European Banking Authority 23 October 2020

Submitted via https://eba.europa.eu/eba-consults-technical-standards-impracticability-contractual-recognition-bail-form

Dear Sirs

Article 55 BRRD – impracticability of contractual bail-in language

The Loan Market Association (**LMA**) is the trade body for the syndicated loan markets in Europe, the Middle East and Africa (EMEA) and was founded in December 1996 by banks operating in these markets. Its aim is to encourage liquidity in both the primary and secondary loan markets by promoting efficiency and transparency, as well as by developing standards of documentation and codes of market practice, which are widely used and adopted. Membership of the LMA currently stands at 750 organisations across over 65 jurisdictions and consists of commercial and investment banks, institutional and other non-bank investors, law firms, rating agencies, borrowers and service providers. The LMA is recognised across the market and has expanded its activities to include all aspects of the primary and secondary syndicated loan markets. Its overall mission is to act as the authoritative voice of the EMEA loan market vis à vis lenders, borrowers, regulators and other interested parties.

The production of recommended documentation is one of the LMA's most important activities and we endeavour to keep our documentation under constant review to ensure that it continues to meet the aims and needs of primary and secondary loan markets. As part of this documentation review, we have produced a model clause for inclusion in our non-EU law governed template facility agreements to assist our members with compliance with Article 55 of the Bank Recovery and Resolution Directive (**BRRD**). We are concerned that firms may have to include the wording required by Article 55 in documents which create liabilities that

are not capable of being bailed-in or where a bail-in of the relevant liabilities would not improve a firm's loss absorbing capacity.

We welcome the opportunity to respond to the EBA's consultation paper[1] on the Draft Regulatory Technical Standards (**RTS**) on impracticability of contractual recognition of bail-in clause under Article 55(6) of BRRD and the Draft Implementing Standards for the notification of impracticability of contractual recognition under Article 55(8) of BRRD, and in particular to comment on questions 3, 7, 8, 9, 16 and 17 of the consultation paper.

> ***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)?***
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> ***7. Do you agree with EBA's proposed conditions of impracticability?***
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> ***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?***
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> ***9. Are the proposed conditions of impracticability clear and meeting their purpose?***

The EBA sets out a number of criteria that it considered as potential conditions of impracticability, but which were not deemed to be within the scope of the RTS. These include liabilities which are contingent on a breach of contract, where the EBA states that "since the liabilities subject to Article 55 have to arise out of a contract in any event, the fact that an underlying liability may be contingent at the time of the formation of the contract, does not of itself prevent the inclusion of Article 55 wording in the contract".

We would ask the EBA to reconsider this for the following reasons, which we discuss in more detail further below:

- Inclusion of Article 55 wording in a contract is unlikely to result in the ability to bail in a liability arising from a breach of that contract, as the amount of any such liability would not normally be set under the contract but would either be agreed separately between the parties or would be determined as a result of litigation;
- The EBA's conclusion is inconsistent with the guidance on impracticability provided by the Commission in the recitals to BRRD2;

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[1] https://eba.europa.eu/sites/default/documents/files/document_library/Publications/Consultations/2020/EBA/CP/2020/15/897588/EBA-CP-2020-15-Impracticability_contractual_recognition_bail-in_%2855BRRD%29.pdf

- Excluding liabilities contingent on a breach of contract would be consistent with the approach taken in other jurisdictions and taking a different approach may put EU institutions at a competitive disadvantage without improving their position upon resolution.

Inclusion of Article 55 wording in a contract is unlikely to result in the ability to bail in a liability arising from a breach of that contract

We acknowledge the EBA's statement in the consultation paper that the fact that an underlying liability may be contingent at the time of formation of the contract does not prevent the inclusion of Article 55 wording in the contract. However, we consider that there are other reasons why this situation gives rise to impracticability.

In the context of the syndicated loan markets, our concern is that firms are most often party to syndicated lending documentation, not as borrowers, but as credit providers or in some administrative capacity. Obviously, in the rare case that a firm is party to syndicated lending documentation as a borrower, its borrowing facilities are clearly capable of being bailed in.

However, in the more normal scenario of financial institutions lending to a non-financial institution, the definition of "liability" under Article 55 will encompass typical obligations undertaken by firms as credit providers and administrative parties in syndicated lending documentation. The types of obligation undertaken by a financial institution in those capacities under syndicated lending documentation are of five broad types:

- *Extension of financial accommodation*: for example, the obligation to lend or to issue a letter of credit at the borrower's request;
- *Payment conduit*: administrative parties act as a conduit for payments between the borrower and the lenders and hold amounts on trust in certain circumstances, such as on an enforcement of security;
- *Contingent payment obligations*: for example, indemnities against losses suffered by administrative parties. In the ordinary course these obligations would be relevant only in the event of default by the borrower;
- *Commercial restrictions*: for example, obligations to safeguard the confidentiality of the borrower's information, or an agreement with the other lenders not to take enforcement action in some circumstances;
- *Administrative obligations*: intended to facilitate the smooth running of a multilateral facility, such as requirements to make prescribed notifications and to pass on information.

These obligations would typically only give rise to liabilities where the financial institution breaches an obligation, and liabilities arising from breach of these obligations are not capable

of being quantified at any given point in time. If a breach of these obligations occurs, the amount of damages that may be payable as a result would not be known (or reasonably capable of being known) until a judgment is given.

