August 2017

ISDA

ISDA Position Paper
Challenges with Expanding BRRD Moratoria Powers

The European Commission (EC) published amendments to its Bank Recovery and Resolution Directive (BRRD 2) at the end of last year that are intended to harmonise the use of moratoria powers by resolution authorities in the European Union (EU).

But these amendments – which propose to introduce two new moratoria powers – will put European financial institutions at a severe competitive disadvantage globally, pose significant challenges to financial stability, and introduce new levels of uncertainty into the recovery and resolution process.

By introducing new moratoria that could significantly extend the period in which obligations are not performed and institutions are prevented from terminating, closing out and netting for non-performance, the proposed rules would have several key consequences:

- Put institutions subject to the BRRD at a competitive disadvantage, as end users would be less likely to transact with an entity if they can't terminate for failure to satisfy payment and delivery obligations for a lengthy and potentially indeterminate period.

- Undermine the careful balance between promoting recovery and resolution and ensuring financial stability, and put the bank resolution regime in Europe at odds with the Financial Stability Board's (FSB) carefully negotiated recommendation for a two business-day limitation on stays.

- Challenge 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.

- Result in significant capital and margin increases for institutions subject to the BRRD to cover potential exposures during the longer stay period.

- Trigger opt-out provisions in certain of the ISDA resolution stay protocols – threatening a global industry and regulatory effort to ensure the effective recognition of resolution actions on a cross-border basis.

- Potentially result in disruptive and costly calibrations to the ISDA Standard Initial Margin Model (ISDA SIMM), an industry wide methodology for calculating initial margin for non-cleared derivatives.

- Run contrary to the principal objective of the BRRD, as a lengthy freeze on making and receiving payments increases the risk of a bank and its counterparties failing.

BACKGROUND

This paper considers the implications of certain aspects of the proposal to amend the EU BRRD[1], published by the EC on November 23, 2016 (referred to as BRRD 2), for the international derivatives markets. In particular, it focuses on the BRRD 2 proposals relating to the new powers to suspend payment and delivery obligations (the moratoria proposal). It also considers amendments to the moratoria proposal suggested, in each case, by:

- The Maltese presidency of the Council of the European Union for a meeting of the Council Working Party on Financial Services on May 22, 2017 (the Maltese presidency amendments); and

- The Estonian presidency of the Council of the European Union for a meeting of the Council Working Party on Financial Services (Risk Reduction Measures) on July 13, 2017 (the Estonian presidency non-paper and, together with the Maltese presidency amendments, the presidency proposals).

This note contains an overview of the proposals, followed by a comprehensive analysis of the concerns raised by the proposed amendments.

OVERVIEW

Aim of BRRD 2 in Relation to Moratoria: The EC published BRRD 2 with the stated aim of, among other things, harmonising the application by resolution authorities of moratoria tools in the course of resolution[2].

Moratoria Proposal: The EC's suggested solution to the harmonisation issue has been to propose two new moratoria powers: one for use pre-resolution and the other for use in resolution. The Estonian presidency non-paper considered the options of: (i) abandoning the pre-resolution moratorium altogether; or (ii) keeping it but: (a) linking its duration to that of the in-resolution moratorium especially where they would apply together so that they exceed seven working days; (b) limiting its use to exceptional cases; or (c) leaving it at the discretion of EU member states to apply at a national level where necessary.

Duration: Each power has the effect of suspending payment and delivery obligations for up to five working days (ie, 10 working days if used consecutively), with the in-resolution power reduced to a three working-day period in the proposed Maltese presidency amendments (ie, eight working days if used consecutively), or extended to up to 20 working days in the Estonian presidency non-paper (ie, 25 working days if used consecutively)[3]. Under one possible interpretation, the in-resolution power could be utilised on multiple consecutive occasions, making the maximum period of suspension uncertain. Each of these periods is in addition to existing BRRD stays, including the two business-day stays on termination rights and on payment and delivery obligations, meaning that the aggregated periods of suspension could last 10, 12, 27 or more working days, respectively.

[1] Directive 2014/59/EU of the European Parliament and of the Council of May 15, 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

[2] This appears to disregard the fact that netting and collateral arrangements are not subject to national level moratoria by virtue of the protection afforded to them by the Financial Collateral Directive (directive 2002/47/EC of the European Parliament and of the Council of June 6, 2002 on financial collateral arrangements)

[3] While it is acknowledged in the Estonian presidency non-paper that many delegations can accept a duration of five working days for an in-resolution moratorium, it suggests a discretionary power to extend that period in exceptional circumstances, subject to a maximum period of 20 working days

Concerns: The moratoria proposal raises a number of serious concerns for ISDA and its members. In particular:

Potential Source of Systemic and Liquidity Risks:
Use of either moratorium power would automatically trigger a corresponding stay of termination rights under the existing provisions of Article 68 of the BRRD.

The combined effect of the moratoria proposal and Article 68 would be such that the parties:

- Would not be able to enforce the payment and delivery obligations (including the obligation to post collateral); and

- Would have no rights to terminate, close out and net any agreements.

Even if the stay of termination rights under Article 68 were not to apply, the effect of the moratoria proposal alone would be such that counterparties would effectively be prohibited from terminating, closing out and netting for non-performance of payment and delivery obligations (because during the moratoria, there would be no obligation to satisfy the payment and delivery obligations). This would have the effect of leaving the institution that is subject to the BRRD (a BRRD institution) and all of its counterparties at risk of potentially unlimited exposures for a prolonged period of time – during which, among other things, hedges would likely become dislocated from the exposure that they are intended to mitigate.

The implementation of the moratoria proposal could also dampen market liquidity, severely challenge corporate activities and undermine investor confidence across the wider market. For example, a company that issues bonds in a foreign currency may hedge itself by entering into a cross-currency swap with a bank in the EU. Under the terms of the swap, the bank will pay the company the amount of currency it in turn is required to pay bondholders on the maturity date of the bonds. If the bank is made the subject of an extended moratorium period, then the company itself may be forced into insolvency and will be unable to pay the bondholders. This then forces losses onto bondholders, the ranks of which may include retail investors, either directly or via their membership of pension funds or holdings in Undertakings for Collective Investment in Transferable Securities (UCITS).

If replicated across the BRRD institution's range of counterparties, as well as in respect of the BRRD institution itself, this outcome would clearly be detrimental to the financial stability of the markets and the BRRD institution, and would be contrary to the FSB's Key Attributes for Effective Resolution Regimes for Financial Institutions[4].

BRRD Institutions at a Competitive Disadvantage:
More generally, the moratoria proposal represents a substantial departure from the standards and framework agreed by the FSB, global regulators and market participants. The two business-day de facto limitation on stays under the globally agreed FSB framework represents a carefully negotiated balance between the recognition that resolution authorities need time to perform their duties, and the need to avoid creating disruption, liquidity crises and contagion in the wider market.

[4] Available at: http://www.fsb.org/wp-content/uploads/r_141015.pdf

If implemented, the EU would become out of synch with other jurisdictions, therefore increasing operational costs and undermining the competitiveness of BRRD institutions generally vis-à-vis their non-EU counterparts. Market participants, and end users in particular, which were very vocal in the development of stays under the FSB framework and adamant about two business-day limitations on such stays, would be very unlikely to transact with an entity against which they could not terminate for failure to satisfy payment and delivery obligations for a 10 business-day, 12 business-day or longer time period.

