Mr Valdis Dombrovskis,
Vice-President for the Euro and Social Dialogue
European Commission

Mr Toomas Tõniste,
Minister of Finance, Estonia
President of the ECOFIN Council

Mr Gunnar Hökmark,
Member of the European Parliament

Mr Roberto Gualtieri,
Chair of the ECON Committee
European Parliament

04 October 2017

Need for reconsideration of the proposed introduction of new moratoria tools

Dear Sirs,

The purpose of this letter is to highlight the continued concerns shared by the undersigned associations[1] with the proposed introduction of two new moratoria powers under the BRRD.[2] While we continue to strongly support the objectives of putting in place the legislative framework and effective resolution plans, we believe that the introduction of these new moratoria powers could have serious negative consequences which could impact financial stability and undermine the good progress to date.

The proposed tools enable the authorities to stay the payment and delivery obligations of an institution across a wide range of banking activities, both in anticipation of, and after, entry into resolution. Both moratoria powers would enable a stay to be imposed for five working days each and if used together in conjunction with the existing stay power, potentially for 12 working days or longer. This is significantly longer than the internationally-agreed standard of up to 48 hours (in total).[3] The implementation of the proposed tools would undermine the careful balance struck in the FSB *Key Attributes of Effective Resolution Regimes for Financial Institutions* to both promote orderly resolution and ensure financial stability.

[1] The Association for Financial Markets in Europe (AFME) represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society. AFME is listed on the EU Transparency Register, registration number 65110063986-76.

The EBF serves as the voice of the European banking sector, uniting 32 national banking associations in Europe that collectively represent some 3.500 banks – large and small, wholesale and retail, local and international – employing some two million people. Banks represented through the EBF together make available in excess of €20 trillion in loans to businesses and households across Europe, and provide the infrastructure to securely handle some 400 million payment transactions per day. Launched in 1960, the EBF is committed to creating a single market for financial services in the European Union and to supporting EU policies that foster economic growth. The EBF is listed on the EU Transparency Register, registration number: 4722660838-23.

[2] Proposed amendments to Directive 2014/59/EU (BRRD) to introduce articles 29a, 63(1b), and 63(1)(n)

[3] As established in the FSB Key Attributes of Effective Resolution Regimes - http://www.fsb.org/wp-content/uploads/r_141015.pdf

The proposed amendments to moratorium powers in the BRRD are a significant extension in scope and effect compared to the existing BRRD moratorium powers and national moratorium regimes. It is not correct, as some proponents of the amendments have said, to compare the BRRD amendments to that of existing national moratorium powers in countries like Germany. The nature and application of moratorium powers at national level in countries like Germany are more limited in their operation than what is being proposed in the BRRD, specifically the existing national moratorium powers don't create additional payment moratoriums for derivatives transactions.

Unintended impacts of the proposed tools

We are concerned that a number of adverse consequences could result from the introduction of the proposed moratoria and the magnitude of the impact deserves further attention. In particular:

- **Contagion and systemic risk**: the imposition of a stay on payment and delivery obligations will impact on counterparties of the institution which may be reliant on payment and/or delivery for their own liquidity and risk management. The application or existence of a stay power is also likely to make markets more sensitive to stress as counterparties could be impacted at an earlier stage, potentially destabilising other banks.
- **Competitiveness of European banks**: in addition to the significant impact on capital and margin highlighted below, the existence of the proposed moratoria is likely to adversely affect the competitiveness of European banks in the global market-place. Counterparties are less likely to deal with an institution where they may be left without the ability to manage market risk or the risk of default through accessing deposits, managing collateral or exercising close-out and/or termination rights for an extended period.
- **Significant increases to risk exposure, capital and margin**: extended stay powers exceeding two days, without adequate safeguards for financial contracts and that prevent non-defaulting counterparties from closing-out financial contracts entered into under a master netting agreement, will expose the counterparties to incalculable risks from the transactions. The proposed new moratoria could also result in a significant capital and margin increase for both institutions under resolution and their counterparties to cover potential exposures during the longer stay period. Further to this, the new tools may adversely impact the recognition of netting arrangements for counterparties. For example, the application of the proposals may result in certain master netting agreements not being treated as "qualified master netting agreements (QMNAs)" from a U.S. perspective, which would have an adverse capital impact for U.S. institutions. As a result, such institutions may reduce participation in European capital markets and instead focus on other capital markets.
- **Incentives and viability of recovery**: the potential extended stay, in particular prior to resolution is likely to incentivise counterparties to run and/or cease further

business with the bank at an earlier stage, potentially threatening recovery of a stressed institution and pushing it towards failure.

