

23 April 2012

European Commission
DG Internal Markets
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EU Discussion Paper on Debt Write Down dated 30 March 2012

Dear Ms de Basaldua and Mr Fornies- Martinez,

We believe DG Internal Markets' have made substantial progress in developing the bail-in concept and is generally travelling in the right direction. We commend the Services' courage for promoting an approach to resolution that even if common place for corporate restructurings is unfamiliar to bank investors and is change making in that regard. In the context of the current Eurozone crisis, there are fears, as we saw on Tuesday at your roundtable, that if not designed properly, bail-in could adversely affect the supply and pricing of long-term senior debt. On the other hand, if designed with utter simplicity and allows flexibility to those firms that are best placed to use bail-in while allowing firms for whom it may be inappropriate, to employ alternative arrangements for their resolution, we expect it will have a stabilising effect on markets.

We see two key issues for designing bail-in properly: 1) it should be flexible: firms using bail-in should not be subject to a minimum amount requirement nor restricted to where a bail-in could occur in their structure, and 2) with the exception of deposit guarantee schemes and deposits not covered by any such scheme, which our members continue to consider, in principle, all unsecured liabilities should be bailable, including derivatives, so that a wide range of situations can be addressed. As a matter of practice, however, we expect that certain classes of liabilities, including derivatives, might need to be excluded to make bail-in more practical and efficient and avoid systemic disruptions.

1. Flexibility

Resolution policy is premised on the shared desire between industry and regulators to prevent a failure of an institution from becoming a burden on taxpayers. Thus, the recognition that regulators need a tool-kit of options to deal with differently structured banks (investment, commercial, retail, universal), in varying types of financial crises (capital, liquidity, domestic, cross border). Accordingly, each firm has been tasked with writing its own bespoke resolution plan to be agreed by its home and, where appropriate, host resolution authorities. We should not underestimate the power this

reform will have: the mere assemblage of information and firms taking responsibility for their own destinies by developing resolution that are the most likely to be effective for them – will significantly help authorities resolve firms effectively.

We must recognise, however, that not all tools will work for all firms. A bail-in will likely not work for firms that are largely funded by deposits with little to no capital markets funding. Deposits are the bank's equivalent to a company's customers – they are their lifeblood. Without them, there is no business. If they are compromised in a recap they will likely leave the firm (even where reimbursed by a DGS). Deposit funded institutions may be more appropriately resolved by using a bridge to run off the good assets (loans) and transferring the deposits to a solvent institution. UK banks Northern Rock, Bradford & Bingley and Dunfermline are cases in point. A Lehman, on the other hand, could have been recapitalised (bailed-in).

The difficulty with establishing a minimum amount is finding a level appropriate for all firms. It needs to be incumbent upon each firm to show its investors that the firm is resolvable. A firm employing bail-in will need to persuade its senior investors that it has sufficient capital. This will inform their pricing dialogue, as it should.

Another problem of a minimum amount as we heard on Tuesday is it risks creating an artificial trigger for signalling systemic distress that may in reality be unwarranted. A firm may be distressed before – or after – the trigger is breached.

Firms should be permitted to establish bail-in plans at the place in their structure that makes the most sense for them. In most cases this will be at the holding company level but not in all. In cross border situations, concerns that a subsidiary may not be supported by a parent can be dealt with in group resolution plans and firm-specific cooperation agreements. These plans will be supplemented by a variety of corporate law techniques to upstream or downstream funds or equities intercompany debt. The key is that these plans are simple and easy to implement.

2. Derivatives

We recommend that derivatives be included within the scope of the authorities' bail-in powers. As a practical matter, however, derivatives counterparties are a firm's trade creditors. Bailing them in could push up the cost of prudent hedging activity and lead to further demands for collateral in circumstances where supply is scarce. These concerns leave AFME to conclude that while it should be legally possible to bail-in derivative we don't envision that it would necessary or practical in all but extraordinary circumstances.

As for grandfathering, we believe it would be a mistake to grandfather any instruments as it effectively creates super senior class of instruments. Bail-in should be treated on a par with the other resolution powers and all be implemented at the same time.

Our members are continuing to consider the other issues raised in your discussion paper, in particular, the bailinability of deposit guarantee schemes and deposits not covered by any such scheme.

Yours sincerely



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