
EBA/CP/2014/33

5 November 2014

Consultation Paper

Draft Regulatory Technical Standards

On the contractual recognition of write-down and conversion powers under Article 55(3) of the Bank Recovery and Resolution Directive (BRRD)

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1. Responding to this Consultation

The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in 5.2.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by 05.02.2015. Please note that comments submitted after this deadline, or submitted via other means, may not be processed.

Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EC) No 45/2001 of the European Parliament and of the Council of 18 December 2000 as implemented by the EBA in its implementing rules adopted by its Management Board. Further information on data protection can be found under the Legal notice section of the EBA website.

2. Executive Summary

Pursuant to Article 55(1) of Directive 2014/59/EU (BRRD) Member States shall require institutions¹ and entities referred to in points (b), (c) and (d) of Article 1(1) of that Directive to include a contractual term by which the creditor or the party to the agreement creating a relevant liability recognises that liability may be subject to the write-down and conversion powers² and agrees to be bound by any reduction of the principal or outstanding amount due, conversion or cancellation that is effected by the exercise of those powers by a resolution authority.

Article 55(1) of the BRRD specifies the list of liabilities which are excluded from the requirement to include the contractual term. The requirement does not apply in relation to a liability that is:

- excluded under Article 44(2) of the BRRD;
- a deposit referred to in point (a) of Article 108 of the BRRD;
- governed by the law of a Member State;
- issued or entered into before the date on which a Member State applies the provisions adopted in order to transpose Section 5 (the bail-in tool) of Chapter IV (resolution tools) of Title IV (resolution) of the BRRD.

In addition the requirement does not apply where the resolution authority of a Member State determines that liabilities or instruments governed by the law of a third country can be subject to the write-down and conversion powers by a Member State resolution authority pursuant to:

- the law of the third country, or
- a binding agreement concluded with that third country. (See the second subparagraph of Article 55(1) of the BRRD.)

Article 55(3) of the BRRD requires the EBA to develop draft regulatory technical standards (RTS) in order to further determine the list of liabilities to which the exclusion in Article 55(1) of the BRRD applies and the contents of the term required in that paragraph, taking into account banks' different business models.

This Consultation Paper includes the EBA's proposal for the draft RTS and explains the approach the EBA has taken in relation to the proposal.

¹ 'Institution' is defined in point (23) of Article 2(1) of the BRRD.

² The 'write-down and conversion powers' are defined in point (66) of Article 2(1) of the BRRD as the powers referred to in Article 59(2) and in points (e) to (i) of Article 63(1) of the BRRD.

Consistent with its mandate under Article 55(3) of the BRRD, the EBA has not proposed any new grounds of exclusion (for example, new forms of liabilities to which the requirement to include the contractual term does not apply or a de minimis threshold as regards the value of the liabilities subject to the requirement specified in the first subparagraph of Article 55(1) of the BRRD). This is because the creation of new exclusions would involve changing an essential element of the Level 1 text (the BRRD) and making policy choices which the EBA is not empowered to do as such matters are reserved to the co-legislators under Article 290(1) of the Treaty on the Functioning of European Union.

Instead, the draft RTS further determines the list of liabilities to which the exclusion from the requirement to include the contractual term applies. For example, the RTS specifies key elements which Member State resolution authorities should assess are present before determining that the liabilities or instruments referred to in the first subparagraph of Article 55(1) of the BRRD can be subject to write-down and conversion by a Member State resolution authority pursuant to the law of a third country or to the binding agreement with that third country. This will ensure that the exclusion is interpreted homogenously across the Union (and therefore that contractual terms are required to be included in the same cases across the Union).

The draft RTS also specifies a list of mandatory components which must be present in the contractual term required pursuant to Article 55(1) of the BRRD. These include provisions specifying the express acknowledgement, agreement and consent of the counterparty to the application of write-down and conversion powers by the Member State resolution authority and their potential effects in terms of the liability under the agreement.

This approach is intended to strike a balance between the need to achieve an appropriate level of convergence whilst ensuring that differences in legal systems and cultures of third countries as well as other differences arising from different forms of liability (in particular, debt instruments and capital instruments) can be taken into account by Member State resolution authorities, institutions and relevant entities through the addition of further elements if necessary to achieve the policy goal of ensuring that the write-down and conversion powers can be applied effectively in relation to liabilities governed by the law of a third country.

