in third countries globally. The proposed restriction to specifically resolution authorities would fail to capture other relevant authorities capable of impacting firms' ability to include recognition clauses in contracts. The draft RTS overlooks the role that local statute or instructions from other authorities may have. An impediment to inserting the relevant contractual recognition clause(s) in contracts governed by third country law may be due to supervisory authority requirements or guidance, for example.

One of the key issues with seeking to obtain contractual recognition of bail-in in third country law governed liabilities, can sometimes be the lack of understanding a counterparty has of resolution, due to no, or limited, resolution frameworks in their local jurisdiction. The concept of a resolution authority may not exist in some jurisdictions. The powers typically exercised by a resolution authority in a sophisticated jurisdiction may be divided amongst a number of governmental authorities in an emerging market jurisdiction. We therefore strongly suggest that the final RTS should not be confined to third country resolution authorities, but should refer more broadly to any third country authority or applicable law.

A good example of this in practice is India, where the Reserve Bank of India (RBI) has stated in 2017 (in a formal letter) that foreign banks incorporated in the EU (and obliged to follow the BRRD) and operating in India shall ensure that their liabilities in India do not include any contractual term in the contract that has the effect of bailing-in these liabilities in the event of resolution. The RBI is not a resolution authority as there is currently no resolution scheme in place in India equivalent to the EU's resolution framework.

We would also like to draw the attention of the EBA to other specific cases where local authorities or governments have requested the industry to develop standards and templates, in particular templates of guarantees and counter-guarantees. In Algeria, by order of the government, the banking industry has implemented templates of local guarantees and counter guarantees and these cannot be amended in practice. This specific case, and others like it, lead to cases of impracticability that we believe should be covered by the proposed impracticability condition under draft Article 1(1)(b). We would therefore strongly recommend that the EBA amend its draft to include such cases where the institution is unable to amend a contract/template because of a third country practice related initially to an authority decision.

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?**

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?**

There are several examples of instruments that should be considered that are not used in the context of trade finance activities, and which may be subject to conditions of impracticability. These include letters of credit, letters of guarantees, performance bonds or tender bonds (or similar instruments, where the counterparty requires the agreement to be according to very specific text that cannot be amended). Such an example may be where a government body tenders a project. There are also many examples that are based on confirmations via telephone or SWIFT messages, or on the basis of established market practices and standards, and therefore without standard contractual documents. These include deposit/certificates of deposits, interbank guarantees, loans and lines of credit, as well as spot transactions in securities or foreign exchange.

These activities span multiple possible areas that can fall outside trade finance, but are nevertheless sources of impracticability that should be recognised. These activities do not always entail contractual language that is set through the use of an international protocol or equivalent documents, but do present examples where counterparties will not accept changes to contractual terms and are therefore clear examples of impracticability. This includes standard language that has developed within a market due to market practices or norms, and not necessarily via a protocol or standard term set by a body or authority. Often in these transactions there is no time or opportunity to negotiate the wording of the contractual terms. It is very important that these are captured in some way in the final RTS, which we provide our thoughts on in further detail below.

Further examples in this vein of impracticability include service provision contracts which create relevant liabilities that are not excluded liabilities. These contracts include counterparties such as agent banks, clearing agents, custodians, collateral managers, venues (including CCPs, exchanges and trading venues/platforms, and vendors) and brokers, where these service providers/counterparties typically operate on standard terms (or licenses) which cannot be bilaterally negotiated, or where there is very limited or no scope to negotiate. There are some common themes in these situations. AFME members' experience of service providers which refuse to include contractual recognition of bail–in is that such service providers display some or more of the following traits:

i) They act as a key part of the securities creation/issuing/distribution, trading, settlement or holding infrastructure in the market or multiple markets;

ii) They may be created by statute or pursuant to a statute;

iii) The contractual documents – terms and conditions, rules, operating procedures – are subject to direct review or supervision by a government entity;

iv) The service provider is required to provide services to all members/participants on the same terms.

In other cases, these service providers may simply be commercial entities that are not willing or will not agree, despite vigorous negotiation, that the contracts with them need to include such bail-in provisions.

