10 December 2009

Feedback document on CP 27

Introduction

1. On 22 June 2009, the Committee of European Banking Supervisors (CEBS) submitted for public consultation its draft implementation guidelines regarding Hybrid Capital Instruments[1]. The guidelines are structured in five main parts covering the topics of permanence, flexibility of payments, loss absorbency, limits and SPV issuances.

2. The consultation period ended on 23 September 2009. 19 responses were received; all of them 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 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 hybrid capital instruments.

5. A few respondents stated their preference for a more principles-based approach since in their view a too prescriptive approach could jeopardize the level playing field and put EU banks at a disadvantage compared with international competitors.

6. On the content, a large number of respondents considered the guidelines related to buy-backs to be too prescriptive and expressed their desire for a more flexible approach. Many comments were also received on the loss absorbency features, with regard in particular to conversions and write-down mechanisms.

Permanence

7. Some respondents asked for clarification of the way to calculate "incentives to redeem" (at the issue date or during the hybrid's life).

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[1] CP27 is published under: http://www.c-ebs.org/getdoc/90b2c355-ce93-46de-abd7-bcdf7dc5636e/CEBS-2009-104-Final--(Consultation-paper-on-hybrid.aspx

[2] Under http://www.c-ebs.org/getdoc/7b28a788-3c79-4da4-9c08-fb3c042d4104/Responses-to-CP27.aspx

8. Several respondents indicated that it may be too prescriptive to fix a precise conversion ratio for stock settlement mechanisms. Requests were also made for more insight into the reason underlying the choice of the 150% limit and for clarification of the way to calculate the conversion ratio. A number of respondents suggested introducing a cap on potential dilution instead.

9. The vast majority of respondents considered the proposed guidance on buy-backs to be too prescriptive and that it may undermine capital management flexibility and management of hybrid securities in the secondary market. Several respondents asked for the deletion of the guidance on buy-backs from the proposed guidelines.

10. Several respondents disputed CEBS's assertion that buy-backs are equivalent to a call or redemption. A common view was expressed on the fact that buy-backs may take place at any time, as for common equity, at the discretion of the institution and its supervisor. Respondents stressed that buy-backs within the first five years should be allowed without mandatory replacement.

11. The information to be submitted to competent authorities in the case of calls or redemptions was considered by many respondents to be too demanding. Some of them indicated that the time horizon (3-5 years) requested for the planned development of data like solvency and own funds (§64c[3]) is too extensive.

12. Many respondents proposed a limit of 10% (instead of 5%) for repurchased instruments held by the institution at any time. Some respondents would like to have the limit based on the total amount of all hybrid instruments issued instead of individual issues.

CEBS's response:

The rules that spell out which step-ups can be considered to be moderate form part of the Sydney Press Release of the Basel Committee on Banking Supervision and have been copied out without any change. CEBS does not see any reason for deviating from them. The assessment of the level of the incentive has to be made at the date of issuance.

Clarification of the way to calculate the conversion ratio will be provided in the final version of the guidelines. The conversion ratio is meant to limit the potential dilution.

It is CEBS's conviction that buy-backs are very similar to redemptions in prudential terms. CEBS therefore does not see any reason to take-back the restrictions proposed for hybrid buy-backs relating to prior authorization by the supervisor and the minimum duration of 5 years before a buy-back can take place.

The time horizon requested for the development of data is an example. The time horizon used shall nevertheless be of sufficient length and 3 years is generally considered to be a minimum.

On repurchased instruments held for market making purposes, CEBS agrees that at any time repurchased instruments shall not account for more than 10% of the relevant issue, instead of 5%, but a limit of 3% of the total amount of all outstanding hybrid instruments is introduced, and institutions will have to comply with whichever of the two limits is the lowest. That does not prevent the issuer from buying back a larger amount but, in that case, it should require the prior authorization of the competent authority.

[3] Paragraphs referred to in this document correspond to the paragraphs in CP27.

Flexibility of payments

13. Several respondents disputed that the requirement for dividends and coupons to be cancelled at the supervisor's request should be on a fully discretionary basis. Some respondents feared that differing interpretations by national authorities may threaten the level playing field.

14. A few requests were made to amend the conditions for waiving dividends/coupons under dividend pushers (§83) when dividends to shareholders are paid in shares.

15. Some respondents considered that no restriction should be put on the use of dividend pushers and stoppers.

16. Concerns were expressed about the fiscal consequences of the guidelines on ACSM mechanisms and the potential resulting impact on the level of own funds.

CEBS's response:

CEBS believes that supervisors shall have the ability to intervene at any time they think it is necessary and at the minimum when there is a breach of capital requirements or in order to prevent such a breach occurring. Supervisors expect that issuers will not wait for supervisory intervention before cancelling payments when necessary in view of the financial and regulatory situation of the institution.

Dividend pushers and stoppers are considered to be limitations on full flexibility of payments. Thus, their use shall be restricted to ensure a large degree of flexibility to cancel payments.

CEBS agrees that a hybrid distribution should not be triggered through a "dividend pusher" when a payment on junior or pari passu securities is made exclusively in shares.

