14 June 2010

Feedback document to the CP 33

Introduction

1. On 17 December 2009, the Committee of European Banking Supervisors (CEBS) submitted its draft Implementation Guidelines for public consultation regarding Instruments referred to in Article 57(a) of Directive 2006/48/EC recast[1]. The guidelines are structured in four main parts covering the topics of definition of capital in the sense of Article 57(a) and Recital (4), permanence, flexibility of payments and loss absorbency.

2. The consultation period ended on 31 March 2010. 20 responses were received, 15 of which are published on the CEBS's website[2].

3. This paper presents a summary of the key points arising from the consultation and the changes made to address them. It also includes a feedback table which reflects CEBS's detailed views on the public responses.

General comments

4. Respondents generally supported CEBS's objectives and welcomed the opportunity to comment on the proposed implementation guidelines on core capital instruments.

5. Many respondents welcomed CEBS's willingness to address the specificities of mutual and cooperative banks in the guidelines, but urged CEBS to clarify and amend these provisions in order to more fully take into account the peculiarities of the cooperative model.

6. The vast majority of respondents expressed concerns about the fact that, in their view, the draft guidelines seem to go beyond the mere interpretations of Article 57a and Recital 4 of the Capital Requirements Directive (CRD). In practice, they consider that CEBS exceeded its mandate and that the draft guidelines can be regarded as presaging the decision of the Basel Committee on Banking Supervision (BCBS), which appears to be inappropriate to respondents. Respondents would like CEBS to ensure alignment of the guidelines with the current Capital Requirements Directive (CRD) and to have further amendments completed as soon as the new international standards are finalised.

7. Several respondents commented on the fact that the consultation paper did not propose grandfathering rules while they are believed to be crucial to ensuring a

[1] CP33 is published under: http://www.c-ebs.org/Publications/Consultation-Papers/All-consultations/CP31-CP40/CP33.aspx

[2] Under http://www.c-ebs.org/Publications/Consultation-Papers/All-consultations/CP31-CP40/CP33/Responses-to-CP33.aspx

smooth transition to the new standards and to alleviating confusion among market participants and banks.

CEBS's response:

Some modifications have been made to take into account comments from the cooperative sector (particularly on caps and on the reference to the ordinary share as a benchmark – cf. infra).

CEBS is entitled to give an interpretation of the CRD text and the guidelines reflect CEBS's views on what core capital should be. Recital 4 states that i) it should be possible to include instruments providing preferential rights for dividend payment on a non-cumulative basis if they absorb losses pari passu with ordinary shares and ii) that the specificities of non-joint stock companies should also be taken into account.

With regard to a preferential right, the CRD text does not elaborate explicitly on the characteristics of the distribution of payments. The criteria introduced by the guidelines are needed to ensure that the instrument fully absorbs losses pari passu with ordinary shares in a going concern situation, in accordance with Article 57(a). Flexibility of payments is one of the features which ensures loss absorbency and should not be assessed separately from other loss absorbency features. Granting a preferential right may prevent the instrument from being fully loss absorbent pari passu with ordinary shares. The introduction of the final guidelines has been made more explicit on this.

The guidelines have the advantage of ensuring consistency with the current BCBS work in order to avoid that instruments issued in the future are not recognised as Core Tier 1 when the BCBS framework is implemented. Concerning the timeline of implementation, the guidelines have to be transposed into the national legal framework of the Member States by 31 December 2010. CEBS is ready to revisit its guidelines as far as necessary to take into account possible changes in the global regulatory framework.

A clarification has been brought in the feedback table to indicate that core capital instruments non-compliant with the guidelines are deemed to fall under Article 57(ca) of the CRD and be treated as hybrids (Article 154(9) of the CRD).

Definition of capital in the sense of Article 57(a) and Recital (4)

8. The vast majority of respondents considered that making ordinary shares the benchmark for assessing the eligibility criteria of core capital instruments to be debatable. The respondents were of the idea that only the prudential criteria specified in the CRD should serve as the benchmark, rather than a specific legal form. Several respondents asked for the introduction of references to capital instruments of non-joint stock companies.

9. One respondent indicated that, in his view, a common definition of core capital instruments should exclusively build on Article 57(a) (and not on Recital 4) as that is the only reference that can be legitimately taken into account.

10. Several respondents argued against potential restrictions on the existence of different classes of shares.

11. One respondent disputed whether, indeed, the instruments have to be recognised as equity under national law.

12. Several comments were made, which took note the use of employee share schemes or share option/save schemes and market-making activities.