3. Background and rationale

Objective

Directive 2014/59/EU (BRRD) requires Member States to confer on their resolution authorities a number of powers including the powers to write-down or convert³ relevant capital instruments⁴ in accordance with Article 59 of the BRRD, including in the context of an application of the bail-in tool (Chapter IV (resolution tools) of Title IV (resolution) of the BRRD). The bail-in tool shall enable the resolution authority:

- to recapitalise an institution⁵ or entity referred to in point (b), (c) or (d) of Article 1(1) of the BRRD;
- to convert to equity or reduce the principal amount of claims or debt instruments that are transferred to a bridge institution or under the sale of business tool or the asset separation tool. (See Article 43 of the BRRD.)⁶

Member States must ensure that the powers may be applied to all relevant liabilities of an institution or relevant entity.

Liabilities of an institution or relevant entity may be governed by the law of the Member State of establishment or another Member State in which case the application of the write-down and conversion powers would be effective as a matter of law.

However, some liabilities (for example, debt securities) may be governed by the law of a third country. In the absence of a regime to secure the effectiveness of an application of the write-down and conversion powers by a Member State resolution authority (whether under the local law of a third country or pursuant to an international agreement) it is possible that a third country court may not recognise the effect of the application of the powers by that resolution authority.

For this reason Article 55(1) of the BRRD requires Member States to require institutions and relevant entities to include in relevant agreements a contractual term by which the creditor or party to the agreement creating the liability recognises that liabilities may be subject to the write-down and conversion powers and agrees to be bound by any reduction of the principal or outstanding amount due, conversion or cancellation that is effected by the exercise of those powers by a Member State resolution authority.

³ The 'write-down and conversion powers' are defined in point (66) of Article 2(1) of the BRRD as the powers referred to in Article 59(2) and in points (e) to (i) of Article 63(1) of the BRRD.

⁴ 'Relevant capital instruments' are defined in point (74) of Article 2(1) of the BRRD.

⁵ 'Institution' is defined in point (23) of Article 2(1) of the BRRD.

⁶ See further recitals (67), (68), (70) to (73), (77) and (78) of the BRRD.

A ‘relevant agreement’ means an agreement creating relevant liabilities (i.e. all liabilities other than those which are excluded liabilities under Article 44(2) of the BRRD or are deposits referred to in point (a) of Article 108 of the BRRD) which is:

- governed by the law of a third country; and
- issued or entered into after the date on which provisions to transpose Section 5 (the bail-in tool) of Chapter IV of Title IV of the BRRD are applied. (See the first subparagraph of Article 55(1) of the BRRD.)

The requirement to include the contractual term does not apply where the Member State resolution authority determines that the liabilities or instruments can be subject to the write-down and conversion powers as a result of national law in the third country or a binding agreement with that third country. (See the second subparagraph of Article 55(1) of the BRRD.)

Content

Article 55(3) of the BRRD requires the EBA to develop draft RTS in order:

- to further determine the list of liabilities to which the exclusion in Article 55(1) of the BRRD applies; and
- to determine the contents of the contractual term to be required to be included in relevant agreements.

The EBA’s proposal for the draft RTS is set out in the next chapter of the Consultation Paper. An overview of each part of the draft RTS is set out below.

Article 2: Definitions

The definitions set out in the BRRD are applied for the purposes of the draft RTS. In particular, it refers to the write-down and conversion powers as defined in point (66) of Article 2(1) of the BRRD (i.e. the exercise of the powers independently of, or in conjunction with, resolution action). A number of definitions are also introduced for the purposes of the draft RTS, including a definition of ‘relevant transposition measures’ which is to mean the provisions adopted by the relevant Member State for the purposes of implementing in full Section 5 of Chapter IV of Title IV of the BRRD.

Article 3: Further determining the liabilities to which the exclusion in Article 55(1) of the BRRD applies

The EBA is required to ‘further determine the list of liabilities to which the exclusion in [Article 55(1)] applies’ (Article 55(3) of the BRRD).

Pursuant to this mandate the EBA proposes to further determine the grounds of exclusion specified in the first and second subparagraphs of Article 55(1) of the BRRD.

