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Dear Sirs

RE: Proposed Moratorium Powers under Bank Recovery and Resolution Directive (BRRD)

The Asset Management Group of the Securities Industry and Financial Markets Association ("**SIFMA AMG**" or "**AMG**")[1] and ICI Global[2] (together, the "**Associations**") welcome the opportunity to comment on the European Commission's (the "**Commission**") proposal amending Directive 2014/59/EU (the "**BRRD**") on loss-absorbing and recapitalisation capacity of credit institutions and investment firms, published on 23 November 2016 (the "**Proposal**").[3] The

[1] SIFMA AMG brings the asset management community together to provide views on policy matters and to create industry best practices. SIFMA AMG's members represent U.S. and multinational asset management firms whose combined global assets under management exceed $39 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds.

[2] ICI Global carries out the international work of the Investment Company Institute, serving a fund membership that includes regulated funds publicly offered to investors in jurisdictions worldwide, with combined assets of US $25.2 trillion. ICI Global seeks to advance the common interests and promote public understanding of regulated investment funds, their managers, and investors. Its policy agenda focuses on issues of significance to funds in the areas of financial stability, cross-border regulation, market structure, and pension provision. ICI Global has offices in London, Hong Kong, and Washington, DC.

[3] Proposal for a Directive of the European Parliament and of the Council amending Directive 2014/59/EU on loss-absorbing and recapitalisation capacity of credit institutions and investment firms and amending Directive 98/26/EC,

Associations have significant concerns regarding the Commission's Proposal to expand the powers of resolution authorities to suspend payment and delivery obligations of an institution subject to resolution powers under BRRD (an "**Affected Institution**") in the pre-resolution and resolution phases ("**Additional Moratorium Powers**") for up to five working days each time either such power is used. [4]

These Additional Moratorium Powers disproportionately and unnecessarily shift risks to pension funds, regulated investment funds (*e.g.*, US mutual funds and UCITS), private funds and other investors for whom asset managers serve as fiduciaries by undermining important contractual rights in financial contracts and bank account relationships. The Associations' members seek to meet their clients' investment objectives and, relatedly, liquidity needs and risk constraints by entering into financial contracts with Affected Institutions, including derivatives contracts, repurchase agreements and securities lending agreements, on behalf of their clients or the fund. They also establish bank account, time deposits, custodial and brokerage arrangements pursuant to which large cash and securities positions are held with Affected Institutions. The Additional Moratorium Powers undermine protections that are part of these agreements and arrangements by lengthy suspension of payment and delivery obligations, which are subject to very limited exceptions.[5] This ability to suspend drastically alters credit risk profiles of Affected Institutions, an important factor assessed when entering into such arrangements. It likewise undermines important rights, including contractual termination and the ability to access collateral and bank accounts that protect clients against the deteriorating credit of an Affected Institution.

As discussed below, the Associations believe that this proposed expansion is inconsistent with FSB principles and relevant laws applicable to buy-side market participants, and market participants generally, in the EU and US. Consequently, the risk of becoming subject to the Additional Moratorium Powers is likely to curtail the ability of regulated investment funds and investment managers regulated in the US and Europe to deal with banks in the European Union and with their affiliated companies.

We believe that no Additional Moratorium Powers should be introduced for the following three core reasons.

I. Inconsistency with FSB Principles

The Associations believe that Additional Moratorium Powers conflict with the FSB's Key Attributes of Effective Resolution Regimes of Financial Institutions (the "**FSB Principles**")

Directive 2002/47/EC, Directive 2012/30/EU, Directive 2011/35/EU, Directive 2005/56/EC, Directive 2004/25/EC and Directive 2007/36/EC (November 23, 2016) (COM/2016/0852 final), available at: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2016:0852:FIN.

[4] See Articles 27, 29 and 63 of the Proposal.

[5] The Additional Moratorium Powers would be subject to very limited exemptions such that the Affected Institution would only be required to continue to make payments in respect of covered deposits, eligible investor compensation schemes and amounts it owes directly to payment and settlement systems, central counterparties and central banks.

endorsed by the G20 in November 2011[6] and create a disproportionate and unnecessary divergence from the agreed international approach to orderly resolution of financial institutions.

The preamble to the FSB Principles sets out a number of objectives that should apply in order for an effective resolution of financial institutions to occur without systemic disruption. These include (i) ensuring the continuity of systemically important financial services, and payment, clearing and settlement functions; (ii) ensuring the rapid return of segregated client assets; (iii) avoiding unnecessary destruction of value; and (iv) providing speed and transparency and as much predictability as possible through legal and procedural clarity. We are of the view that, for the reasons we more fully set out below, the Additional Moratorium Powers are inconsistent with the objectives of these FSB Principles.

