



August 30, 2016

European Banking Authority
Floor 46 One Canada Square
London E14 5AA

By electronic delivery to mrelreport@eba.europa.eu

Re: EBA Interim Report on MREL: Third country recognition of resolution powers

Dear Sir/Madam:

BAFT (Bankers Association for Finance and Trade) is an international financial services trade association whose membership includes a broad range of financial institutions throughout the global community. As a worldwide forum for analysis, discussion, and advocacy in international financial services, BAFT member banks provide leadership to build consensus in preserving the safe and efficient conduct of the financial system worldwide.

BAFT is writing to offer comments on the European Banking Authority's recent *Interim Report on MREL*¹ (the "**Report**"). While we note that the report covers a number of issues related to minimum requirement for own funds and eligible liabilities (MREL), for the purposes of this letter we only offer comment on "Section 6.2, Third country recognition of resolution powers".²

We thank the EBA for its work to highlight and address the effects of Article 55 of the EU Bank Recovery and Resolution Directive (2014/59/EU) ("**BRRD**") on global trade. As we detailed in our letter to former European Commissioner, Jonathan Hill, we are concerned about serious negative consequences on the real economy if trade finance liabilities continue to be subjected to an EU bail-in tool as called for in Article 55 of the BRRD.³ In fact, we believe trade may have already been harmed by the implementation of the requirement, and we urge swift and appropriate action to mitigate any further deceleration of trade flows.

¹ European Banking Authority (EBA). *Interim Report on MREL*. EBA-Op-2016-12. 12 July 2016.

² *Ibid.*, 61.

³ BAFT Letter to European Commissioner Jonathan Hill re Contractual recognition of bail-in under Article 55 of the Bank Recovery and European Banking Authority re Contractual recognition of write-down and conversion powers under Article 55(3) of the Bank Recovery and Resolution Directive (BRRD); EBA/CP/2014/33 of 5 February 2015: <http://www.baft.org//Handlers/AptifyAttachmentHandler.ashx?AttachmentID=RuHyX%2bINRPA%3d>

1. The BRRD's Contractual Bail-In Requirement

As you know, Article 55 of the BRRD requires that European Member States introduce legislation providing for the "bail-in" of obligations as part of the European bank resolution framework.

European financial institutions covered by the BRRD are required to include in contracts under non-EU law, language that would require the client counterparty to agree to recognize the bail-in of liabilities. The intent of this requirement is to make sure that, if an institution were to be resolved, that there is equal treatment of all creditors, regardless of whether or not the contract is governed by EEA law or not.

The BRRD specifically exempts certain types of liabilities from this requirement, including secured liabilities and certain liabilities with an original maturity of less than seven days.

2. Concerns Identified with the Contractual Bail-in Requirement

There are a number of concerns and negative consequences that have arisen with the application of Article 55 to trade finance:

- We share a commitment to establishing rules that allow financial institutions to resolve themselves in a crisis both quickly and efficiently, limiting impacts on the wider economy and the public citizenry, as is the intended policy objective of the BRRD. Because of that shared commitment, we must emphasize that the bail-in of trade finance liabilities as, for example, letters of credit or bank guarantees ("contingent liabilities") will not help in terms of bank resolvability because they are contingent liabilities. Therefore, requiring the incorporation of contractual recognition of bail-in into such contracts has no benefit in terms of loss absorbency. Liquidating contingent liabilities would not help recapitalize a bank to improve its financial position for a number of reasons:
 - First, from an accounting perspective, contingent liabilities are not included on the balance sheet. Instead, they represent off-balance sheet obligations of the company.
 - Second, contingent liabilities do not have a value before the bank is actually asked to pay (which is triggered by a respective claim), and therefore their bail-in won't improve the financial situation of the bank in resolution.
 - Finally, such liabilities are neither included in *Minimum Requirement for Own Funds and Eligible Liabilities* (MREL), nor under *Total Loss-Absorbing Capacity* (TLAC), and therefore such liabilities are likely to be excluded from bail-in by the resolution authority (under Article 44.3 of the BRRD).
- As noted in our letter to the European Banking Authority in February 2015, "contractual language in the area of trade finance in particular is highly standardized and the inclusion of BRRD compliant language in such agreements would raise doubts in counterparties' minds as to the commitments being made."⁴ It is difficult for banks to add contractual bail-in terms to some types of trade finance liabilities because there are standard documentary rules set by international bodies and long-established, industry-wide electronic message formats, for example, the Society for Worldwide Interbank Financial Telecommunication ("SWIFT") Message Types, the International Chamber of Commerce's UCP 600, ISP98, and others. Banks are not able to amend these standards (rules and message types) unilaterally without an intense multi-year approval process that - even then - may not be approved and adopted. In the case of SWIFT

⁴ BAFT Letter to European Banking Authority re Contractual recognition of write-down and conversion powers under Article 55(3) of the Bank Recovery and Resolution Directive (BRRD); EBA/CP/2014/33 of 5 February 2015: <http://www.baft.org//Handlers/AptifyAttachmentHandler.ashx?AttachmentID=RuHyX%2bINRPA%3d>

messages, the message formats do not feature a data field that is capable of including the necessary information called for in the provision. In the case of public sector contracts – like those with government entities – banks very often are not in a position to negotiate the terms of such contracts provided to them and drafted by the relevant government entity.