The EBA has gone some way to try to recognise such issues with regard to its proposed draft Article 1(1)(d), which specifically refers to terms covering the membership of financial market infrastructures (FMIs). However, as drafted, this provision does not fully capture other incidences of this issue, which have the same underlying cause such as with the entities listed above. We would therefore recommend the EBA amend Article 1(1)(d) as follows, particularly to ensure this condition of impracticability is not limited to only those instances observed with regard to the membership of FMIs:

> "(d) the liability is governed by contractual terms to which the institution or entity 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***, including, without limitation, liabilities arising pursuant to contracts that govern the terms of direct or indirect membership to, participation in, or provision of service by, a non-Union body or third party, including, without limitation, financial market infrastructures and service providers***;"

Given the acknowledgement by the EBA of this issue as a valid condition of impracticability, i.e. where institutions or entities are in practice unable to amend the contractual terms, we believe this should be applicable regardless of the counterparty-type, or the contract's/instrument's intention or purpose. It is very important that this condition of impracticability is a general condition and is not limited to certain types of contracts. As per the EBA's own approach, the underlying conditions that give rise to impracticability should be the focus, and therefore the final RTS should reflect this.

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

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

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

Whilst we welcome the approach that the EBA has taken with regard to setting the conditions of impracticability, we respectfully disagree with some of the EBA's conclusions. In particular, there are several areas of impracticability faced by firms which we do not believe are adequately covered by the proposed RTS. We feel that it is important that the experiences of institutions and entities, and the realities that have persisted in this area over the past four years are recognised.

We therefore ask the EBA to ensure that the scope of the conditions of impracticability are sufficiently broad and recognise that all the cases of impracticability that may arise cannot be listed in a comprehensive manner. It would be helpful to leave open the possibility for other conditions of impracticability that may occur, with appropriate safeguards being provided through the ability of resolution authorities to require a clause where necessary for resolvability. We have set out above our suggested amendments to article 1(1)(d) above.

We explain below some examples of challenges which firms face where we believe it is important to ensure that the RTS is sufficiently broad to capture appropriate instances of impracticability that may arise.

Inability to amend the contract: We recognise the EBA's position on counterparty refusal, and the reference to BRRD2 Recital 26, which states that such a refusal should not on its own be considered a cause of impracticability. However, counterparty refusal should not be disregarded completely as an underlying issue that could give rise to conditions of impracticability.

The insertion of a bail-in recognition clause is reliant upon bilateral agreement to any such amendment and cannot be inserted unilaterally. Absent this agreement it is not just impracticable but <u>impossible</u> for a bail-in recognition term to be inserted into the relevant documentation. This is in reality a very clear example of an institution or entity being unable, in practice, to amend the relevant contract which is recognised as a condition for impracticability under Article 1(1)(d) of the draft RTS. Examples of particular challenges include where the contract is on standard terms and where there is no time or opportunity to negotiate inclusion of contractual recognition.

Where counterparty refusal gives rise to an institution being unable in practice to amend the relevant contract, we consider that this should be accommodated within the scope of the RTS. We would strongly encourage the EBA to make this clear in their final RTS.

As discussed further below, if this situation is not accommodated as a case for applying the waiver, it is unclear how an institution or entity could insert the necessary recognition clauses in such a situation. If the consequence of this would be that the institution decides not to enter into the transaction (for itself and possibly also for its client), or has to terminate its commercial relationship with the counterparty, this would represent a disproportionate and damaging outcome, despite the limited (if any) impact this may have on a firm's resolvability. Such a consequence would have broader ramifications for the competitiveness of European banks, their ability to service their clients and run their businesses, as well as for the global markets in which they may be able to operate.

Service providers: We believe that it is important to recognise that particular challenges arise in relation to contracts with service providers, where an institution or entity will be in receipt of services as identified earlier in our response to question 8. The experience of our members to date is that many third country banks and other service providers will not agree to the inclusion of any such contractual recognition provisions. The provisions are not commercially attractive to them and the regulatory compulsion does not fall on them. The institution or entity has to either sign the contract without the bail-in provision or find an alternative service provider (if such provider exists). The latter can be a time-consuming and expensive exercise which might still prove fruitless: there might not be an alternative service provider at all, e.g. where banking or securities custody is nationalised or centralised, or not of the required standard. In other cases an institution or entity must engage with all the available service providers in order to service its clients and transaction counterparties.

For example, in collateral management, the requirements around the provision of collateral for uncleared over-the-counter derivatives empower the collateral provider to select the collateral manager. If the institution is the collateral receiver, it must agree to use this collateral manager even if the collateral manager will not agree to the insertion of bail-in recognition provisions.