13. A few respondents did not support the prohibition of indirect issuances.

CEBS's response:

CEBS confirms that, for joint-stock companies, the benchmark should be ordinary shares. For non-joint stock companies, the final guidelines have been amended to state that mutual and cooperative shares are equivalent to ordinary shares, provided that they fulfil the eligibility criteria developed in the guidelines (especially concerning loss absorbency). New Paragraphs 5, 33, 34 of the final guidelines have been modified accordingly.

As to the requirement that instruments be recognised as equity capital, including under accounting standards, criterion 1 has not been changed in respect of this point. The current CRD text requires capital instruments to be regarded as equity capital under accounting rules. Where IFRS are the relevant accounting standards, CEBS does not see the need to depart from this principle. CEBS is ready to revise its guidelines on this point, if need be, taking into account potential changes in the IFRS rules.

CEBS does not prevent institutions from granting credits to their customers when they are at the same time shareholders of the institution. It is the institution's responsibility to identify the purpose of the loans they grant. If this purpose is the financing of own shares, this is not acceptable. The guidelines do not cover the case of the cooperative banks where a shareholder needs to buy a share to obtain a loan. Criterion 2 remains unchanged.

On market-making activities, there is no prohibition on such activities, but the corresponding positions on own shares must be deducted from own funds as stated by the CRD.

On employee share schemes, CEBS will investigate this issue further in relation to BCBS's current work. The purpose is to avoid double deduction if the options granted to employees are already considered as a cost in accounting statements and deducted from Core Tier 1, but this cannot lead to a departure from the principle that the institution should not grant credits to finance the subscription of its own shares.

CEBS does not see the need to change the guidelines concerning the prohibition of indirect issuances. It is not current practice to recognise indirect issuances in Core capital. The purpose of the instrument is to absorb losses at the level of the entity and not at the level of the SPV. This does not prevent the inclusion of minority interests in common equity at the consolidated level.

Permanence

14. Several respondents stressed the specificities of cooperative shares regarding restrictions to the redemption of the shares. The permanence criteria should be considered fulfilled when there are sufficient safeguards such that redemption and buy-backs would not materially impinge on the availability of an institution's core capital.

15. Some respondents disagreed that redemptions and/or buy-backs should be subject to a prior supervisory approval. Some respondents asked for the introduction of a defined yearly allowance / threshold ("de minimis" clause). Others asked for a "net perspective" to take into account not only redemptions but also issuance of capital, especially for cooperative banks.

16. Furthermore, respondents were generally of the view that capital instruments that are bought-back should only be deducted from own funds if and when they have been effectively bought-back. Generally, respondents considered that the appropriate reference point should be the moment when capital flows out of/into the bank, but that no deduction should be operated as long as the capital is still available to the institution.

17. Some participants considered that the information to be communicated to supervisors before a redemption or buy-back to be too extensive and feared a duplication of information already available to authorities with regard to Pillar 2 / ICAAP.

CEBS's response:

The concept of "sufficient certainty" has been clarified in the feedback table: for joint-stock companies, it is the moment when the redemption/buy-back is disclosed to the market; for non-joint stock companies, it is the moment when the decision to redeem is taken.

Furthermore, the text (new paragraphs 54 and 59) leaves sufficient flexibility for supervisors to define a process for redemptions and buy-backs ("competent authorities may define a process") and a threshold ("materiality of the amount"), even for market-making activities. These paragraphs have nevertheless been slightly modified to indicate that the supervisor may define an ex-ante process by which it may define in advance an amount that can be redeemed or bought-back by the institution without triggering a deduction. A deduction would only occur when sufficient certainty (cf. supra) has been proved. In practice, the principle of a prior authorization is maintained in any case. There is no exception, even in cases where there is a replacement by equivalent capital. In this latter case, the process to be applied by the supervisor, under paragraphs 56 and 61, should, nevertheless, be proportional.

Concerning the need for institutions to demonstrate that they can re-access the market (new paragraphs 55 and 60), the final guidelines have been modified to indicate that the institution should assess its ability to re-access the market as part of the capital planning process and that this has to be part of the assessment undertaken by the supervisor to be made as per paragraphs 55 and 60. This assessment should take into account the nature of the institution and its source of core capital funding (notably for non joint stock companies).

On the information to be communicated to supervisors, the institution does not have to communicate information the supervisor may already have under the Pillar 2 process.

Flexibility of payments

18. Respondents generally questioned the assertion that the existence of a cap would tend to encourage banks to make payments up to the level of that cap.

