

9 March 2010

**Public hearing on CEBS's Consultation Paper on  
Instruments referred to in Article 57(a) of Directive 2006/48/EC  
recast**

**Note of meeting**

London, 23 February 2010

The Committee of European Banking Supervisors (CEBS) held a public hearing on 23 February 2010 to present its draft proposal for implementation guidelines on instruments referred to in Article 57(a) of Directive 2006/48/EC recast (capital instruments). The hearing was chaired by David Guillaume (Chair of the CEBS Subgroup on own funds).

Around 80 representatives from individual institutions, banking associations, rating agencies, investors and supervisory authorities attended the hearing and contributed to a lively discussion.

**1. Background**

The draft proposal is based on the latest amendments to the Capital Requirements Directive (CRD) which introduce explicit rules for the treatment of instruments eligible as capital and, in particular, requirements for their inclusion in institutions' original own funds without limits. The Consultation Paper responds to the request in Article 63a (6) that CEBS shall elaborate guidelines for the convergence of supervisory practices regarding instruments referred to in point (a) of Article 57.

**2. CEBS' draft proposal on capital instruments**

David Guillaume explained the main objectives of CEBS's draft proposal on capital instruments<sup>1</sup> and detailed proposed guidance related to the four main parts of the paper, covering the topics of (i) Definition of capital in the sense of Article 57(a) and Recital 4 (ii) Permanence (iii) Flexibility of payments and (iv)

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<sup>1</sup> Available at <http://www.c-eps.org/Aboutus/Key-Dates/2010/CEBS-organises-a-public-hearing-on-its-draft-imple.aspx>

Loss absorbency. After the presentation, participants were asked for comments. The main questions and comments are briefly summarised below.

## **2.1. On Definition of capital and permanence**

Some participants asked for more clarification on the provisions on buy-backs, especially in the following cases: employee/compensation schemes, market making activities and treasury stocks. One participant quoted the case of general authorizations for buy-backs given by the General Assembly. One participant raised the question of redemptions of mutual/cooperative shares.

CEBS indicated that it will consider further each of these situations depending on the written answers received. The intention is not to interfere with provisions allowed under national laws. CEBS will also elaborate further on the case of general authorizations given by the General Assembly. On mutual/cooperative shares, CEBS's guidelines allow an annual application for redemption. In any case, CEBS would consider it inconsistent to have provisions on buy-backs for hybrid instruments and not for capital instruments, even bearing in mind that this may raise legal issues in some jurisdictions.

One participant asked for more details on criterion 4 concerning discretionary repurchases or other means of effectively reducing capital in a discretionary manner allowable under national law. In particular, a parallel has been drawn with the possibilities for redeeming hybrid instruments under certain circumstances (e.g. modification in the tax treatment or disqualification as Tier 1 capital).

CEBS reaffirmed that capital instruments should not be redeemable. This does not mean, however, that a reduction of capital pursuant to company law is not permitted (which may happen under exceptional circumstances - e.g. restructurings) but in such cases the conditions listed in the Consultation Paper should be fulfilled.

Several participants asked if it was CEBS's intention to restrict investment possibilities for fixed income investors. In particular, restrictions on fixed returns may hinder investments from this type of investors.

In response, CEBS stressed that it has focused on the quality of eligible capital instruments and not on the nature of the investor base or the types of potential buyers of the instruments. The objective is to keep the top Tier bucket as pure as possible and to keep it simple. Moreover, CEBS's guidelines aim to define criteria for core capital eligible instruments, but not the appropriate level of core capital.

Some participants wanted to know if some kinds of instruments that are not registered as equity under national law may nevertheless be eligible as core capital instruments. Other participants expressed concerns about the accounting treatment of capital instruments considering the work still in progress to review IAS39 and the general uncertainty on accounting rules.

