14 August 2020

ICMA RESPONSE TO EBA CONSULTATION PAPER ON DRAFT RTS ON THE CONTRACTUAL RECOGNITION OF STAY POWERS UNDER ARTICLE 71a(5) OF DIRECTIVE 2014/59/EU

The following responses were submitted to the EBA's consultation paper on draft RTS on the contractual recognition of stay powers under Article 71a(5) of Directive 2014/59/EU (BRRD II) on behalf of the ICMA Legal & Documentation Committee and the ICMA European Repo and Collateral Council using the EBA's online consultation form.

Question 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?

Whilst we are supportive of a non-prescriptive approach, we have concerns regarding the mandatory elements proposed, not least if these do not align with (or disrupt recognition arrangements put in place in accordance with) the Financial Stability Board's *Principles for Cross Border Effectiveness of Resolution Actions* (the **FSB Principles**).

In relation to the repo market, well established mechanisms such as the ISDA 2015 Universal Resolution Stay Protocol[1] and the ISDA Resolution Stay Jurisdictional Modular Protocol[2], have been developed to provide for efficient and effective recognition of national resolution powers and are widely used by the market to import recognition language into industry standard contracts, including the Global Master Repurchase Agreement (**GMRA**). The RTS requirements should not disrupt or render ineffective such mechanisms. This would be an inefficient route to the stated aims and represent a regressive step in efforts to implement stay recognition frameworks. At a minimum, the elements required by the RTS should be aligned with the FSB Principles so that existing mechanics which meet national recognition requirements are deemed compliant. A carve out from the requirements of the RTS should be considered for agreements which already contain recognition language in accordance with the national requirements of a Member State. This is particularly relevant in the case of master agreements, such as the GMRA, which are negotiated on the basis of being in place for many years.

Question 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?

Headline: Proposed Article 1(2) in the draft RTS is problematic and should be removed from the final RTS. This proposed article requires the contractual recognition of stay powers to include a description of the

[1] ISDA - https://www.isda.org/protocol/isda-2015-universal-resolution-stay-protocol/

[2] ISDA - https://www.isda.org/protocol/isda-resolution-stay-jurisdictional-modular-protocol/

powers of the relevant resolution authority set out in Articles 33a, 69, 70, and 71 of Directive 2014/59/EU as transposed by the applicable national law governing the resolution of the institution of entity concerned, and a description of the requirements of Article 68 of Directive 2014/59/EU as transposed by the applicable national law. In addition, the proposed requirement for parties to recognise that they shall "endeavour to ensure the effective application" of resolution powers in proposed Article 1(3)(a) is problematic and should be removed from the final RTS.

Primary bond market background and rationale: It is understood that contractual recognition of stay powers (an **Article 71a BRRD clause**) may be required in certain underwriting agreements entered into by an issuer of bonds and a syndicate of underwriting banks in the context of a new bond issue. This is because these contracts are likely to fall within the definition of "financial contract" under Directive 2014/59/EU, as amended (**BRRD II**) and typically provide for the exercise of one or more termination rights to which certain articles of BRRD II would apply if the financial contract were governed by the laws of a Member State. Such termination rights typically operate in favour of the syndicate of underwriting banks, meaning that contractual recognition of stay powers would be relevant where the syndicate banks' counterparty (ie the bond issuer) is an in-scope entity.

The parties to underwriting contracts in this context will be sophisticated and capable of referring to, and understanding, provisions of law that are referenced in their contracts. It therefore seems unnecessary and disproportionate to require a description of the relevant BRRD II powers, noting that this could result in several pages of description in some cases. The recognition required pursuant to proposed Article 1(3) in the draft RTS already envisages a cross-reference to, and high-level description of, each of the relevant provisions of BRRD II. This should be sufficient to meet the requirements of Article 71a, without further lengthy description and explanation.

In addition, there could be circumstances in which there are multiple in-scope entities to an underwriting contact incorporated in different Member States in respect of which an Article 71a BRRD clause is needed (e.g. an in-scope issuer incorporated in one Member State and one or more in-scope guarantors incorporated in other Member State(s)). In these circumstances, the current approach in Article 1(2) will mean there will need to be descriptions of various different national transpositions of BRRD powers in different Member States. This is likely to entail a significant administrative burden for the in-scope entities, without an obvious purpose or benefit for resolution authorities seeking to exercise their powers in the context of a contract between sophisticated counterparties to an underwriting contract.