In order to better reflect these challenges, we suggest that the impracticability conditions be extended to service providers through amendments to Article 1(1)(e) and (2). We have ensured that this is consistent with our proposed amendments to Article 1(1)(d) above.

> "(e) the liability is owed either to a commercial or trade creditor ***or a service provider*** 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 ***with that creditor or service provider***;"
>
> "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 ***to include into the contractual provisions governing a relevant liability the contractual term referred to in Article 55(1) of that directive*** where the instrument, agreements or contractual terms***;***
>
> > ***(a)*** can only be concluded under the terms set by the counterparty or by the applicable standard terms or protocol***; or***
> >
> > ***(b) cannot be amended despite bona fide negotiation by the institution or entity with the counterparty***."

Liabilities contingent on breach of contract: Whilst we agree with the EBA that a liability being contingent on an event occurring does not in itself necessarily give rise to impracticability, the level 1 text is clear under Recital 26 that where the liability concerned is created by virtue of a breach of contract, it could be considered impracticable to include contractual recognition clauses.

> *"For example, under certain circumstances, it could be considered impracticable to include contractual recognition clauses in liability contracts in cases where … the liability which would be subject to the contractual recognition requirement is contingent on a breach of contract…".*

Given the level 1 text is clear in this regard, we would strongly encourage the EBA to include a condition of impracticability that sufficiently captures liabilities that are contingent on a breach of contract. This is already

recognised elsewhere, for example in the UK Prudential Regulation Authority's (PRA's) supervisory statement[3] on this issue:

> *"2.2 BRRD firms could, for instance, take the view that the inclusion of contractual recognition language is impracticable if: ... the liability which would be subject to the contractual recognition requirement is contingent on a breach of the contract."*

To be clear, this wording is aimed at capturing contracts that could only give rise to a liability that could be bailed-in (i.e. monetary payment) if there is a breach of contract and damages are awarded or otherwise payable. Such contracts are distinguishable from contracts for debt claims (like bonds) where there is always a payment liability (until discharged). At present the draft RTS implies that such contingent liabilities which may arise from virtually every contract of an institution which is not a contract for a debt, including non-disclosure agreements, letter of representations and warranties, engagement terms, travel bookings etc., which give rise to a liability only in the case of the contract's breach (and sometimes only determined in front of a court), should include a contractual recognition of bail-in clause. Such requirement would be disproportionate, with no regard to the likelihood of a payment or monetary liability available to be bailed-in. It is important that contracts which only give rise to liabilities in the event of their breach are clearly deemed impracticable under the final RTS, as instructed by the level 1 text.

With respect to contracts which do not contemplate any liability on the part of the institution, it is likely to be challenging to demonstrate why contractual recognition is required. This could be damaging to the relationships between institutions and their clients. Clients would also need to seek legal counsel in order to understand the potential legal consequences of the bail-in recognition clause. This would increase the time needed to finalise contracts or cause banks to lose business to non-European competitors.

Similarly, it would not be clear how they would be quantified for the purpose of notifying the relevant resolution authority. Greater clarity here would be welcomed, for example, whether such liabilities could be determined as being of nil value, as at the time of notification that would be accurate.

More broadly, recognising bail-in remains particularly challenging where the liability in question is of an undetermined, or undeterminable value (as is the case for unliquidated liabilities contingent on a breach of contract). This can lead to confusion in counterparties, particularly where equivalent resolution tools do not exist in local jurisdictions, or where resolution frameworks are not as well developed. This confusion can often result in counterparty refusal, which therefore brings about instances of possible impracticability as set out above.

In all contracts, there always exists the possibility of a firm incurring a liability for damages if it commits a breach of contract. The quantum of damages would be ascertained by a court and hence would not be capable of quantification at the outset. If all such potential liabilities were required to be subject to a bail-in clause, the practical effect would be that a firm would be required to remediate all contracts, because all contracts will embody a potential liability contingent on a breach of contract. It is for this reason that the level 1 text and various authorities such as the PRA have taken the view that a liability contingent on a breach of contract should be deemed impracticable to make subject to a bail-in clause. Accordingly, there is considerable merit in the EBA recognising that a liability contingent on a breach of contract would qualify for the impracticability waiver.