CEBS underlined that current CRD II provisions require instruments referred to in Article 57(a) to be regarded as equity capital under national law in order to be eligible as core capital instruments. With regard to the accounting

treatment, it is highly probable that an instrument which is registered as a liability will not fulfil the other nine criteria developed in CEBS's guidelines under the current accounting rules. The question is rather to assess which considerations lead an instrument to be regarded as a liability. If accounting rules change in the future, CEBS is ready to examine the potential impact on its guidelines.

One participant asked about situations where the existence of voting or non-voting rights attached to different categories of shares may raise problems.

CEBS made it clear that if the only difference between two categories of shares is the existence of voting rights there is no issue concerning the eligibility of both categories of shares as core capital. CEBS guidelines aim to cover situations where privileges (usually higher returns) are granted to one category of shares to compensate for the absence of voting rights.

## **2.2. On flexibility of payments**

Some participants questioned the provisions relating to caps on payments and to fixed coupons. One participant indicated that instruments with fixed coupons but mandatory deferrals of the coupons may be preferable to instruments with no fixed coupons.

In CEBS's view, experience shows that the cap often represents a commitment from the credit institution to make a payment on the related instrument. On fixed coupons, CEBS's guidelines are consistent with the Basel proposals.

One participant underlined the inconsistency on preferential rights for dividends between the CEBS guidelines and the Basel proposals.

CEBS acknowledged that there is a difference in this field but its guidelines are based on the current EU CRD provisions.

## **2.3. On loss absorbency**

One participant asked for clarification on the possibility of having different categories of shares, or shares with different predictable returns, depending for example on different businesses within the same company.

CEBS reminded attendees that the guidelines do not prevent the issuance of different categories of shares but all the existing categories must have the same mechanisms in terms of loss absorbency and must share losses *pari passu*. Only the most subordinated instruments will be eligible as core capital.

One participant questioned the need for different categories of capital instruments to rank *pari passu* in liquidation.

CEBS answered that Recital 4 of the Directive makes it clear that instruments that do not rank *pari passu* with ordinary shares during liquidation should be regarded as hybrid instruments.

## **2.4. On grandfathering**

Several participants asked for more clarification on grandfathering, for example for existing instruments with attached caps or on the scope of the grandfathering (hybrid instruments only or both hybrid and core capital instruments). Others participants wanted to have more information on the implementation date of the EU grandfathering provisions and especially to be assured that these provisions will not be applicable before the end of 2010.

CEBS reminded the meeting that CRD II provisions on grandfathering cover not only hybrid instruments but also core capital instruments that are not compliant with the new provisions and that will be qualified as hybrid instruments under the new regime. CEBS indicated that grandfathering provisions have to be discussed further with the EU Commission and at CEBS level. The issue is not only related to the CRD II provisions but also to the interaction between these provisions and the forthcoming CRD IV provisions, as well as with the Basel final proposals.

## **3. On implementation timeline and Basel work on capital**

Several participants asked about the implementation timeline of the CEBS guidelines in relation to the Basel proposals' implementation timeline.

CEBS indicated that the implementation timeline adheres to the CRD provisions. Furthermore, CEBS guidelines on core capital are quite closely aligned with the Basel proposals on Core Tier 1 instruments. CEBS is nevertheless ready to revise its final guidelines as far as necessary to take into account the progress of Basel's work.

One participant asked CEBS to shorten its guidelines on capital instruments and not to go beyond the CRD provisions.

CEBS stressed that the CRD text requires CEBS to elaborate guidelines for the convergence of supervisory practices. In CEBS's opinion, the guidelines laid down in CP33 give a good interpretation of the CRD provisions. A credit institution that fulfils the CEBS guidelines fulfils in substance Basel requirements for core Tier 1 instruments. Furthermore, the CEBS guidelines are far more precise than the Basel proposals on provisions applicable to non-joint stock companies and allow appropriate recognition of cooperative/mutual shares.

Participants in the hearing were encouraged to send in their written comments on CP33 by 31 March 2010. All comments received will be published on CEBS's website unless respondents explicitly request otherwise. The revised version of the document, based on the results of the public consultation, is expected to be ready around the end of the 1<sup>st</sup> semester of 2010 and will be published on the CEBS website.