Repo market background and rationale: As the foremost standard agreement for documenting cross border repo, the GMRA is used by sophisticated market participants, capable of understanding legislative provisions included in contracts. Moreover, where in-scope entities are using the GMRA, they will already be familiar with, and have made provision for, national stay regimes in their master agreement documentation (including via the ISDA resolution stay related protocols referenced above). Against this backdrop, requiring firms to provide their counterparties with a description of the relevant BRRD II powers seems entirely superfluous and will necessitate a significant documentation exercise of limited, if any, value.

We therefore suggest that proposed Article 1(2) is removed from the final RTS.

We also consider that the proposed requirement for parties to recognise that they shall "endeavour to ensure the effective application" of resolution powers in proposed Article 1(3)(a) is problematic and should be removed from the final RTS. Article 71(4) of BRRD II states that the resolution authority's

application of the relevant resolution powers will not be prevented by the lack of a contractual recognition term in an agreement and therefore this Article 1(3)(a) component seems redundant. Furthermore, it is unclear how a party would *ensure effective application* of resolution powers or whether they would have the capacity to do so.

Question 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?

Headline: No, we do not believe that having an Article 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. We suggest that proposed Article 1(5) is removed from the final RTS.

Background and rationale: Applying the governing law of a Member State to an Article 71a BRRD clause seems likely to complicate the enforcement process for a resolution authority seeking to exercise its powers under BRRD II by requiring a third country court (where such third country court has jurisdiction) to consider and apply the law of a Member State, rather than its own law. This has the potential to unnecessarily complicate any enforcement proceedings (e.g. by requiring the involvement of expert witnesses regarding the law of the relevant Member State in the third country court), in opposition to EBA's stated aims.

This approach will also unnecessarily complicate the drafting or remediation of relevant contracts by requiring different governing law provisions for different clauses.

Furthermore, this approach is not required by the FSB Principles and, as far as we know, has not been adopted in other jurisdictions' implementation of such principles.

In relation to the repo market, requiring that an Article 71a BRRD clause be governed by the law of a Member State will greatly complicate the legal due diligence required by firms entering into master agreements such as the GMRA, including a significant expansion to the scope of the legal opinion coverage obtained to assess enforceability.

This particular requirement may also have unintended consequences on the regulatory netting treatment of the GMRA (and other master agreements used for regulatory netting purposes) under the Capital Requirements Regulation. It is likely that such a contractual amendment would trigger requirements under the European Central Bank netting recognition process[3], which if not satisfied could result in transaction exposures being treated on a gross basis. The significant regulatory capital impacts are not accounted for in the EBA's impact assessment.

[3] See FAQs on the notification process for the recognition of netting agreements - https://www.bankingsupervision.europa.eu/press/letterstobanks/html/netting_agreement_FAQs.en.html

Overall, this proposed requirement undermines legal certainty, increases litigation risk and disproportionately adds to the cost and complexity of doing business. We suggest that it is removed from the final RTS.

Question 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)?

ICMA will consider with members whether it is appropriate to develop a standard clause for use in underwriting agreements for new bond issues. This clause is likely to be developed with this specific context in mind, and so may well differ from other forms of standard clauses developed by other bodies for use in other contexts.

With respect to the GMRA, ICMA will consider with members whether contract remediation used to fulfil existing resolution stay recognition requirements might be utilised in this regard. This will involve cross industry collaboration, most notably with ISDA who foster the protocols mentioned above. The potential document remediation exercise is significant and could only follow after industry coordination on, and development of, the necessary contractual mechanism.

In relation to this question, it is important to note that the transposition deadline for BRRD II is 28 December 2020. Therefore it is likely that there will be only a very short window (if any) between the final RTS being adopted and Article 71a taking effect. This presents two difficulties: (i) all market participants likely need to prepare for the implementation of Article 71a on the basis of the EBA's *proposed* draft RTS, without any guarantee that such draft will be adopted in this form; and (ii) this provides repo market participants with an unrealistic and inadequate timeframe to undertake the significant document remediation exercise necessary to fulfil the requirements. This is particularly unsatisfactory in the context of the other challenges that market participants are facing this year.