Consistent with this mandate, the EBA has not proposed any new grounds of exclusion (for example, new forms of liabilities to which the requirement to include the contractual term does not apply or a de minimis threshold as regards the value of the liabilities subject to the requirement). This is because the creation of new exclusions would involve changing an essential element of the Level 1 text (the BRRD) and making policy choices which the EBA is not empowered to do as such matters are reserved to the co-legislators under Article 290(1) of the Treaty on the Functioning of European Union. It is also to be observed that all liabilities of an institution or relevant entity, unless expressly excluded as a result of Article 44(2) of the BRRD, are within the scope of the bail-in tool. Therefore in order to ensure that the write-down and conversion powers can be applied effectively with regard to any liability governed by the law of a third country and not otherwise excluded pursuant to the BRRD it is appropriate that the contractual term should be required to be included unless a third country law or binding international agreement provides an alternative mechanism to secure the effectiveness of an application of such powers (see further below).

In light of the mandate the EBA proposes to:

- clarify that the contractual term is required to apply to any unsecured portion of a liability even if the liability is otherwise secured; the term is also required where a liability is fully secured but may become unsecured (for example due to unexpected falls in the value of collateral) consistent with the third subparagraph of Article 44(3) of the BRRD which makes clear that a security interest shall not prevent a Member State resolution authority from applying the write-down and conversion powers to any unsecured portion of the liability;
- clarify that in point (d) of the first subparagraph of Article 55(1) of the BRRD the reference to liabilities issued or entered into after the relevant transposition date is to include: (a) liabilities under agreements entered into after the transposition date; (b) liabilities created after the transposition date under agreements entered into before that date; (c) liabilities under agreements entered into before the transposition date but amended after that date; (d) liabilities under debt instruments issued after the transposition date, including under programmes existing prior to the transposition date;
- set out the key elements of the third country law or binding international agreement which Member State resolution authorities should assess are present before determining that the liabilities or instruments referred to in the first subparagraph of Article 55(1) of the BRRD can be subject to write-down and conversion by a Member State resolution authority pursuant to the law of a third country or to the binding agreement with that third country.

The EBA's proposal with regard to liabilities issued or entered into after the date on which a Member State applies the provisions adopted in order to transpose Section 5 (the bail-in tool) of Chapter IV (resolution tools) of Title IV (resolution) of the BRRD is intended to prevent regulatory arbitrage and ensure the write-down and conversion powers can be applied effectively in relation

to any liabilities created after the transposition date. Where netting arrangements are in place and cover liabilities pre-dating the transposition date and any new liabilities created after that date, it is to be expected that parties to the contract would prefer that the contractual term apply to the full netting set rather than split the netting set into pre-transposition set and post-transposition set.

The EBA's proposal with regard to third countries is intended to strike a balance between the objective of harmonising the approach the Member State resolution authorities adopt to the assessment process and the objective of preserving the role of the resolution authorities in making the determination. Accordingly it is proposed that the draft RTS specify a minimum list of elements which must be present under the third country law or binding international agreement in order for the Member State resolution authority to determine that a third country law or binding agreement is sufficient to secure the effective application of the write-down and conversion powers.

The third country law or binding international agreement may make provision for a process to recognise and give effect to or to support (for example, by suspending or preventing local actions) the application of the write-down and conversion powers by the Member State resolution authority. This process may involve an administrative or judicial procedure. It may also involve the use by the third country authority of its own powers in support of the actions of the Member State resolution authority. The third country law or binding international agreement may also include provisions which, once a trigger event has been satisfied (e.g. the triggering of resolution by a Member State resolution authority and the application of resolution powers by that authority), enable recognition without any further action on the relevant authority.

Article 4: The contents of the contractual recognition term required by Article 55(1) of Directive 2014/59/EU

The EBA is tasked with determining the 'contents' of the contractual term required to be included pursuant to Article 55(1) of the BRRD.

The EBA has considered whether to propose in the draft RTS a specific clause or a list of mandatory components to be included in the term.

The EBA does not consider it appropriate to specify a clause as this may not be effective in all jurisdictions or suitable for all forms of liability falling within the scope of Article 55(1) of the BRRD. Rather the EBA considers that listing the key mandatory elements of the term strikes the right balance between securing an appropriate level of convergence whilst ensuring that differences in legal systems and cultures of third countries as well as other differences arising from different forms of liability (in particular, debt instruments and capital instruments) can be taken into account by Member State resolution authorities, institutions and relevant entities.