Loss absorbency

17. Some respondents stressed that in their view the guidance on mandatory and contractual mechanisms such as write-downs or conversions is too prescriptive. Terms embedded in hybrid Tier 1 capital are considered sufficiently flexible and most appropriate to allow recapitalisation if need be. In the opinion of some respondents, write-downs and conversions do not increase the loss absorption capacity of hybrids nor make recapitalisation more likely.

18. Many respondents considered that writing down permanently the nominal amount of the principal at a trigger point (§114a) would disadvantage hybrid holders compared to equity holders which is not coherent with hybrid holders ranking.

19. In case of trigger points for write-downs, respondents considered that the trigger point should in any case be left to the discretion of the institution and its competent authority.

20. Respondents generally considered it more appropriate to leave flexibility to each institution to have or not have different levels of subordination.

CEBS's response:

CEBS believes that the loss absorbency features of a hybrid instrument should not be limited to the fact that the instrument helps to prevent insolvency. The purpose of trigger mechanisms is not to disadvantage hybrid holders compared to common shareholders, but to place them in an identical situation concerning the share of losses from the trigger point on. Before activating these mechanisms, the issuer and its supervisor may consider other measures.

CEBS agrees that different levels of subordination are acceptable if sufficient transparency on these levels is provided by institutions.

Limits

21. Several respondents considered that instruments with an incentive to redeem should be allowed in the 35% or 50% limit (depending on their characteristics) if not called.

22. Some respondents suggested that instruments convertible into shares with certainty should be classified in Core Tier 1 (thus without any limit applying to them).

23. Respondents expressed mixed views on defining the term "emergency situations" in the terms of the contract.

CEBS's response:

Innovative instruments usually provide for further call options after the first call option and step-up. Permanence of the hybrid instrument is not ensured in such cases.

As long as an instrument converts into capital in emergency situations, and complies with all other requested requirements, it can be included in the 50% bucket.

CEBS identified cases which give rise to an "emergency situation" in order to provide clarity and promote consistent application. Such cases shall be considered as the minimum for an emergency situation, leaving room to both supervisors and institutions to trigger conversion at an earlier stage if necessary. All the features valid for non-convertible hybrids are applicable to mandatorily convertible hybrids, and certainly at the minimum when there is a breach of regulatory limits.

Hybrids instruments issued through an SPV

24. Only a few comments have been received on this particular aspect of the guidelines.

25. Comments particularly focused on consolidation aspects (§139) and mitigation of legal risks associated with issues in foreign jurisdictions (§144).

CEBS's response:

CEBS agrees to amend the wording to give more clarification on consolidation aspects.

Specific comments

26. A few respondents would like further clarification regarding transitional measures for hybrid instruments to know how the proposed limit structure will apply to grandfathered instruments.

CEBS's response:

CEBS may consider in the short term indicating how instruments non-compliant with the new regime should be included in the different sets of limits.

Annex

Feedback table on CP 27: summary of the public responses and suggested amendments

CP27	Summary of comments received	CEBS's response	Amendments[4] N/R: change not required
General comments			
	Respondents generally supported the objectives of CEBS and welcomed the opportunity to comment on the proposed implementation guidelines for hybrid capital instruments. Although believing that the objectives of CEBS are well founded, one respondent is less convinced and is concerned by the objective of immediately achieving common implementation. A few respondents insisted on their general preference for a principles-based approach since over-prescriptive rules may result in an unsound system and put EU banks at a competitive disadvantage vis-à-vis international competitors. Many comments have been made on the proposed guidelines on buy-backs which were often considered to be too prescriptive. The vast majority of respondents expressed concerns about the need	See below for detailed responses.	

[4] Paragraphs mentioned in this feedback statement correspond to the paragraphs of CP 27. The numbering of the paragraphs may have changed in the final version of the guidelines. The new numbering has been provided when appropriate.

	to maintain some flexibility on buy-backs for capital management purposes. Two respondents would like further clarification of the transitional measures for hybrid instruments to know how the proposed limit structure will apply to grandfathered instruments.	CEBS may consider in the short term indicating how instruments non-compliant with the new regime should be included in the different sets of limits.	
Permanence			
General comments	One comment has been made on the fact that the market is already regulated minimum synthetic maturities to manage time horizons and no further regulation should be needed. Two respondents asked CEBS to confirm that instruments with a maturity equal to the life of the issuer should be considered undated for prudential purposes as formerly stated in CP17. One respondent believed that undue importance has been placed on the permanence of capital.	The CRD defines the rules relating to permanence. CEBS's guidelines clarify these rules. CEBS believes that it is naturally the case that instruments end with the life of the issuer. Therefore, instruments whose maturity is linked to the life of the issuer fulfil the criterion to be considered undated. Article 63a (6) CRD requests CEBS to elaborate guidelines for the convergence of supervisory practices with regard to hybrid instruments. Naturally, the wording of the CRD has to be the starting point. Article 63a (2) CRD stipulates that "*2. The instruments shall be undated or have an original maturity of at least 30 years. [...]*" Therefore, it goes without saying that the guidelines cannot stand back behind the requirements set forth already by	N/R