Additionally, regardless of their willingness to transact with such entities, laws applicable to certain end users, including UCITS, US mutual funds and investment companies, and similarly regulated funds in other jurisdictions, could prevent such end users from transacting with an entity subject to the moratoria proposal[5].

Potential Significant and Adverse Increase in Capital and Margin Requirements from Loss of Netting:
Extending the length of time during which non-defaulting counterparties' termination rights (triggered by a BRRD institution's failure to satisfy payment and delivery obligations) would not arise could negatively impact the recognition of netting arrangements as risk reducing for counterparties in jurisdictions where the ability to net is contingent upon parties being able to terminate and close out upon a default within prescribed time frames. This would almost likely affect counterparties in the US, and may impact counterparties in the EU and other jurisdictions. Any loss of netting would require calculation of exposures on a gross basis, and therefore increase capital requirements significantly.

Furthermore, netting requirements for regulatory capital purposes in the US are the same as those for non-cleared margin. Accordingly, US counterparties of entities subject to the moratoria proposal may be prevented from posting and collecting collateral on a net basis. This may lead to a significant increase in the amount of collateral required to be transferred.

Other Potential Significant and Adverse Increases in Capital Requirements:
Aside from loss of netting, entities would likely have to account for a potential exposure to market movements for 10, 12 or a potentially undefined number of days without the ability to terminate and close out when computing risk-based capital requirements, which could significantly increase the amount of capital that entities are required to hold.

Potential Significant and Adverse Increase in Margining Requirements:
Extending the length of the existing stay periods under BRRD could significantly increase counterparties' margin period of risk (MPOR).

The MPOR for a portfolio of transactions is based on the time expected to elapse between the last exchange of collateral with a defaulting entity and the time at which the non-defaulting entity can close out or liquidate the portfolio. MPOR is then used to calculate initial margin requirements for the portfolio of transactions to ensure initial margin held by the non-defaulting counterparty would cover market movements during the MPOR.

[5] We support the more detailed discussion of these points on pages 5-7 of the letter dated June 29, 2017 from SIFMA Asset Management Group and ICI Global to Dr Mario Nava, Ms Kadri Marlin and Gunnar Hökmark

Currently, MPOR calculations are predicated on a maximum two business-day stay before non-defaulting counterparties may exercise termination rights for non-performance of payment and delivery obligations under financial contracts such as derivatives. The moratoria proposal potentially extends this to 10, 12, 27 or a potentially undefined number of business days, which could significantly increase the amount of initial margin that parties would be required to post. This could have a corresponding negative effect on the liquidity of instruments used as collateral to satisfy initial margin requirements.

Disruption and Cost Impact on ISDA SIMM™:
The ISDA SIMM is designed to cover a 10-day period, which is the baseline MPOR for a netting set derived from non-cleared margin rules. If the moratoria proposal is implemented, then the extended stay period would exceed MPOR currently specified under regulations in certain jurisdictions, which could lead regulators to determine that the ISDA SIMM is no longer sufficient as a result, and require it to be recalibrated to a longer period to reflect the moratoria proposal. This would be hugely disruptive and costly to implement for derivatives market participants across the globe.

If non-cleared margin rules in the EU are changed to reflect the moratoria proposal, absent changes to equivalent rules in other jurisdictions, the EU rules would deviate from those in jurisdictions outside the EU, which would result in European entities potentially unable to use the ISDA SIMM without compensating adjustments being made. This would be hugely expensive for European entities and their counterparties, and would add an additional layer of complexity, putting European entities at a competitive disadvantage compared to their non-EU competitors.

'Opt Out' Provisions Under the Resolution Stay Protocols Triggered:
Introduction of the moratoria proposal could be interpreted as a material adverse change to relevant provisions of applicable legislation, and therefore trigger the option for adhering parties to opt out of the ISDA 2014 Resolution Stay Protocol and the ISDA 2015 Universal Resolution Stay Protocol vis-à-vis other adhering parties that could be subject to such legislation. Any such opt-out would undermine the extensive work that has been done by international regulatory authorities to ensure effective recognition of resolution actions on a cross-border basis.

Undermines Legal Certainty of Financial Collateral Arrangements:
Legal certainty as to the effectiveness of financial collateral arrangements is critical to stability and efficiency of the financial markets. The Financial Collateral Directive protects that legal certainty and safeguards financial collateral arrangements from certain provisions of national insolvency laws, but not in the context of a bank resolution. Harmonisation of pre-existing European moratoria provisions that arise from local insolvency laws and are inappropriate for financial institutions under the BRRD will undermine the safeguards and protections afforded by the Financial Collateral Directive.

Runs Contrary to the Principal Objective of BRRD:
Making and receiving payments is fundamental to the business of any BRRD institution, particularly credit institutions. Any freeze on such activity will exponentially increase the risk that the bank in question will fail. It therefore runs counter to the principal objective of the BRRD.

Failure of Proposals to Achieve Aim:
ISDA does not consider that the EC's proposal achieves its stated aim of further harmonising European moratoria provisions, and that aim is defeated by the Estonian presidency non-paper's suggestion that discretion be provided to extend the in-resolution moratorium of up to 20 working days. ISDA considers that the EC's aim to ensure that the BRRD has been consistently transposed by all EU member states would be better achieved via other means.

CURRENT POSITION

The BRRD currently provides for the following stay powers:

General Resolution Stay: Article 68(3)

Article 68(3) (the general resolution stay) overrides any termination, suspension, modification, netting or set-off rights and cross-default provisions that would otherwise arise under contracts entered into by the institution under resolution (and certain other group entities of such institution) on the occurrence of certain trigger events provided that substantive obligations under the contracts, including payment and delivery obligations and the provision of collateral, continue to be performed. These trigger events comprise 'crisis prevention measures' (broadly, the exercise of the pre-resolution powers by the resolution authorities) and 'crisis management measures' (broadly, the exercise of any resolution powers with respect to the entity under resolution) as defined in the BRRD.

The general resolution stay applies automatically on the occurrence of a trigger event; it is not subject to any discretion of the resolution authorities. As a result of the general resolution stay, counterparties of BRRD institutions may not exercise the termination and other rights described above on account of the exercise of crisis management measures or crisis prevention measures, but (subject to other provisions of the BRRD described below) could exercise such rights on account of other defaults (including payment and delivery defaults) provided that they do not arise from the occurrence of events directly related to the trigger event.

Temporary Stay Powers: Articles 69 – 71

In addition to the general resolution stay, the resolution authorities have a number of powers to temporarily stay certain contractual rights or obligations (special stay powers) as follows:

- Two-way stay on payment and delivery obligations[6] – the ability to suspend each party's payment and/or delivery obligations[7] under any contract to which the institution under resolution is party (Article 69(1) Stay)[8];
- Stay on enforcement of security interests[9] – the ability to restrict secured creditors of an institution under resolution from enforcing security interest in relation to any assets of that institution under resolution;
- Stay of termination rights[10] – the ability to suspend the termination rights of any party to a contract with an institution under resolution.