Accordingly, it is proposed that the draft RTS include a list of mandatory components which must be present in the contractual term required pursuant to Article 55(1) of the BRRD. These include provisions specifying the express acknowledgement, agreement and consent of the counterparty

to the application of write-down and conversion powers by the Member State resolution authority and their potential effects in terms of the liability under the agreement, including:

- the reduction of the amount outstanding, including to zero;
- the cancellation of the relevant agreement creating the liability;
- the conversion of the liability into ordinary shares or other instruments of ownership, for example of the entity under resolution, the parent undertaking or a bridge institution, and that these shares or other instruments of ownership will be accepted in lieu of rights under the relevant agreement;
- the variation of terms in connection with the exercise of the write-down and conversion powers, for example the variation of the maturity of a debt instrument.

Other matters

Legal opinions and interaction with Article 45(5) of the BRRD (MREL)

The EBA notes that the third subparagraph of Article 55(1) of the BRRD specifies that Member States shall ensure that resolution authorities may require institutions and relevant entities to provide authorities with a legal opinion relating to the legal enforceability and effectiveness of contractual recognition terms included in liabilities governed by the law of a third country.

It is also to be noted that Article 45(5) of the BRRD (application of the minimum requirement for own funds and eligible liabilities) specifies that where a liability is governed by the law of a third country Member State resolution authorities may require institutions to provide an opinion demonstrating that any decision of the resolution authority to write-down or convert that liability would be effective under the law of that third country, having regard to the contract governing the liability, international agreements on the recognition of resolution proceedings and other relevant matters.

It is to be expected that where a relevant agreement which is otherwise eligible to count towards MREL includes components of a contractual term as specified in the draft RTS, the agreement can count towards MREL. However, in accordance with Article 45(5) of the BRRD, it should remain possible for Member State resolution authorities to require institutions to demonstrate that the exercise of powers would have effect with regard to that liability in the third country concerned (for example, to take account of any relevant judicial proceedings or changes to third country law which may have an impact on the likelihood of the recognition of the application of powers).

Ongoing international work in this area

The EBA is aware of ongoing international work in relation to statutory and contractual approaches to the recognition of the exercise of write-down and conversion powers and other resolution powers. In particular, the EBA notes the Financial Stability Board's (FSB) *Consultative Document: Cross-border recognition of resolution action* published on 29 September 2014 and has sought to align its proposals with the FSB's proposals insofar as compatible with the BRRD and otherwise appropriate.⁷

⁷ The Consultative Document is available here: http://www.financialstabilityboard.org/publications/c_140929.htm.

4. Draft RTS on the contractual recognition of write-down and conversion powers under Article 55(3) of the Bank Recovery and Resolution Directive (BRRD)

In between the text of the draft RTS that follows questions can be found on specific aspects of the proposed text, which respondents to the public consultation should consider in their responses.

COMMISSION DELEGATED REGULATION (EU) No .../..

of XXX

[...]

supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards for the contractual recognition of write-down and conversion powers

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council,⁸ and in particular Article 55(3) thereof,

⁸ OJ L173, 12.6.2014, p.190.

Whereas:

- (1) Directive 2014/59/EU requires Member States to confer on their resolution authorities a range of powers, including the write-down and conversion powers as defined in point (66) of Article 2(1) of that Directive which can be applied independently of, or in conjunction with, resolution action.
- (2) It is important to ensure that the write-down and conversion powers can be applied effectively in relation to all liabilities that are not excluded as a result of Article 44(2) of Directive 2014/59/EU.
- (3) In order to help ensure that the write-down and conversion powers can be applied effectively in relation to liabilities governed by the law of a third country Article 55(1) of Directive 2014/59/EU provides that Member States shall require institutions and entities referred to in points (b), (c) and (d) of Article 1(1) of that Directive to include a contractual term by which the creditor or party to the agreement creating the liability recognises that the liability may be subject to the write-down and conversion powers and agrees to be bound by any reduction of the principal or outstanding amount due, conversion or cancellation that is effected by the exercise of those powers.
- (4) All liabilities other than those falling within the list of liabilities to which the exclusion in Article 55(1) of Directive 2014/59/EU applies should include the above mentioned contractual term.
- (5) Pursuant to Article 55(3) of Directive 2014/59/EU the EBA is required to develop draft regulatory technical standards in order to further determine the list of liabilities to which the exclusion in Article 55(1) of that Directive applies, and the contents of the term required in that paragraph, taking into account banks' different business models.
- (6) This Regulation is based on the draft regulatory technical standards submitted by the EBA to the Commission.
- (7) The EBA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010,⁹

HAS ADOPTED THIS REGULATION:

Article 1- Subject matter

This Regulation further determines the list of liabilities to which the exclusion in Article 55(1) of Directive 2014/59/EU applies and the contents of the contractual term required in that paragraph.