[3] PRA Supervisory Statement SS7/16: The contractual recognition of bail-in: impracticability, June 2016 - https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2016/ss716.pdf

Acquired liabilities: We understand the approach that the EBA has put forward with regard to acquired liabilities, in particular suggesting that the contract surrounding the purchase of the relevant liability could itself have the contractual recognition of bail-in clause inserted to meet the requirement under Article 55. However, it is not clear how this would deal with the situation in all circumstances as a contract between purchaser and seller would not amend the terms of contracts with third parties or otherwise impose obligations on third parties to which they have not consented. We therefore believe that in certain circumstances cases of impracticability may arise, and should therefore be accommodated for in the final RTS.

For example, the EBA should consider circumstances where the contract for acquisition (or similar types of contracts) is not with the counterparty to which the liability is owed. Examples include (i) an assignment agreement by means of which an existing lender transfers part of or all its position in a syndicated facility agreement to a new lender – where the transfer agreement will be executed by the assignee, the assignor and the facility agent but not by the borrower and the other parties under the facility agreement – or (ii) an adherence letter to a non-disclosure agreement (NDA) – as it will not be signed by the beneficiary of the underlying NDA but by the original recipient under said document and the new recipient). Where this is the case the counterparty to which the liability is owed cannot give recognition that they may be bailed-in, as they may not be party to the transaction of acquisition. Therefore, including any such clause would not be effective, and the requirement would not have been met.

This leaves the institution or entity relying on being able to amend the existing contract to insert the relevant clause if it were to meet the requirement under Article 55. However, where this is not possible, either because the institution or entity has no power to amend, or the counterparty does not agree to any amendment, a case for impracticability should be recognised. We therefore strongly recommend that the EBA ensure such scenarios are accounted for in the final RTS.

Liabilities with no underlying contractual documentation: We would welcome clarity from the EBA on the expectations for institutions to apply the requirements under Article 55, and the possibility to apply the impracticability waiver, where there is an absence of contractual documentation. For different kinds of transactions and liabilities, an agreement can be made by telephone or SWIFT message (for example with regards to some deposits and certificates of deposits, interbank guarantees etc). It would be important to understand how the EBA expects institutions to include a bail-in clause if there is no contractual documentation, and just as importantly, whether the lack of contractual documentation itself can be deemed a condition of impracticability. We believe that this should be accounted for in the final RTS given the obvious difficulties that would be faced in trying to insert a clause into a contractual agreement that does not exist.

English law governed liabilities: It is important to consider the implications of the UK's withdrawal from the EU on contractual recognition of bail-in requirements. This issue is of particular importance if the EU and UK fail to put in place a mutual recognition of resolution actions before the conclusion of the transition period. In particular, the EBA should give due consideration to liabilities which are governed by English law and that are being transferred from an entity in the UK to an entity in an EU Member State. Where contracts are being novated, they will be treated as new contracts governed by what will become the law of a third country and be brought within the scope of Article 55. A temporary impracticability exemption for these liabilities would be helpful in support of firms' Brexit planning to ensure that they can continue to service their EU clients, as in line with broader supervisory expectations. We also note that the PRA has announced that it will apply a temporary transitional power to provide UK banks with at least 15 months to include relevant clauses for new or materially amended contracts governed by the law of an EU Member State, with the exception of MREL liabilities.

In this respect, we would like to highlight the importance of resolution authorities carrying out their assessments on the equivalence and recognition of the write down and conversion powers under English law, as soon as possible, and we urge them to conclude binding agreements in case of a negative outcome, as foreseen in the final subparagraph of Article 55.

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

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

16. Do you consider the templates and instructions clear?

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

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

We broadly agree with the EBA's approach to developing the draft ITS, however we believe that the disclosure requirements as set out in the draft template are very detailed, and a number of the requirements would not in fact apply to many categories of liabilities for which it would be legally or otherwise impracticable to include bail-in clauses in the contractual terms. These include, for example, agreements with agent banks, custodians, collateral managers, financial market infrastructures and venues (such as CCPs, exchanges, trading platforms and brokers).

In relation to these contracts, most of the columns (such as final maturity date, renewable, renew frequency, liability, type, insolvency ranking, nominal amount, etc.) in the table will not be applicable, as these are not financing arrangements or contracts, but rather are more similar to service provision contracts. Where we would not deem disclosure requirements to be relevant for certain liabilities, we would support an option to leave those fields as blank or indicate as "N/A".

