June 1, 2016

Jonathan Hill, Lord Hill of Oareford
Commissioner for Financial Stability, Financial Services and Capital Markets Union
European Commission
Rue de la Loi / Wetstraat 200
1049 Brussels
Belgium

Re: Contractual recognition of bail-in under Article 55 of the Bank Recovery and Resolution directive (BRRD)

Dear Lord Hill:

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 express its concerns regarding the effect of Article 55 of the EU Bank Recovery and Resolution Directive (2014/59/EU) ("BRRD") on global trade. We would like to highlight the 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, and would urge the Commission to address the concerns as outlined.

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 non-EEA law.

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

BAFT members share a commitment to establishing rules that allow financial institutions to resolve themselves in a crisis quickly and efficiently, limiting impacts on the wider economy and the public citizenry, as is the intended policy objective of the BRRD. Nevertheless, there are a number of concerns and negative consequences that have arisen with the application of Article 55 to trade finance.
• The bail-in of trade finance liabilities, for example, letters of credit or bank guarantees ("contingent liabilities"), will not help in terms of bank resolvability. Therefore, requiring the incorporation of contractual recognition of bail-in into such contracts has no benefits in terms of loss absorbency. Liquidating contingent liabilities would not help recapitalize a bank to improve its financial position for a number of reasons:
  
  o First, from an accounting perspective, contingent liabilities are not included on the balance sheet. Instead, they represent off-balance sheet obligations of the company.
  o Second, contingent liabilities do not become actual liabilities until the bank receives a valid claim meeting the conditions required, and therefore their bail-in won’t improve the financial situation of the bank in resolution.
  o Finally, such liabilities are not included in Minimum Requirement for Own Funds and Eligible Liabilities (MREL), nor under Total Loss-Absorbing Capacity (TLAC), 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.” It is not operationally practical for banks to add contractual bail-in terms to some types of trade finance liabilities because there are globally accepted standard documentary rules set by international bodies such as the ICC (ex. Uniform Customs and Practice 600, Uniform Rules for Demand Guarantees 758, International Standby Practices 98, and others) and long-established, industry-wide electronic message formats, for example, the Society for Worldwide Interbank Financial Telecommunication ("SWIFT") Message Types. Individual banks or even across the EU, are not able to amend these standards unilaterally without an intense multi-year approval process that - even then - may not be approved and adopted. In the case of SWIFT 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, banks very often are not in a position to change pre-defined terms, and requiring the addition of bail-in clauses may be both operationally impractical and also not feasible from a governmental policy perspective.

• 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 particular liability or transaction is governed by a non-EEA country or not at the time of 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 time convincing the counterparties of non-EU law governed contract 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. This would place 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.

1 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
Finally, the concerns raised above have contributed to mixed adoption, application, and interpretation of the bail-in requirement by many member states. This has resulted in considerable uncertainty and confusion for firms subject to the BRRD requirement and an uneven regulatory framework implementation across European member states for which specific clarification and remediation will be highly effective.

3. **Addressing and Fixing the Concerns Presented**

We believe the best solution to the challenges outlined above would be for the scope of article 55 to be modified in the BRRD. We would urge the Commission to 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”). Specifically, we would ask for a revision that focuses on instruments eligible for **Minimum Requirement for Own Funds and Eligible Liabilities (MREL)**, ensuring that contingent liabilities would not be captured by Article 55. This offers a more optimal approach to reaching the important policy objectives of quick and efficient resolution and would promote a consistent approach across Member States.

4. **Conclusion**

In summary, we believe the concerns outlined have ripple effects beyond banking institutions. 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 companies in the EU that rely on EU banks for trade finance 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. The European Commission has a unique and important opportunity to 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 highlight these concerns 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,

Tod R. Burwell
President and Chief Executive Officer

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