Loan Market Association
the authoritative voice of the EMEA market

LSTA
THE LOAN SYNDICATIONS AND TRADING ASSOCIATION®

EU Bail-in Rule - Publication of LMA and LSTA Contractual Recognition Clauses

The Loan Market Association (**LMA**) and the Loan Syndications and Trading Association (**LSTA**) have today each issued recommended forms of clause for use in loan documentation to the extent required by Article 55 of EU Directive 2014/59 relating to contractual recognition of bail-in.[1] This statement refers to the form of clause prepared by the LMA as the **LMA Variant** and the form of clause prepared by the LSTA as the **LSTA Variant** (together, the **Bail-In Clauses**). These forms are available via the websites of the LMA and LSTA and are issued in accordance with the terms and conditions relating to the clauses included on those websites.

Given the global nature of the loan markets, the wide-ranging applicability of Article 55 and the need to promote efficiency in loan markets, the LMA and LSTA have worked together to seek to ensure that the Bail-In Clauses are as consistent as possible. However, they recognise that differences in the markets in the USA and EMEA mean that it may not be appropriate or possible for those Bail-In Clauses to match each other exactly. The reasons for this include differences in terminology, structure, and governing law in loan documentation and in loan market practices; the need for the LMA Variant to be flexible enough to be adapted for use in a variety of different legal documents; the need for the LSTA Variant to be suitable for use in the US loan market and for inclusion in New York law governed loan documents; and the LMA's desire to provide optional wording capable of being used to provide for possible future legal and regulatory developments both in Europe and elsewhere.

As a result the Bail-In Clauses being issued today include the LMA Variant recommended by the LMA and the LSTA Variant recommended by the LSTA. Market participants will want to review each Bail-In Clause and come to their own conclusions as to any modifications which may be needed to ensure that it is suitable for the subject document.

As part of the co-operation between the LMA and the LSTA, the LMA Variant and the LSTA Variant each refer to a common EU Bail-In Legislation Schedule which has been prepared by the LMA in order to describe the relevant national implementation legislation and write-down and conversion powers. That Schedule has been published on the LMA website and is available to all LMA and LSTA members.

December 22, 2015

[1] An overview of Article 55 can be found in the LMA document entitled "*The recommended form of Bail-In Clause and Users Guide*" and in the LSTA Market Advisory dated September 2015.

EU Bail-In Rule

Form of Contractual Recognition Provision

LSTA Secondary Market Documents[1]

Acknowledgement and Consent to Bail-In of EEA Financial Institutions[2]. Notwithstanding anything to the contrary in [name of secondary document] or in any other agreement, arrangement or understanding between the parties hereto, if Buyer is an EEA Financial Institution, Seller acknowledges, and if Seller is an EEA Financial Institution, Buyer acknowledges, that any liability of such EEA Financial Institution under this Agreement, to the extent such liability is unsecured, may be subject to the write-down and conversion powers of an EEA Resolution Authority and each party hereto agrees and consents to, and acknowledges and agrees to be bound by:

(a) the application of any Write-Down and Conversion Powers by an EEA Resolution Authority to any such liabilities arising hereunder which may be payable to it by Buyer or Seller (as applicable); and

(b) the effects of any Bail-in Action on any such liability, including, if applicable:

(i) a reduction in full or in part or cancellation of any such liability;

(ii) a conversion of all, or a portion of, such liability into shares or other instruments of ownership in Buyer or Seller, as applicable, its parent undertaking, or a bridge institution that may be issued to it or otherwise conferred on it, and that such

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[1] This model provision has been prepared for inclusion in the LSTA's form of secondary market documents and will be included, in substantially similar form, in the LSTA's Model Credit Agreement Provisions (MCAPs). Further background on the scope and requirements of the European bail-in rules can be found here in the LSTA's September 2015 Market Advisory. Affected European institutions and their counterparties incorporating these model provisions into any agreements are responsible for making an independent determination of their suitability for the transactions in question, their individual circumstances, and compliance with any applicable law.