If the draft template is approved in its current form, the level of detailed disclosures required will likely place an excessive burden on institutions and possibly delay timely notifications to the resolution authority. We would instead support a simplification of the template to the most essential disclosure requirements, which we believe would include: "Institution/Entity", "Type of Entity", "Service Received", "Contract Description" and "Governing Law of Contract". These fields are currently utilised for the notification to a National Resolution Authority (NRA), and therefore believe that these disclosure fields are sufficient for the purpose of the impracticability notification. We would encourage the EBA to consider simplifying the proposed disclosure requirements to this effect.

Given the large amount of granular information required by the template, it would be operationally impracticable for firms to complete the notification on a per contract basis. The frequency of notification should be appropriately calibrated to alleviate resources for both firms and the resolution authority. In this context, we would support the possibility for institutions to notify on a quarterly basis.

We understand that resolution authorities can introduce 'categories' of liabilities, and we believe that these may prove very useful in 'badging' notifications, such that resolution authorities can quickly prioritise different notifications for assessment. Inevitably there will be those that are very straight forward, e.g. for trade finance liabilities, and some that are less so. If the 'categories' section can be utilised in a harmonised manner in a way that reduces burdens on all, then this would be welcomed. However, it is important that resolution authorities do not set up numerous different local rules/instructions/categories, and we would support any such work being undertaken in a collegiate fashion through the EBA.

Templates and instructions

We have identified the following challenges associated with completing a number of the individual disclosure requirements. We would urge the EBA to reconsider the inclusion of these areas in the final template, or to allow for voluntary disclosure at a minimum:

- “Renewable?”: given that all liabilities can be renewed or extended if all parties agree, it is unclear whether this should only be marked “yes” if it can be renewed unilaterally by the counterparty without consent from the bank.
- “Liability type”: for clarity, we believe the sixth bullet in the proposed Annex 2 should be split into two liability types: “Loan (borrowing)” and “Loan (lending)”.
- “Insolvency ranking”: We believe that this requirement should be made optional as we do not see its relevance to loan agreements where the credit institution acts as lender, or where the concerned liabilities are contracts with agent banks, financial market infrastructures or venues.

  We also believe that in order to aid institution’s identification of the relevant insolvency ranking, a specific chart of insolvency ranking (0080) would be helpful if it were to be communicated by the NRA (or the EBA) to the institution. Alternatively, institutions will have to leverage on the insolvency ranking chart communicated by the SRB for instance, which may not capture variance in certain Member States. A common chart is necessary for institutions to facilitate the notification process and would foster harmonisation among banks. The insolvency ranking in a third country’s creditor hierarchy for liabilities issued by third country subsidiaries is often hard to obtain. It would therefore be very helpful if the EBA or the relevant resolution authorities were able to develop and maintain an up-to-date database of creditor hierarchy for the main third country jurisdictions.
- “Nominal Amount”: we do not believe this requirement would apply where the liabilities are contracts with agent banks, financial market infrastructures or venues, for many contingent liabilities or (if not amended as per our comments above) contractual damages for breach of contract (and are therefore unquantifiable at the time the contract is entered into). In these circumstances, this disclosure requirement should be made optional.
- “Maturity”: we do not believe this requirement would apply where liabilities are not ‘term’ liabilities under English law, or are liabilities that are ‘at call’, or ‘on demand’, or are contingent liabilities, as these would not have a stated remaining maturity. In these circumstances, this disclosure requirement should be made optional.
- “Likely Impact”: Annex 2 does not clearly specify what is required here. We believe more detailed instructions are required to complete this field.
- “Code”: As the RTS/ITS concerns liabilities that are governed by third country law, the LEI code may not be widely available in other jurisdictions, especially if institutions are dealing with non-US counterparties. Access to national codes can vary significantly across jurisdictions. It may therefore be more practical to allow institutions to provide their own internal identifier for such counterparties.
- “Governing law”: The governing law for trade finance liabilities governed by International Chamber of Commerce (ICC) rules (e.g. URDG458, URDG758 or ISP98) is not always clear. In principle, obligors and beneficiaries in such contracts can settle their dispute directly at the ICC’s international court of arbitration. As such, the governing law and the identification of the competent court is less relevant for ICC trade finance contracts. Whilst some jurisdictions may define the governing law as that of the guarantor, this is not always the case, as other jurisdictions apply differing rules. In some circumstances conflict of law rules need will need to be considered, further complicating this matter. We therefore propose this also be made an optional field.