19. Many respondents did not support the prohibition on caps on payments and fixed amounts, either because it does not, in their view, pose any problems from a prudential perspective, or because it has consequences for the investor base. The existence of a cap for cooperative shares is, on the contrary, a way of avoiding over-distribution of profits and of raising the proportion of earnings retained and, thus, contributes to the growth in own funds.

20. Other respondents contested the requirement for a cap to be applicable to all instruments since this is viewed as a threat to the existence of different categories of shares.

21. A few respondents disagreed with the prohibition on dividend pushers/stoppers and ACSM features.

CEBS's response:

Two different situations have to be considered concerning the cap on payments, firstly the case of joint stock companies issuing ordinary shares and, secondly the case of non-joint stock companies.

There is in the first case no doubt that there should be no cap on payments for ordinary shares. Introducing an indicative rate for other instruments issued, certainly for joint stock companies that are listed, is a clear indication that this rate will be paid, which undermines the flexibility of payments.

Nevertheless, the wording of paragraphs 68 and 69 has been changed with a view to making this point clearer.

For the specific case of non-joint stock companies, CEBS recognises that the existence of a cap is designed to protect the reserves and should be preserved, even when there are different categories of cooperative shares. CEBS agrees that the cap should not necessarily be defined by the law alone but also by the statutes of the company since the purpose is to protect the reserves on non-joint stock companies. For cooperative banks issuing cooperative shares with a cap and other core instruments without a cap, CEBS agrees that this is acceptable if the instruments fulfil all other criteria (no indicative rate, absorb the first losses pari passu, same ranking in liquidation, potential preference limited to a multiple of the dividend on the instrument that does not have a preferential right, etc).

Dividend pushers/stoppers must be prohibited; otherwise the instruments are not pari passu anymore. Preferential rights are allowed, but the instruments have, first, to be pari passu both in going concern situations and in liquidation. In the same vein, ACSM features must be prohibited but an institution may pay its dividends in shares.

Loss absorbency

22. Several respondents consider that the entitlement to a claim on residual assets in liquidation is not relevant as a criterion for eligibility, in particular for non-joint stock companies.

23. Representatives from the cooperative sector underlined that, in the co-operative model, cooperative shares are governed by a different economic logic, whereby cooperative shares can co-exist with other capital instruments without there being any difference in loss absorbency.

24. They also underlined the fact that different capital instruments with differing rights of access to reserves coexist in cooperative banks.

25. A few respondents expressed concerns that the proposed interpretation is not in line with the wording of Article 57(a).

CEBS's response:

CEBS has already recognised that the entitlement to a claim on residual assets in liquidation is not relevant as a criterion for eligibility for non-joint stock companies.

The CRD text stipulates that capital instruments have to rank pari passu in liquidation, thus different rankings cannot be accepted.

Annex

Feedback table on CP 33: summary of the public responses and suggested amendments

CP33	Summary of comments received	CEBS's response	Amendments[3] N/R: change not required
General comments			
	Respondents generally supported CEBS's objectives to contribute to a harmonisation of the definition of core capital and welcomed the opportunity to comment on the proposed implementation guidelines on core capital instruments. The vast majority of respondents contested the appropriateness of designating ordinary shares or a specific legal form of company as the benchmark for core capital instruments. Many respondents welcomed CEBS's willingness to address the specificities of mutual and cooperative banks in the guidelines, but urged CEBS to clarify and amend these provisions in order to better take into account the peculiarities of the cooperative model. In particular, they underlined the fact that cooperative capital instruments offer the same quality in prudential terms as ordinary	Some amendments have been made to the final guidelines in respect of ordinary shares being taken as a benchmark and in order to take on board some comments from the cooperative sector. The rationale for the cap on payments has been clarified. (See below for detailed comments).	

[3] Paragraphs mentioned in this feedback statement correspond to paragraphs of the CP 33. The final numbering of the paragraphs may have changed in the final version of the guidelines.