[6] Article 69 of the BRRD

[7] See Article 69(3) of the BRRD

[8] Under Article 68(5) of the BRRD, non-performance of payment and delivery obligations during this time period would not constitute non-performance for purposes of the general resolution stay

[9] Article 70 of the BRRD

[10] Article 71 of the BRRD

The special stay powers share the following features:

- Unlike the general resolution stay, the special stay powers do not apply automatically and require the resolution authority to explicitly use this power when taking resolution action;

- If exercised, the terms and period of the suspension or restriction must be published by the resolution authority at the same time as it publishes a copy of the order or instrument by which the resolution action is taken[11];

- The suspension or restriction can be imposed until midnight at the end of the business day following the date on which the order or instrument is published[12]. Therefore, the stay will apply from the moment the resolution authority takes any resolution action, and effectively can last no more than two business days;

- The special stay powers do not apply to certain specific arrangements – namely: (i) for all three special stay powers, the powers will not apply where the counterparty or secured creditor is a payment or settlement system or an operator thereof [13] , a central counterparty[14] or a central bank; and (ii) in relation to the Article 69(1) stay only, the power will not apply to claims under a deposit guarantee scheme[15] or an investor compensation scheme[16].

THE MORATORIA PROPOSAL

If adopted, the moratoria proposal would introduce two new moratoria powers to the BRRD framework – namely, the powers to suspend payment or delivery obligations to which the institution is party:

- For the purpose of: (i) carrying out an assessment on whether the institution infringes or is likely in the near future to infringe requirements under EU financial services laws[17]; or (ii) making a determination on whether the institution is failing or likely to fail (the proposed pre-resolution moratorium)[18]; and

- When the resolution authority decides that: (i) the exercise of the suspension power is necessary for the effective application of one or more resolution tools; or (ii) for the purposes of carrying out the valuation in accordance with Article 36 of the BRRD (the proposed in-resolution moratorium)[19].

[11] See Article 83(4) of the BRRD

[12] See Articles 69(1), 70(1) and 71(1) of the BRRD

[13] That is a system designated under Directive 98/26/EC on settlement finality in payment and securities settlement systems

[14] Defined by reference to the CCP definition in point (1) of Article 2 of Regulation 648/2012, also known as the European Market Infrastructure Regulation (EMIR)

[15] In relation to eligible deposits under Directive 2014/49/EU on deposit guarantee schemes (DGSD II)

[16] In relation to eligible claims under Directive 97/9/EC on investor compensation schemes

[17] Referred to in the first sentence of Article 27(1) of the BRRD

[18] See draft Articles 27(1)(i) and 29a of the BRRD

[19] See draft Articles 63(1)(n), 63(1a) and 63(1b) of the BRRD

The Proposed Pre-Resolution Moratorium

The proposed pre-resolution moratorium would become an 'early intervention measure' and a 'crisis prevention measure' for the purposes of the BRRD. As such, the imposition of the proposed pre-resolution moratorium would trigger the suspension of termination rights and other rights under the general resolution stay[20]. As currently drafted, the moratorium would apply for a maximum period of five 'working days'[21] and, similarly to the Article 69(1) Stay:

- Is explicitly drafted as a 'two-way' suspension (ie, it would apply to payment and delivery obligations of the entity under resolution and its counterparty)[22]; and
- Would not apply: (i) where the counterparty is a payment or settlement system[23] or an operator thereof, a central counterparty (CCP)[24] or a central bank; or (ii) to claims under a deposit guarantee scheme[25] or an investor compensation scheme.

Unlike the special stay powers, the proposed pre-resolution moratorium would be exercisable by the competent authority, with the option[26] for individual EU member states to allow the power to be exercised by the resolution authority in conditions set out in Article 32(2) of the BRRD if the proposed pre-resolution moratorium is necessary to make the determination of whether the institution is failing or likely to fail[27].

The Estonian presidency non-paper comments that many EU delegations have highlighted concerns about the use of the proposed pre-resolution moratorium, the benefit of which is considered disproportionate to the value it would add. On that basis, the Estonian presidency non-paper suggests the options of: (i) abandoning the concept of pre-resolution moratorium; or (ii) keeping it but: (a) linking its duration to that of the in-resolution moratorium, especially where they would apply together so that they exceed seven working days; (b) limiting its use to exceptional cases; or (c) leaving it at the discretion of EU member states to apply at a national level where necessary.

The Proposed In-Resolution Moratorium

The proposed in-resolution moratorium would qualify as a 'resolution power', the application of which is in turn a 'resolution action' and thereby a 'crisis management measure' within the meaning of the BRRD. As such, imposition of the proposed in-resolution moratorium would trigger the suspension of termination rights and other rights under the general resolution stay. It would, however, be a separate general power that would apply in addition to the existing special stay powers or the general resolution stay.

[20] As 'early intervention measures' under Article 27 constitute 'crisis prevention measures' under Article 2(1)(101) and the general resolution stay is triggered by a 'crisis prevention measure' under Article 68(3) of the BRRD

[21] See draft Article 29a(2) of the BRRD

[22] See draft Article 29a(6) of the BRRD

[23] Provided that such system is a system designated under Directive 98/26/EC on settlement finality in payment and securities settlement systems

[24] Defined by reference to the CCP definition in point (1) of Article 2 of Regulation 648/2012, also known as EMIR

[25] However, the Article 69(1) moratorium excludes 'eligible deposits' (as defined in DGSD II), whereas the draft proposed pre-resolution moratorium is disapplied only in relation to 'covered deposits', which are eligible deposits up to the protection limit (which, apart from the temporary high balance limit, is set at €100,000 or its equivalent – in the UK, this corresponds to the Financial Services Compensation Scheme's deposit protection limit of £85,000). Consequently, the scope of the proposed pre-resolution moratorium is wider than the existing Article 69(1) suspension (as the former also covers eligible deposits beyond the covered deposit element thereof)

[26] See draft Article 29a(8) of the BRRD

[27] Under Article 32(1)(a) of the BRRD

Under the moratoria proposal, the power would apply for a maximum period of five 'working days' (the precise power in any case would be defined by the resolution authority)[28], but arguably with flexibility as to the point at which the proposed in-resolution moratorium might be exercised. Under one interpretation, the power could be utilised on multiple consecutive occasions, making the maximum period of suspension uncertain.

The Maltese presidency amendments propose reducing the maximum period of the proposed in-resolution moratorium to three 'working days'[29]. Based on comments received from EU delegations, the Estonian presidency non-paper suggests that five working days seems to be a suitable duration, although an option to have a discretionary power to extend up to a maximum of 20 working days has been proposed for discussion.

In addition, the Maltese presidency amendments clarify that the proposed in-resolution moratorium would be a two-way suspension[30].

POTENTIAL ISSUES

Suspension of Termination Rights When Payment and Delivery Obligations (Including in Relation to Collateral) Are Not Being Performed

In key attribute 4.3, the FSB states that termination rights should only be suspended where the substantive payment and delivery obligations of the contracts continue to be performed. They go on to explain[31] that this is in order to preserve the continued functioning of the market's risk (collateral) and liquidity (cash flow) mechanisms:

"…the resolution authority should have the power to stay temporarily such [termination and other] rights provided that the substantive obligations under the contract, including payment and delivery obligations, and provision of collateral, continue to be performed. Limited in this way, the restrictions on early termination rights set out in paragraph 1.2 do not affect other rights of counterparties under a netting and collateralisation agreement….If a firm in resolution fails to meet any margin, collateral or settlement obligations that arise under a financial contract…its counterparty…would have the immediate right to terminate and close-out the contract."

