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CONTRACTUAL RECOGNITION CLAUSES

AN UPDATE ON BAIL-IN AND STAY CLAUSES IN LIGHT OF BREXIT AND BRRD 2

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ART 55 BRRD

CONTRACTUAL RECOGNITION OF BAIL-IN

Overview

- **Requirement** – EU entities to include a contractual recognition of bail-in clause (a “**Bail-in Clause**”) into contracts:
 - where such EU entity owes a liability to its counterparty; and
 - which are governed by non-EEA law (known as third-country law).
- **Effective Date** – 1 January 2016.
- **Trigger to include a Bail-in Clause:**
 - **New Agreements** – agreement entered into after the Effective Date;
 - **Existing Agreements** – agreement is “materially amended” on or after the Effective Date (i.e. almost any amendment to the agreement except minor typographical changes or changes to notice provisions – includes the creation of a new liability under an Existing Agreement (e.g. entering into a new transaction under an existing ISDA master agreement)).
- **Liabilities in scope:**
 - “Liability” not defined in BRRD.
 - in UK, PRA defines “liability” as:
 - any liability of the in-scope entity to a counterparty arising under or in connection with the agreement, whether it is present or future, certain or contingent, ascertained or sounding only in damages; and
 - that liability is governed by third country law.
 - Certain exemptions available (see next slide).

ART 55 BRRD

CONTRACTUAL RECOGNITION OF BAIL-IN (CONTINUED)

Exemptions under BRRD



- liabilities protected by deposit protection schemes (covered deposits);
- client assets;
- liabilities with an original maturity of less than 7 days owed by the bank to a credit institution or investment firm (excluding intragroup transactions);
- liabilities of less than 7 days remaining arising from participation in designated settlement systems owed to such systems or operators or participants in such systems;
- liabilities owed to employees;
- liabilities owed to pension schemes;
- liabilities to suppliers of services (other than financial services) critical to the daily functioning of the bank's operations.

ART 55 BRRD

CONTRACTUAL RECOGNITION OF BAIL-IN (CONTINUED)

UK PRA Impracticability

UK PRA already has concept of impracticability – see [Supervisory Statement 7/16](#).

PRA impracticability only applies to in-scope UK Entities – EU entities face same issues.

“Impracticability” means that no Bail-in Clause is required:

1. Where it is unlawful in the relevant jurisdiction for the counterparty to agree to a Bail-in Clause;
2. Where the contract is on standardised terms over which the in-scope entity has no power to amend;
3. **The liabilities under the agreement are all contingent on a breach of contract.**

No notification requirements.

ART 55 BRRD

CONTRACTUAL RECOGNITION OF BAIL-IN (CONTINUED)

UK PRA Impracticability (continued)



- confidentiality agreements/NDAs;
- contractual indemnities, where payment of which is contingent on a breach of contract;
- mandate or engagement letters;
- contracts with FMI's on the FMI's standard terms.

ART 55 BRRD

CONTRACTUAL RECOGNITION OF BAIL-IN (CONTINUED)

Impracticability under BRRD 2

- EU entities face same issues as those noted on previous slide – some have sought to extrapolate UK concepts of impracticability.
- BRRD 2 comes into effect on 28 December 2020.
- BRRD 2 introduces the impracticability concept into EU law.
- Circumstances where impracticability is available is to be specified by the EBA.
- Notification requirement – requires detailed information, e.g. tracking of quantum of liabilities governed by the relevant agreement.
- EBA grounds for impracticability generally mirror the UK PRA grounds
- However, no ground of impracticability for **liabilities which are contingent on breach of contract or sound only in damages.**
- Intentional policy choice by the EBA.
- [RTS](#) not yet final.

ART 55 BRRD

CONTRACTUAL RECOGNITION OF BAIL-IN (CONTINUED)

Brexit

Withdrawal Agreement:

- transition period until 1 January 2021.
- UK treated as still part of the EU during the transition period for the purposes of EU derived legislation, including BRRD.
- UK must implement EU derived legislation which comes into effect during the transition period, including BRRD 2.

Following the end of the Brexit transition period:

- laws of any part of the UK (e.g. English law) become “third country law” for purposes of art 55 BRRD (as amended by BRRD 2) as it continues to apply throughout the EU27.
- UK will make retain its pre-transition period art 55 regime with amendments to reflect the fact that UK is no longer part of EU (third country law for UK BRRD purposes becomes “**non-UK law**”).

BRRD 2 impracticability in the UK:

- BRRD 2 impracticability comes into effect 28 December 2020 – i.e. before the end of the transition period.
- draft BRRD 2 Brexit SI:
 - UK implements changes to impracticability on 28 December 2020, but they cease to have effect on 1 January 2021
 - current broader UK impracticability with no notification requirements will continue to apply in the UK
- see also PRA consultation [CP18/20](#)
 - temporary suspension of existing Contractual Recognition of Bail-in Part of PRA Rulebook between 28 Dec 20 and 1 Jan 2021

ART 55 BRRD

CONTRACTUAL RECOGNITION OF BAIL-IN (CONTINUED)

UK Entities

- A Bail-in Clause is required in any and all contracts which:
 - are governed by non-UK law; and
 - imposes any liability on a UK Entity; and
 - it is not otherwise excluded or impracticable to include the Bail-in Clause.

Agreement	Trigger	Requirement to include Bail-in Clause
New agreements (non-UK law)	Entered into on or after 1 January 2021	Required (unless Excluded or Impracticable).
Existing agreements (EEA law)	Materially amended on or after 22 March 2022 (PRA transitional relief applies)	Required (unless Excluded or Impracticable) if materially amended (this includes the creating of a new liability under an existing agreement or virtually any other amendment except minor typographical changes or changes to notice provisions).
Existing agreements (Third Country law, excluding EEA law, e.g. New York)	Materially amended on or after 1 January 2016	Required (unless Excluded or Impracticable) if materially amended (this includes the creating of a new liability under an existing agreement or virtually any other amendment except minor typographical changes or changes to notice provisions).