⁹ Regulation (EU) 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

Article 2- Definitions

For the purposes of this Regulation the definitions in Article 2 of Directive 2014/59/EU and the following definitions shall apply:

- (1) ‘counterparty’ means a party to a relevant agreement other than the entity;
- (2) ‘entity’ means an institution or entity referred to in point (b), (c) or (d) of Article 1(1) of Directive 2014/59/EU that is party to a relevant agreement;
- (3) ‘relevant agreement’ means an agreement, including the terms of a capital instrument, creating a liability to which Article 55(1) of Directive 2014/59/EU applies;
- (4) ‘relevant Member State’ means the Member State in which the entity is established;
- (5) ‘relevant resolution authority’ means the resolution authority, as defined in Article 3 of Directive 2014/59/EU, empowered under the relevant transposition measures of the relevant Member State to exercise the write-down and conversion powers in respect of the entity or, where applicable, the Single Resolution Board established by Regulation (EU) No 806/2014 of the European Parliament and the Council establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010¹⁰, the Council and the Commission when taking actions under Article 18 of such Regulation;
- (6) ‘relevant transposition date’ means the date on which the relevant Member State applies the relevant transposition measures;
- (7) ‘relevant transposition measures’ means the provisions adopted by a Member State in order to transpose Section 5 of Chapter IV of Title IV of Directive 2014/59/EU.

Article 3- Liabilities to which the exclusion in Article 55(1) of Directive 2014/59/EU applies

1. The list of liabilities to which the exclusion in Article 55(1) of Directive 2014/59/EU applies shall be interpreted in accordance with this Article.
2. For the purposes of point (a) of the first subparagraph of Article 55(1) of Directive 2014/59/EU, a liability shall not be excluded to the extent that it is, or may become, unsecured in part or in full even if the liability was at the point of its creation fully secured.
3. In point (d) of the first subparagraph of Article 55(1) of Directive 2014/59/EU the reference to liabilities issued or entered into after the relevant transposition date is to include:
 - (a) liabilities created after that date under agreements entered into before that date;

¹⁰ In OJ L 225 of 10.07.2014, p. 1.

- (b) liabilities under agreements amended after that date regardless of whether or not the liability is created after that date;
- (c) liabilities under agreements entered into after that date;
- (d) liabilities under debt instruments issued after that date.

Q1: Do you agree with the approach the EBA has proposed for the purposes of further determining points (a) and (d) of the first subparagraph of Article 55(1) of the BRRD (which form part of the list of liabilities to which the exclusion in Article 55(1) of the BRRD applies)? In particular, it is to be noted that Article 3(2) of the draft RTS refers to liabilities that 'may' become unsecured. Respondents are invited to comment on this approach and, should they disagree with this proposal, suggest possible alternative approaches.

4. A liability or instrument referred to in the first subparagraph of Article 55(1) of Directive 2014/59/EU can be determined to be within the scope of the second subparagraph of that paragraph where the law of the third country or the binding agreement provides for an administrative or judicial procedure which:
- (1) at the request of the relevant resolution authority or at the initiative of a third country authority:
 - (a) enables an administrative or judicial authority within a reasonable period:
 - (i) to recognise and give effect to the exercise of the write-down and conversion powers by the relevant resolution authority, or
 - (ii) to support through the application of powers the exercise of the write-down and conversion powers by the relevant resolution authority; or
 - (b) provides for the recognition and effect of the exercise of the write-down and conversion powers by the relevant resolution authority without the need for any further steps on the part of the relevant resolution authority;
 - (2) may involve:
 - (a) subjecting liabilities governed by the law of the third country to the exercise of the write-down and conversion powers by the relevant resolution authority;
 - (b) the taking of actions by an administrative or judicial authority, including actions:
 - (i) to perfect the application of the write-down and conversion powers by a relevant resolution authority;
 - (ii) to close out derivative contracts;