	shares and as such should be placed on the same footing as the latter. Several respondents were not supportive of the provisions on caps on payments and fixed amounts and some of them were concerned with the potential effects on a narrowing of the investor base.		
	The vast majority of respondents expressed concerns about the fact that, in their view, the draft guidelines seem to go beyond the mere interpretations of Article 57a and Recital 4 of the Capital Requirements Directive (CRD) through the introduction of additional criteria based on the recommendations of the Basel Committee on Banking Supervision (BCBS). The draft guidelines can thus be regarded as presaging the decision of the BCBS, which appears to be inappropriate to respondents since this could, in their view, put EU banks at a competitive disadvantage and would mean bringing forward the implementation date of the Basel proposals. Respondents would like CEBS to ensure alignment of the guidelines with international standards and to have further amendments to be completed as soon as the new standards are finalised.	CEBS is entitled to give an interpretation of the CRD text and the guidelines reflect CEBS's views on what core capital should be. Recital 4 states that i) it should be possible to include instruments providing preferential rights for dividend payments if they absorb losses pari passu with ordinary shares and ii) that the specificities of non-joint stock companies should also be taken into account. With regard to a preferential right, the CRD text does not elaborate explicitly on the characteristics of the distribution of payments. The criteria introduced by the guidelines are needed to ensure that the instrument fully absorb losses pari passu with ordinary shares in going concern in accordance with Article 57(a). Flexibility of payments is one of the features which ensure loss absorbency and should not be assessed separately from other loss absorbency features. Granting a preferential right may prevent the instrument from being fully loss absorbent pari passu with ordinary shares.	Introduction to be modified to be made more explicit.

	Several respondents commented on the fact that the consultation paper did not propose grandfathering rules while they are believed to be crucial to ensuring a smooth transition to the new standards and to alleviating confusion among market participants and banks. One respondent is of the view that grandfathering on core capital instruments should be discarded. Another respondent would like to see grandfathering arrangements include State aids arrangements and Government injections of Core capital.	The guidelines have the advantage of ensuring consistency with the current BCBS work in order to avoid that instruments issued in the future are not recognised as Core Tier 1 when the BCBS framework is implemented. As to the timeline of implementation, the guidelines have to be transposed into the national legal frameworks of the Member States by 31 December 2010. CEBS is ready to revisit its guidelines as far as necessary in order to take into account the possible changes in the global regulatory framework. Core capital instruments non-compliant with the guidelines are deemed to fall under Article 57(ca) of the CRD and be treated as hybrids (Article 154(9) of the CRD).	
Definition of capital in the sense of Article 57(a) and Recital 4			
General comments	The vast majority of respondents considered that making ordinary shares the benchmark for assessing the eligibility criteria of core capital instruments to be debatable. The respondents were of the idea that only the prudential criteria specified in the CRD should serve as the benchmark, rather than a specific legal form. One respondent disputed whether, indeed, the instruments have to	Some modifications have been made to take into account comments from the cooperative sector (particularly with the reference to ordinary shares being a benchmark – cf. infra). See below for detailed comments.	

	be recognised as equity under national law. One respondent understood that CEBS considers IFRS as the relevant accounting standard for the classification of capital instruments (paragraph 40). Another respondent suggested that it be made clear that IFRS are only relevant, where they are imposed by relevant legislation, or where their use is an option under national law. One respondent indicated that, in his view, a common definition of core capital instruments should exclusively build on Article 57(a) (and not on Recital 4) as that is the only reference that can be legitimately taken into account. Several respondents argued against potential restrictions on the existence of different classes of shares. Several comments have been made to take into account the use of employee share schemes or share save/option schemes and market making activities. A few respondents did not support the prohibition of indirect issuances.		
Question 1 **1.1** Are the guidelines in relation to the features of capital instruments sufficiently clear, or are there issues which need to be elaborated further? Please provide concrete proposals as to how the text could be amended	The guidelines were generally judged to be sufficiently clear. Several respondents asked for amendments on paragraphs 17 and 34 to introduce references to capital instruments of non-joint stock companies. Several comments have been made indicating that the existence of different categories of instruments should not be prohibited and that the current wording of paragraph 38 is too imprecise. Furthermore, one respondent would like the guidelines to clarify that, as indicated during the open hearing, merely a difference in voting rights is not regarded as creating a privilege for one of the classes or as affecting the general loss absorbency capacity.	For joint-stock companies, ordinary shares should be included in capital under Article 57(a) and should be the benchmark for assessing the features of other instruments. For non-joint stock companies, CEBS agrees that mutual and cooperative shares are equivalent to ordinary shares, provided that they fulfil the eligibility criteria developed in the guidelines (especially concerning loss absorbency).	Paragraphs 17 and 34 of the Consultation Paper to be modified accordingly.