- **Reaction of depositors:** Any uninsured or insured depositors within the scope of the powers would be incentivised to withdraw their deposits at the first sign of stress for fear of the prospect of a lengthy stay on their access. Liquidity is therefore likely to dry up at an earlier stage as counterparties will be concerned about the prospects of a stay. Any expansion of the scope of the proposed moratoria to include covered deposits would further exacerbate this issue. As soon as a moratorium has been imposed, all depositors will be incentivised to ensure that all their incoming payments are diverted to other bank accounts that they may already have or would be incentivised to open immediately. Following the lifting of the moratorium, the rational course of action for all depositors will be to remove their deposits with immediate effect.
- **Undermining resolution objectives:** one of the core objectives of resolution is to ensure that the institution is able to continue its critical economic functions. These critical functions will include making and receiving payments and therefore an extended stay of obligations is likely to run directly contrary to achieving this objective, potentially threatening the viability of the resolution, and subsequent restructuring plan, and destroying value for investors.
- **Triggering opt-out provisions in certain ISDA resolution stay protocols/undermining the acceptance for contractual recognition of stays:** As the proposed moratoria would deviate from the international consensus regarding stays in respects of netting agreements and financial contracts (which assumes that such stays do not exceed 48 hours in view of the potential risk exposure to counterparties) the proposed moratoria may amount to an adverse change to applicable legislation that would trigger opt out rights under the 2014 Resolution Stay Protocol and the 2015 Universal Resolution Stay Protocol, threatening a global and regulatory effort to ensure effective recognition of resolution actions on a cross-border basis. Significant progress has been made in putting in place cross-border recognition of resolution stays, which has materially enhanced the resolvability of GSIBs. This will also reduce the already limited acceptance for contractual recognition clauses in respect of stays included in other master agreements.
- **Disruption of payment, clearing and settlement systems in the EU and globally:** the proposed moratoria do not exclude operational deposits which are necessary for day-to-day custody, clearing, and cash management activity for a wide range of government, corporate, investment funds, and other financial institutions in the EU and globally, with very significant implications for end investors and potential contagion effects. For example, a UCITS or other similar investment fund which sells securities held in its investment portfolio in order to meet a client redemption request may be unable to meet this obligation throughout the suspension period imposed by resolution authorities on an EU custodian bank. These effects would reduce the ability of the EU financial system to withstand stress and disruption,

undermine the attractiveness and depth of the EU capital markets and place unwarranted pressure on custodian and other banks providing payment, clearing, and cash management services.

- **Undermines legal certainty of financial collateral arrangements**: the proposal challenges the effectiveness of crucial financial netting and collateral arrangements, by removing the protection provided to them by the Financial Collateral Directive against the effects of national moratoria. Whereas the Financial Collateral Directive protects such contracts from the adverse effects of moratorium powers under national insolvency laws, no such protection would be available were moratorium powers introduced under BRRD, which supersedes the Financial Collateral Directive.
- **Cross-border cooperation:** the proposed moratoria would take the EU out of line with the international standards on resolution and could create additional concerns for cross-border cooperation. The FSB *Key Attributes of Effective Resolution Regimes for Financial Institutions* clearly states that such a tool should not only be time limited (to 48 hours) but also be available only during resolution. These proposals represent a clear departure from what has already been agreed upon internationally, especially with the suggestion of an additional tool prior to resolution.

Objectives of the proposals

We also do not believe that the proposed moratoria would achieve their stated objectives of harmonising implementation of existing national moratoria, addressing liquidity concerns or providing more time to conduct a valuation.

- The proposed moratorium powers for the BRRD will represent an add-on (rather than replacement) to existing national moratoria and go beyond the current scope of liabilities and instruments from that currently captured by these national moratoria, with particular impact on derivatives transactions. Harmonisation of moratorium regimes would be better achieved by ensuring consistent implementation of the existing BRRD stay powers.
- We do not believe that the moratoria would address liquidity concerns either prior to or in resolution. Ensuring that banks have sufficient liquid assets to meet their obligations is addressed through other measures such as the LCR and NSFR and ongoing supervision. Following a determination that a bank is "failing or likely to fail", a liquidity funding plan forms an important part of the resolution plan for a bank, supported where necessary by central bank or other public-sector backstop liquidity support, consistent with the FSB Guiding Principles on Funding in Resolution.[4]
- The existence of the moratoria would make it more challenging for institutions to rely on private sources of funding because counterparties are more likely to withdraw liquidity at an earlier stage and less likely to provide liquidity to a bank in a stressed situation for fear of the application of an extended moratorium.

[4] http://www.fsb.org/wp-content/uploads/Guiding-principles-on-the-temporary-funding-needed-to-support-the-orderly-resolution-of-a-global-systemically-important-bank-%E2%80%9CG-SIB%E2%80%9D.pdf

- Rather than introduce the proposed moratoria, the co-legislators and resolution authorities should focus on putting in place the necessary planning and public liquidity backstop provision for funding in resolution, in line with the FSB guiding principles.
- Application of the moratoria would not provide more time to conduct a valuation prior to resolution as they would lead to a rapid deterioration in the value of the bank introducing further volatility in the value of an institution during this period.

We are concerned that the above impacts highlighted by our associations[5] have not been adequately assessed, in particular with respect to large cross-border banks. Even if the new powers were foreseen to be applied as last resort tools, or only after an institution is declared ‘failing or likely to fail’, their mere existence on paper could trigger a number of the unintended consequences highlighted above. We therefore call on the co-legislators to fully assess the impact before proceeding with this aspect of the proposals, and recommend that the moratoria are not included in the current revisions to the BRRD. If necessary a review clause could be inserted with this issue being considered further as part of the BRRD review in 2018.

We strongly believe that in the event that, following a full assessment of these risks, the co-legislators consider that changes are required to the existing framework, it is important that any changes are discussed at a global level through the Financial Stability Board to ensure a consistent approach and avoid putting European institutions at a competitive disadvantage.

We stand available to discuss these issues further and support the evaluation of their impact.

Yours sincerely,

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Association for Financial Markets in Europe

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Cc:
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[5] AFME - https://www.afme.eu/globalassets/downloads/briefing-notes/afme-rrn-moratorium-tools-in-the-rrm-package.pdf (June 2017)

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