ART 55 BRRD

CONTRACTUAL RECOGNITION OF BAIL-IN (CONTINUED)

EU27 Entities

- A Bail-in Clause is required in any and all contracts which:
 - are governed by non-**EEA** law; and
 - imposes any liability on an **EEA** Entity; and
 - it is not otherwise excluded or impracticable to include the Bail-in Clause.

Agreement	Trigger	Requirement to include Bail-in Clause
New agreements (non-EEA law)	Entered into on or after 1 January 2021	Required (unless Excluded or Impracticable).
Existing agreements (UK law)	Materially amended on or after 1 January 2021 (No transitional relief available (c.f. UK entities))	Required (unless Excluded or Impracticable) if materially amended (this includes the creating of a new liability under an existing agreement or virtually any other amendment except minor typographical changes or changes to notice provisions).
Existing agreements (Third Country law, excluding UK law, e.g. New York)	Materially amended on or after 1 January 2016	Required (unless Excluded or Impracticable) if materially amended this includes the creating of a new liability under an existing agreement or virtually any other amendment except minor typographical changes or changes to notice provisions).

BRRD 2

CONTRACTUAL RECOGNITION OF STAYS

- No current EU wide contractual stay regime.
- **BRRD 2 Stay Requirement** – EU entities to include a contractual recognition of stay clause (a “**Stay Clause**”) into contracts:
 - which meet BRRD definition of “financial contract”; and
 - which are governed by non-EEA law (known as third-country law).
- **Effective Date** – 28 December 2020.
- **Trigger to include a Contractual Stay Clause:**
 - **New Agreements** – agreement entered into after the Effective Date;
 - **Existing Agreements** – agreement is “materially amended” on or after the Effective Date (i.e. almost any amendment to the agreement except minor typographical changes or changes to notice provisions – includes the creation of a new liability under an Existing Agreement (e.g. entering into a new transaction under an existing ISDA master agreement)).
- **“Financial contract” includes:**
 - securities contracts (incl. contracts for the sale and purchase of securities, repo agreements and stock lending agreements);
 - commodities contracts;
 - futures and forwards;
 - swaps and other classes of derivatives; and
 - master agreements relating to the above transaction types.

BRRD 2

CONTRACTUAL RECOGNITION OF STAYS (CONTINUED)

Brexit

Withdrawal Agreement:

- transition period until 1 January 2021
- UK treated as still part of the EU during the transition period for the purposes of EU derived legislation, including BRRD
- UK must implement EU derived legislation which comes into effect during the transition period, including BRRD 2.

Following the end of the Brexit transition period:

- laws of any part of the UK (e.g. English law) become “third country law” for purposes of BRRD 2 stay regime as it continues to apply throughout the EU27
- UK will make retain its pre-transition period stay regime with amendments to reflect the fact that UK is no longer part of EU (third country law for UK BRRD purposes becomes “**non-UK law**”) (see next slide for interaction with existing contractual stay regimes).

BRRD 2

CONTRACTUAL RECOGNITION OF STAYS (CONTINUED)

Interaction with existing contractual stay regimes

- Some jurisdictions, e.g. UK, France, Germany and Italy, already have their own contractual stay regimes in force since 2016.
- Apply to broadly same contracts as BRRD 2 contractual stays.
- However, BRRD 2 contractual stay regime requires Stay Clause to be in heavily prescribed form. RTS currently in draft but main issues with the requirements for a Stay Clause to:
 - describe local stay powers; and
 - be governed by the laws of an EU jurisdiction.
- If RTS enacted as drafted, current German, French, Italian and UK stay clauses will not be compliant with BRRD 2 requirements – would lead to extensive repapering effort – advocacy ongoing.
- **UK position following the end of the transition period:**
 - BRRD 2 Brexit SI revokes contractual stay RTS and pre-resolution stay requirements in BRRD 2
 - no need to repaper contracts which already contain a UK Stay Clause
 - see also PRA consultation [CP18/20](#) – temporary amendment of Stay in Resolution Part of PRA Rulebook between 28 Dec 2020 and 1 Jan 2021 to reflect pre-resolution stay requirements (amendment to definition of “crisis management measure”)

ISDA PROTOCOLS

ARTICLE 55 BRRD AND CONTRACTUAL STAY

Use of ISDA Protocols for Compliance

	ISDA Article 55 BRRD Protocol	UK Jurisdictional Modular Protocol	Other EU Jurisdictional Modular Protocols
Regulatory requirement addressed?	Article 55 BRRD	UK contractual stays (pre-BRRD 2 stays)	Existing EU contractual stays (pre-BRRD 2 stays), e.g. French, German, Italian.
Entities impacted	UK and EU27	UK	Entities in the relevant EU jurisdiction (e.g. French, German, Italian)
Effective to amend non-ISDA documentation?	Potentially – amends “Covered ISDA Master Agreements” and “Covered Other Agreements”	Potentially – purports to apply to all agreements in-scope of UK stay rules (see definition of “Covered Agreement”)	Potentially – purports to apply to all agreements in-scope of the relevant stay rules (see definition of “Covered Agreement”)
Wording effective post BRRD 2?	Yes	Yes	Subject to finalisation of draft RTS and related advocacy
Governing law of agreements amended?	Non-EEA law	Non-EEA law	Non-EEA law
Brexit – amends English law agreements?	Potentially (not applicable for UK entities)	N/A	Potentially
Brexit – amends EU27 law agreements?	No (not applicable for EU27 entities)	No	N/A

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