The City of London Law Society

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Banking Reform Bill Team
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

7 September 2012

By post and by email (banking.commission@hmtreasury.gsi.gov.uk)

Dear Sir/Madam

Re: White Paper on "Banking Reform: delivering stability and supporting a sustainable economy"

This submission is made by the City of London Law Society ("CLLS") in support of the submission made by the Law Society of England and Wales in relation to the consultation on the White Paper "Banking Reform: delivering stability and supporting a sustainable economy". It has been prepared by the Financial Law Committee but expresses views which are of concern more widely, particularly with regard to the potentially serious adverse effects arising from seeking to limit the choice of law used for ring-fenced banks, which we believe would be unnecessary and counterproductive.

We are also deeply concerned at the possible other unintended consequences and costs to UK regulated banks and their customers, and, indeed the economy as a whole, if the ring-fencing arrangements were to take the shape proposed. We say more on this below.

The CLLS represents approximately 15,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues.

We do not intend to go into all the issues which the Law Society has addressed, but here single out those which are of greatest concern:

Form of Proposed Ring Fencing

We share the concerns expressed by the Law Society about the form of the proposed ring-fence arrangements and that the impact assessment is not adequate to accurately assess the true cost, which, together with the cost of unintended consequences, could be very significant, to the point when the advantages of the proposals are substantially undermined. This is not an objection to the concept of ring-fencing as such: the main counter-consideration to the introduction of ring-fencing in the current economic climate is that the present level of actual and expected cost of complying with BASEL III at the time of the euro crisis, appears already to be limiting the ability of banks to meet customer needs for affordable loan capital, and the further very substantial costs of a major reorganisation and limitations on business activities falling on UK banks alone, would seem particularly to add to that problem, potentially to cause others and to disadvantage the UK economy at a time when it needs growth and the availability of affordable loan capital for UK businesses.

We are also concerned that the proposed "mandating" arrangements would be seen as an attempt to sideline the ability of banks regulated in the EU to exercise their passport rights in the UK and/or an interference with the EU rules on free movement of capital. These would potentially make the arrangements illegal under EU law and potentially expose the UK government to damages claims from affected banks (following the principles applied in *R v. Secretary of State for Transport, Ex Parte Factortame Ltd and Others,* [1999] UKHL 44; [2000] 1 AC 524; [1999] 4 All ER 906; [1999] 3 WLR 1062). Once the arrangements are reframed to avoid those risks, it is necessary to assess the economic impact of banks regulated elsewhere in the EEA being able to offer a wider range of seamless service to UK customers at potentially lower cost and the ways in which ring-fencing could be achieved while maintaining a more level playing-field.

Impact Assessment

The proposals are presently vague in areas which would significantly affect the impact assessment: for example, every restriction on what a ring fenced bank can do will have its own cost, but these are not fully spelt out or considered individually to the extent identified. In addition, there are no case studies indicating the effect on customers of the proposals, so there can be no proper understanding of whether ring-fenced banks would be actually able to meet the needs of customers, especially those whose main trading is in non-EEA currencies (particularly the US Dollar) whose principal trading partners are outside the EEA, or who need to operate the finance of a manufacturing or other business facility outside the EEA seamlessly with a principal UK business: not all these customers will be able easily to form relationships with non-ring-fenced banks. A failure to meet customer needs would tend to stifle growth of affected businesses and/or would force businesses to deal with non-UK regulated banks, potentially on a riskier basis for them and for the UK economy in the event of a future financial crisis.

We agree with the Law Society that substantially more work is needed to produce a soundly based impact assessment.

Restrictions on Use of non-EEA Laws by Ring-Fenced Banks

We strongly believe that this aspect of the proposals should be abandoned.

This would be seen by non-EU States as a protectionist measure damaging the UK as a free trade nation and inviting retaliation from major non-EEA economies. This in turn could impact on the use of English law and English dispute resolution internationally and on the businesses of legal firms who provide English law services outside the EEA. We wholly endorse the more detailed observations in the Law Society paper. We do not believe that this can have been intended or that there can be any need to risk such consequences.

The purpose of the proposal is not entirely clear, but in so far as the White Paper suggests that it may be intended to address concerns that foreign laws may not recognise transfer orders in resolutions under the Banking Act 2009 or similar measures, we do not believe that it would either address that concern effectively or that it would be an appropriate means to do so. A more effective measure, both within and without the EEA , would be to require UK regulated banks to obtain explicit agreement from major contractual counterparties to accept the effects of the resolution regime, in the event that it should have to be applied, without reference to governing law.

Bail-in

On the subject of bail-in, we repeat the views we expressed to the European Commission earlier this year, (see " Response to the Working Document of the European Commission, DG Internal Market, on bail-in as a debt write-down tool" which is annexed to the Law Society Response and available on the Financial Law Committee section of the CLLS website at http://www.citysolicitors.org.uk/FileServer.aspx?oID=1169&lID=0. We would be very deeply concerned were the UK to "front run" this proposal which would add substantially to the cost of capital for UK regulated banks and damage competitiveness, unless adopted not just by the EU but throughout the G20 and the EEA.

Even if bail-in were to be adopted, we are of the view that trading assets and obligations of banks, such as deposits in the ordinary course of business, obligations to make loans and to deal with banking customers or customer groups on a net basis, as well as obligations to suppliers of goods and services, are wholly unsuitable to be included in, or disrupted by, the application of bail-in to obligations to creditors. These are either:

- the trading assets and liabilities of the bank (or of a bridge bank) as a going concern once reconstructed (so that obligations must be met in full so as to retain customers and restore trust in the continuing business), or
- they will fall into an insolvency where the insolvency ranking should be applied.

Accordingly, only equity or other share capital and the sort of debt obligations (such as bonds, loan stock and loan facilities) which would typically be by agreement written off, written down or converted into equity in a consensual scheme of arrangement under the Companies Act are suitable for bail-in. Given that capital may need to be raised (or have already been raised) in foreign currencies under foreign laws, it is desirable that bail-in only applies where this is expressly agreed by the investor(s) at the time of issue of the relevant instrument or in the relevant contract.

We should be happy to discuss our concerns and possible ways of addressing them with you further if this would be helpful.

Yours faithfully,

Dorothy Livingston
Chair, Financial Law Committee

(The names of the members of the CLLS Financial Law Committee are available on the CLLS website. Sarah Paterson of Slaughter and May did not participate in this submission.)