Under the moratoria proposal, however, whether or not amended by the presidency proposals, exercise of either of the proposed moratoria would trigger a corresponding stay on termination and other rights under the general resolution stay. As a result, the counterparties to a BRRD institution:

- Would not be able to enforce the BRRD institution's payment and delivery obligations (including the obligation to post collateral) vis-à-vis the counterparties; and

- Would have no rights to terminate, close out and net any agreements.

[28] See draft Article 63(1a) of the BRRD

[29] Under the revised draft Article 61(1a) of the BRRD following the Maltese presidency amendments

[30] Under the new draft Article 63(1e) of the BRRD following the Maltese presidency amendments

[31] Appendix I, Annex 5 to the FSB key attributes

This is clearly contrary to the FSB's key attributes.

The effect of such prohibition on enforcement of rights, both by a BRRD institution and all of its counterparties, would be to expose them to the risk of incurring potentially unlimited exposures for a very material period of time. Over such a long period, hedges would likely become dislocated from the risk they are intended to reduce, which may, in fact, materially increase the losses incurred by the BRRD institution or its counterparties.

The effect of this would be felt particularly acutely in sectors of the economy that rely on closely matched hedging arrangements, and could affect utility providers, pension funds, small and medium sized enterprises, or (directly and indirectly) private individuals. The ripples from such market volatility would therefore be felt outside the financial sector.

Collateral would also become dislocated from the exposure it is designed to secure, which may increase the exposure of a BRRD institution and its counterparties over a very material period of time. The likelihood and potential magnitude of such a dislocation and increased exposure would be amplified by the extended length of the proposed moratoria.

Length of the Proposed Moratoria

The wording of the proposed in-resolution moratorium suggests the power can be exercised at any time in order to support the application of a resolution tool[32]. Depending on how this provision is interpreted, it could allow the resolution authority to:

- Invoke the proposed in-resolution moratorium at the point at which the resolution order is made, such that it runs contemporaneously with the Article 69(1) stay period (in which case, the combined moratorium and stay period would be up to five business days[33]);

- Invoke the proposed in-resolution moratorium at the end of the Article 69(1) stay period, which could extend the combined moratorium and stay period from the current maximum two business days under the BRRD up to seven business days[34], or (if combined with the proposed pre-resolution moratorium) up to 12 business days[35]; or

- Potentially invoke the proposed in-resolution moratorium each time deployment of an in-resolution tool is attempted – for example, multiple uses of the asset separation tool. This could extend the combined moratorium and stay period beyond seven[36] business days, or (if combined with the proposed pre-resolution moratorium) beyond 12[37] business days. Given that no limit is imposed on use of the proposed in-resolution moratorium, the maximum duration is uncertain under this interpretation.

[32] That is, the sale of business or the bail-in tool (under Article 38 or 43 of the BRRD, respectively), the use of a bridge institution (the 'bridge institution tool' under Article 40 of the BRRD) or an asset transfer to one or more asset management vehicles (the 'asset separation tool' under Article 42 of the BRRD)

[33] Or three business days if the Maltese presidency amendments are adopted

[34] Or five business days based on the shortened three-day proposed in-resolution moratorium if the Maltese presidency amendments are adopted

[35] Or 10 business days based on the shortened three-day proposed in-resolution moratorium if the Maltese presidency amendments are adopted

[36] Or 10 business days based on the shortened three-day proposed in-resolution moratorium if the Maltese presidency amendments are adopted

[37] Or 15 business days based on the shortened three-day Proposed in-resolution moratorium if the Maltese presidency amendments are adopted

The Estonian presidency non-paper suggests that each time the proposed in-resolution moratorium is exercised, its duration could be set at five working days, but with national discretion to extend it for up to 20 working days.

Given that each invocation of the proposed in-resolution moratorium will trigger the stay on termination and other rights under the general resolution stay, the moratoria proposal (irrespective of the presidency proposals) represents a substantial departure from the global standards agreed as part of the FSB key attributes, under which it is suggested that resolution stays should not exceed two business days[38].

Moreover, even if the proposed in-resolution moratorium did not trigger the general resolution stay, it would have the same effect as if it stayed termination and other rights (including rights to close out and net) upon payment and delivery defaults, because it would effectively prevent payment and delivery defaults from occurring (as such obligations would be suspended). Any such deviation from internationally agreed standards requires a very significant additional degree of justification. ISDA is unable to identify justification of that kind in the current context.

Furthermore, a departure from standards and framework agreed by the FSB and global regulators would bring the EU out of synch with other jurisdictions; this could increase operational costs for BRRD institutions and their counterparties in many aspects. Inevitably, the increase in costs and the added complexity would undermine the competitiveness of EU entities generally vis-à-vis their non-EU counterparts.

Market participants, and end users in particular, which were very vocal in the development of stays under the globally agreed FSB framework and adamant about two business-day limitations on such stays, would be very unlikely to transact with an entity against which they could not terminate for failure to satisfy payment and delivery obligations for a 10, 12 or 27 business-day or longer time period. Regardless of their willingness to transact with such entities, laws applicable to certain end users, including UCITS, US mutual funds and investment companies, and similarly regulated funds in other jurisdictions, could prevent such end users from transacting with an entity subject to the moratoria proposal[39].

Impact on Cashflow for the BRRD Institution and Market Counterparties

The implementation of the moratoria proposal could have a number of other unintended consequences on the economy at large. Market liquidity and its resilience are important for financial stability and real economic activity. There is a risk that a prolonged suspension of payment or delivery obligations would introduce cashflow issues both to BRRD institutions and their counterparties, which in turn could affect financial stability. For example:

- **Corporate bonds:** Corporate bonds are an important source of funding for many companies, and investors of such bonds include institutional investors and retail investors, either directly or via their membership of pension funds or holdings in UCITS. A company that issues bonds in a foreign currency may hedge its interest rate exposure and/or swap the issuance proceeds into another currency that it needs for operational reasons. In this case, the company may enter into a cross-currency swap with a bank in the EU. Under the terms of a swap, the bank will pay the company the amount of currency it requires to pay bondholders on periodic interest payment

[38] See paragraphs 4.2 -4.3 and Appendix I, Annex 5 of the FSB key attributes

[39] We support the more detailed discussion of these points on pages 5-7 of the letter dated June 29, 2017 from SIFMA Asset Management Group and ICI Global to Dr Mario Nava, Ms Kadri Marlin and Gunnar Hökmark

dates or on the maturity date of the bonds. If the bank is made the subject of an extended moratorium period, the payment obligations of the bank would not arise, and the company itself may be forced into insolvency as it may default on its payment obligations owed to its bondholders. This then forces losses onto bondholders, ranks of which may include institutional investors as well as retail investors.

- **Loans:** A counterparty that has hedged its interest rate risk under a loan with the BRRD institution would still be obliged to make payments under its loan even if it did not receive corresponding amounts from the BRRD institution subject to a stay.