- "Legal opinion": Whilst we note that the proposed instructions to the draft ITS indicate legal opinions as optional, i.e. "*it can be provided by the institution as it considers appropriate to support its notification"*, broadly we do not consider it necessary for institutions to provide these. We strongly believe that providing legal opinions for these purposes would be very onerous. We would welcome express clarity from the EBA that there is no obligation or requirement for a legal opinion to be included in any notification by the relevant resolution authority, and would consider it appropriate for the template to not include this section accordingly.

Beyond these areas, that in our view warrant further clarification, we wish to highlight that there is a general lack of clarity on the time necessary for the institutions to comply with the notification requirements. Whilst we understand that this may depend on the way in which the resolution authority will request the templates to be submitted, further clarity would be welcomed. We also wish to take this opportunity to note that if the template submission is required through XBRL format, it would likely take a greater amount of time for firms to implement the final notification template into their systems, and this should be factored into the decisions of the resolution authorities.

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?

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

The time to implement the technical specifications could be significantly high and hinges on several factors, including:

(i) the geographical footprint of individual institutions and entities;
(ii) the type of business operated in third country jurisdictions; and,
(iii) the willingness of resolution authorities to switch to a category-based notification system based on Article 55(7) BRRD2.

Institutions with an extensive business footprint across third countries, especially in trade finance, may need more than a year to put in place the necessary systems needed to notify on a regular basis thousands of contracts with all the information required by the current draft ITS. In particular, changes will have to be made to the 'feeding process' of the IT systems in order to capture data which are not currently picked up in existing systems (e.g. competent court for stand-by letters of credit governed by ICC rules).

Further complications are also likely to arise where information is needed for existing liabilities that are materially amended after the application of the requirement of Article 55. Searching for such information required for in the draft ITS could take a significant amount of time as firms are likely to have to go through a file-by-file search for the individual liability or contract concerned.

The time necessary to implement the adequate IT systems will hinge on whether or not resolution authorities are willing to switch to a category-based notification system as made possible under Article 55(7) BRRD. Line-by-line notifications on an on-going basis would require a significant investment to revamp existing reporting IT systems. Notification in batches on the other hand would be more proportionate and less burdensome for trade finance liabilities, which in any event should be deemed impracticable and therefore this approach should not be detrimental to a firms resolvability. If however this is not taken forward there are likely to be further complications in building out any such system that requires line-by-line notifications for trade finance liabilities, including for example the expected publication in mid-2021 of key SWIFT standards, which will most likely have implications for the back office management of trade finance liabilities.

The time necessary for banks to comply with these requirements will also depend on the way in which the resolution authorities will ask for the templates to be submitted. If the submission is required through XBRL

format, it will most probably take more time to be implemented, with contracts inevitably being signed and, in some circumstances fully completed, before the resolution authority has time to process the notification.

Pending application of the ITS it is important that resolution authorities provide a pragmatic means for notification of liabilities subject to the waiver.

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

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

We believe that there are several elements that need to be clarified with regard to the conditions for a resolution authority to exercise its ability to require the inclusion of a contractual recognition term, including how institutions and entities may go about delivering on this requirement. We comment on this in turn below.

Link to resolvability: The EBA consultation paper does not comment on the resolution authority's assessment needing to take into account "*the need to ensure the resolvability of the institution or entity*, " when concluding on the use of the impracticability waiver, as per Article 55 (2) third paragraph. We believe this is a highly relevant part of the resolution authority's assessment as it links impracticability of inclusion of a bail-in clause with the effect of such a clause (or its absence) on resolvability.

In many situations it may not be impracticable to include a bail-in clause under the strict terms as set out by the EBA, but where at the same time the absence of such a clause has no real effect on the institution's resolvability. Good examples are contingent liabilities, including those that only arise following a breach of contract (as discussed above), liabilities that are hard to quantify or cannot be quantified with sufficient degree of certainty, and liabilities that upon discharge result in an immediate recourse claim on another party.

We therefore encourage the EBA to consider ensuring that the conditions are clear in the final RTS, that the resolution authority can only allow the absence of the necessary recognition clause where it has found this to have no material impact on a firm's resolvability.