- (iii) to render unenforceable or ineffective or to prevent or suspend actions or proceedings or the exercise of contractual rights in connection with the exercise of the write-down and conversion powers by the relevant resolution authority;
- (3) provides that any grounds on which an administrative or judicial authority may refuse to take one or both of the actions referred to in subparagraph (1)(a) are clearly stated and are limited to one or more of the following exceptional cases:
 - (a) the exercise of the write-down and conversion powers by the relevant resolution authority would have adverse effects on financial stability in the third country concerned;
 - (b) the exercise of the write-down and conversion powers by the relevant resolution authority would result in third country creditors and depositors being treated less favourably than creditors including in particular depositors located or payable in a Member State with similar legal rights;
 - (c) recognition or support would have material fiscal implications for the third country concerned;
 - (d) the effects of such recognition or support would be contrary to the national law in the third country concerned,

providing, at the time of the assessment pursuant to the second subparagraph of Article 55(1) of Directive 2014/59/EU, it is clear that these cases would not prevent recognition or support in every instance in which the write-down and conversion powers are applied.

- 5. For the purposes of paragraph 4:
 - (1) a period shall be a ‘reasonable period’ if it enables recognition or support within a period which the relevant resolution authority determines will not compromise the effective application of the write-down and conversion powers by that resolution authority;
 - (2) an ‘administrative or judicial authority’ is a body empowered to take one or both of the actions described in paragraph 4(1)(a)(i) and (ii).

Q2: Do you agree with the approach the EBA has proposed for the purposes of further determining the second subparagraph of Article 55(1) of the BRRD (which forms part of the list of liabilities to which the exclusion in Article 55(1) of the BRRD applies)?

Article 4- Contents of the contractual term required by Article 55(1) of Directive 2014/59/EU

A relevant agreement shall include as a contractual term the following elements:

- (1) acknowledgment, agreement and consent by each counterparty that the liability of an entity under the relevant agreement may be subject to the exercise by a relevant resolution authority of its write-down and conversion powers;
- (2) identification of each relevant resolution authority and the legislation under which write-down and conversion powers are conferred on the relevant resolution authority;
- (3) a specification of the write-down and conversion powers of each relevant resolution authority under the relevant transposition measures or, where applicable, under Regulation (EU) No 806/2014, in particular the powers to:
 - (a) reduce, in part or in full, the principal amount of or outstanding amount due (including any accrued but unpaid interest) in respect of the liability of an entity under the relevant agreement;
 - (b) convert, in part or in full, the liability of an entity under the relevant agreement into ordinary shares or other instruments of ownership of the entity or another person;
 - (c) cancel debt instruments issued by the entity;
- (4) acknowledgement, agreement and consent by each counterparty that:
 - (a) it is bound by:
 - (i) any reduction in the principal amount or outstanding amount due (including any accrued but unpaid interest) in respect of the liability of an entity under the relevant agreement;
 - (ii) the conversion of that liability into ordinary shares or other instruments of ownership,
that may result from an exercise by a relevant resolution authority of its write-down and conversion powers;
 - (b) the terms of the relevant agreement will be varied as may be necessary to give effect to the exercise by a relevant resolution authority of its write-down and conversion powers and the counterparty will be bound by such variations; and
 - (c) it will accept in lieu of rights under the relevant agreement any ordinary shares or other instruments of ownership into which the liability of an entity under the relevant agreement may be converted by a relevant resolution authority; and
- (5) acknowledgement, agreement and consent by each counterparty that the contractual term described by this Article constitutes the entire agreement between the parties on the matters described therein to the exclusion of any other agreements, arrangements or understandings between the parties relating to the subject matter of the relevant agreement.

Q3: Do you agree with the approach the EBA has proposed with regard to the components of the contractual term required pursuant to Article 55(1) of the BRRD?

Article 5- Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

It shall apply immediately.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

*For the Commission
The President*

*[For the Commission
On behalf of the President*

[Position]

5. Accompanying documents

5.1 Draft Cost-Benefit Analysis / Impact Assessment

Introduction

Article 55(3) of the BRRD requires the EBA to develop draft regulatory technical standards (RTS):

- to further determine the list of liabilities to which the exclusion in Article 55(1) of the BRRD (the exclusion from the requirement to include a contractual term) applies; and
- to specify the contents of the term required in Article 55(1) of the BRRD, taking into account banks' different business models.