Similar examples can be identified across the financial markets' entire product range. Were these scenarios to be played out across a significant proportion of the BRRD institution's counterparty population (which may include sovereigns, municipalities, charitable institutions and businesses critical to the national economies of EU member states), it may have a systemic contagion effect, as well as negatively impact the potential for a successful resolution of the BRRD institution.

There is also the wider market concern that the length of the proposed moratoria (or the ability for resolution authorities to impose multiple moratoria in respect of the same BRRD institution, consecutively or otherwise) may present a level of uncertainty in the general market to an extent that it could dampen investor confidence and further constrict liquidity and investment. Such market concern would only intensify if the Estonian presidency non-paper's suggestion for resolution authorities to have a further discretionary power to extend the in-resolution moratorium period to up to 20 working days in exceptional circumstances is taken into account.

Impact on the Capital and Margin Treatment of Netting Arrangements

An extended moratorium could have a negative impact on the regulatory capital position of market participants that are counterparties to BRRD institutions. For this purpose, it is important to note that these counterparties could be established anywhere in the world. Therefore, the impact of the moratoria proposal on the regulatory capital position should be considered under regulatory capital requirements in various jurisdictions. This part of the paper focuses on the requirements applicable to US banks and the impact for EU counterparties under EU Regulation 575/2013 (the Capital Requirements Regulation or CRR)[40] (since they are viewed as key requirements for ISDA members).

For US counterparties, ISDA is concerned there is a danger that master netting agreements entered into with BRRD institutions would not qualify to be treated as such under the US regulatory capital regulations if the moratoria proposal proceeds. This is because recognition of netting agreements under US regulations is dependent on any netting, set-off or liquidation of collateral being capable of taking place promptly upon default of the institution subject to stays under specified resolution or insolvency proceedings in the US or substantially similar foreign proceedings[41].

[40] In the context of derivatives, netting agreements may be recognised as risk reducing for the purposes of determining counterparty credit risk under section 7 of Chapter 6 (counterparty credit risk) of Title III to the CRR. This is in contrast to netting agreements in respect of repurchase transactions, securities or commodities lending or borrowing transactions, long settlement transactions and margin lending transactions, which may be considered under the same provisions or under Chapter 4 (credit risk mitigation) of Title III to CRR

[41] Based on the definitions of 'qualified master netting agreement' in the regulatory capital regulations applicable to entities regulated by the Board of Governors of the Federal Reserve Bank (FRB) (12 CFR Part 217), the Office of the Comptroller of the Currency (OCC) (12 CFR Part 3) and the Federal Deposit Insurance Corporation (FDIC) (CFR Part 324)

Given the extended suspension of payment and delivery obligations under the moratoria proposal, there is a significant risk that the proposed pre-resolution moratorium and proposed in-resolution moratorium would not be deemed substantially similar to US resolution measures. If this is the case – or for so long as there is a risk that this is the case – any netting agreements entered into by US counterparties with BRRD institutions would cease to be eligible for recognition under US regulatory capital regulations. As a result, US counterparties would have to calculate exposures to BRRD institutions on a gross basis, which would increase capital requirements significantly.

Similarly, a concern may also arise for US counterparties subject to US non-cleared margin rules[42], where the netting requirements are identical to those under the US regulatory capital regulations. The moratoria proposal, if implemented, could prevent certain US counterparties from collecting and posting on a net basis with respect to their non-cleared swaps. This issue could also complicate netting for margin requirements in other jurisdictions, which may lead to a significant increase in the amount of collateral required to be transferred. In a broader context, this could have significant negative impacts for BRRD institutions as counterparties from jurisdictions other the EU, such as the US, would be expected to pass the increased costs onto the BRRD institutions: in effect, the pool of counterparties with which BRRD institutions could do business would likely be substantially reduced if the moratoria proposal is introduced.

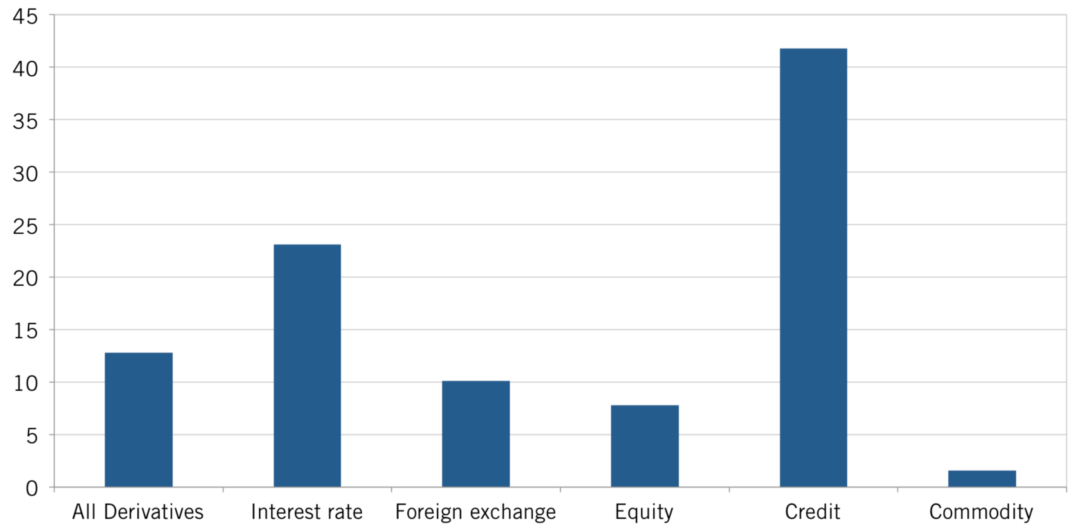
For EU counterparties, contractual netting agreements that would ordinarily be recognised by the competent authorities under Article 296 of CRR for regulatory capital purposes would no longer be recognisable. Recognition under the CRR is contingent, among other things, on the non-defaulting party having a right to receive (or an obligation to pay) a net sum of the positive and negative mark-to-market values of netted transactions where the circumstances relating to the use of the suspension and stay powers would result in the entity in resolution being in default under CRR. While ISDA assumes the EC and European regulatory authorities would not characterise the suspensions and stays so they lead to de-recognition under Article 296, it would be important for the EC or the European Banking Authority (EBA) to provide guidance to that affect or other assurances that the moratoria proposal would not undermine institutions' position under Article 296 or otherwise under the CRR so as to ensure harmonised implementation and consequences across the EU.

By way of illustration, Chart 1[43] shows the potential increase in derivatives mark-to-market value resulting from the loss of the ability to use netting and offsetting mechanisms. Figures are based on six global banks' reported net and gross derivatives assets. Based on the 'all derivatives' multiple of 13x, and assuming a bank with $30 billion in derivatives risk-weighted assets (RWAs) held on a net basis, loss of netting could increase RWAs to $390 billion. Assuming a capital ratio of 8% and a capital cost of 15%, capital would increase to $31.2 billion from $2.4 billion, and the resulting rise in capital costs would be $4.3 billion per annum. In addition, loss of netting would have a significant adverse impact on banks' leverage ratio and net stable funding ratio, which could drive up capital and liquidity requirements even more.

