ABI's remarks on CEBS consultation paper on implementation guidelines regarding Hybrid Capital Instruments (CP 27)

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POSITION PAPER

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Introduction

The Italian Banking Association (ABI) is grateful for having the opportunity to participate in the CEBS consultation as regards the guidelines for the convergence of supervisory practices on hybrid capital instruments that aim to complement the new Capital Requirements Directive (CRD) provisions concerning such instruments.

ABI has already participated in previous public consultations regarding hybrid instruments, in particular the CEBS consultation published on 6 December 2007 (CP 17, "Draft proposal for a common EU definition of Tier 1 hybrids", aimed at aligning the treatment of hybrid instruments as eligible capital among the Member States) and the European Commission consultation on possible changes to the Capital Requirements Directive launched on 16 April 2008.

Nevertheless, ABI considers this stage of consultation relevant to build an effective and convergent transposition of the new provisions in the Member States.

In general ABI agrees with the contents of the document provided by CEBS. Furthermore ABI supports most of the comments reported in the EBF paper on this item.

The responses given by ABI to several proposed questions are hereafter reported, in accordance with the contents of the consultation document.

The remarks reported in the following paragraphs consider some of the questions addressed in the consultation paper and a number of other issues not addressed in the same paper, marked point by point.

Remarks on CEBS questions

A. Permanence

With regard to the requirement of permanence, we would point out that the Consultation Paper does not refer to the CEBS position set out in its feedback on the above mentioned CP17 (dated 3 April 2008), according to which "also instruments whose maturity is linked to the life of the issuer fulfil the criterion to be undated".

This position has been confirmed by the European Commission in its feedback on the consultation on possible changes to the CRD (dated 30 June 2008) which provides that instruments with a maturity equal to the life of the issuer will be considered undated for prudential purposes.

We believe that there is currently no reason to modify this assumption. Therefore, we suggest that CEBS confirms its position, that is of interest for issuers who typically do not issue pure undated instruments, but rather financial instruments with a maturity equal to the duration of the bank.

Question 1:

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.

1.2 Please describe the potential impact of a cap of 150% relating to stock settlement of the conversion ratio. Please provide evidence.

A recent development in the hybrid capital market is the presence in the structures of reset mechanisms that reset coupons based on the interest rate if hybrids are extended after the call date. The purpose of such reset mechanism is not to introduce an incentive to redeem but, if the instrument is not called, to reset the coupon to a market interest rate (e.g. based govt yield, midswap, etc) at the time of reset.

This mitigates or eliminates the interest rates optionality embedded in the issuer call option in fixed rate transactions. The reset features may be combined with credit spread step-ups, but should not themselves be viewed as an incentive to redeem, provided the reset occurs at the original credit spread.

An example for a reset structure is Standard Charter Tier 1 issued on 16 June refix to 5yr US Treasury after 5.5 years at initial credit spread with refixes every 5 years thereafter, with an “incentive spread step-up” to 150% of the initial credit spread after 10.5 years and each 5.5 anniversary). The treasury refix in year 5.5 and every 5 years thereafter should not itself incentivise redemption (notwithstanding the step-up in year 10). Therefore, if an equivalent deal was executed with a rate reset every five years, but without a step-up in year 10.5, it should not be considered as an incentive to redeem.

Regarding question 1.2, CEBS should provide additional clarity on how the number of shares underlying the instrument is calculated to avoid misinterpretation of paragraph 56. Shareholders could have an advantage from the cap. In addition CEBS should consider permitting the difference between the market value of the share received by investors and the nominal value of the bond to be paid in cash, particularly if a 150% limit on the conversion cap is used, instead of the more flexible cap of 200% that had been under consideration previously.

Paragraph 58 (No reclassification of instruments with an incentive to redeem).

CEBS wrote what the qualification of moderate is at issue date and gave examples (that some Member State translated into rules) without specify the sources (statistic studies, financial formulas, etc).

Moreover, the attribution of the quality "moderate" to an incentive when linked to an absolute value (i.e. 100 basis point) could be affected during the hybrid life. It's possible that the perception of market participant for an expectation of the hybrids being redeemed at a call date change (as what occurred recently). On the other side, incentives now considered moderate could in future be perceived by market participants as strong. CEBS indicates (*Paragraph 54*) two economic incentives as examples but some regulators introduced the absolute value (100 bps) into their national rules without annual updates.

Thus, the mechanism of moderate incentives needs to be elaborated further with the industry in order to introduce some arrangements in the link to an absolute value.

Paragraph 62 (Supervisory consent to a call or redemption of a hybrid instrument)

We think that if the process for calls exercise will be based on a fully completed ICAAP, it will be difficult or impossible for investors to price the extension risk incorporated in hybrids. The ICAAP is an annual process that takes several months to complete. Regulatory response also takes a long time.

Furthermore, the trigger requested on the base of Pillar 2 could also change following the national economic development (CEBS in Position paper on a countercyclical capital buffer[1] suggests that SREP - Supervisory Review and Evaluation Process - could be a tool to implement a countercyclical capital buffer). This uncertainty could result in less attention paid to incentives and a request by investors for a significantly higher remuneration if calls are not exercised.

Regarding to the SREP, even this process is time consuming and inflexible.

We would propose a set time frame for a response from the regulator under normal circumstances (e.g. a time of one month should be sufficient for the regulator to make an assessment), as the issuer decision is based on

[1] http://www.c-ebs.org/getdoc/715bc0f9-7af9-47d9-98a8-778a4d20a880/CEBS-position-paper-on-a-countercyclical-capital-b.aspx

solvency but also on market opportunity especially as certain instruments have rolling floating calls for the issuer it is not defined for which period the application and approval is valid.