As a result, at the point in time when the liability is capable of being quantified and bailed in, the liability that is being bailed in arises under the relevant judgment (which governs the existence, amount and terms of payment of the liability) rather than under the original contract (which simply provided for the circumstances in which liability might arise). Any judgment given by the courts of a non-EU jurisdiction would not itself include Article 55 wording and would not be affected by the inclusion of Article 55 wording in the underlying contract.

This means that, while it would be possible to include Article 55 wording in the underlying contract, this would not enable the exercise of write-down or conversion powers to reduce the amount of any judgment debt. As a result, it is impracticable to seek to write down or convert a judgment debt through inclusion of Article 55 wording in the underlying contract.

We would also respectfully ask the EBA to consider the proportionality of requiring inclusion of Article 55 wording in contracts where the only relevant liability would arise as a result of breach of the contract. Requiring inclusion of Article 55 wording in such contracts may put EU firms at a competitive disadvantage in international loan markets, since non-EU firms are, so far as we are aware, not required to include similar wording in loan documentation and so may avoid dealing with EU firms to avoid being subject to these requirements. As a result, this requirement may put EU firms at an unnecessary disadvantage when the inclusion of such language would not in practice further the aims of the BRRD.

Commission guidance in the recitals to BRRD2

The European Commission had already considered the types of situation that could give rise to impracticability, and listed these in recital 26 of BRRD2[2] which states that:

> 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 […].

Based on this clear guidance from the Commission, we understand that the expectation was for the EBA to specify the circumstances in which it would be impracticable for firms to include Article 55 wording in contracts where the only relevant liability is contingent on a breach of contract, rather than to conclude that this does not give rise to impracticability. We note that

[2] Directive (EU) 2019/879 of the European Parliament and of the Council of 20 May 2019

the EBA supports this view in its comments on the decision to exclude refusal by the counterparty to agree to be bound by a contractual bail-in recognition clause, where it states that "the mandate under Article 55(6) should be interpreted in conjunction with the relevant Recital 26 of Directive (EU) 2019/879 of the European Parliament and of the Council".

Approach taken in other jurisdictions

A further point to consider, regarding the possibility of putting EU firms at a disadvantage compared to non-EU firms, is that in the UK the Prudential Regulation Authority has published guidance [3] which states that BRRD firms may take the view that including contractual recognition language in their contracts is impracticable where the liability which would be subject to the contractual recognition requirement is contingent on a breach of the contract.

As a result, UK firms will not be required to include Article 55 wording in their syndicated loan documents, to the extent that these are governed by non-UK law.

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?

Impracticability notification template

We have a number of concerns regarding the proposed technical specifications set out in the draft ITS – in particular we are concerned that the amount and level of detail of information required is not proportionate to the requirement in Article 55 BRRD for an institution to provide all information requested by the resolution authority in order for the resolution authority to assess the effect of such notification on the resolvability of that institution or entity. While Article 55 does not provide an exhaustive list of information that should be included in the notification, it only indicates that the notification should address the class of liability and the justification for considering it impracticable to include the term. The information proposed in the draft ITS goes significantly beyond this.

The draft ITS seem to expect that firms would make this notification on a contract by contract basis, including information on the amount of the liability governed by the relevant contract and on the counterparty to the relevant contract. However, we understand that an institution would not be required to make this notification every time it executes a contract that creates a

[3] https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2016/ss716.pdf?la=en&hash=2902017E3A15B4CFFEE957D20C126BA7AFEB1B93

liability where it is impracticable to include the Article 55 wording, but rather that institutions would make this notification in relation to classes of contract (for example, if a relevant third country authority prohibits local banks from including the Article 55 wording in any contract, an institution would notify its resolution authority that it will be unable to include Article 55 wording in contracts with those banks on the grounds of impracticability).

In addition, it is unclear what information is required in relation to some of the notification fields. In particular:

- What information should institutions report in the "liability ID field"? Are institutions expected to allocate an ID to every contract that they enter into that does not include Article 55 wording? And are firms now expected to maintain a register of all of these IDs as well? This would clearly impose significant additional operational and record keeping requirements on institutions.
- How should firms calculate total liabilities in the context of an open ended contract under which the only liability is an obligation to pay periodic fees? For example, if a firm enters into a licensing agreement under which it receives a particular service or information in exchange for a periodic fee for so long as the contract remains in existence, how should the firm calculate its total liabilities under the contract? Similarly, if those liabilities would change from time to time under the contract (for example, depending on the value of the contract or assets underlying the contract), how should firms determine what their "total liability" would be under the contract? Is this the total liability on the date on which the contract is entered into (which may be zero), or the total liability at some other point in the lifetime of the contract?
- What information should firms include under "likely impact"?
- What is meant by "number of underlying liabilities"?

If the EBA agrees that it is impracticable to include contractual bail-in language where relevant liabilities arise only as a result of breach of contract, we would also note that firms would not know the value or "final maturity date" of the liabilities contingent on a breach of contract at the time of notification, as by definition those liabilities would not have crystallised at that point.

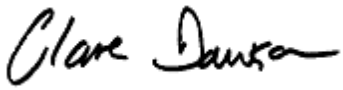
Conclusion

We would therefore be grateful if the EBA could reconsider its position on the impracticability of including contractual bail-in language in contracts where the only relevant liability would arise out of breach of contract. This would provide EU firms with much needed certainty when entering into relevant loan documentation governed by third country laws. We would also be

grateful if the EBA would consider developing a notification template that is more proportionate to the notification requirement.

We would be pleased to discuss any aspect of the above with you in more detail. If we can be of any further assistance, please do not hesitate to contact me by email at clare.dawson@lma.eu.com or on +44 207 006 2216.

Yours faithfully,



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