		the CRD.	
<u>Question 1</u> **1.1** Are the guidelines in relation to "incentive to redeem" sufficiently clear or are there issues which need to be elaborated further? Please provide concrete proposals how the text could be amended	Some respondents asked for clarification of the wording on the step-up calculation and one of them would like the guidelines to state that incentives to redeem are to be evaluated at the issue date.	The introduction of explicit rules for the treatment of hybrid capital instruments into the CRD was not intended to create a new definition for eligible Tier 1 hybrid capital instruments but to provide guidelines for a common EU interpretation of the eligibility criteria set out in the "Sydney Press Release" (SPR) of the Basel Committee of Banking Supervision as applicable. The rules that spell out which step-ups can be considered as moderate and therefore be permitted already form an integral part of the SPR and have been copied without any change. CEBS does not see any reason for deviating from them.	N/R
	Some respondents considered that the attribution of the quality "moderate" to an incentive could be affected during the hybrid's life and one respondent asked for further discussion with the industry on the mechanism of moderate incentives. Another respondent indicated that the incentive to redeem should be able to be evaluated at any time and not only at the date of issue.	The step-up calculation as set out in paragraph 54 has to be based on the date of issue. Otherwise, no decision could be taken about the applicable limit for the instrument in question. Furthermore, the evaluation – and consequently reclassification - would have to take place constantly.	N/R

		Arguably, 100 basis points in the light of the current market situation might be viewed as far too prudent. However, CEBS is currently adopting the parameters contained in the SPR.	
	One respondent believed that the final three sentences of paragraph 53 introduce uncertainty and are too wide ranging.	Currently, step-up clauses are the only form of incentive to redeem used in the market (apart from principal stock settlements mechanisms which CEBS also qualifies as an incentive to redeem). However, as the volume and complexity of hybrids are constantly increasing, the market being very imaginative, CEBS sees a great need to preserve sufficient flexibility for supervisors to react to possible future market innovations.	N/R
	One respondent drew attention to recently issued instruments with a reset mechanism whose purpose is not to introduce an incentive to redeem.	CEBS will make a monitoring of this type of issuance and will examine these features. As a first approach, reset mechanisms could be considered as incentives to redeem in current market conditions since they are associated with a call date.	
	Some respondents questioned the relevance of the term 'in the	Agreed.	Paragraphs 20 and 53 (renumbered 5

	perception of market participants' in paragraph 53.		and 52) to be changed (delete "in the perception of market participants")
1.2 Please describe the potential impact of a cap of 150% relating to stock settlement of the conversion ratio. Please provide evidence.	Respondents generally understood the rationale for setting a cap and viewed it as a reasonable prudential approach. However, some comments have been made on the potential disincentive to exercise the call option and the reduction of the efficiency and value of the stock settlement. In this view, it may be too prescriptive to fix such a precise limit to the conversion ratio. Other comments asked for more insight into the reason underlying the choice of the 150% limit and clarification/examples of the way to calculate the conversion ratio (nominal value, market value, number of shares underlying the instrument, etc) to avoid misinterpretation. Several respondents stressed that the basis for the conversion ratio would not be clear (nominal value, market value etc.) Some respondents suggested introducing a cap on potential dilution instead. One respondent asked for it to be made clear that any difference between the nominal value of the instrument to be redeemed and	Current issues carrying a principal stock settlement mechanism often provide for high conversion ratios. This is critical in CEBS's view as the degree of dilution created is considered too great Therefore, introducing a cap was the intention. Agreed. Guidelines are defined based on the incentives to redeem existing at the time. Limiting the potential dilution is the intention through the use of a conversion ratio. The possibility for the holder to require that the difference is paid	N/R Paragraph 56 (renumbered 55) clarified through a foot note. N/R

	the results of the application of the 150% ratio could be settled in cash.	in cash conflicts with the ability of the issuer to not call the instrument.	
	One respondent indicated that in his view there is great difficulty in judging whether this percentage will be appropriate through the cycle and encouraged CEBS to review this in the future.	Agreed.	
<u>Question 2</u> **2.1** Are the guidelines in relation to "buy back" sufficiently clear or are there issues which need to be elaborated further? Please provide concrete proposals how the text could be amended	The vast majority of respondents expressed concerns about the need to maintain some flexibility on buy-backs for capital management purposes and management of hybrid securities in the secondary market. In their view CEBS's guidelines on buy-backs are too prescriptive.	CEBS is convinced that buy-backs are to great extent comparable to a call or redemption in prudential terms and that therefore hybrid buy-backs should be subject to most of the – if not to the same – regulatory approval process.	
	Many respondents considered that some of the information to be provided to the supervisor for calls or redemptions is too demanding and some of them would like to leave the final say to each supervisor. Others would expect the possibility of the redemption or call of a hybrid instrument to be addressed in either the annual ICAAP/SREP process or the course of regular dialogue with the regulator.	The information to be provided to the competent authority in order to enable it to decide on its prior consent to a call or redemption should for the most part already be available within the credit institution as they form part of the information to be provided in the context of the ICAAP.	N/R
	For some respondents, it would be useful for the final paper to clarify that the data listed in paragraph 64 need to be submitted only if the information is not yet available to the competent authorities.	The guidelines mention several times that the information listed in paragraph 64 only has to be submitted (again) if it is not already available to the competent authority (see paragraph 64, first sentence). Where feasible, the assessment process can also be linked with the SREP (see paragraph 62, last sentence). All further particulars are to be	N/R