As per Article 10(1) of the EBA Regulation (Regulation (EU) No 1093/2010 of the European Parliament and of the Council), any draft RTS developed by the EBA shall be accompanied by a cost and benefit analysis. Such annex shall provide the reader with an overview of the findings as regards the problem identification, the options identified to remove the problem and their potential impacts.

This annex presents the cost-benefit analysis of the policy options considered in these RTS. Given the nature of the RTS, the IA is mostly high-level and qualitative in nature.

Policy background

Liabilities of an institution or of a relevant entity referred to in points (b), (c) and (d) of Article 1(1) of Directive 2014/59/EU (the BRRD) may be governed by the law of the Member State of establishment or of another Member State in which case the application of the write-down and conversion powers defined in point (66) of Article 2(1) of the BRRD would be effective as a matter of law.

However, some liabilities (for example, debt securities) of an institution or relevant entity may be governed by the law of a third country. In the absence of a regime to secure the effectiveness of an application of the write-down and conversion powers by a Member State resolution authority (whether under the local law of a third country or pursuant to an international agreement) it is possible that a third country court may not recognise the effect of the application of the powers by that resolution authority. A refusal to recognise the application of the powers could undermine the effectiveness of actions on the part of a Member State resolution authority to restore the financial condition of an institution or relevant entity for the purposes of addressing a threat to financial stability and/or the interests of depositors and clients.

For this reason Article 55(1) of the BRRD requires Member States to require institutions and relevant entities to include in relevant cases (specifically, liabilities governed by a third country

law) a contractual term by which the creditor or party to the agreement creating the liability recognises that liabilities may be subject to the write-down and conversion powers and agrees to be bound by any reduction of the principal or outstanding amount due, conversion or cancellation that is effected by the exercise of those powers by a Member State resolution authority.

The requirement to include the contractual term does not apply in relation to the liabilities listed in points (a) to (d) of the first subparagraph of Article 55(1) of the BRRD or where a Member State resolution authority determines that the liabilities or instruments can be subject to the write-down and conversion powers as a result of national law in the third country or a binding agreement with that third country (see the second subparagraph of Article 55(1) of the BRRD).

Problem definition

Drivers

There is a risk of divergences in the approach of the resolution authorities to the interpretation of the exclusion from the requirement to include the contractual term as set out in Article 55(1) of the BRRD and, where the requirement to include the contractual term applies, the contents of the contractual term.

For example, having regard to the second subparagraph of Article 55(1) of the BRRD, some Member State resolution authorities may determine that a third country law or binding international agreement is sufficient to secure the effective application of the write-down and conversion powers (thereby displacing the requirement to include the contractual term) even if, pursuant to that law or agreement, a third country authority has a right to refuse recognition on *any* grounds, whereas other resolution authorities may regard a third country law or international agreement as sufficient only if the grounds on which a third country authority may refuse recognition are strictly limited to exceptional cases.

To give another example, the resolution authorities may take a different view as to the necessary contents of contractual term intended to implement the requirement in Article 55(1) of the BRRD; some Member State resolution authorities may require extensive provision, others may require more limited provision.

Problems

Uneven playing field between institutions

Such heterogeneity in the application of the requirement to include the contractual term could lead to an uneven playing field for institutions and relevant entities. It is reasonable to expect that this could have an impact on the availability and cost of funding for institutions and relevant entities (e.g. with those institutions in Member States where resolution authorities adopt a more relaxed approach to the application of the requirement to include the contractual term benefitting from a potential funding advantage).

Ineffectiveness of the resolution power in the third countries

In addition, divergences in approach could reduce the effectiveness of the write-down and conversion powers as regards liabilities governed by the law of a third country where, for example, a Member State resolution authority has determined that a contractual term is sufficient but it does not, in fact, secure the effective application of the write-down and conversion powers or where a third country law or binding international agreement enables a third country authority to refuse recognition or support on any grounds at the point of resolution. This could lead to financial stability implications in the Member State concerned and in the Union as a whole.

Objectives

The objective of the RTS is to promote convergence of approach in the application of the list of liabilities to which the exclusion in Article 55(1) of the BRRD (the exclusion from the requirement to include a contractual term) applies and the contents of the contractual term required by that paragraph.

A central element to promoting convergence of practice is to specify a common set of principles to guide the interpretation of the exclusion in Article 55(1) of the BRRD and to set out a common list of the components of the contractual term required under that paragraph.