[42] PR Rule § __.2 (https://www.gpo.gov/fdsys/pkg/FR-2015-11-30/pdf/2015-28671.pdf) and CFTC Rule §23.151 (https://www.gpo.gov/fdsys/pkg/FR-2015-11-30/pdf/2015-28671.pdf) - paragraph 1 of the definition of 'eligible master netting agreement'

[43] Source: 2016 annual reports of six global banks

Chart 1: Impact on Derivatives Mark to Market Value from Loss of Netting



Aside from loss of netting, entities would likely have to account for a potential exposure to market movements for 10, 12, 27 or a potentially undefined number of business days without the ability to terminate and close out when computing risk-based capital requirements. This could significantly increase the amount of capital that entities are required to hold. While it may be difficult to quantify the impact on capital, as it may vary from institution to institution (depending on its own internal model), using a mathematical formula, it is estimated that the capital increase from adding 10 working days to existing MPORs could be in the region of between 20% and 40%, depending upon the current prevailing MPOR applicable to a given netting set.

This increase would apply to the capital allocated to a bank's derivatives portfolio. The estimated capital increase is based on a calculation that assumes: (a) MPOR impact on capital and margin calculations is proportional to the square root of the annualised MPOR; and (b) no initial margin adjustment is required as a result of an increased MPOR. Where higher initial margin is required as a result of an increased MPOR, the increase in initial margin may alleviate the capital impact to some extent (but would not offset it completely, in part due to the application of collateral haircuts). However, in reality, it is simply transferring a cost increase from capital to a margin funding cost. Furthermore, the relative impact on derivatives portfolios can be even more pronounced when applied to a derivatives asset portfolio calculated on a net basis taking into account margin and offsetting positions.

Impact on Margin Requirements

As noted above, MPOR for derivatives is based on the time expected to elapse between the last exchange of collateral with a defaulting entity and the time at which the non-defaulting entity can close out or liquidate the portfolio. MPOR varies based on whether a portfolio is cleared or non-cleared and the liquidity of the products in the portfolio. Today, MPOR accounts for the possibility of limited stays (up to two business days under the BRRD) on termination and other rights. If an additional period of five, 10, 20 or more business days is required to be factored in as a result of the moratoria proposal and the presidency proposals, then there is a significant concern MPOR may materially increase.

This in turn would result in firms being burdened with significantly increased initial margin obligations, which could consequently have a detrimental impact on the liquidity of assets commonly used as collateral for initial margin purposes. In addition, moratoria and stays have the effect of locking in capital and liquidity as margin/collateral management are disrupted.

The moratoria proposal could also have a hugely disruptive impact on the ISDA SIMM, which is an industry standard methodology created in response to the initial margin calculation requirements. The ISDA SIMM was launched on September 1, 2016 to facilitate compliance with the rules on margin for non-cleared derivatives, and is being widely adopted by derivatives market participants. The ISDA SIMM is designed to cover a 10-day period, which is the baseline MPOR for a netting set derived from non-cleared margin rules. If the moratoria proposal is implemented, then the extended stay period would exceed MPOR currently specified under regulations in certain jurisdictions. This could lead regulators to determine that the ISDA SIMM is no longer sufficient as a result, and require it to be recalibrated to a longer period to reflect the moratoria proposal. This would be hugely disruptive and costly to implement for derivatives market participants across the globe.

Furthermore, if non-cleared margin rules in the EU are changed to reflect the moratoria proposal, then – absent equivalent changes to regulations in other jurisdictions – the EU rules would deviate from those in jurisdictions outside the EU, which would result in European entities potentially unable to use the ISDA SIMM without compensating adjustments being made. This would be hugely expensive for BRRD institutions and their counterparties, and would add an additional layer of complexity. It would also render BRRD institutions at a competitive disadvantage compared to their non-EU competitors.

Impact on Parties to ISDA's Stay Protocols

ISDA and its member firms have worked closely with the FSB and a number of national resolution authorities to develop the 2014 Resolution Stay Protocol (the RSP) and the 2015 Universal Resolution Stay Protocol (the URSP). The moratoria proposal may amount to an adverse change to applicable legislation that would trigger the parties' right to opt out of the RSP and URSP vis-à-vis counterparties that could be subject to the proposed moratoria[44]. This would impact the efficacy of the arrangements agreed by the FSB, global regulators and market participants in order to ensure effective recognition of stays in a cross-border resolution.

Parties adhering to the RSP and URSP contractually agree to recognise stays and other limitations on the exercise of default rights in applicable special resolution regimes, including the BRRD as implemented in a number of EU jurisdictions, under which other adhering parties could be resolved. This contractual recognition addresses the risk that a resolution authority would not be able to enforce such stays and other limitations against counterparties to foreign-law governed agreements (third-country law agreements in the EU). The recognition therefore ensures that counterparties to foreign-law governed agreements are on equal footing with counterparties to local-law governed agreements and addresses one of the key impediments to an effective cross-border resolution identified after the recent financial crisis.

[44] Under Section 4(b)(i)(B) of the RSP and the URSP

If adhering parties to the RSP and URSP exercise the opt-out rights, it could result in an uneven playing field with regard to the exercise of default rights against an entity in resolution under the BRRD. This opt-out would be 'one way', which means BRRD institutions could lose the resolvability benefits of the RSP or URSP if their counterparties elect to opt out with respect to them, but would remain adherents to the RSP or URSP, as applicable, for the purpose of contractually agreeing to recognise stays and other limitations that could apply to non-affected adherents. Such a result would clearly disadvantage EU banks.

Even more problematic, adhering parties would be able to selectively opt out with regard to some but not all affected counterparties, which could disproportionally affect banks viewed as 'weaker' and/or banks in certain EU jurisdictions. Additionally, once the opt-out rights are triggered, adhering counterparties could exercise them at any time, which means they could wait until a bank shows signs of distress. These outcomes could seriously undermine efforts over the past several years to end 'too big to fail', and could therefore negatively impact financial stability.

The opt-out rights were included in the RSP and the URSP to ensure entities adhering to those protocols do not contractually agree to recognise stays in a cross-border resolution other than stays that satisfy the globally agreed FSB criteria. Accordingly, the only way to avoid triggering the opt-out rights is to ensure that stays satisfy such criteria, which we believe should be a key tenet of the BRRD in any event.

Resolution Objectives and Operation of a Bank

The objectives of any resolution action under the BRRD expressly include ensuring continuity of critical functions; none of the other objectives are in any way contradictory to that objective.

The fundamental purpose of a bank is liquidity transformation. As the EC rightly notes in its impact assessment, a moratorium will "freeze the bank's liquidity". Put bluntly, a bank with no liquidity is an insolvent bank; any extended period for which the bank effectively has no access to liquidity exponentially: (i) increases the risk that the bank in question will be failing or likely to fail; and (ii) decreases the likelihood of a successful resolution – namely, one in which any surviving bank has a strong franchise value.

The risks associated with a freeze of liquidity are even more acute in a pre-resolution scenario. The purpose of any crisis prevention measure (as defined under the BRRD) should rightly be to minimise the need for resolution action to be taken by maximising the possibility of a private-sector-led recovery of the institution in question. Inhibiting the ability of a bank to carry out its essential activities by preventing it from making payments is entirely irreconcilable with this aim.