		determined by national supervisors in the light of (already) applicable reporting requirements at the national level.	
	One respondent asked for clarification of the extent to which paragraphs 61 to 67 (on the application process) apply in cases of buy-backs.	The paper is clear on the fact that the competent authorities shall apply the same process to the buy-back of a hybrid instrument as to a call or redemption.	N/R
	Two respondents asked for the term "less information" in paragraph 67 to be defined in a way which is as reduced as possible. Some respondents asked for clarification of some terms like 'foreseeable future' (paragraphs 60, 68, 69), 'well in advance' (paragraph 62) and 'sufficient capital buffers' (paragraph 69).	On the term "less information", the supervisor may assess, in some cases, and on a case-by-case basis, that a notification is sufficient and not ask for more information. All the other terms quoted by the respondents are concepts linked to the ICAAP process defined by the supervisor. CEBS would like to underline that its intention is not to provide a "tick box" approach.	N/R
	Several respondents asked for a shorter period than 5 years for the data needed under paragraph 64 item c (2 or 3 years would be appropriate).	3 to 5 years is an example. The time horizon used for the data shall nevertheless be of sufficient length.	N/R
	Several respondents suggested introducing a time limit for receipt of the prior consent of the regulator or at least asked that supervisors be able to give approval at short notice.	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 is foreseen already by the CRD itself. Since the CRD does not contain a time frame for	N/R

		supervisory consent to a call or redemption of hybrid instruments, CEBS deems to have no legal basis to introduce a time limit; where relevant, national legislation will apply. In any case, in CEBS´ view, it is absolutely indispensable to preserve the necessary room for manoeuvre for supervisors.	
	One respondent saw the need for more clarification regarding the cancellation of instruments, which were issued, but which a bank still holds on its books (ready for sale to the “second market”). It should be clarified in the guidelines that this is not a “buy back” since the issuing process has not been completed. Thus, the restrictions in the guidelines should not apply under those circumstances.	Cancellation of instruments which have not yet been sold to external investors is not to be considered a buy-back. The corresponding amounts should not be counted as regulatory capital anyway.	N/R
	One respondent was sympathetic to CEBS’s desire to restrict early buy-backs of hybrids. Several respondents requested the elimination from the guidelines of the guidance on buy-backs.	As has been pointed out before, it is CEBS´s conviction that buy-backs are very similar to a call or redemption in prudential terms. CEBS therefore does not see any reason to take back the restrictions proposed for hybrid buy-backs. This is especially true against the background that the BCBS is currently discussing the introduction of restrictions and the need for supervisory approval for buy-backs of common stock.	
2.2 CEBS is considering whether buy backs should under certain conditions also be permissible before five years and without			

replacement. A number of CEBS members would support such a provision under strict conditions and subject to prior supervisory approval, notably if the buy back responds to exceptional circumstances, is acceptable from a prudential point of view and results in a lasting improvement of the institution's solvency situation. A number of other members have concerns regarding such an exemption, in particular as it may compromise the permanence of the hybrid instrument by enhancing investors' pressure on banks to buy back outstanding hybrids and by providing incentives for banks to reduce their overall capital position at times when their own credit quality is decreasing. As a basis for its decision CEBS therefore wishes to gather further evidence on the following points:			

2.2.1 What would be the impact if buy-backs before five years after the issue of the instrument were only allowed under the conditions described in paragraph 72? Please provide evidence.	Several respondents disputed CEBS's assertion that buy-backs are analogous to the exercise of call options at par and hence should be treated in the same way. Respondents expressed common views on the fact that buy-backs may take place at anytime, as common equity, at the discretion of the institution and its supervisor. A prohibition on buying back hybrid capital instruments in the first 5 years would unduly limit flexibility to manage the capital structure and may persuade banks instead to repurchase ordinary shares not subject to such a limitation. Thus, respondents stressed that buy-backs within the first five years should be allowed. The replacement should not be mandatory. In cases of replacement, this may be with an instrument already issued or issued through an exchange offer. Some respondents indicated that in their view buy-backs should not require any regulatory approval.	See above See above (comment on current discussions at Basel level). The guidelines are designed to address the treatment of hybrids to be issued in the future. CEBS agrees that some recent buy-backs of hybrid instruments may have been justified when there is an urgent necessity to reinforce so-called Core Tier 1 and because some oustanding hybrids are not sufficiently loss absorbent. Buy-backs in this case enabled to crystallize losses for hybrid holders and restore the financial situation of the issuing institution. Nevertheless, CEBS expects future issues of hybrid instruments to be of better quality, in particular with reinforced loss absorbency features. Therefore, when there will be a need to reinforce Core Tier 1 or restore the financial situation of an issuer, CEBS expects that the loss absorbency mechanism will be used first. Buy-backs of future issues without replacement should not be frequent.	N/R In general N/R