Definition of the technical options

It is important to make clear that for the first part of the EBA's mandate under Article 55(3) of the BRRD it is possible only for the EBA to 'further determine' the list of exclusions set out in Article 55(1) of the BRRD. It is not possible for the EBA to specify further grounds of exclusion from the requirement to include the contractual term. This is because the creation of new exclusions would involve changing an essential element of the BRRD and would involve making policy choices which the EBA is not empowered to do as such matters are reserved to the co-legislators under Article 290(1) of the Treaty on the Functioning of European Union. Therefore, the EBA had only one 'technical option' for this part of the mandate i.e. to 'further determine' the existing list of excluded liabilities.

The EBA has identified only three points on which further determinations can be usefully made. These are with regard to:

- point (a) of the first subparagraph of Article 55(1) of the BRRD, the treatment of secured liabilities referred to in Article 44(2)(b) of the BRRD;
- point (d) of the first subparagraph of Article 55(1) of the BRRD, the interpretation of the reference to liabilities issued or entered into after the relevant transposition date;
- the second subparagraph of Article 55(1) of the BRRD, the key elements of the third country law or binding international agreement which Member State resolution

authorities should assess are present before determining that the liabilities or instruments referred to in the first subparagraph of Article 55(1) of the BRRD can be subject to write-down and conversion by a Member State resolution authority pursuant to the law of a third country or to the binding agreement with that third country.

Technical options

Following the EBA's mandate, three options have been considered regarding the contents of the contractual term:

Option A: the specification of the mandatory contents *with no flexibility* for institutions and relevant entities to supplement these components.

Option B: the specification of mandatory contents *with flexibility* for institutions and relevant entities to supplement the clause with additional components from a *closed list* set out in the RTS.

Option C: the specification of mandatory contents *with flexibility* for institutions and relevant entities to supplement the clause with additional components (i.e. no closed list).

Assessment of the technical options

Under Option A, the contents of the contractual term could be developed with no flexibility for institutions and relevant entities to supplement these components.

This option would secure a very high degree of consistency as regards the approach of the Member States, institutions and entities to the contents of the contractual term. However, this option would not enable institutions and relevant entities to supplement these contents as necessary to take account of any specificities arising in relation to a particular type of liability or a specific third country law.

Option B would offer a wider degree of flexibility in that, in addition to the mandatory components, it would enable institutions and relevant entities to supplement the mandatory components with optional components drawn from a closed list presented in the RTS.

This option would also promote a high degree of convergence but would also enable some specificities arising in relation to a particular type of liability or a specific third country law to be taken into account. However, it does not appear possible to anticipate in advance all potential issues that may be identified in the future with regard to a particular type of liability or specific third country law and therefore would be too rigid.

Option C aims to find a balance between the need for harmonisation and flexibility. Under this option the mandatory contents are set out in the RTS but there are no limits on the ability of institutions and relevant entities to supplement the contents if necessary to take account of issues arising in relation to a particular type of liability or specific third country law (but of course Member States must ensure that resolution authorities may require institutions and entities to

provide authorities with a legal opinion relating to the legal enforceability and effectiveness of such a term (third subparagraph of Article 55(1) of the BRRD)).

Preferred option

Given the potential costs and benefits of the technical options, Option C is the preferred option to address the identified problems.

Q4: Do you agree with the draft Impact Assessment? Can you provide any numerical data to further inform the Impact Assessment?

5.2 Overview of questions for Consultation

Respondents are invited to comment in particular the following questions.

Questions:

- 1. Do you agree with the approach the EBA has proposed for the purposes of further determining points (a) and (d) of the first subparagraph of Article 55(1) of the BRRD (which form part of the list of liabilities to which the exclusion in Article 55(1) of the BRRD applies)? In particular, it is to be noted that Article 3(2) of the draft RTS refers to liabilities that 'may' become unsecured. Respondents are invited to comment on this approach and, should they disagree with this proposal, suggest possible alternative approaches.**
- 2. Do you agree with the approach the EBA has proposed for the purposes of further determining the second subparagraph of Article 55(1) of the BRRD (which forms part of the list of liabilities to which the exclusion in Article 55(1) of the BRRD applies)?**
- 3. Do you agree with the approach the EBA has proposed with regard to the components of the contractual term required pursuant to Article 55(1) of the BRRD?**
- 4. Do you agree with the draft Impact Assessment? Can you provide any numerical data to further inform the Impact Assessment?**