[2] Affected European institutions are required to include certain specified elements in contractual recognition provisions. Those requirements are set out in the technical standards published on 3 July 2015 by the European Banking Authority for adoption by the European Commission for application in all EU Member States (which can be found at https://www.eba.europa.eu/documents/10180/1132911/EBA-RTS-2015-06+RTS+on+Contractual+Recognition+of+Bail-in.pdf). This provision incorporates the elements appropriate for the typical liabilities of parties to a transaction in the secondary loan market but would need to be adapted for use in any particular secondary market transaction.

The draft technical standards also require a description of the write-down and conversion powers of each applicable EEA Resolution Authority in accordance with the national law implementing the European Bail–In Rules. The applicable definitions, therefore, contain a reference to the EU Bail-In Legislation Schedule published on the website of the Loan Market Association (LMA). That Schedule sets forth the relevant national implementing legislation and write-down and conversion powers (see the link to the LMA website below).

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shares or other instruments of ownership will be accepted by it in lieu of any rights with respect to any such liability under this Agreement; or

(iii) the variation of the terms of such liability in connection with the exercise of the write-down and conversion powers of any EEA Resolution Authority.

"**Bail-In Action**" means the exercise of any Write-Down and Conversion Powers by the applicable EEA Resolution Authority in respect of any liability of an EEA Financial Institution.

"**Bail-In Legislation**" means, with respect to any EEA Member Country implementing Article 55 of Directive 2014/59/EU of the European Parliament and of the Council of the European Union, the implementing law for such EEA Member Country from time to time which is described in the EU Bail-In Legislation Schedule.

"**EEA Financial Institution**" means (a) any credit institution or investment firm established in any EEA Member Country which is subject to the supervision of an EEA Resolution Authority, (b) any entity established in an EEA Member Country which is a parent of an institution described in clause (a) of this definition, or (c) any financial institution established in an EEA Member Country which is a subsidiary of an institution described in clauses (a) or (b) of this definition and is subject to consolidated supervision with its parent;

"**EEA Member Country**" means any of the member states of the European Union, Iceland, Liechtenstein, and Norway.

"**EEA Resolution Authority**" means any public administrative authority or any person entrusted with public administrative authority of any EEA Member Country (including any delegee) having responsibility for the resolution of any EEA Financial Institution.

"**EU Bail-In Legislation Schedule**" means the EU Bail-In Legislation Schedule published by the Loan Market Association (or any successor person), as in effect from time to time. [3]

"**Write-Down and Conversion Powers**" means, with respect to any EEA Resolution Authority, the write-down and conversion powers of such EEA Resolution Authority from time to time under the Bail-In Legislation for the applicable EEA Member Country, which write-down and conversion powers are described in the EU Bail-In Legislation Schedule.

[3] The EU Bail-In Legislation Schedule may be found at http://www.lma.eu.com/pages.aspx?p=499.

EU Bail-In Rule

Form of Contractual Recognition Provision

LSTA Variant[1]

Acknowledgement and Consent to Bail-In of EEA Financial Institutions[2]. Notwithstanding anything to the contrary in any Loan Document or in any other agreement, arrangement or understanding among any such parties, each party hereto acknowledges that any liability of any EEA Financial Institution arising under any Loan Document, to the extent such liability is unsecured, may be subject to the write-down and conversion powers of an EEA Resolution Authority and agrees and consents to, and acknowledges and agrees to be bound by:

(a) the application of any Write-Down and Conversion Powers by an EEA Resolution Authority to any such liabilities arising hereunder which may be payable to it by any party hereto that is an EEA Financial Institution; and

(b) the effects of any Bail-in Action on any such liability, including, if applicable:

(i) a reduction in full or in part or cancellation of any such liability;