		Thus, the only acceptable circumstances for buy-backs without replacement of outstanding hybrids not compliant with CEBS guidelines are exceptional circumstances (i.e. capital restructurings of banks in stress situations and when the hybrid instrument is not sufficiently loss absorbent, notably because it does not comply with the new guidance)	
2.2.2 Please describe circumstances – other than current market conditions - in which a buy-back at an earlier stage without the requirement to replace them with instruments of the same or better quality would be justified from a prudential perspective.	Some of the circumstances quoted by the respondents are the following: cost of capital, regulatory/rating agencies recognition, accounting, tax, mergers and take-overs, larger than expected profit accumulation, capital restructuring in view of recapitalisation, decrease of risk weighted assets, replacement of excess Tier 1 capital by profits (buy-back at a price below par), reduction of capital buffers to normal levels after a stress situation.	See above.	N/R
2.2.3 Which criteria should be provided in order to address the above mentioned concerns, and in particular to avoid setting incentives to deplete the capital base of banks whose credit	Several respondents stressed that, in their view, there is no need for further criteria to be included. One respondent insisted on specific aspects being included in the initial documentation, like calls for early redemption, substitution clauses. Regulators should be ready to discuss on a case by case basis on unforeseen cases.	Agreed.	N/R

quality is decreasing?			
2.3 What would be the impact of limiting the amount of repurchased instruments held by the institution at any time to 5% of the relevant issuance? Please provide evidence.	The vast majority of respondents proposed a 10% limit instead of 5%. For some respondents, the proposed limit of 5% should not be based on individual issues but on the total amount of all hybrid instruments issued. One respondent considered that buy-backs based on a newly assessed capital position should not be limited to any general threshold but be assessed by the regulator on an individual basis. Several respondents asked CEBS to be more prescriptive in the wording of paragraph 73 to avoid national discretions. One of them asked for further clarification of whether limited activities for market making or market smoothing purposes are subject to the prior approval of the competent authorities.	A good compromise between the responses received is to set the limit as the lower of either: 1. 10% of the relevant issue or 2. 3% of the total amount of all outstanding hybrid instruments, provided that supervisors may apply stricter limits. CEBS does not believe that there is real room for national discretions. Supervisors must have the ability to look at the market making activities of supervised institutions.	Paragraph 73 to be changed accordingly
Flexibility of payments			
General comments	Several respondents disputed that the requirement for dividends and coupons to be cancelled by supervisory request should be on a fully discretionary basis, with the potential for insufficient transparency. Such regulatory intervention should remain an exceptional situation and refer to a clearly identified risk (like breach of capital requirements according to article 75 of the CRD) or be based on the ICAAP process. Some respondents feared that	Supervisory intervention is necessary and it cannot be constrained to a specific time. Supervisors must intervene any time they feel it is necessary, at the minimum when there is a breach or to prevent such a breach	N/R

	various interpretations by national supervisory authorities could be disadvantageous for individual institutions.	from occurring. Supervisors expect that the issuer will not rely on their intervention but will decide itself to cancel its payments in view of its financial situation. Refraining from taking such a decision could lead to further depletion of the bank's resources and to a worsening of its situation.	
	One respondent did not agree with paragraph 78 that payments of coupons or dividends on hybrids can only be made from distributable reserves. Other respondents asked for more clarity on the term "distributable items" quoted in paragraph 78 and some of them assumed that a coupon payment from retained earnings or disclosed reserves is possible.	Distributable items are defined under national laws. In general, it may include the result for the year, retained earnings and distributable reserves.	
	One respondent was not supportive of the statement in paragraph 83 that payments "should also be waived if the major part of the dividend to shareholders is not paid in cash but in shares".	Agreed.	Paragraph 83 to be amended accordingly
	One respondent expressed concerns about potential national tax consequences arising from the fact that any coupon or distribution not paid is forfeited and no longer due as stated in paragraph 77.	Coupons must be cancelled if necessary (CRD text).	N/R
<u>**Question 3**</u> Are the guidelines in relation to dividend pusher or stopper sufficiently clear or are there issues which need to be elaborated further? Please provide	The guidelines were generally judged sufficiently clear. A few respondents indicated that a hybrid distribution should not be triggered through a "dividend pusher" given a payment on junior or pari passu securities in shares exclusively. Two respondents wanted to have paragraph 83 modified to waive dividends/coupons if the entire (instead of the major part) of the	Agreed. See above.	Paragraph 83 to be amended to add a reference to pari passu instruments.

concrete proposals how the text could be amended?	dividend to shareholders is not paid in cash but in shares. Another respondent wanted to have the entire sentence deleted.	 Not agreed: dividend pushers and stoppers are considered to be limitations on full flexibility of payments.	 N/R
What would be the impact of the restriction on the use of dividend pusher and stopper? Please provide evidence.	Respondents expressed different views on this point. Some of them considered that no restriction should be put on the use of dividend pushers and stoppers since such mechanisms are a fundamental feature of hybrid capital instruments. Such restrictions may disadvantage hybrid instrument holders thus making the instruments less marketable. Some respondents indicated that, in their view, dividend pushers or stoppers do not hinder recapitalisation.	CEBS has considered the ranking between shareholders and hybrid holders in accepting dividend stoppers and pushers. CEBS estimates that dividend stoppers or pushers limit the flexibility of payments and it is prudentially justified to waive them when necessary.	N/R
<u>Question 4</u> **4.1** Are the guidelines in relation to ACSM sufficiently clear or are there issues which need to be elaborated further? Please provide concrete proposals how the text could be amended.	One respondent asked for modifications to paragraph 90 to confirm that banks must have full discretion on payments but subject to dividend pushers and stoppers as applicable: "over the payment of the coupons or dividend at all times, *subject to the application of dividend pushers and stoppers under conditions of articles 82 to 85*". Another respondent underlined that, in its view, the condition to have full discretion over the payment of the coupons is by its nature not applicable to dividend pushers. In the situation where an issuer has tried to enhance its authorized capital with the goal of satisfying the deferred coupons, but not received approval from the meeting of shareholders, the ACSM should be recognised as	CEBS disagrees with the proposed modifications to paragraphs 90 and 91. "full discretion": as the ACSM is an obligation to pay and there is already protection for the hybrid holders. "without delay" is there to make sure that the ACSM is triggered	In general N/R

