Update Report on Amendments to Article 55 BRRD prepared for the ICC Banking Commission Legal Committee Meeting in Tbilisi, October 2018

1. Background

The Bank Recovery and Resolution Directive (*2014/59/EU*) (**BRRD**) establishes a framework for the recovery and resolution of EU credit institutions and significant investment firms. The BRRD's aim is to ensure that authorities have tools and powers to tackle crises at banks.

Under Article 55 (1) BRRD the Member States must require covered entities to include a contractual bail-in recognition clause in all of their agreements (under which liabilities can arise) governed by the law of any non-EU country. All EU countries have transposed the BRRD into their national laws.

It is impracticable to insert bail-in recognition clauses in trade finance contracts. Often it is not clear if trade finance contracts are governed by the law of a non-EU country. Besides, a bail-in of trade finance liabilities is normally impossible and if possible at all, it would not improve the resolvability of the bank.

The ICC and other trade bodies and stakeholders have voiced their concerns about some aspects of the BRRD including the Article 55 requirement. In particular, they have asked the EU legislator for the dis-application or amendment of the article.
The EU legislator has recognised the problems and concerns and started a process of amending the BRRD, including Article 55.

2. The Legislative Process

The long process of amending BRRD has now reached the trilogue stage. The EU Commission, European Parliament and the Council of the EU have each published their own amendment proposals.

The EU Commission's proposal of November 2016 is the oldest of the three. The Council and EP followed with the publication of their proposals in May 2018 and June 2018 respectively.

The process involves a continuous shifting of positions, evolving views and discussions inside and between each of these three bodies of the EU. It may well be that the current position of the EU Commission is no longer reflected in its proposals from November 2016 and that its position has moved towards the more ambitious proposals of the Council and the EP.

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The trilogue is expected to be concluded by the end of 2018. The amendments to BRRD are expected to be adopted early 2019. Member states will probably have 12 months to transpose the directive into national legislation. It is expected that banks in an EU member state will have to comply with the new rules within 6 months from the date of transposition in that member state.

So assuming the amendments will be adopted by the EU legislator in Q1 2019 and member states use the maximum amount of time for transposition into their nationals laws, banks will become subject to the new BRRD rules by Q3 2020 at the latest.

2. The Amendments to Article 55 BRRD

None of the proposals include an express exemption from the Article 55 requirement for trade finance. However, in each of the three current proposals Article 55 BRRD will be amended in a way that allows an exemption for trade finance from the contractual recognition requirement **where that is** "*legally, contractually or economically impracticable*" (the EU Commission) or "*legally or otherwise impractical*" (the EU Council and EP).
As argued before by the ICC Banking Commission such waiver or exemption should be available and appropriate for trade finance liabilities.

Unfortunately, the EP's proposal still contains a cap on the liabilities that can benefit from the exemption. This is unnecessary because (i) of the other safeguards already in place for any exemption and (ii) such a cap is impossible to calculate. I understand that this cap is not generally supported outside the EP.

In the Commission and the EP's proposals "unsecured debt instruments" cannot be exempted. As highlighted before, that condition is unhelpful as it may rule out promissory notes and bills of exchange accepted by banks.

The cap and the exclusion of unsecured debt instruments are opposed by the various trade bodies that represent finance and trade, including the ICC.

4. Comparison of the three Proposals

The Annex to this report contains an overview of the three different texts proposals for Article 55. One could summarise the relative pros and cons of each proposal as follows:

	Pros	Cons
EU Commission	• No numerical cap on the liabilities that can be exempted.	• 55 (2) (1) requires that the exemption can only apply if the bail-in of the liabilities is (i) recognised in a third country **AND** (ii) is legally, contractually or economically impracticable **AND** (iii) does not impede the

		resolvability of the institution;[1] • "*contractually or economically impracticable*" is arguably narrower than "*legally or otherwise impractical*"; • The exemption cannot include "*debt instruments which are unsecured liabilities*"; • The exempted liabilities must be senior to the MREL liabilities;[2] • The exemption must be granted by the resolution authority of the member state.
EU Council	• No numerical cap on the liabilities that can be exempted; • for liabilities to be capable of exemption they do not have to be liabilities the bail-in of which is recognised in a third country; • "*legally or otherwise impractical*" is arguably wider than "*contractually or economically impracticable*"; • a bank can make its own determination as to the applicability of the	

[1] This is most probably a drafting error. The condition in (a) should not be combined with (b) and (c).

[2] This condition would defeat the object of the amendment exercise as it would exclude from exemption any unsecured liabilities (like most trade finance liabilities). Fortunately, this condition does not feature in the other proposals.

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	exemption; it will have to notify its competent authority; • upon notification, the exemption will apply automatically immediately until and unless the competent authority disagrees; • debt instruments that are unsecured liabilities are not in principle excluded from the exemption; • exempted liabilities do not have to be senior to the MREL liabilities.	
European Parliament	• for liabilities to be capable of exemption they do not have to be liabilities the bail-in of which is recognised in a third country; • "*legally or otherwise impractical*" is arguably wider than "*contractually or economically impracticable*"; • a bank can make its own determination as to the applicability of the exemption; the competent authority will monitor; • the exemption will apply automatically immediately until and unless the competent authority disagrees;	• if the exempted liabilities are debt instruments, they must be secured liabilities; • the amount of exempted liabilities is capped at 15% of the total liabilities which are senior to the so called new class of "non-preferred senior debt" AND the liabilities referred to in Article 55 (1) (a), (b) and (d).

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	• exempted liabilities do not have to be senior to the MREL liabilities.	

5. Preference

Given the pros and cons the Council's proposal should be the preferred one for trade finance. The Council also proposed a new Article 55(7) which requires national resolution authorities to specify, where it deems necessary, the categories of liabilities for which a bank may determine that it is legally or otherwise impracticable to include bail-in clauses. Whether this is a pro or a con, is hard to say. The new sub-article would allow national authorities to tailor for the characteristics of their banks' businesses. However, it could also create an uneven playing field within the EU.

Moreover, it is not entirely clear how this national discretion would relate to the EBA's technical standards that are to further determine the list of liabilities that can be exempted (Article 55(5)) and the EBA's technical standards that are to specify the conditions under which it would be "legally or otherwise impracticable" to insert bail-in clauses (Article 55(6)).

6. The Council's proposal for a new Article 71a – "Contractual Recognition of Resolution Stay Powers"

To my knowledge, this new article has not yet been discussed in our Legal Committee. It only features in the Council's proposal, not in those of the Commission and EP.
The rationale for the clause is the same as for Article 55. Consequently, the same arguments used against Article 55 should largely apply. The question is whether or not we should be equally concerned about this proposed Article 71a from a trade finance perspective.

The clause aims to ensure contractual recognition for a resolution authority's powers to suspend or restrict rights and obligations. However, it only applies to 'financial contracts' (a) under which a new obligation is created, or an existing obligation is materially amended after the national law adoption date AND (b) that provides for the exercise of one or more termination rights or rights to enforce security interests AND (c) which are governed by the law of a non-EU country.

The BRRD definition of 'financial contract' mainly refers to derivatives but does also include inter-bank borrowing agreements for three months or less and master agreements for any of such agreements.

Given condition (b) and the definition of 'financial contracts', would many trade finance contracts be affected?

7. Questions

Legal Committee members are kindly asked to consider (i) the three proposals for the amendment of Article 55 and provide their thoughts on them and (ii) if the proposed Article 71a warrants a response from the ICC to the EU co-legislators.

Many thanks.

11 October 2018

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