(ii) a conversion of all, or a portion of, such liability into shares or other instruments of ownership in such EEA Financial Institution, its parent undertaking, or a bridge institution that may be issued to it or otherwise conferred on it, and that such shares or other instruments of ownership will be accepted by it in lieu of any

[1] This model provision has been prepared for inclusion in a New York law governed credit agreement and will be included in the LSTA's Model Credit Agreement Provisions (MCAPs). Further background on the scope and requirements of the European bail-in rules can be found here in the LSTA's September 2015 Market Advisory. Affected European institutions and their counterparties incorporating these model provisions into any agreements are responsible for making an independent determination of their suitability for the transactions in question, their individual circumstances, and compliance with any applicable law.

[2] Affected European institutions are required to include certain specified elements in contractual recognition provisions. Those requirements are set out in the technical standards published on 3 July 2015 by the European Banking Authority for adoption by the European Commission for application in all EU Member States (which can be found at https://www.eba.europa.eu/documents/10180/1132911/EBA-RTS-2015-06+RTS+on+Contractual+Recognition+of+Bail-in.pdf . This provision incorporates the elements appropriate for the typical liabilities of lenders party to a credit agreement but would need to be adapted for use in other situations, e.g. for an affected European institution as borrower, or in a contract or instrument pursuant to which it has issued equity.

The draft technical standards also require a description of the write-down and conversion powers of each applicable EEA Resolution Authority in accordance with the national law implementing the European Bail–In Rules. The applicable definitions, therefore, contain a reference to the EU Bail-In Legislation Schedule published on the website of the Loan Market Association (LMA) which set forth the relevant national implementing legislation and write-down and conversion powers.

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rights with respect to any such liability under this Agreement or any other Loan Document; or

(iii) the variation of the terms of such liability[3] in connection with the exercise of the write-down and conversion powers of any EEA Resolution Authority.

"**Bail-In Action**" means the exercise of any Write-Down and Conversion Powers by the applicable EEA Resolution Authority in respect of any liability of an EEA Financial Institution.

"**Bail-In Legislation**" means, with respect to any EEA Member Country implementing Article 55 of Directive 2014/59/EU of the European Parliament and of the Council of the European Union, the implementing law for such EEA Member Country from time to time which is described in the EU Bail-In Legislation Schedule.[4]

"**EEA Financial Institution**" means (a) any credit institution or investment firm established in any EEA Member Country which is subject to the supervision of an EEA Resolution Authority, (b) any entity established in an EEA Member Country which is a parent of an institution described in clause (a) of this definition, or (c) any financial institution established in an EEA Member Country which is a subsidiary of an institution described in clauses (a) or (b) of this definition and is subject to consolidated supervision with its parent;

"**EEA Member Country**" means any of the member states of the European Union, Iceland, Liechtenstein, and Norway.

"**EEA Resolution Authority**" means any public administrative authority or any person entrusted with public administrative authority of any EEA Member Country (including any delegee) having responsibility for the resolution of any EEA Financial Institution.

"**EU Bail-In Legislation Schedule**" means the EU Bail-In Legislation Schedule published by the Loan Market Association (or any successor person), as in effect from time to time. [5]

"**Write-Down and Conversion Powers**" means, with respect to any EEA Resolution Authority, the write-down and conversion powers of such EEA Resolution Authority from time to time under the Bail-In Legislation for the applicable EEA Member Country, which write-down and conversion powers are described in the EU Bail-In Legislation Schedule.

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[3] As the typical U.S. credit agreement contains many provisions regulating the liabilities and relationship between other parties that are not EEA Financial Institutions, this provision makes clear by its inclusion of the words "of such liability" that the required acknowledgment of the powers of the applicable EEA Resolution Authority is limited to the liabilities of the affected EEA Financial Institution to other parties under the agreement, and not to the provisions of the agreement as they may otherwise apply to the other parties thereto.