	A few comments have been made questioning the requirement that the instrument has to be valued as capital as well as the links made to accounting references.	As to the requirement that instruments have to be recognised as equity capital, including under accounting standards, criterion 1 has not been changed in respect of this point. The current CRD text requires capital instruments to be regarded as equity capital under accounting rules. Where IFRS are the relevant accounting standards, CEBS does not see the need to depart from this principle. CEBS is ready to revise its guidelines on this point, if need be, taking into account potential changes in the IFRS rules.	N/R
	A few respondents would welcome clarification of the term "legal owner" (paragraph 40), or even better, would like CEBS to adopt the wording of Article 22 of Directive 86/635/EC (shareholder or other proprietor).	CEBS agrees to use the wording "shareholder or other proprietor" instead of "legal owner".	Final guidelines to be amended to replace "legal owner" by "shareholder or other proprietor"
	Several respondents stressed that the current wording of paragraph 44 does not allow either market-making/market-smoothing activities or the use of employee share schemes or share option/save schemes.	On market-making activities, there is no prohibition on such activities but the corresponding positions on own shares must be deducted from own funds as stated in the CRD text.	N/R
		On employee share schemes, CEBS will investigate this issue further in relation with BCBS's current work. The purpose is to avoid double deduction if the options granted to employees are already considered as	N/R

		a cost in accounting statements and deducted from Core Tier 1 but this cannot lead to a departure from the principle that the bank should not grant credits to finance the subscription of its own shares.	
	Regarding the financing provided to shareholders (criterion 2), numerous respondents would like it to be made clearer that the criterion aims at discarding financial engineering intentionally turning debt into equity, but does not preclude a normal relationship with institutional investors, or retail customers (including bank employees) who may have, at the same time, credit facilities and a portfolio invested in bank shares among other securities. Many respondents indicated that it is not possible in all circumstances for banks to be able to fully know what customer loans are used for, except in cases where the bank is knowingly financing the subscription or purchase. Suggestions were to add the word "knowingly" in paragraph 44, or to replace with that incorporating a direct prohibition on banks against the simultaneous offering of loans financing subscription or purchase. One respondent asked for the deletion of the last sentence of paragraph 44. In the same vein, shares that were pledged in the frame of a consumer credit should not be deducted from capital.	CEBS does not prevent institutions from granting credits to their customers when they are at the same time shareholders of the institution. It is the institution's responsibility to identify the purposes of the loans they grant. If this purpose is the financing of own shares, this is not acceptable. The guidelines do not cover the case of the cooperative banks where a shareholder needs to buy a share to obtain a loan. Criterion 2 remains unchanged.	N/R

1.2 Are there any circumstances under which indirect issuances would be justified? Please provide evidence.	Some respondents contested the prohibition on indirect issuances. Three respondents indicated that, in their view, if indirect issuances satisfy all eligibility criteria and, in particular, the requirement that instruments have to be fully paid, then the distribution channel becomes irrelevant. Another respondent stressed that, if instruments referred to in Article 57a are restricted to direct issuances, institutions will most probably not be able to issue in currencies other than their home currency. This flexibility could, however, become of the highest importance for institutions in order that they might manage the capital requirements for risk weighted assets denominated in currencies other than the home currency. One comment was made on the fact that issuances under non-direct means should be allowed where i) the SPV is an operating vehicle owned by the firm ii) where to not issue via an SPV would constraint to the investor base iii) where national corporation law allows issuance via SPVs. Two respondents argued that neither the text of Article 57a nor Recital 4 provide any support for the conclusion that instruments issued via SPVs need to be excluded. One respondent indicated that criterion 3 should take into consideration the context of capital issued through its consolidating financial subsidiaries, including minority interests, and not only have regard to individual issuing institutions.	It is not current practice to recognise indirect issuances in Core capital. The purpose of the instruments is to absorb losses at the level of the entity and not at the level of the SPV. This does not prevent the inclusion of minority interests in common equity at the consolidated level.	N/R
Permanence			
General comments	Several respondents stressed the specificities of cooperative shares regarding restrictions to the redemption of the shares. The permanence criteria should be considered fulfilled when there are sufficient safeguards such that redemption and buy-backs would not		

	materially impinge on the availability of a bank's core capital. One respondent indicated that implementing a formal right to reject the holders' request (as stated in paragraph 54) would expose cooperative banks to the risk of loosing their reputation since members of cooperatives would worry about their savings. Some respondents disagreed that redemptions and/or buy-backs should be subject to prior supervisory approval. Furthermore, respondents are generally of the view that capital instruments that are bought-back should only be deducted from own funds if and when they have been effectively bought-back.		
<u>**Question 2**</u> **2.1** Are the guidelines in relation to Permanence sufficiently clear, or are there issues which need to be elaborated further? Please provide concrete proposals as to how the text could be amended	The guidelines were generally judged sufficiently clear.		
	Several commentators that the situation regarding cooperative shares be considered equivalent to that of joint-stock companies regarding criteria 4, 5 and 6. Comments stressed that there are many mechanisms in different Member States for ensuring that the capital base remains stable and thus a permanence of capital is ensured. The bank's obligation to refuse redemption is subject to numerous regulatory restrictions and, in some cases, supervisory restrictions. In those cooperative banks that are subject to IFRS, the cooperative, or its board, have the unconditional right to decline requests for redemption. In other cooperative banks there are normally many elements that make redemption a very heavy process.	The principle of prior authorization is maintained in any case.	N/R
	Several respondents would like to have confirmation that a prior authorisation for redemption of cooperative shares to be given by the Board of Directors, and ratified at a general meeting, complies with the requirements of paragraph 54.	Agreed.	N/R
	They also proposed aligning the prudential treatment with the accounting treatment, by standardising the relevant definitions - based on the idea of the "unconditional" right of the issuer to refuse	The compliance with IFRIC2 requirements is not sufficient in itself to cancel the need for a prior	N/R