	valid. Proposal for paragraph 83: to add "except if the coupon is to be paid by ACSM". Proposal for paragraphs 90 and 91: "Therefore an ACSM is only acceptable if it achieves the same economic result as a cancellation of the coupon (i.e. there is no decrease in capital) and when the issuer has full discretion over the payment of the coupons or dividends at all times, except for rules applicable to dividend pushers. To meet this condition, the deferred coupons should be satisfied ~~without delay~~ using newly issued instruments, referred to (…). For this purpose, this issuer must on a best effort basis already have authorised but un-issued instruments (…)". Some respondents expressed concerns about the fiscal consequences of the guidelines on ACSM mechanisms and the resulting impact on the level of own funds. Several respondents asked CEBS to change or remove the term 'without delay' in paragraph 90. Another respondent suggested inserting the words "the proceeds of newly issue instruments" in paragraph 90 to better define "newly issued instruments".	immediately and does not further worsen the situation of the bank. Moreover, it prevents the possibility of the holder asking for the coupons to be accumulated during the period from the trigger of the ACSM and the actual payment/delivery of shares. "the proceeds of newly issue instruments" is not acceptable because the ACSM will probably only be used in a stress situation when there is no appetite in the market to subscribe for new shares. Hence, the obligation of the issuer should be limited to exchanging the coupon for new shares.	
4.2 What would be the impact of implementing these guidelines on ACSM mechanisms? Would you propose any other options?	One comment was made on the fact that such a mechanism could increase confidence and demand across the EU. One institution stressed that a systemic pressure triggering the immediate use of ACSM by multiple issuers would imply the issuance of a large number of shares into the market. Hence, the issuer should be able to choose when ACSM should be enacted, possibly within an acceptable period of for instance 3 years. If immediate use of ACSM is maintained, sufficient time for submitting and obtaining shareholders' approval for the use of	See answers above.	N/R

	ACSM and the related issue of ordinary shares should be an exception acceptable to CEBS.		
Loss absorbency			
General comments	One respondent indicated that it does not believe that CEBS should concentrate on any other aspects than regulatory and should welcome an array of mechanisms for loss absorption and returning institutions to financial health. Some respondents stressed that, in their view, mandatory and contractual mechanisms such as write-downs or conversions are clearly far too prescriptive, disregard the principles-based approach and are counterproductive. Terms embedded in hybrid Tier-1 capital are considered sufficiently flexible and most appropriate to allow the institution and its supervisor to efficiently consider a required recapitalisation. Another respondent indicated that it does not believe that the regulator should be able to mandate a conversion into equity. Regulatory intervention should be formally triggered by an assessment by the supervisor that the company will no longer be able to satisfy article 75 of the CRD. Some comments have been made on the fear that the proposed guidelines may reverse the seniority order/subordination between shareholders and investors in hybrid instruments.	See detailed answers below.	
<u>Question 5</u> **5.1**. Are the guidelines relating to the definition of loss absorbency in going concern sufficiently clear or are there issues which need	Generally, the guidance was considered sufficiently clear. An inconsistency has been noted: paragraph 99 restricts conversion to ordinary shares while paragraph 114c suggests any security falling under 57(a). One respondent asked for better clarification that the principles	CEBS agrees that this is inconsistent. The principles are applicable to	Paragraph 99 to be amended accordingly.

to be elaborated further? Please provide concrete proposals how the text could be amended.	set out in the consultation are only applicable to hybrids. Therefore, the consultation paper should explicitly state that capital instruments issued by cooperative companies are outside the scope of the current interpretation guidelines.	instruments that are not eligible under Article 57(a). CEBS will issue guidelines relating to Article 57(a) which will serve to assess whether cooperative shares may be eligible under Article 57(a).	N/R
5.2. Do you agree with the definition of loss absorbency in going concern? If not why and what alternative would you propose?	Some respondents did not support the definition of 'insolvency' for regulatory purposes as stated in paragraph 97 or the definition of 'viability' in paragraph 111. They stressed that criteria mentioned in paragraph 106 are sufficient and that paragraphs 110 to 117 go too far. Some respondents stressed that, in their opinion, mechanisms like write-downs and conversions do not increase the loss absorption capacity of hybrids nor make the recapitalisation more likely nor improve the situation of the institution. In the view of some respondents, such mechanisms should be restricted exclusively to insolvency purposes and to countries where hybrids are considered as liabilities for insolvency purposes. Many respondents considered that the mechanism described in paragraph 114a) (writing down permanently the nominal amount of the principal at a trigger point) would disadvantage hybrid holders compared to equity holders, is not coherent with hybrid holders ranking and would lead to investors pulling back from investment in hybrid instruments. Furthermore, the trigger point for write-downs should in any case be left to the discretion of the institution and its competent authority and such mechanisms should stop when the company resumes paying dividends. Considering that hybrid instruments' features already prevent insolvency and that conversion into ordinary shares does not increase the loss absorbency, CEBS was strongly urged to remove,	CEBS's proposal in CP 27 is consistent with CP 17 which is the basis for the new provisions of the CRD relating to hybrid instruments. CEBS believes that the loss absorbency features of an instrument included in Tier 1 should not be limited to the fact that the instrument helps to prevent insolvency as defined in paragraph 106. If CEBS retains only the criteria in paragraph 106, the loss absorbency feature of a hybrid instrument will be limited, in substance, to the ability to cancel coupon/dividend payments which is not necessarily sufficient to restore the financial situation of a institution when it has suffered substantial losses and/or lost the confidence of its creditors to such an extent that it may be at risk of not being able to continue its business. When this trigger is reached, the	N/R