[4] The LMA variant of the contractual recognition clause offers an option to anticipate future bail-in legislation in countries outside the EEA. This is not required for compliance with the EU Bail-In legislation.

[5] The EU Bail-In Legislation Schedule may be found at http://www.lma.eu.com/pages.aspx?p=499.

"**Defaulting Lender**"[6] means, subject to Section [*Defaulting Lender Cure*], any Lender that (a) has failed to (i) fund all or any portion of its Loans within two Business Days of the date such Loans were required to be funded hereunder unless such Lender notifies the Administrative Agent and the Borrower in writing that such failure is the result of such Lender's determination that one or more conditions precedent to funding (each of which conditions precedent, together with any applicable default, shall be specifically identified in such writing) has not been satisfied, or (ii) pay to the Administrative Agent, any Issuing Bank, any Swingline Lender or any other Lender any other amount required to be paid by it hereunder (including in respect of its participation in Letters of Credit or Swingline Loans) within two Business Days of the date when due, (b) has notified the Borrower, the Administrative Agent or any Issuing Bank or Swingline Lender in writing that it does not intend to comply with its funding obligations hereunder, or has made a public statement to that effect (unless such writing or public statement relates to such Lender's obligation to fund a Loan hereunder and states that such position is based on such Lender's determination that a condition precedent to funding (which condition precedent, together with any applicable default, shall be specifically identified in such writing or public statement) cannot be satisfied), (c) has failed, within three Business Days after written request by the Administrative Agent or the Borrower, to confirm in writing to the Administrative Agent and the Borrower that it will comply with its prospective funding obligations hereunder (provided that such Lender shall cease to be a Defaulting Lender pursuant to this clause (c) upon receipt of such written confirmation by the Administrative Agent and the Borrower), or (d) has, or has a direct or indirect parent company that has, (i) become the subject of a proceeding under any Debtor Relief Law, (ii) had appointed for it a receiver, custodian, conservator, trustee, administrator, assignee for the benefit of creditors or similar Person charged with reorganization or liquidation of its business or assets, including the Federal Deposit Insurance Corporation or any other state or federal regulatory authority acting in such a capacity, or (iii) become the subject of a Bail-in Action; provided that a Lender shall not be a Defaulting Lender solely by virtue of the ownership or acquisition of any equity interest in that Lender or any direct or indirect parent company thereof by a Governmental Authority so long as such ownership interest does not result in or provide such Lender with immunity from the jurisdiction of courts within the United States or from the enforcement of judgments or writs of attachment on its assets or permit such Lender (or such Governmental Authority) to reject, repudiate, disavow or disaffirm any contracts or agreements made with such Lender. Any determination by the Administrative Agent that a Lender is a Defaulting Lender under any one or more of clauses (a) through (d) above shall be conclusive and binding absent manifest error, and such Lender shall be deemed to be a Defaulting Lender (subject to Section [*Defaulting Lender Cure*]) upon delivery of written notice of such determination to the Borrower, each Issuing Bank, each Swingline Lender and each Lender.

[6] These provisions contemplate a modification of the LSTA MCAPs Defaulting Lender Language to extend their scope to a European Lender subject to bail-in, as it is not possible to allow for a reduction in commitments without considering the broader effects of this on the other parties to the agreement. This offers a pragmatic approach to arrangements relating to fronting exposures and other provisions affected by a reduction in commitments and the reinstatement of bailed-in commitments using existing LSTA MCAPs and procedures familiar to the market.

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(iv) Reallocation of Participations to Reduce Fronting Exposure. All or any part of such Defaulting Lender's participation in L/C Obligations and Swingline Loans shall be reallocated among the Non-Defaulting Lenders in accordance with their respective Applicable Percentages (calculated without regard to such Defaulting Lender's Commitment) but only to the extent that such reallocation does not cause the aggregate Revolving Credit Exposure of any Non-Defaulting Lender to exceed such Non-Defaulting Lender's Revolving Credit Commitment. Subject to Section [*Acknowledgment and Consent to EEA Financial Institution Bail-In*], no reallocation hereunder shall constitute a waiver or release of any claim of any party hereunder against a Defaulting Lender arising from that Lender having become a Defaulting Lender, including any claim of a Non-Defaulting Lender as a result of such Non-Defaulting Lender's increased exposure following such reallocation.

