



asset management group



10 September 2018

Re: Implications of Proposal to Amend Moratorium Powers under the Bank Recovery and Resolution Directive 2014/59/EU

Dear Sirs and Madams,

Thank you for continuing to engage with us regarding proposed amendments to the moratorium powers under the Bank Recovery and Resolution Directive (**BRRD**). The undersigned Associations¹ strongly support limiting moratorium powers under BRRD to no more than two business days. The members of our Associations act as fiduciaries to pension funds, regulated funds, private funds, and other investors served by asset managers that, in the aggregate, serve millions of individual investors. Lengthier moratoria would adversely affect these individuals, more than our members, by (i) depriving investors of access to funds and investments during a moratorium, (ii) denying investors the benefit of the collateral associated with these investments, and (iii) possibly forcing the cessation of relationships with EU banks to avoid these unnecessary risks.

We and our members therefore were pleased by the recent position of the Council of the European Union that would provide for a maximum moratorium of two working days (combining the new moratorium power that may be imposed if a bank is determined to be “failing or likely to fail” (**FOLTF**) and the existing in-resolution stay under BRRD). We are concerned, however, that the EU Parliament’s position would make it more difficult to resolve an EU bank, as acknowledged by EU resolution authorities, and would have negative unintended consequences for the EU financial markets. While the Parliament’s position, like the Council’s position, would provide for a maximum moratorium of two working days if a bank is determined to be FOLTF, it would permit the resolution authority to impose an additional two working day moratorium (the existing in-resolution stay under BRRD) after ten working days have elapsed following the end of the first moratorium. We urge the EU to instead adopt the Council’s position on moratorium powers. Our remarks in this letter, which follow up on our prior letters, provide support for this position.²

¹ See end of letter for descriptions of each Association.

² The Associations’ January letter is available at: <https://www.iciglobal.org/pdf/31084a.pdf>. That letter offers data regarding the size of the relevant markets in Europe that may be impacted if pension funds, regulated investment funds, private funds and other investors on whose behalf asset managers act as fiduciaries determine not to enter into transactions with, custody with, or invest in EU banks as a result of an expansion of the proposed moratorium powers. Our June 2017 letter, which provides additional analysis, is available at: <https://www.ici.org/pdf/30761a.pdf>.

Expanding the moratorium powers beyond two business days would raise the following key risks:

- **Regulated investment funds, such as UCITS and US mutual funds, may not transact with or invest in EU banks due to the significant compliance and regulatory risks raised by expanded moratorium powers.** For example, certain regulated investment funds are subject to requirements regarding the liquidity of their investments. An extended stay may raise concerns regarding the ability of regulated funds to satisfy these liquidity requirements, as well as the ability of both EU and US money market funds (MMFs) to satisfy regulatory requirements limiting the maximum maturity of their investments.³ The loss of recourse to collateral caused by an extended stay also may raise concerns regarding the ability of EU and US investment funds to comply with regulatory requirements regarding securities lending transactions and reverse repurchase agreements (“**reverse repos**”).⁴ If extended moratorium powers are added to BRRD, a regulated investment fund’s manager will need to consider these issues as it evaluates its current and future investments in, and transactions with, EU banks. The manager must consider worst case scenarios at the time of an investment and cannot assume the ability to exit the position in advance of a moratorium being imposed.
- **Applying expanded moratorium powers to EU custody banks would be inconsistent with existing regulatory requirements applicable to regulated funds.** The proposed expanded moratorium powers would apply to EU banks that serve as custodians, including those that serve as the EU sub-custodians of global custodians. Applying expanded moratorium powers to an EU custody bank would be inconsistent with EU and US regulatory requirements applicable to regulated funds. UCITS are required to use an EU bank to safekeep their assets, arrange settlement of transactions, and administer their income. A prolonged suspension of payment and delivery obligations owed by a depositary bank to regulated funds could cause such funds to default on their own contractual obligations to investors, CCPs, and other counterparties. Under EU law, UCITS are not be able to engage a non-EU bank to provide this service as the depositary must be established in the same Member State as the UCITS fund.

Applying the expanded moratorium to EU depositary banks also could prevent regulated funds from being able to satisfy their regulatory obligations to provide liquidity to investors. UCITS

³ These regulations require maturity to be determined based on when payments are due unconditionally and without optionality.

