International
Capital
Market
Association

ICMA

European Banking Authority
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One Canada Square
London E14 5AA

Sent by email mrelreport@eba.europa.eu

30 August 2016

Dear Sirs

EBA consultation on interim report on the implementation and design of the minimum requirement for own funds and eligible liabilities (MREL)[1]

The International Capital Market Association (ICMA) welcomes the opportunity to engage with the European Banking Authority (EBA) in relation to the above consultation and sets out its remarks in relation to Section 6.2, Third country recognition of resolution powers, in the Annex to this letter.

Representing a broad range of capital market interests including banks, asset managers, exchanges, central banks, law firms and other professional advisers, ICMA's market conventions and standards have been the pillars of the international debt market for almost 50 years. See: www.icmagroup.org.

ICMA is responding in relation to its primary market constituency that lead-manages syndicated, vanilla debt securities issues throughout Europe on behalf of corporate borrowers. This constituency deliberates principally through ICMA's Primary Market Practices Committee[2], which gathers the heads and senior members of the syndicate desks of 48 ICMA member banks, and ICMA's Legal and Documentation Committee[3], which gathers the heads and senior members of the legal transaction management teams of 21 ICMA member banks, in each case active in lead-managing syndicated debt securities issues in Europe.

Yours sincerely

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[1] https://www.eba.europa.eu/documents/10180/1360107/EBA+Interim+report+on+MREL

[2] More information is available here.

[3] More information is available here.

ANNEX

INTRODUCTION

1. The EBA's recognition that credit institutions face practical difficulties in relation to the inclusion of contractual recognition clauses in certain contracts, and its acknowledgement that some reduction of the burden of compliance with third country recognition requirements is necessary, is welcome.

2. We support the general comments made by AFME on this issue in its response to the EBA and, in particular, the suggestion that the scope of BRRD Article 55 be aligned with the scope proposed in the FSB Principles for Cross-border Effectiveness of Resolution Actions and the TLAC Standard, meaning that the scope of Article 55 would be limited to MREL and any other debt instruments that can be bailed-in (broadly, the third policy option suggested by the EBA in its Interim Report).

3. More specifically, and pursuant to the EBA's invitation to comment on the practical difficulties faced in implementing contractual recognition clauses under BRRD Article 55, we set out below a summary of the challenges experienced by members of ICMA's primary market constituency that underwrite and manage syndicated, vanilla debt securities issues.

PRACTICAL DIFFICULTIES FACED BY BOND UNDERWRITERS

4. In addition to issuing debt securities, banks also act as underwriters (commonly known as managers) of bond transactions for other issuers of debt securities such as corporates, financial institutions, sovereigns and supranational entities in need of funding. When acting in that capacity, banks will enter into a number of contracts relating to their role as manager, both at the time of a bond issue and the time that an issuer establishes or updates an issuance 'programme' under which bonds may be issued.

5. Such contracts include (i) subscription agreements, in which the issuer agrees to issue bonds and the managers agree to subscribe those bonds, (ii) dealer agreements, which set out a framework of contractual terms that can be used at the time of an individual bond issue, (iii) mandate letters, which set out the terms on which a manager is mandated to act for an issuer's bond issue, (iv) non-disclosure agreements, containing confidentiality obligations, (v) an agreement among the managers governing their relationship as between themselves, and (vi) arrangement letters setting out the terms on which the issuer's auditors will provide a comfort letter regarding the issuer's financial position and financial disclosure to the managers.

6. The market's understanding is that in-scope managers' liabilities under these types of contracts generally fall within the current scope of BRRD Article 55.

7. There are various scenarios and market sectors within the cross-border bond market in which it is typical for European managers' obligations to be governed by non-EEA law. For example, contracts that managers enter into for the following types of bond issues may be governed by non-EEA law:

    - European high yield bond issues (typically governed by New York law);

- large, frequent US or supranational issuers' bond issues (sometimes governed by New York law); and
- bond issues by Australian, Asian or Swiss issuers (sometimes governed by the respective local law).