	redemption of the instrument - and amending paragraph 54 accordingly. Another respondent would like CEBS to confirm that paragraph 55 does not apply when cooperative banks comply with IFRIC 2. Two respondents indicated that the requirements that an institution should demonstrate that it can re-access the market (paragraphs 57 and 62) gave rise to serious concerns and did not seem to be feasible in practice. Should CEBS not delete the paragraphs, it was considered imperative that it at least elaborate and exemplify.	authorization. The institution should assess its ability to re-access the market as part of the capital plan and this has to be part of the assessment by the supervisor to be made under paragraphs 56 and 61. This assessment should take into account the nature of the bank and its source of core capital funding (notably for non-joint stock companies).	 Paragraphs 56. 57, 61 and 62 to be modified accordingly.
2.2 Are there any circumstances under which a prior approval of competent authorities for redemptions and buy-backs would not be justified? Please provide evidence.	Several respondents found it inappropriate that redemptions and/or buy-backs should be made subject to prior supervisory approval. Buy-backs of own shares are usually done to hedge the risk related to variable remuneration to be made in shares or share-linked instruments. It is important that this process can run smoothly without any prior approval by competent authorities. One respondent asked that at the very least, no supervisory approval should be required if the amounts bought back were replaced by equivalent capital. Some respondents asked for the introduction of exemptions such as market-making activities, a more precise formulation of the materiality of the amount in paragraph 56, or a defined yearly allowance / threshold ("de minimis" clause). Two respondents found it difficult to understand how the requirement on not announcing buy-backs to holders before the supervisory approval (paragraph 47) would interact with national corporate law which states that a decision to buy-back own shares is decided by the shareholders' general meeting.	The principle of prior authorization is maintained in any case. There is no exception, even in cases where there is a replacement by equivalent capital. In this latter case, the process to be applied by the supervisor under paragraphs 56 and 61 should, nevertheless, be proportional. Furthermore, the current text (paragraphs 56 and 61) leaves sufficient flexibility for supervisors to define a process for redemptions and buy-backs ("competent authorities may define a process") and a threshold ("materiality of the amount"), even for market-making activities. CEBS nevertheless agrees that the supervisor may define an ex-ante process by which it may define in advance an amount that	N/R Paragraphs 56 and 61 to be amended accordingly

	Comments have been made, indicating that paragraph 56 does not take into account the fact that, during the business year, cooperative banks do not only redeem capital, but also issue capital. While redemption may be relevant, it is normally more than compensated for the entry of new members. It, therefore, seems crucial that a "net perspective" is taken. One respondent indicated that it would not be practicable for cooperative banks to transmit an application for normal fluctuation of members. The yearly approval stated in paragraph 58 is still too restrictive and the process would be overreaching in cases in which only insignificant amounts are concerned.	can be redeemed or bought-back by the institution without triggering deduction. The deduction would only occur when sufficient certainty (cf. infra) has been proved.	
	In the view of several respondents, the information required under paragraph 56 is too extensive and any duplication of information requirements under paragraph 56 with regard to Pillar 2 / ICAAP has to be avoided. To avoid any duplication, it should be clear that the information should be limited to information not yet available to the supervisors.	On the information to be communicated to supervisors, CEBS confirms that the institution does not have to communicate information the supervisor may already have under the Pillar 2 process.	N/R
	A few respondents were concerned that the banks might face delays in regulatory approvals and suggested introducing a maximum assessment period for the supervisor. Two respondents suggested that the wording "well in advance" be rendered more precisely.	An obligation for supervisors to respond within a defined time limit is a rather uncommon concept in European banking regulation. In the exceptional cases in which such an obligation has been put in place, it has already been foreseen already by the CRD itself. Where relevant, national legislation will apply. In any case, in CEBS´s view, it is absolutely indispensable to preserving the necessary room for manoeuvre for supervisors.	N/R
	One respondent suggested deleting "usually once a year" in paragraph 58.	Not agreed	N/R
	One respondent asked for clarification for the time horizon observed	The time horizon should be of	