- Many trade finance instruments (most notably, documentary letters of credit) do not contain an expressed governing law. Without that inclusion, it is difficult to determine whether or not any specific liability or transaction is governed by a non-EEA country and particularly not at the time of its issuance. This makes determining application of the Article 55 requirements very difficult.
- A real world effect of the continued contractual bail-in recognition clause is that banks will have a very difficult – if not impossible - time convincing the counterparties of non-EU law governed contracts to accept the language. The likely result will be resistance from non-EU trade finance counterparties which will ultimately force these counterparties to either choose non-EU banks or simply elect not to undertake the transaction at all. In fact, many of our members have already reported deals being scuttled for this very reason. This places European banks at a significant competitive disadvantage as compared to banks outside of the EU that do not have to comply with such requirements. The latter option – the transaction not happening at all – would have serious impacts for manufacturers and the real economy.
- Finally, the concerns raised above have contributed to a mixed adoption, application, and interpretation of the bail-in requirement by many member states. This has resulted in considerable uncertainty and confusion for BRRD firms subject to the requirement and an uneven regulatory framework implementation across European member states for which specific clarification and remediation will be highly effective.

We were pleased to see the EBA recognize these concerns in its provisional recommendation related to third country recognition of resolution powers. We fully agree with the report's assessment that, "some reduction of the burden of compliance with third country recognition requirements is necessary."⁵

3. Addressing and Fixing the Concerns Presented

As we articulated in our letter to Commissioner Hill, we believe the best solution to the challenges outlined above would be for the scope of article 55 to be modified in the BRRD. That is why we recommend the Commission amend the scope of the liabilities to which the contractual recognition requirement applies in the BRRD by aligning it with the guidance of the Financial Stability Board ("FSB").⁶

The Report lays out three policy approaches for potential adoption that could "narrow the scope of the requirement in Article 55 while maintaining the effectiveness of contractual recognition for MREL liabilities."⁷ These include:

i. Introduce additional exemptions, in particular for CCP membership agreements, and defined categories of trade creditors.

⁵ EBA, *Interim Report on MREL*, 61.

⁶ Financial Stability Board's principles for cross-border effectiveness of resolution actions. Pg. 7. 3 November 2015: <http://www.fsb.org/wp-content/uploads/Principles-for-Cross-border-Effectiveness-of-Resolution-Actions.pdf>

⁷ EBA, *Interim Report on MREL*, 62.

ii. Introduce a power for resolution authorities to grant waivers from Article 55, where this would not create an impediment to resolvability. This could be limited to liabilities which are either a) not eligible for MREL or b) not eligible for bail-in. Alternatively, clarify that penalties should only be applied by resolution authorities when failure to implement Article 55 constitutes an impediment to resolvability.

iii. Limit the scope of Article 55. Under this option Article 55 would apply only to instruments which are eligible for MREL.

BAFT believes the most effective and reliable way to achieve efficient and effective resolution is by limiting the scope of Article 55 to MREL and other debt instruments that can be bailed in. This doesn't necessarily mean that the respective liabilities are "MREL eligible" but rather have valuable relevance for MREL, also taking into account proportionality as well as appropriateness. This suggestion is similar to policy approach (iii)⁸ and would provide much greater clarity of what liabilities are obligated. Further, it would reduce regulatory burdens while ensuring proper resolution of firms in time of crisis. Finally, it would provide much needed consistency across European member states.

We would also suggest, in the interest of adding further flexibility and objectivity, that the respective resolution authority should be granted additional powers to grant a waiver as outlined in policy approach (ii)⁹ or a similar solution that best fits the respective institutions settings. The resolution authority understands each institution's individual settings and would be in the best position to grant such a waiver.

4. Conclusion

In summary, we believe the challenges outlined above have ripple effects beyond banking institutions. The 28 member states of the European Union accounts for around 15% of the world's trade in goods.¹⁰ These present a global trade problem affecting every part of the chain, from exporters and importers, to governments and to consumers. If the requirement to provide contractual recognition of bail-in provisions is kept in its current form, as it applies to contingent liabilities in trade finance space, we strongly believe it will diminish trade flows across the global supply chain and put the EU banks in a disadvantaged position globally, while bringing no benefits for EU banks resolvability. Further, the hardest hit will be small and medium size enterprises and mid-market businesses that do not have the luxury of electing to source in multiple jurisdictions.

We thank the EBA for recognizing these concerns and for your dedication to arriving at a result that works for both regulators, firms, and taxpayers alike. As noted above, we believe a sound and sensible solution is one derived between a nuanced blending of policy approaches (ii) and (iii), respectively.

⁸ Ibid.

⁹ Ibid.

¹⁰ Eurostat. Statistics Explained. *International Trade in Goods*. 29 July 2016.
<http://ec.europa.eu/eurostat/statistics-explained/index.php/International_trade_in_goods#Main_statistical_findings>

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In our view, this would ensure a consistent approach across member states, protect and strengthen the prevalence of global trade, and better allow for the effective resolution for institutions that may face serious challenges.

We very much appreciate the opportunity to comment on your recent paper and look forward to further dialogue on these important issues going forward. For further information, please contact John Collins, Vice President, International Policy at jcollins@baft.org or +1-202-663-5514.

Very truly yours,

A handwritten signature in black ink that reads "Tod R. Burwell". The signature is written in a cursive style with a large, prominent initial "T".

Tod R. Burwell
President and Chief Executive Officer