8. There are a number of practical factors that have made it challenging for managers to include a contractual recognition of bail-in clause in these types of contracts.

    a. Often, the managers' counterparties and the lawyers preparing the documentation for these transactions are based outside of Europe, typically in the jurisdiction of the relevant governing law, and so have been unfamiliar with the requirements of BRRD.

    b. Bond issues often need to be executed on a very short timetable to allow issuers to take advantage of short issuance windows in volatile markets. As such, European banks may be invited to join a transaction as manager as late as two days before the documentation needs to be entered into. At that stage, they may be expected to enter into the contracts without commenting on the substance of them, as non-European banks (who are not familiar with the requirements of BRRD) may have negotiated what they believe to be a satisfactory position on behalf of the managers as a whole.

    c. Documentation for some bond issues is relatively "commoditised", and there is limited opportunity for managers to make changes to it generally.

    d. Moreover, some managers' counterparties (in particular European and non-European supranational issuers) are unable to agree to the inclusion of a contractual recognition of bail-in clause due to restrictions in their constitution.

    e. Difficulties have also arisen where the in-scope managers' counterparty is an auditor, because auditors have found it difficult to agree to a contractual recognition of bail-in clause as they may be restricted from agreeing to take shares in a company they audit in case it prejudices their independence.

9. Compounding the above, managers of bond issues have found it difficult to explain to their counterparties why a contractual recognition clause is needed in respect of their obligations. Where a bank acts as an <u>issuer</u> of debt securities, it is understandable that resolution authorities would wish to be able to exercise bail-in powers in respect of those securities. A contractual recognition of bail-in where those securities are governed by non-EEA law therefore seems to be a logical requirement. However, the rationale for requiring a contractual recognition of bail-in to be included in contracts where the in-scope bank acts as a <u>manager</u> of another issuer's debt securities is tenuous, because the connection between the liabilities of the bank as a manager under such contracts and the bank's resolvability is remote.

    a. The majority of manager liabilities under typical contracts for bond issues are contingent liabilities that could arise only if the manager breaches the contract, such as a liability that could arise if the manager were to breach a confidentiality obligation. Managers have relatively limited obligations under bond documentation and will take great care to ensure that they comply with them, so the risk of liability arising is remote and occurs very rarely in practice. The possible quantum of any such contingent liability may also be relatively small. It therefore seems highly unlikely that such contingent liabilities would impact on a manager's resolvability.

b. Aside from a manager's contingent liabilities in respect of a potential breach of contract described above, a manager is also obliged to subscribe the bonds. This involves the syndicate of managers paying the issuer the purchase price for the bonds on the issue date and immediately on-selling the bonds to investors (thereby recovering the money paid to the issuer in respect of the bonds). It is conceivable that a resolution authority may wish to be able to bail-in the liability that a manager has in respect of the purchase price of the bonds if, for example, the manager were to enter into resolution between the time that the subscription agreement is signed and the issue date of the securities. However, the likelihood of a resolution authority needing or wanting to do this in practice is remote.
    i. First, the period between the subscription agreement being signed and the date that the managers need to pay for the securities is usually only two business days.
    ii. Second, in a typical bond issue, the bonds will have already been allocated to investors by the time the subscription agreement is signed. Therefore it is highly unlikely that a manager will pay for bonds and not be able to on-sell those bonds to investors. Such a situation would involve (a) a default by one or more investors who had previously agreed to purchase the bonds and (b) the managers being unable to find replacement investor(s) to purchase the bonds. That situation happens very rarely in practice. If it were to happen, it could be due to market events that would constitute *force majeure* under the terms of the subscription agreement, which would mean that the managers would not be under an obligation to purchase the bonds in any event.

It is therefore highly unlikely that a manager's liability in respect of subscribing bonds would impact on its resolvability.

10. To summarise, BRRD Article 55 has posed significant practical challenges for in-scope managers of bond issues due to the very broad scope of the requirement. While the pragmatic approach to implementation of some resolution authorities has been helpful, a European-wide solution focusing on limiting the scope of BRRD Article 55 while maintaining the effectiveness of contractual recognition for MREL instruments would be welcome. As noted above, this could be achieved in the manner suggested in AFME's response to the EBA, which is broadly aligned with the third policy option outlined by the EBA in its Interim Report.