Market Advisory

September 22, 2015

"The EU Bail-in Rule"

Introduction

Beginning in January 2016, European banks and certain other European loan market participants will be subject to "bail-in" rules under which certain of their unsecured liabilities will be subject, at the election of applicable European regulatory authorities, to cancellation, write-downs, modification of terms, or conversion into equity to resolve and to recapitalize the affected institutions. These rules require that, when such institutions enter into contracts governed by non-European law (including agreements governed by the laws of New York and other states), the bail-in provisions must be acknowledged contractually. Affected institutions are required to give notice to their contractual counterparties that any such liabilities arising under agreements entered into or amended starting as soon as January 2016 are potentially subject to compromise in a bail-in by the applicable European regulatory authorities and to obtain the express contractual agreement of their counterparties to acknowledge that the obligations are subject to bail-in and to accept the terms of any bail-in as they apply to such contractual obligations. Affected institutions will be subject to regulatory sanctions if they do not comply.

Many institutions that are subject to these new requirements are active participants in the U.S. loan markets. As the deadline for implementation approaches, they will be required to assess carefully which of their contracts contain obligations that will be subject to bail-in and when they must comply with the regulatory requirement for counterparties to acknowledge and agree in advance to bail-in. Affected institutions and their contractual counterparties (whether or not subject themselves to the regulatory requirement) will want to consider the consequences of agreeing to the required contractual bail-in provisions and the wide range of transactions that may be affected. In the simplest case, an affected institution that is a borrower under a U.S. credit agreement will need to make sure that appropriate language is included in the agreement to acknowledge its lenders' recognition and acceptance of the terms of any future bail-in of such borrower's obligations thereunder. But there are also circumstances in which the affected institution's obligations in other capacities, even as a lender, may trigger the requirement for counterparty agreement, including with respect to credit commitment obligations (under a revolving credit facility or otherwise), obligations as a letter of credit issuer, unfunded participations in syndicated letter of credit or swingline facilities, and certain obligations in respect of secondary market transactions.

Background – the European bail-in powers

The ability to bail-in the claims of unsecured creditors is seen by the European financial regulatory authorities as a fundamental tool in the post-financial crisis reforms designed to ensure that failing financial institutions can be resolved and recapitalized without recourse to the publicly funded bail-outs that were a feature of the financial crisis. Although U.S. regulators are likely to adopt some sort of bail-in, preliminary indications are that any U.S. bail-in requirement would be limited to requiring systemically important institutions to issue specified amounts of long-term debt providing for bail-in. Because the U.S. regulators do not believe that bail-in resources should come from the banking sector, banking organizations would not be permitted to invest in such instruments.

This bail-in regime is required to be implemented by the member states of the European Union (**EU Member States**)[1] pursuant to the EU Bank Recovery and Resolution Directive (**BRRD**). Under the BRRD, these regulatory requirements which are generally effective on 1 January 2016, although subject to detailed implementation by regulatory authorities of the applicable EU Member States for institutions within their jurisdiction. Some EU Member States, such as the U.K and Germany, are more advanced in this process than others.