Introduction of new thresholds separate to that in level 1 text: We welcome the EBA's proposed inclusion of a threshold to help guide resolution authorities in their assessment of liabilities that have not been deemed to meet a condition for impracticability. It is important that resolution authorities have discretion on how to address these liabilities, however, we have concerns with regard to the lack of explanation as to how these thresholds were calibrated, and how in practice they will be applied.

Given that the waiver may be utilised by many different types of institution or entity, of differing size, business model, geographical footprint, it would be inappropriate for a one-size-fits-all threshold to be introduced. The threshold of €20million appears somewhat arbitrary, and does not apply in a proportionate manner. It is important that resolution authorities are able to take account of the relevant circumstances when making decisions, and to help avoid scenarios where compliance with the requirement under Article 55 is rendered impossible. As such, we believe that a degree of flexibility for resolution authorities is necessary and appropriate. If the resolution authority determines that the lack of contractual recognition of bail-in for the relevant liability does not have a material impact on the resolvability of an institution, it should not be overly constrained by the RTS.

We would also welcome greater clarity from the EBA on how these thresholds were calibrated, and whether they would look to undertake their quantitative questionnaire initiative again now that the initial operational burdens of the COVID-19 pandemic have passed, and firms are better placed to inform the EBA's analysis.

There is also a need to fully consider how the threshold will apply with regard to 'nominal amount' and 'remaining maturity'. Whilst the draft RTS are clear that liabilities with less than 6months remaining maturity and a nominal value below €20million would fit within the threshold, no consideration is given to liabilities that do not have a clear nominal value or a stated remaining maturity.

For example, liabilities that are not 'term' liabilities under English law, or liabilities that are 'at call', or 'on demand', or contingent liabilities, are typical types of liabilities that would not have a stated remaining maturity. Contingent liabilities, including those that are contingent only upon the breach of a contract, are also not likely to have a clear nominal value. The EBA should therefore clarify how such liabilities should be treated, in particular whether such liabilities should be deemed to be included within the thresholds where either, or both, nominal value and remaining maturity are not defined. If so, the final RTS should clarify this, as at present it reads that both maturity and nominal value elements need to be fulfilled, and this fails to consider the types of liabilities highlighted above.

In any case, we strongly believe that these threshold conditions should be independent, and not cumulative conditions. The current proposals unnecessarily constrain the ability of the resolution authority to take account of the relevant circumstances and apply a proportionate approach.

Requirement for inclusion: The possible consequences that firms would face in the event of being required to include a relevant contractual clause, despite having sought to apply the impracticability waiver, do not appear to have been fully considered. It is not clear how an institution or entity, that has itself determined impracticability to have been met, will be able to insert such a clause after a resolution authority's decision to require inclusion. Institutions and entities will not have any legal tool to oblige the counterparty to accept such inclusion. It is therefore unclear how institutions or entities are expected to comply with this requirement. This also further demonstrates the importance for the final RTS to accommodate the instances of impracticability that are already being observed, and to provide as much certainty as possible to firms such that inclusion is not required where impracticability is met.

Institutions should not be required to give up on transactions in these situations, and may in fact have already undertaken and completed them, as many incidences of impracticability occur where liabilities are created for a very short period of time. It is also unclear how this would apply in cases where impracticability has been determined where an existing liability is being materially amended, or where the liability relates to a transaction that does not allow or afford for time to be spent on lengthy negotiations. It would not be possible for an institution to walk away from its obligations within the contract where it has determined impracticability to include the relevant clauses, but where the resolution authority disagrees and subsequently requires inclusion.

In light of the current draft RTS, there are many instances of impracticability that may not be captured. Were institutions or entities required to walk away from any such business where the resolution authority does not agree with the determination of impracticability, this would have a significant impact on in-scope institutions and entities from being able to conduct key business activities around the world. One example would be secondary loan trading activities, where it would be difficult to negotiate with borrowers or sponsors to require the inclusion of bail-in language, but under a strict application of the requirements may see European banks being unable to offer services. This has commercial consequences for European banks in cases where the client refuses the inclusion of the contractual bail-in clause and where local banks do not have to do so.