	in part or entirely, by different respondents, paragraphs 112 to 117.	hybrid instrument should be able to share losses as if an ordinary share or in a similar way. The mechanism should be clearly defined in the contract and may be activated at the discretion of the issuer or the supervisor when it is necessary. Before activating this mechanism, the issuer and the supervisor may consider other measures, meaning that the activation of the mechanism is not necessarily mandatory. The purpose of the mechanism is not to disadvantage hybrid holders compared to common shareholders but to place them in the same situation when the trigger is reached and there are no other remedies within a manageable timeframe. If the mechanism is not activated, the cost for hybrid holders may be higher because the issuer runs the risk of liquidation.	
5.3. Do the guidelines provide sufficient flexibility for institutions to design mechanisms that fulfil the objective of loss absorbency in going concern? What alternative would you propose? Does this flexibility raise level playing field issues?	Many respondents stressed that the issuer should have the possibility of designing mechanisms that do not hinder recapitalisation. Some suggested that to avoid an uneven playing field, CEBS monitors how Member States have used the flexibility provided in the guidelines. One respondent indicated that the premises of paragraph 109 suggest that a debt instrument should have a mechanism that qualifies it as equity under a stress scenario from an accounting perspective (to determine an insolvency situation). The guideline may lead to improper accounting mechanisms whereby a dated Tier 1 hybrid instrument (considered as debt under IFRS, and	Paragraph 115 states that other mechanisms may be applied provided that they achieve the objective of "not hindering the recapitalisation". CEBS will monitor new issues in the future. The guidelines do not define the accounting treatment of hybrid instruments. The purpose of paragraphs 108 and 109 is to underline that the assessment of the loss absorbency feature of	N/R N/R

	limited to 15% of total Tier 1 under CRD rules) may become more subordinated than other less limited Tier 1 hybrid instruments (if converted in equity for example).	hybrids depends also on insolvency laws.	
	One comment was made on paragraph 112 that states that "the new capital provided to recapitalise the institution should not be used directly or indirectly to benefit existing hybrid holders". Some existing instruments currently have a provision whereby once the "principal write-down" trigger is reached, the issuer is required to propose a share capital increase – to the extent legally and economically possible – before writing down the principal of the notes. The respondent understands that such a feature is a way to ensure that the capital increase is timely (which avoids, together with complementary provisions, using funds from a recapitalisation to service payments to hybrid holders), and does not contravene CEBS guidelines. Some respondents asked for modifications to paragraph 117 aimed at replacing 'to the market' with 'to the investor' and deleting 'for example as part of pillar 3 requirements/disclosures'.	Paragraph 116 underlines that the issuer and supervisor may consider other remedies than immediately using the loss absorbency mechanism. The ability of the issuer to increase capital by a sufficient amount may be a reason to not activate the loss absorbency mechanism.	N/R
	One respondent considered that; in paragraph 114, letter b) sentence 2 and sentences 4 and 5 seem contradictory and proposes to delete sentence 2.	The new annex XII of the CRD provides that the issuer must disclose the main features of hybrid instruments. CEBS considers that the mechanism for loss absorbency is a main feature. The sentences are not contradictory but the last is an unnecessary repetition of paragraph 83.	N/R Last sentence of paragraph 114 b) to be deleted and paragraph 114 b) to be clarified.

5.4. Do you think that different levels of subordination allow sufficient transparency on the ability of these instruments to cover losses in liquidation? Alternatively, would you prefer to completely preclude different ranking between hybrids?	Respondents generally considered it more appropriate to leave flexibility to each institution to have or not to have different levels of subordination and recommend not precluding any order of priority among hybrid instruments themselves. One respondent wanted all hybrids within the same bucket to rank pari passu in a liquidation.	CEBS agrees that different levels of subordination are acceptable if this is transparent.	N/R
Limits			
<u>Question 6</u> **6.1** Are the guidelines relating to the assignment of hybrids instruments to one of the three limits sufficiently clear or are there issues which need to be elaborated further? Please provide concrete proposals how the text could be amended.	Respondents generally confirmed that the guidance is sufficiently clear. Several respondents considered that instruments with an incentive to redeem should be allowed in the 35% or 50% limit (depending on their characteristics). Another respondent stressed that the impossibility of moving an instrument out of the 15% limit when it is not called is debatable but understands the prudential rationale.	Innovative instruments usually provide for further call options after the step up (in some cases every 6 months/1 year). Permanence is not ensured in such cases. Moreover, admitting reclassification would imply a case by case assessment of the characteristics of the instrument, which would leave further room for national discretion.	N/R
	One respondent wanted clarification of the fact that the ”up to 50% bucket” will also include hybrids that can be converted into capital under other circumstances than emergency situations.	As long as the instrument converts into capital in emergency situations, and fulfils all other requirements of this bucket, it can be included in the 50% bucket.	N/R