The European bail-in tool is designed to be used either to recapitalize an institution outside a formal insolvency proceeding so as to enable it to continue as a going concern, or to write-down liabilities that have been assumed by a bridge institution established to acquire the business of the failed institution with a view to capitalizing the bridge institution. The BBRD provides that the applicable resolution authorities will have powers to cancel or modify the institution's liabilities in a manner that reflects the hierarchy of claims in insolvency. These powers are broad: the interests of existing shareholders may be cancelled, diluted or transferred and the claims of unsecured creditors may be converted into equity, written down sufficiently to absorb the losses incurred, and other terms, including maturity and interest payable, may be varied. The object of the bail-in provisions is to achieve a comparatively smooth process for resolving and recapitalizing failing institutions without resort to publicly funded bailouts or the loss of going concern value that might otherwise be incident to a liquidation.

In Europe, any resolution actions taken by the relevant authorities in any member state of the European Union would be recognized and given effect throughout the other EU Member States as a matter of law pursuant to changes introduced to the Credit Institutions Winding Up Directive (Directive 2001/24/EC) by the BRRD. For this reason, no changes are required for any contracts governed by the law of any EU Member State. Such recognition will be extended to the European Economic Area (**EEA**)[2] in due course.

In other jurisdictions, including the United States, because the provisions will not be automatically recognized or implemented, the European regulators have, pursuant to Article 55 of the BRRD (**Article 55**), required affected institutions entering into contracts

[1] Austria, Belgium, Bulgaria, Cyprus, Croatia, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxemburg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and United Kingdom,

[2] The EEA is comprised of the EU member states, Iceland, Lichtenstein and Norway.

under the laws of such other jurisdictions creating liabilities subject to bail-in to obtain the contractual agreement of their counterparties to the bail-in of the affected liabilities (a **recognition clause**) and may impose regulatory sanctions on those that fail to comply.

Contractual recognition of bail-in – requirements for affected European institutions under Article 55 of the BRRD

Article 55 applies to EU (and other EEA) regulated banks and certain investment firms, financial holding companies and financial institutions that are subsidiaries of any of the above.

The contractual recognition rule applies to all non-EEA liabilities of affected institutions incurred on or after 1 January 2016 except for liabilities that are excluded from bail-in (including, in broad terms) secured liabilities (to the extent of the security), liabilities in respect of deposits made by individuals and small and medium size enterprises, liabilities under covered bonds and fiduciary arrangements, liabilities to employees (other than bonuses), certain commercial or trade creditors, tax authorities and deposit guarantee schemes, and certain short term liabilities to banks, investment firms, and EU-designated clearing houses and payment and settlement systems.

Although the BRRD does not include a definition of "liability," for UK institutions, the UK's Prudential Regulatory Authority has defined "liability" as any debt or liability to which a relevant institution is subject, whether it is present or future, certain or contingent, ascertained or sounding only in damages. There was some hope for greater clarity in the technical standards published on 3 July 2015 by the European Banking Authority for adoption by the European Commission for application in all EU Member States (the **Final RTS**), but many issues are still unsettled. For example, although the BRRD provides that secured liabilities are excluded from bail-in (to the extent of the security), the Final RTS provides that an agreement with respect to a secured liability must contain the creditor's agreement to bail-in unless the liability will be fully secured on a continuous basis. The Final RTS also clarifies that existing agreements amended on or after January 1, 2016 will also need to comply with the Article 55 requirements.

Implementation of Article 55

For affected institutions, the potential impact of the recognition clause requirement goes beyond the loan market, and is relevant to many of their cross border transactions and all of their operations outside Europe. Other organizations, such as ISDA and ASME are also reviewing its implications for their markets and developing model clauses for inclusion in appropriate agreements. The LSTA, with the assistance of Allen & Overy LLP and input from its member institutions, is reviewing the potential effects on U.S. loan market practices and documentation, including the extent to which the inclusion of the Defaulting Lender provisions from the LSTA's Model Credit Agreement Provisions might mitigate the recognition requirements of affected members of the syndicate under a U.S. Credit Agreement. Given the short period until implementation, the breadth of the bail-in powers, and the ongoing examination of the universe of liabilities and agreements that are potentially affected, it is expected that this note is the first in a series of bulletins on this topic over the next few months.