More particularly, the FSB Principles specifically set out considerations for moratorium powers in the context of resolution. We set out below the relevant FSB Principle 4.3:

"*Should contractual acceleration or early termination rights nevertheless be exercisable, the resolution authority should have the power to stay temporarily such rights where they arise by reason only of entry into resolution or in connection with the exercise of any resolution powers. The stay should:*

> *i. be strictly limited in time (for example, for a period not exceeding 2 business days);*
>
> *ii. be subject to adequate safeguards that protect the integrity of financial contracts and provide certainty to counterparties (see I-Annex 5 on Conditions for a temporary stay); and*
>
> *iii. not affect the exercise of early termination rights of a counterparty against the firm being resolved in the case of any event of default not related to entry into resolution or the exercise of the relevant resolution power occurring before, during or after the period of the stay (for example, failure to make a payment, deliver or return collateral on a due date).*"

While Articles 69 to 71 (inclusive) of the BRRD included moratorium powers broadly in line with FSB Principle 4.3, the Additional Moratorium Powers contained in the Commission's Proposal overreach the standards agreed at the G20 level. The Additional Moratorium Powers are neither proportionate nor based on a qualitative or quantitative assessment of their impact on financial stability and market confidence. Importantly, the Additional Moratorium Powers would create divergence between, on the one hand, the resolution regimes of Switzerland and the United States, which currently have moratorium powers aligned with the FSB Principles and, on the other hand, the European Union.

We also are concerned that the proposed combined or repeated use of the Additional Moratorium Powers provides broad discretion that can be used inconsistently with the purpose of the BRRD

[6] FSB, Key Attributes of Effective Resolution Regimes for Financial Institutions (October 15, 2014), available at: http://www.fsb.org/what-we-do/policy-development/effective-resolution-regimes-and-policies/key-attributes-of-effective-resolution-regimes-for-financial-institutions/#3resolutionpowers.

and FSB principles. For example, it may encourage the authorities to use Additional Moratorium Powers to attempt to "wait out" adverse market conditions. If sudden changes in financial markets cause an Affected Institution's securities financings and derivative positions to deteriorate in value, an authority may repeatedly suspend payments and deliveries in hopes that the market recovers in a few days. Such speculation would be, however, at the expense of the Affected Institution's counterparties. While the Affected Institution might benefit from any improvement in market conditions, its counterparties would suffer the consequence of continued market deterioration. Further, there could be no assurance that the markets would improve during the suspension period. The current safeguards in the legislation do not address this risk, rather the provisions of Article 63 appear to encourage the authorities to repeatedly suspend payments during market turbulence until such a time that a valuation can be made with certainty.

II. **Globally significant destruction of value and procedural uncertainty**

Globally significant market documentation such as the ISDA Master Agreements and the Global Master Repurchase Agreement typically provide for very short grace periods for non-payment[7] which are significantly less than five working days. Daily margin calculations and transfers, which were strengthened and mandated as a result of other G20 commitments, are also hard-wired into these contracts in order to prevent the build-up of large deficiencies and unsecured risk. In recommending a maximum two-day stay, the FSB Principles took account of this fact. In order for our members to avoid cross defaulting under their obligations under these documents with other counterparties, and even the Affected Institution itself, during the extended moratoria contemplated under the Additional Moratorium Powers, they would need access to funds from a source other than the Affected Institution and significantly could only have certainty of funds if dealing with an institution outside of the scope of the new powers.

For example, the investment mandates for many regulated investment funds and separate accounts require their manager to neutralize the effects of foreign currency fluctuations on their portfolios. To implement this strategy, the manager will often use foreign exchange forward contracts ("FX Forwards"), which are not required to be centrally cleared, in order to hedge the exposure to foreign currencies. If one of the counterparties to an FX Forward is an Affected Institution, then implementation of the moratorium powers would prevent the manager from complying with its mandate. If the manager tries to cover the impaired FX Forward with a new FX Forward it will risk creating an unhedged exposure if the Affected Institution eventually avoids resolution proceedings or transfers the FX Forward to another counterparty. If the manager does not try to cover the impaired FX Forward, the portfolio will be left unhedged if a resolution proceeding is commenced and the FX Forward is not transferred.

The limited period of the current moratorium powers ameliorates this potential dilemma. A manager could use the period to negotiate an FX Forward to cover the portfolio's exposure. If the impaired contract is not transferred within the period, the new FX Forward would be executed. Although the portfolio may not be fully hedged during this brief period, the potential for currency fluctuations during at most two working days is much less than during the more indefinite periods proposed for the Additional Moratorium Powers. Suspending an Affected Institution's payment

[7] For example, two Business Days in the case of the 1992 ISDA Master Agreement.

and delivery obligations for such an extended period could deprive some counterparties of margin needed to cover their other obligations and could prevent other counterparties from winding-down contracts in order to reduce exposure to the underlying securities or assets.

History shows that every additional day's delay in terminating or covering FX Forwards can significantly increase potential losses. For example, in early 2015 the euro fell against the US dollar for a sustained period. At one point, starting February 25, 2015, a one-month Euro/Dollar forward declined 1.45% over a two business day period, whereas the forward declined 7.61% over a twelve business day period. Counterparties to such contracts could have seen their losses more than quintupled had a resolution authority exercised Additional Moratorium Powers during this period.

Inconsistency with laws relevant to Pension Funds, Regulated Investment Funds, Private Funds and other Investors

Proposed changes to the BRRD are not compatible with or weaken the EU legislative framework designed to protect investors.[8] Buy-side market participants and asset managers operating in the European Union are subject to a range of European Union laws that govern the operation of investment funds and outline the responsibilities of their management companies. These laws include a focus on the relationship between fund management companies and Affected Institutions as a way of ensuring a high level of investor protection and improving confidence among investors.