6.2 Do you believe that the conditions imposed to mandatory convertible are proportionate and balanced? Would you propose any other options?	Some respondents indicated that, in their view, instruments which should convert into shares with certainty should be classified as Core Tier 1 (so without limits). One of these respondents also underlined that the features proposed by CEBS in paragraph 131 ("an issuer should have the flexibility to convert at any time") are not market practice, and should not be imposed on instruments qualifying for the CRD's "50% limit".	Instruments eligible without limits are defined by Article 57(a), which requires that such instruments, inter alia, share losses pari passu with ordinary shares, both on going concern and in liquidation. According to the guidelines on hybrids, in order to be eligible up to 50%, hybrids shall convert mandatorily only in emergency situation, i.e. at least when the bank is in breach of capital requirements. This means that losses that do not lead to a breach of capital requirements are not shared by hybrid holders pari passu with ordinary shareholders. In exchange for the downside risk hybrid holders receive a prefixed remuneration, whose consistency with Article 57(a) is also questionable.	N/R
	Some respondents expressed concerns about inserting or even precisely defining "emergency situations" in the contractual terms as this could, in their opinion, limit the ability of institutions and competent authorities to act with sufficient flexibility. They cautioned as well against the requirement that any higher regulatory limit must be identified in the terms and conditions to avoid disclosing discussions between institutions and regulators that should be treated confidentially. Other respondents on the contrary asked for more clarification of the term "emergency situations".	CEBS agrees that the contract should not limit the ability of the institutions or the competent authorities to act with sufficient flexibility. Convertible instruments are subject to all the rules applicable to other hybrid instruments for which the mechanism of loss absorbency may be used when the losses lead to a significant deterioration of the solvency position (see paragraphs 115 and 116) and certainly when there is a breach of the minimum ratio. For convertible instruments,	Paragraphs 125 to 127 to be amended accordingly.

		the breach of the minimum ratio should be considered as an emergency situation and as a floor for mandatory conversion, leaving room both to supervisors (as explicitly provided for in the CRD) and to institutions to trigger conversion at an earlier stage if needed. The fixed trigger differentiates hybrids eligible for the 50% bucket from other hybrids with conversion features eligible up to 35%.	
	One respondent required modifications to paragraphs 133 (justification of the conversion ratio) and 134 (calculation of the number of instruments to be delivered). One respondent found the conversion mechanism seems extremely severe and indicated that CEBS should not stipulate a formula for fixing the conversion rate.	As regards paragraph 133, the objective is to ensure loss absorbency and not to avoid corporate governance issues. As regards paragraph 134, not agreed.	N/R
	Two respondents suggested clarifying in paragraph 131 that the investor's conversion option does not need to be mandatory.	Agreed.	Paragraph 131 to be amended accordingly.
	One respondent feared that the possibility given to competent authorities to trigger the conversion of the hybrid if necessary (paragraph 127) may not be exercised in the same way by all national regulators when facing similar situations.	Reference should rather be made to paragraphs 128-129. Some discretion is inherent in the exercise of supervisory judgment in specific cases. An effort has been made to set general criteria according to which such a decision shall be taken.	N/R
	Some respondents asked for clarification/examples on the	Reference is made to current	

	functioning of the conversion ratio (paragraph 135). Other respondents asked for the deletion of the reference to Pillar 2 in paragraph 130.	market practices. Reference to Pillar 2 is meant to address the assessment on capital adequacy made by the supervisor as the outcome of the SREP.	N/R
Hybrid instruments issued through an SPV			
<u>Question 7</u> Are the guidelines relating to the indirect issues of hybrids instruments sufficiently clear or are there issues which need to be elaborated further? Please provide concrete proposals how the text could be amended.	Respondents provided few comments on this aspect. One respondent asked CEBS to clarify that SPV structures should be acceptable not only for solo capital calculations but also for consolidated capital calculations. One respondent asked for more clarification with respect to the organisation of loss absorbency and consolidation within the accounts of the parent institution. Other respondents suggested deleting the sentence referring to consolidation within paragraph 139 which is considered to be confusing and wrongly understood as referring to consolidation as an accounting concept.	Agreed – paragraph 139 can be amended to clarify that indirect hybrid instruments can be included within the consolidated capital of the group but may also be included as part of solo capital where an institution has regulatory permission to use solo consolidation (Article 70 of the CRD) or when the on-lending agreement with which resources are transferred to the parent company fully complies with hybrids' eligibility criteria.	Paragraph 139 to be amended accordingly
	Some respondents proposed to smooth or clarify the requirement in paragraph 144 concerning legal risks associated with issues in foreign jurisdictions.	Not agreed. This requirement does not need to be smoothed. Banks issuing hybrid instruments indirectly through SPVs are required to demonstrate that associated legal risks are mitigated. The current text provides enough flexibility for individual authorities to determine	N/R

		how an indirect issuer of hybrid capital should demonstrate the mitigation of such associated risks. It is not sufficient for an issuing institution to just "consider" such associated risks.	