Accordingly, ISDA is of the view that the potentially negative consequences associated with use of the proposed pre-resolution moratorium in terms of its potential impact on liquidity, dislocation of collateral and hedges and the potential evaporation of market confidence in the institution render it an inappropriate crisis prevention measure in the context of a financial institution.

This concern is exacerbated by the Maltese presidency amendments, which remove the exclusion of covered deposits from the scope of both of the proposed moratoria[45]. The effect of this would be to include all deposits in scope of the proposed moratoria, and would prevent retail and other depositors from having access to their funds during the extended suspension period. This would contradict the approach taken under the existing Article 69(1) stay, which excludes 'eligible deposits'[46] from the scope of the suspension of payment/delivery obligations.

[45] By amending draft Article 29a(3)(c) (for pre-resolution moratorium - now renumbered as Article 30a(3)(c) following the Maltese presidency amendments) and draft Article 63(1b)(c) of the BRRD (for in-resolution moratorium)

[46] Which include 'covered deposits', as discussed under Incorrect transposition of existing moratoria provisions above

ISDA notes that the Estonian presidency non-paper considered that the application of moratorium tools to covered deposits would trigger pay-out under the Deposit Guarantee Schemes Directive (DGSD)[47], and therefore including covered deposits in scope of the moratoria proposal appears to be a feasible option. However, this seems at odds with the EC's impact assessment, which indicated that of 12 member states that have implemented EU law so that covered deposits were in scope of moratoria powers, only five indicated that a moratorium intervention on covered deposits would constitute a pay-out event under DGSD[48].

Although the intention is to harmonise local laws, by including covered deposits within the scope of the moratoria proposals, the potential mismatch in transposing EU law could lead to regulatory arbitrage and a difference in treatment of retail and other depositors with respect to access to the local depositor protection schemes between different member states. Ultimately, this could lead to retail and other depositors being left out of pocket without access to their money deposited in a bank or to compensation under a deposit guarantee scheme.

ISDA considers that extending the scope of both the proposed pre-resolution moratorium and the proposed in-resolution moratorium to include 'covered deposits' and 'eligible deposits' would have a significant negative impact on market stability and severely affect private individuals. In the event the proposed powers are applied to eligible deposits, depositors will not be able to access their deposits nor potentially have recourse to the local deposit guarantee scheme (depending on local transposition of DGSD II and whether a moratorium would constitute a payout event locally).

Apart from personal disruption to the individuals, the application of any suspension powers to covered deposits could result in further contagion across the banking industry and potentially lead to bank runs when depositors panic and withdraw their deposits for fear of being locked out of their current and savings accounts at other banks that are not covered by the moratoria. These risks would not be mitigated by the Estonian presidency non-paper suggesting that depositors be given limited access to their funds.

Purpose and Approach to Convergence

As set out in the impact assessment document[49] published by the EC in relation to the BRRD 2 proposal, the stated driver behind the moratoria proposal is greater convergence among member states with respect to the availability and application of moratoria in resolution. This has two limbs:

- The EC is concerned that member states have transposed the existing BRRD moratoria provisions in very different ways (the BRRD harmonisation purpose); and
- In the case of the proposed pre-resolution moratorium, to further harmonise European moratoria provisions – in particular, in light of various member states' existing pre-resolution moratoria (the general moratoria harmonisation purpose).

[47] Directive 2014/49/EU (as amended), under Article 2(8) thereof

[48] See third and fourth paragraphs and footnote 49 on page 26 of the impact assessment

[49] Available at: http://ec.europa.eu/info/system/files/161123-impact-assessment_en.pdf

Taking these in turn:

BRRD Harmonisation Purpose

- It is difficult to see how the current proposal would ensure that additional powers as part of the moratoria proposal are implemented in a harmonised way if the EC's stated concern over divergence in implementation of the current BRRD moratoria powers is not clearly addressed. The proposal in the Estonian presidency non-paper to provide discretion to increase the proposed in-resolution moratorium period to up to 20 working days in limited circumstances would appear to defeat any semblance of harmonisation.

  In addition, the data referred to in the impact assessment[50] does not provide a clear picture of the moratoria powers that apply in various member states. It would therefore be prudent to undertake a further detailed study in order to evaluate the precise scope of moratoria powers in different member states and whether such powers derive from the BRRD, local insolvency laws or other sources, and whether their purpose and use is compatible with the objectives of the resolution regime under the BRRD.

- As regards divergence in implementation of the general resolution stay and the special stay powers, ISDA supports the EC's aim to ensure consistency across EU member states. Achieving consistency, however, does not necessitate any change to the substantive powers provided for under the BRRD. Focusing on the Article 69(1) stay, greater harmonisation may be achieved by introducing some amendments to Article 69(1) that no suspension of payment and delivery obligations may extend beyond midnight on the business day following the resolution order. In addition, greater consistency could be achieved by mandating the EBA to prepare guidelines on the use of stay and moratoria powers under the BRRD.

Incorrect Transposition of Existing Stay Provisions

- The impact assessment notes that in several member states, moratorium powers extend also to 'covered deposits' (12 member states) and that "payment obligations to 'CCPs or payment settlement systems' are on the other hand excluded from the scope of moratorium powers in most Member States (9)". Article 69(4) of the BRRD clearly states that the Article 69(1) stay shall not apply to 'eligible deposits' (which includes 'covered deposits') and payment and delivery obligations owed to payment and settlement systems and CCPs.

  Therefore, it appears that some member states have misinterpreted/mis-transposed Article 69(1) of the BRRD by applying the Article 69(1) stay to 'covered deposits' (contrary to the exemption in Article 69(4)(a)) or 'payment obligations to CCPs or payment settlement systems' (contrary to the exemption in Article 69(4)(b)). ISDA considers that, if implemented, the moratoria proposal would not address this issue and could potentially lead to further divergence in interpretation of the BRRD stay provisions. Instead, the focus of any harmonisation efforts should be on ensuring uniform application of existing stay powers given the wide discrepancies identified by the EC in the impact assessment.

[50] See section 2.8 of the impact assessment

General Moratoria Harmonisation Purpose

- In order for the general moratoria harmonisation purpose to be adequately justified, ISDA considers that the EC, relying on information from EU member states, must establish that the pre-existing (insolvency) moratoria powers (which, as referred to in the impact assessment, apply at a national level in a number of EU member states) are well adapted for: (a) application to financial institutions; and (b) use in the context of a rescue procedure. Limited detail on such existing moratoria has been provided by the EC.

- ISDA understands that where moratoria powers exist outside the current BRRD, they are ordinarily of general application – ie, they were not specifically designed to apply to banks and other financial institutions. As such, it is questionable whether they adequately take into account the nature of such institutions' business (see Resolution Objectives and Operation of a Bank above).

  In addition, ISDA understands that whenever such powers have been exercised, they have arisen preceding an insolvency of the entity in respect of which such powers have been invoked. Resolution is fundamentally a rescue process – its aim is to ensure continuity of the critical functions of the institution concerned. The consequences of such existing moratoria powers are therefore antithetical to the resolution objectives. Accordingly, without further detail to support the EC's position as regards the general moratoria harmonisation purpose, ISDA is concerned this is misconceived.