For example, the UCITS Directive (2014/91/EU) requires funds to offer investors bimonthly liquidity, although in practice most UCITS funds offer daily or weekly redemptions. Certainly a continuous 12 working day moratorium of the kind permitted in the Proposal, would result in all UCITS funds with significant exposure to an Affected Institution being required to suspend redemptions or taking other extraordinary action. This consequence of the Additional Moratorium Powers appears to undermine a key goal of the UCITS Directive.

Likewise, the AIFM Directive (2011/61/EU) and the UCITS Directive require that managers of regulated funds retain an Affected Institution as Depositary to hold their assets, arrange settlement of their transactions and administer their income. Given regulatory requirements that Depositaries play a central role in the operation of European authorised investment funds, it is clearly important that a prolonged suspension of payment and delivery obligations owed by a Depository to such investment funds does not cause such investment funds to default on their own contractual obligations to investors, CCPs, G-SIFIs and other Affected Institutions. Although Article 44(2) of the BRRD explicitly protects liabilities that arise from holding client money from bail-in, there is no provision in the Proposal which guarantees that Depositaries will continue to perform all of

[8] We understand that the Commission itself is committed to improving the consistency of EU rules through its work as part of the Better Regulation agenda (See Better regulation) and that DG FSMA has called for evidence of inconsistencies (See call for evidence).

their obligations during the application of the Additional Moratorium Powers even to the limited extent of honouring obligations to pay cash on deposit or deliver assets in custody.

Further, the potential application of Additional Moratorium Powers may curtail the ability of regulated investment funds and US investment managers to invest in Affected Institutions subject to these new powers. For example, both UCITS and US money market funds are subject to limitations on the maximum maturity of investments and are (or will be in the case of UCITS money market funds under new EU regulations) required to hold portions of their portfolio in instruments maturing in one or in seven days. Regulations require maturity to be determined based on when payments are due unconditionally or without optionality. The Additional Moratorium Powers would introduce an element of optionality that may prevent these funds from accurately determining a bank instrument's maturity with any certainty and thereby prevent them from using these instruments to satisfy regulatory requirements. Compounding this problem is that, by the end of 2018, most US mutual funds will be required to classify investments as "highly liquid" or "moderately liquid" based on their ability to be converted into cash within three or seven days.[9]

Loss of recourse to collateral also could impede investments. Generally, diversified US investment companies may not invest more than 5 percent of their assets in a single issuer. Rule 5b-3 under the 1940 Act allows investment companies to engage in reverse repurchase agreements in excess of this limit, provided the obligation to repurchase is "collateralized fully." This rule reflects the significantly reduced risks of obligations secured by highly liquid collateral as compared to unsecured obligations and encourages more conservative investments. Moratorium powers that would limit recourse to collateral beyond the period envisioned by the FSB Principles could undermine the basis for this exception, forcing US funds to treat reverse repurchase agreements as equivalent to unsecured extensions of credit. Apart from regulatory concerns, diminution of collateral protection could dissuade investment managers and funds from engaging in reverse repurchase agreements, securities loans, and derivative contracts as a response to increased credit risks. At a minimum, it will reduce or even eliminate any discount in the cost of collateralized funding and increase the overcollateralization margins for these transactions. This will reduce the volume of such transactions and the efficiency of the financial markets.

The Additional Moratorium Powers are inconsistent with other EU standards requiring all market participants to make payments and deliveries within a short timeframe. For example, EMIR (Regulation No 648/2012) requires that in order to mitigate counterparty credit risk, market participants (both Affected Institutions and the Associations' members) that are subject to the clearing obligation should have risk-management procedures that require the timely, accurate and appropriately segregated exchange of collateral in respect of uncleared OTC derivatives. In respect of both cleared and uncleared OTC derivatives, daily variation margin requirements in relation to payment of cash collateral and delivery of non-cash collateral now apply to counterparties (including the Associations members and their clients) subject to European regulation and to the Affected Institutions with whom they trade. A five-day moratorium that is applied to payment or delivery obligations of an Affected Institution will make such daily margining impossible. In this

[9] Rule 22e-4 under the Investment Company Act of 1940 (the "1940 Act").

way, the proposed Additional Moratorium Powers appear to undermine both the objectives of effective resolution and the goals of EMIR.

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For the reasons outlined above, the proposed Additional Moratorium Powers undermine important rights of investors as well as other initiatives undertaken at the European level to provide for a robust and resilient financial system.

Should you have any questions or wish to discuss these matters further, please do not hesitate to contact Laura Martin at 212-313-1176 or lmartin@sifma.org, Sarah Bessin at 202-326-5835 or sarah.bessin@ici.org, Dan Waters at +44 207 961 0831 or dan.waters@ici.org, John McGrath at +44 (0)20 7360 2547 or jmcgrath@sidley.com or Michele Navazio at 212-839-5310 or mnavazio@sidley.com.

Yours faithfully,

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