⁴ An EU MMF that enters into a reverse repo must have the right to terminate the agreement at any time upon no more than two working days notice, and ensure that the market value of the assets received as part of the agreement is at all times at least equal to the value of the cash provided. Registered US investment funds engaging in securities lending transactions must have the ability to terminate the loan at any time and recall the loaned securities within the ordinary settlement time. For a registered US investment fund to engage in reverse repos with a single issuer in an amount (when combined with the fund’s other holdings in the issuer) in excess of 5% of the fund’s assets (when combined with the fund’s other holdings in the issuer), the fund must ensure the obligation to repurchase is “collateralized fully.”

and US mutual funds are required to offer investors the ability to redeem their shares. UCITS funds must offer bimonthly liquidity, although in practice the vast majority of them permit daily redemptions. US registered open-end funds must offer securities that can be redeemed within seven days and must hold a portion of their portfolios in highly liquid assets to support their obligations. In addition, EU MMFs are prohibited from holding their deposits with credit institutions unless the deposit can be withdrawn at any time. Thus, the application of expanded moratorium powers to EU custodian banks could prevent regulated funds from being able to satisfy these regulatory requirements and could impede the ability of asset managers to satisfy redemption requests from investors.

- **Expanded moratorium powers would create significant uncertainty, and attendant risk, for pension funds, regulated investment funds, private funds and other investors served by asset managers that enter into collateralized, netted trading agreements with EU bank counterparties.** Contractual uncertainty and increased counterparty risks due to extended moratorium tools would be unique to EU banks given that other major jurisdictions have enacted narrow moratorium powers, consistent with the FSB's Key Attributes of Effective Resolution Regimes of Financial Institutions.⁵ For example, while net exposures to EU banks under such trading agreements are required to be collateralized, a fund would have no assurances that the collateral delivered by an EU bank would be adequate to cover the exposure on the date a moratorium was lifted. Such a result would be inconsistent with the policies underlying global derivatives regulatory reform, which emphasize globally consistent reporting, exchange trading, central clearing, and risk-mitigating margining. Asset managers to regulated funds and other clients, as fiduciaries, would have to weigh the risks of transacting with EU banks, and would be disincentived from entering into transactions with them. Even if they continue to transact with EU institutions, the rates and collateral requirements are likely to be less favorable than for institutions in FSB compliant regimes.
- **The EU Parliament's proposed addition of a ten-day break between exercise of moratorium powers would create significant market uncertainty and make it more difficult to resolve an EU bank.** Parliament's proposal would require that the FOLTF moratorium be lifted after two working days. Following a period of ten business days after the lifting of that stay, however, a resolution authority could impose the existing in-resolution moratorium under BRRD for two working days. For the reasons above, we urge the EU to not expand moratorium powers beyond two business days *total* consistent with the maximum period noted in the FSB's Key Attributes of Effective Resolution Regimes of Financial Institutions. We also strongly recommend against permitting imposition of a second moratorium only ten days following the imposition of the FOLTF moratorium. We agree with

⁵ 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/#4set-off>.

the concerns expressed by Elke König, Chair of the Single Resolution Board, who recently remarked that:

... we do not support the possibility to use the current stay power only 10 business days after using the new moratorium tool, as the Parliament's text suggests. This seems unnecessary, if not counter-productive: If market participants have the expectation that an additional stay (under current powers) could be applied 10 days after the application of the moratorium tool, this might undermine market confidence in the resolved entity. ...⁶

Rather than facilitating a resolution, providing authority to impose a second moratorium following a ten-day period is likely to increase market uncertainty, making it more difficult to resolve a failing bank. Investors will expect that their ability to transact with, custody with, and invest in an EU bank in resolution may again be impaired even after the FOLTF stay has been lifted. This concern is likely to decrease investor confidence, resulting in less liquidity for, and investment in, the bank at the very time it is most needed. Such a result is contrary to the regulatory objectives of BRRD, which are to (i) safeguard the continuity of essential banking operations; (ii) protect depositors, client assets and public funds; (iii) minimise risks to financial stability; and (iv) avoid the unnecessary destruction of value.⁷

For these reasons, the undersigned Associations believe that expansion of the BRRD moratorium would be harmful to investors both within and outside of the EU and would be harmful to the EU financial markets. Providing for imposition of a second moratorium following a ten-day period would create harmful uncertainty in the markets and be counterproductive to BRRD's objectives. We therefore urge the European Union to adopt the Council's position on moratorium powers under BRRD to remain aligned with other major jurisdictions and avoid these risks.

Yours faithfully,

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⁶ Speech by Elke König, Chair of the SRB at the ECON Committee Hearing, European Parliament (July 11, 2018), available at <https://srb.europa.eu/en/content/speech-elke-konig-chair-srb-econ-committee-hearing-european-parliament>.

⁷ See *EU Bank Recovery and Resolution Directive (BRRD): Frequently Asked Questions* (Apr. 2014), available at http://europa.eu/rapid/press-release_MEMO-14-297_en.htm.

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