

Mr Hannes Huhtaniemi
DG Internal Market
Commission of the European Union
Brussels,
B-1000
Belgium



26 April 2012

Dear Mr Huhtaniemi,

Re: Working Document of the European Commission, DG Internal Market, on bail-in as a debt write-down tool

I am writing to you today in support of the Response to the working Document submitted by the City of London Law Society, on 20th April 2012. I write on behalf of the Law Society of England and Wales (EU Interest Representative Register ID: 38020227042-38).

The Law Society is the representative body of over 140,000 solicitors in England and Wales. The Society negotiates on behalf of the profession and makes representations to regulators and Government in both the domestic and European arena. This response has been prepared on behalf of the Law Society by members of our Working Party on Banking Reform. The working party is made up of senior and specialist lawyers and an economist, with expertise in banking and financial services regulation, competition law, EU law and international commercial law.

The Law Society of England and Wales supports the Commission's stated objective of ensuring that regulatory authorities in Member States have the necessary resolution tools to take effective action when banks get into financial difficulty and to help minimize disruption to markets and economies. We would welcome the development of mechanisms which achieve this aim and ensure the continuity of essential financial services for consumers and businesses.

Accordingly, we appreciate the publication of the Commission's discussion document on the appropriate rules for the operation of bail-in as a mechanism for enhancing stability in the financial system.

The Law Society has not prepared a full response to this discussion document. Instead, we are writing in support of the response submitted by the City of London Law Society (CLLS). In this response paper, the CLLS raises a number of important points about the principles and practicalities of bail-in.

The Law Society of England and Wales concurs with the general view of the CLLS that the key guiding principles should be certainty and clarity in the law, together with the principle of freedom of contract¹. The Law Society is of the view that any tool which may interfere with the ability of banks and their funders to agree the terms on which they deal requires the strictest safeguards and protections, so that (i) investors and counterparties cannot be taken by surprise, (ii) funding is correctly priced and (iii) the rule of law is effectively respected. Thus if the regulatory aim is that a certain percentage of a bank's liabilities should be capable of conversion into equity (subject to bail-in) in the event that the bank gets into financial difficulties, that bank should be free to achieve that target in a consensual matter, eg through defined securities issued, and/or defined deposits

¹ CLLS comments, paragraphs: 5, 68 and 69.

accepted, on terms that allow for bail in. The regulatory aim should not be achieved by giving regulators powers of conversion over all the bank's liabilities subject to exceptions of uncertain scope.

In the light of these more general comments, we therefore agree with the CLLS suggestion that the range of liabilities which can be 'bail-inable' should be defined clearly and limited to suitable classes of liability, where the value of the liabilities can be readily ascertained. This more limited application of bail-in is to be preferred over a wide ranging approach covering all liabilities (with a limited number of exemptions). We take this view not only for the principled reasons set out above, but because of the impracticalities of having a wide-range of liabilities subject to 'bail-in'. We consider the CLLS response paper to make this point powerfully. A bail-in policy which is limited in its nature, and which is clear on the liabilities to which it applies, is far more workable and much less complex than a less discriminating approach. In particular the Law Society shares the views of the CLLS with regard to the list of liabilities set out in the CLLS response to Question 3 of the discussion document. We would respectfully urge the Commission to consider carefully the arguments made by the CLLS in relation to each of these liabilities.

The Law Society also supports the suggestion in the CLLS response that it must be clear from the outset whether a particular liability is likely to be subject to 'bail-in'. This clarity is in our view absolutely fundamental to the requisites of the principle of legal certainty. Liabilities subject to compulsory bail-in will be more risky than those which are not. The increased uncertainty associated with a bail-inable liability will increase the risk premium which all creditors require when they deal with banks. This will in turn lead to higher funding costs and reduce the competitiveness of affected banks and their groups, as compared with those whose principle operations are outside the EU. The costs of an over-inclusive approach will be borne by EU economies as the costs incurred by banks will feed through to customers. In addition, there is an increased risk funds will be less available generally, and in particular that the increasing reality of the risk of actual bail-in will lead to a flight of funding from any evidently weakening bank and precipitate an avoidable and unnecessary crisis with its accompanying loss of confidence for the whole banking sector.


In addition, the discussion document does not appear to give sufficient coverage to the danger that bail-in could lead to distortions in the market for bank debt. Bail-in could alter the relative prices of different kinds of liabilities and thus produce a disincentive to some institutions from making decisions which would otherwise be wholly appropriate. We take the view that the longer-term effects of bail-in should be examined more closely before any concrete proposals are put forward.

We share the view of the CLLS that any reforms need to be international, rather than simply confined to the EU. Some agreement under the auspices of the G20 (or similar) would ensure as level an international 'playing field' as is practical. As noted above, the introduction of bail-in could increase financing costs for banks. Increases in such costs would, over time, have an impact on their international competitiveness, and on consumers at home. In turn, this would be likely to have a negative effect on the long-term growth rate of the financial services sector, which would have a knock-on effect on growth rates in the EU. A consistent policy across the major advanced and emerging economies is therefore important. Such an approach would help minimise any potential negative impact, from the introduction of a bail-in scheme, on the business activities of Europe's international banks.

We also concur with the CLLS that a margin of discretion for the parties concerned is key when it comes to how banks meet their reserve requirements, and their ability to absorb losses in general. The Law Society considers that while regulators should set the minimum requirements in respect of banks' loss absorbing capacity, it should be up to the banks themselves to decide what mixture of tools is most appropriate for them (including potentially voluntary bail-in which would be agreed with those providing the bank debt in question). This view is slightly different from that taken by the CLLS in answer to Question 5(a) of the discussion document.

Although this letter is necessarily brief, I felt that it would be worthwhile taking the time to write to you in order to indicate the Law Society's support for the important points made by the CLLS and too emphasise the importance of considering fully the risks and costs of compulsory bail-in. Furthermore, the Law Society looks forward to contributing in greater detail, in the future, to the ongoing debate over banking reform.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'M Stobbs', is written over a faint, circular embossed seal of The Law Society of England and Wales.

Mark Stobbs
Director of Legal Policy, The Law Society of England and Wales