	by the supervisors in their examination (paragraph 55).	sufficient length.	N/R
2.3 Are there any circumstances under which the deduction from own funds is not justified when the issuer has publicly announced its intention to buy-back? Please provide evidence.	One respondent argued that capital instruments that are bought-back should only be deducted from own funds if and when they have been effectively bought-back, or if there is a binding contractual commitment to do so. Cases where an authorization has been given by the management or the General Meeting of shareholders (according to the applicable company law) within a limit (for instance for a share buy-back program) should not lead to a deduction of the authorized amount from own funds before the shares have effectively been bought in the market. Generally, respondents considered that the appropriate reference point should be the moment when capital flows out of/into the bank but no deduction should be operated as long as the capital is still available to the bank. Some respondents fear that the terms “sufficient certainty” and “estimated amount” raise unwelcome interpretation issues.	Not agreed. Not agreed. “Sufficient certainty” means the following: for joint-stock companies, the moment when the redemption/buy-back is disclosed to the market; for non-joint stock companies, the moment when the decision to redeem is taken.	N/R
Flexibility of payments			
General comments	Respondents generally questioned the assertion that the existence of a cap would tend to encourage banks to make payments up to the level of that cap. Many respondents did not support the prohibition of caps on payments and fixed amounts, either because it does not, in their view, pose any problems from a prudential perspective, or because it has consequences for the investor base. The existence of a cap for	The wording of the final guidelines has been amended. See detailed comments below.	

	cooperative shares is, on the contrary, a way of avoiding over-distribution of profits and of raising the proportion of earnings retained and thus contributes to the growth in own funds. Other respondents contested the requirement for a cap to be applicable to all instruments, since this is viewed as a threat to the existence of different categories of shares.		
<u>Question 3</u> **3.1** Are the guidelines in relation to flexibility of payments sufficiently clear, or are there issues which need to be elaborated further? Please provide concrete proposals as to how the text could be amended.	The guidelines were generally judged sufficiently clear. Some respondents disputed the requirement under criterion 6; they highlighted the point that management does not have full discretion on payments on ordinary shares since the decision is left to be taken by the shareholders.		
	A few respondents suggested the possibility of compulsory distributions under certain circumstances, when, for example, the bank is "well capitalised".	Not acceptable.	
	One respondent would like to have confirmation that the right of shareholders to propose and approve a dividend does not preclude the eligibility of the shares to core capital, in countries where the company law provides so for joint-stock companies.	Agreed.	
	A few respondents disagreed with the prohibition on dividend pushers/stoppers and ACSM features.	Dividend pushers/stoppers must be prohibited; otherwise, the instruments are not pari passu anymore. Preferential rights are allowed, but the instruments have first to be pari passu, both in going concern situations and in liquidation. In the same vein, ACSM features must be prohibited but an institution may pay its dividends in shares.	N/R
	A few respondents found the wording "multiple" (paragraph 69) unclear and asked for clarification.	This means that the potential preference is based on the dividend on the instrument with no	N/R

		preference multiplied by x and not on the dividend on the instrument with no preference + x%.	
3.2 Are there any circumstances under which the restrictions on payments (in particular those related to non-fixed amounts and caps) would not be justified? Please provide evidence.	Representatives from the cooperative sector made the point that by limiting the amount distributed, a cap serves to raise the proportion of earnings retained by the bank, and, hence, to increase the bank's own funds. Removing the cap on payments on cooperative shares would be counterproductive in prudential terms since it would limit the growth in the own funds of cooperative banks. As a consequence, they would like to have a more general exemption for cooperative banks and would like the deletion of the requirement that the cap is applicable to all instruments (paragraph 71). One respondent asked that the derogation curently valid only for cooperative banks be made available to all mutuals and cooperative banks that observe, through their constitution, the principle of limited interest on capital and not only to pure cooperatives. One respondent stressed that the principles must be applicable irrespective of the legal form. Should an exemption be granted to admit caps for original own funds instruments, this must apply to all credit institutions. One respondent indicated that the exemption contained in paragraph 71 was too narrow, since caps are to be found not only in national law but also in the statutes. One respondent considered that basing a remuneration principle on a reference to the principal amount invested in no way detracts from the loss absorbency ability of the instrument. More generally, respondents argued that distributions should be capable of being expressed as a percentage of the principal amount paid in or the nominal amount of the instrument, and asked for the deletion of the corresponding provisions in the guidelines.	Two different situations have to be considered concerning the cap on payments, firstly, the case of joint stock companies issuing ordinary shares, secondly, the case of non-joint stock companies. There is, in the first case, no doubt that there should be no cap on payments for ordinary shares. Introducing an indicative rate for other instruments issued, certainly for joint stock companies that are listed, is a clear indication that this rate will be paid, which undermines the flexibility of payments. Nevertheless, CEBS agrees to amend the wording of the final guidelines to bring clarification on caps and fixed amounts. Furthermore, for the specific case of non-joint stock companies, CEBS recognises that the existence of cap is designed to protect the reserves and should be preserved, even when there are different categories of cooperative shares. The cap should not necessarily be defined by the law, but also by the statutes of the company since the purpose is to protect the reserves. For cooperative banks issuing cooperative shares	Paragraphs 27, 70 and 71 to be amended. Paragraph 27 and 71 to be amended.