As previously highlighted, there are also a number of other types of agreements with counterparties such as exchanges, trading platforms, CCPs vendors, brokers and other service providers (those with agent banks, clearing agents, custodians, collateral managers) that may not agree to include bail-in provisions despite multiple requests by institutions to include bail-in provisions which makes it impracticable and impossible

for such institutions to ensure compliance with Article 55. This leaves such institutions with a difficult decision to either be in non-compliance with Article 55 or not enter into the relevant agreement with such counterparties. This may result in an institution not being able to access a certain jurisdictional market if it is via a local broker or by being direct a member of a trading platform, exchange or CCP, or where there is only one custodian or clearing agent in that particular market who can provide such services. Such a regulatory limitation on the institution may prevent access to that particular market, which would ultimately disadvantage the customers of European institutions, and potentially disrupt markets.

We believe that these considerations need to be taken into account by the resolution authority when it is making its assessment.

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 believe that there is an urgent need for the EBA to clarify the current proposed language within the draft RTS under Article 3. At present, readers could interpret the RTS to mean that the 3 months refer to either:

(i) the time period within which banks have to include a bail-in clause; or,
(ii) the time necessary for the resolution authority to notify to the banks its decision.

In line with our reading of the level 1 text, the correct interpretation is the latter, but this should be clarified. It is important that firms have clarity that the resolution authority has not concluded that it is not legally or otherwise impracticable within a timely period following a waiver notification being made, although we note that under the level 1 text it is clear that the obligation to include the contractual recognition is automatically suspended from the moment of receipt by the resolution authority of the notification. As short a period as possible is important to provide certainty, particularly given that the timeframe may also impact the feasibility of remedying the situation should the resolution authority determine that the waiver should not apply.

For contracts that should meet the current draft conditions for impracticability within the RTS, e.g. trade finance contracts, we consider it critical that a fast-track or automatic non-objection process be put in place. This would be to avoid such situations arising where resolution authorities have to process thousands of notifications that are for a straight-forward application of the waiver, but also to ensure certainty for institutions in a timely manner.

If, contrary to our view, the EBA is proposing to introduce a timeline for a firm to include a contractual recognition clause following a determination by the resolution authority that it is not impracticable to do so, we do not believe that specifying a limited period is appropriate. As we have highlighted, the feasibility of including a clause in contracts where the firm has determined that it is impracticable to do so, and the consequences of this, are uncertain. It is therefore important to ensure that there is sufficient flexibility for the resolution authority to address this in an appropriate manner and over an appropriate period depending upon the circumstances.

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

Impact assessment: The Impact Assessment in our view does not properly consider the burdens that institutions would face were they to be unable to apply the waiver in the cases of impracticability already observed. As noted above, there are several areas that are currently not accommodated for in the draft RTS, but are areas where institutions cannot insert relevant contractual terms for the recognition of bail-in. If these

are not covered by the final RTS there may well be implications for European banks and their ability to compete in third country jurisdictions. The consequences for institutions in having only very limited conditions for impracticability need to be given greater consideration within the impact assessment.

Responses to the quantitative questionnaire: We would welcome from the EBA further information with regard to the quantitative questionnaire that is referred to in the consultation paper. We understand from the EBA public hearing that this has in some way informed the proposed thresholds to guide resolution authority decisions to require inclusion of the contractual clause. It would therefore be appropriate that the analysis is representative of the institutions that are most likely to encounter cases of impracticability, and we would feel it equally appropriate that further details of the EBA's analysis be published.

We would also like to stress that the quantitative survey was launched in March of this year and conducted through a period of time where institutions encountered unprecedented operational burdens in response to the outbreak of COVID-19. The questionnaire was also classified as voluntary. This led to several institutions prioritising other business critical operations and functions over the questionnaire. There was also in some instances a lack of clarity over the scope and perimeter of the instruments and contracts that were intended to be covered by the questionnaire, which may have led to differences in how institutions responded.

We would therefore encourage the EBA to re-run this exercise to better inform the thresholds that they have proposed to introduce. We are concerned that given the pressure on large banks during the pandemic, and that they are the most likely to encounter cases of impracticability by virtue of offering greater numbers of financial products on a cross-border basis, the exercise will unfortunately suffer from a bias towards respondents that do not share these characteristics. This may therefore lead to an unrepresentative assumption on the number, and other features, of liabilities that encounter impracticability issues. We would therefore welcome further analysis in this regard to ensure an informed and proportionate outcome.

We welcome any questions or views you may have on this response and we are very happy to discuss these issues further.

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