Undermines Legal Certainty of Financial Collateral Arrangements

Legal certainty on the effectiveness of financial collateral arrangements promotes cross-border transactions within the EU, and is critical to stability and efficiency of the financial markets. The Financial Collateral Directive protects that legal certainty, and safeguards financial collateral arrangements from certain provisions of national insolvency and reorganisation rules (including, for example, the disapplication of the statutory freeze on enforcement of security that arises in administration proceedings in England), but not in the context of bank recovery and resolution. As highlighted above, the data from the impact assessment is not sufficiently detailed to give a clear indication of the scope and nature of those national moratoria powers intended to be harmonised. In particular, it is uncertain whether those powers derived from local insolvency rules that would afford similar protections to close-out netting and financial collateral arrangements. Therefore, harmonisation of pre-existing European moratoria powers that stem from local insolvency laws, and which may not be suitable for financial institutions for use in the context of a resolution under the BBRD, would undermine the safeguards and protections afforded by the Financial Collateral Directive.

Furthermore, the EU non-cleared margin rules specify that initial margin must be easily enforced in a timely manner to protect the collateral taker on the default or insolvency of the collateral provider. Market participants are reliant on the robustness of financial collateral arrangements that benefit from protection against national insolvency moratorium and which, consequently, can be enforced in a timely and efficient manner in order to meet initial margin requirements under the EU rules. It seems possible that implementing the moratoria proposal for the sake of the general moratoria harmonisation purpose could result in additional conflicts of law issues, and create uncertainty as to how entities subject to EU non-cleared margin rules and their counterparties could continue trading in compliance with initial margin requirements.

CONCLUSION

ISDA is concerned that the Moratoria Proposal introduces a series of highly undesirable consequences while at the same time failing to advance its aim of harmonising European moratoria provisions. ISDA believes the existing BRRD stay periods represent a carefully negotiated balance between the twin goals of resolving failing financial entities and maintaining financial stability for those that remain in good financial health. ISDA therefore urges the EC, member states, resolution authorities and the Estonian presidency not to proceed with the moratoria proposal.

APPENDIX 1
TECHNICAL DRAFTING CONSIDERATIONS

In the event the EC is not minded to revise its policy position with respect to the moratoria proposal, which would be ISDA's preference, ISDA notes the following technical points with respect to the drafting of BRRD 2 insofar as it relates to the moratoria proposal:

1. In light of the EC's statement that any moratoria should not exceed five days, ISDA understands that the ability for an indefinite re-set of the proposed in-resolution moratorium is a drafting oversight and that draft Article 63(1)(1a) should be amended as follows:

   "1a. The period of the suspension pursuant to paragraph 1(n) shall commence at the time the notice of suspension under Article 83(4) is published[51] and shall not exceed…"[52]

2. The wording of Article 36(1) of the BRRD suggests the valuation exercise thereunder is meant to take place before any resolution action is taken. As the proposed in-resolution moratorium (as currently drafted) would itself be a 'resolution action' (and, in any event, is drafted so it can be invoked together with or after the resolution tool is exercised), this results in a potential contradiction in the text of the BRRD that, from a technical perspective, could render the proposed in-resolution moratorium uninvokeable when it is intended to be used in connection or to assist with a valuation exercise under Article 36 of the BRRD.

3. It is unclear whether the proposed in-resolution moratorium is meant to be a two-way suspension. Unlike the proposed pre-resolution moratorium, the wording of the proposed in-resolution moratorium provisions does not explicitly reference the power applying to both counterparties[53]. Although one interpretation of the wording of the draft Article 63(1)(n) would be that the power could have two-way effect (since the power applies to payment or delivery obligations to which institution or entity "is party", which should capture payment or delivery obligations of both parties), ISDA considers that the current drafting lacks legal certainty. While certainty in itself is necessary, the application of the suspension on a one-way basis would give rise to risk for counterparties that would be extremely difficult to manage.

   This could be addressed by effectively replicating Article 69(3) in relation to draft Article 63(1)(n). The new draft Article 63(1e) introduced under the Maltese presidency amendments would sufficiently address this concern.

4. A right to appeal would need to be provided for in national law in relation to the exercise of the proposed pre-resolution moratorium[54] and the proposed in-resolution moratorium[55] in accordance with Article 85(2) of the BRRD, which could prove problematic in practice.

5. We assume references to 'working days' in the draft moratoria proposal should be replaced with references to 'business days' (as the former term is not defined in the BRRD).

[51] For the purposes of our drafting comment, we assume that Article 83(4) of BRRD will capture the in-resolution moratorium proposal

[52] Note that 'resolution tool' is defined by reference to Article 37(3) of BRRD, and comprises the sale of business tool, the bridge institution tool, the asset separation tool and the bail-in tool

[53] The draft Article 63 of the BRRD does not include an equivalent provision to that set out in the draft Article 29a(6) of the BRRD

[54] As the proposed pre-resolution moratorium would qualify as a 'crisis prevention measure' within the meaning of the BRRD

[55] As the proposed in-resolution moratorium would qualify as a 'crisis management measure' as it is a 'resolution power', the application of which in turn is a 'resolution action', which is a 'crisis management measure' within the meaning of the BRRD

6. Article 83(4) of the BRRD does not capture any of the draft Articles that introduce the proposed pre-resolution moratorium – ie, draft Articles 27(1)(i) and 29a. The proposed in-resolution moratorium would be captured as it would be a 'resolution action'. However, Article 83(4) specifically requires publication of the terms and period of suspension or restriction under Articles 69 – 71 (ie, the special stay powers) in the resolution order or instrument, and no amendments to Article 83(4) have been proposed. It is not clear whether the omission of reference to draft Articles 63(1)(n), 63(1a) or 63(1b) is a drafting omission, and consequently whether the intention is for the proposed in-resolution moratorium to start at the same time a resolution tool is exercised.

Accordingly, unlike the existing special stay powers, one interpretation could be that there is no obligation on the resolution authority to publish a notice or instrument of its exercise of the proposed in-resolution moratorium, or indeed the exercise by the competent authority (or resolution authority) of the proposed pre-resolution moratorium, despite their discretionary nature. A lack of clarity over the exercise of these powers would introduce unnecessary and substantial market uncertainty in a resolution (or potential resolution) scenario – a time at which the markets can be expected to be unusually volatile in any event – as no counterparty would know whether its rights to terminate agreements, enforce security or demand payment/delivery would be enforceable against the institution that is subject to the proposed pre-resolution moratorium or the proposed in-resolution moratorium.

We note that a new draft Article 63(1f) proposed under the Maltese presidency amendments purports to rectify this issue by requiring member states to ensure that resolution authorities follow the notification procedures set out in Articles 82 and 83 of the BRRD "without delay" when exercising the powers under the proposed in-resolution moratorium. However, this wording still lacks legal certainty as it: (i) does not specify whether the exercise of the proposed in-resolution moratorium is to be published; (ii) does not clarify when the publication (if any) would need to be made (and "without delay" lacks legal certainty); and (iii) does not address the issue of the publication of the proposed pre-resolution moratorium.

For the reasons given above, Article 83(4) should be amended, or a new Article 83(4a) added, so as to explicitly require resolution authorities to publish some notice regarding their exercise of the proposed in-resolution moratorium and the proposed pre-resolution moratorium.

ABOUT ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 875 member institutions from 68 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org.