		with a cap and other instruments without a cap, CEBS agrees that this is acceptable if these latter fulfil all other criteria of the guidelines (no indicative rate, pari passu loss absorbency, same ranking in liquidation, potential preference limited to a multiple of the dividend on the instrument that does not have a preferential right, etc).	
	Some respondents made the point that the proposed requirement would exclude, for the future, that part of the market representing “fixed income” investors who accept loss absorbency, but require a return to be linked to the investment. One of the respondents indicated also that it would be difficult to place some instruments (including preferred shares) on the market without any prior indication of a specific amount to be paid out as dividend.	As indicated during the public hearing, CEBS focused its work on the quality of eligible capital instruments and not on the nature of the investor base or the type of potential buyers of the instruments. The objective is to keep the top Tier bucket as pure as possible and to keep it simple.	
	Two respondents indicated that neither Article 57a nor Recital 4 provide any support for the conclusion that instruments which have distributions tied to amounts paid in, or capped distributions, need to be excluded.	To ensure that the instruments are pari passu with ordinary shares, the characteristics of the distributions need to be similar to those of ordinary shares.	
Loss absorbency			
General comments	Several respondents consider that the entitlement to a claim on residual assets in liquidation is not relevant as a criterion for eligibility, in particular for non-joint stock companies.	CEBS has already recognised that the entitlement to a claim on residual assets in liquidation is not relevant as a criterion for eligibility for non-joint stock companies.	

Question 4 **4.1**. Are the guidelines relating to loss absorbency sufficiently clear, or are there issues which need to be elaborated further? Please provide concrete proposals as to how the text could be amended.	The guidelines were generally judged to be sufficiently clear. One respondent indicated that the requirements under criterion 9 are irrelevant if different classes of equity capital have different rankings in the event of liquidation. It must be up to the shareholders to decide differences between the different types of classes. Furthermore, it is of the greatest importance that different ways of obtaining access to the capital markets are available. Criterion 9 ought to be redrafted to better reflect the fact that the relevant distinction in a liquidation situation is between claim holders in general, on one hand, and the shareholders collectively on the other. Representatives from the cooperative sector made the point that, in the cooperative model, cooperative shares are governed by a different economic logic, whereby cooperative shares can co-exist with other capital instruments without there being any difference in loss absorbency. If CEBS's approach were to be retained, then the wording should focus on equality of treatment of all capital instruments in terms of loss absorbency and subordination in the event of liquidation, without prejudice to differences in the entitlement of each category of capital instrument to a claim on residual post-liquidation assets (given that such differences have no effect on either loss absorbency or subordination). They also noted that different capital instruments with differing rights of access to reserves coexist in cooperative banks even if the holders of cooperative shares have renounced their access to the reserves. A few respondents expressed concerns that the proposed interpretation is not in line with the wording of Article 57(a). One respondent indicated that there are no instruments attributable to core capital that would absorb losses as they occur, like ordinary shares.	The CRD text stipulates that capital instruments have to rank pari passu in liquidation, thus different rankings cannot be accepted. CEBS guidelines cannot diverge from the CRD text. For cooperative banks, whereby cooperative shares may co-exist with other capital instruments that may be entitled to different rights in liquidation, this is acceptable, provided that they fulfil loss absorbency criteria (especially they must be entitled to a claim on the residual assets that is proportional to their share of capital and not to a fixed claim for the nominal amount).	N/R
4.2. Are there any particular issues CEBS	The vast majority of respondents did not raise relevant further issues		

should consider regarding loss absorbency features, both in going concerns and in liquidation? Please provide evidence.	to be considered by CEBS.		