The proposed process should be divided into two steps:

a) analysis of the capacity to repay hybrids (all the hybrids with a call in a period of time) under the solvency and financial point of view (inside ICAAP process). Under this analysis the issuer estimates the impact on his capital adequacy of the repayment also under a stress point of view (i.e. non call drives to a potential reputational risk, the access to funding market, cost of new funding) and considers others capital management alternatives (i.e. sales of non-core assets, share capital increase). Timing of this analysis may not be consistent with the repayment conditions included in the term sheet.

b) *call exercise request*. Issuer decision is made mainly on market opportunities. A condition to present a request could be that the repayment was included in a previous issuer capital adequacy assessment. The request in this case should be replaced by a call notice to the regulator.

Moreover, we point out that the issuers' different capital break down and the recourse to international fixed income market could raise level playing field issues. "Non-frequent issuers" have a lower reputational risk so that the higher likelihood not to exercise a call only slightly affects the capacity to raise funds. Any additional barriers faced by such infrequent issuers in their call flexibility (as perceived by the market), could further weaken their market access relative to more frequent issuers.

Paragraph 64, *points c) and d).*

These requirements are not compulsory for others capital instruments and will force issuers to extend hybrids. Information sub c) is not always available (approved business plan may have a timeframe of 1 or 2 years). a) and b) could be the minimum information and c) and d) additional information that regulators require if the ICAAP issuers' data doesn't include call exercises. A "refresh" of the process when the issuer presents a repayment request could be difficult and time consuming. In any case, this process should not be extended to UT2s and LT2s.

Question 2:

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.

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.

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.

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 quality is decreasing?

In the Consultation Paper, CEBS provides some guidance in relation to buyback of hybrid instruments. With regard to this issue, CEBS states that, in economic and prudential terms, buy-backs are equivalent to a call or redemption and, consequently, competent authorities shall apply the same process to the buy-back of a hybrid instrument as to a call or redemption.

Thus, CEBS proposes relatively stringent rule-based guidelines on buy-backs of hybrid Tier 1 capital securities. According to the consultation paper, this means that:

- buy-backs shall only take place at the initiative of the issuer;

- buy-backs shall not take place in the first 5 years after the issue date and only with prior supervisory approval;
- if the institution replaces the hybrid instrument it wants to buy back with capital of at least the same or better quality, buy-backs may take place in the first 5 years after the issue date, provided that the new instrument has already been issued and is subject to supervisory approval.

According to paragraph 73 of the consultation paper, however, competent authorities are not prevented from permitting limited activities for market making or to level markets. Financial institutions are required, in this case, to have in place adequate policies in respect of such transactions in order to avoid material holdings in their own hybrid instruments. CEBS has proposed that, at any time, repurchased instruments held by the financial institution shall not account for more than 5% of the relevant issue.

Furthermore, CEBS requests an advice in considering whether to make buy-backs permissible before five years and without replacement.

With regard to buy-backs, we believe in general that buy-backs of hybrid Tier 1 securities are fundamentally different from call options, as they represent a transaction between two consenting parties, as opposed to a unilateral right to redeem.

Just as an issuer’s ability to repurchase its own shares at market prices does not negatively impact the “permanence” of ordinary equity, the same applies to hybrid Tier 1 capital.

As evidenced by recent market developments, buy-back transactions executed by European financial institutions since March 2009 have in no way: (i) been a result of market pressure on issuers to repurchase securities (as may be the case with respect to certain call option redemptions); or (ii) resulted in an undue reduction of issuer capitalisation levels below regulatory requirements.

Restricting issuer’s flexibility in repurchasing hybrid Tier 1 securities could have the following unintended consequences:

- requirement of hybrid Tier 1 to be more permanent than ordinary equity, considering that there are no restrictions on repurchasing ordinary shares within 5 years of having issued them;
- preventing issuers from restructuring their capital base, thereby potentially hindering recapitalisation. This is particularly relevant in case of mergers or take-overs where buy-backs can be a way of removing legacy instruments with undesired payment pusher effects or providing capital at a group level where it is no longer needed (see the recent Santander/Abbey or Lloyds/HBOS buy-back deals);

- preventing certain issuers from using market opportunities to create core capital due to discounted buy-back prices, and not others (the proposed 5-year minimum period between issuance and buyback has no correlation with an issuer's capitalisation).

Regarding other circumstances in which a buy-back at an earlier stage - without the requirement to replace hybrids with instruments of the same or better quality - would be justified from a prudential perspective, we point out the following: i) when the issuer presents a tender offer on instruments with a seasoning higher than 5 years in order to give the market participants equal treatment and reach a larger number of investors; ii) when an issuer intend to re-set the capital break-down. Through a Tier 1 buy back, it is possible to increase the Core Tier 1 and decrease Tier 1, giving the possibility to the issuer to create more room for future hybrid issues.

Given the above, we believe that financial institutions need more flexibility in carrying out these transactions, in order to achieve the efficient management of their Tier 1 instruments with reference, for example, to market conditions, level of capital, Tier 1 ratios and capacity to expand or reduce risky activities.

Therefore, in our view neither the proposed 5-year restriction on buy-backs nor the 5% allowance "for market making or market smoothing" purpose is appropriate.

We believe that:

- under certain circumstances, buy backs could be permissible before five years without replacement, with prior supervisory approval;
- an amount of 10% should be capable of being redeemed or bought back, for market making purposes, without the prior approval of the competent authorities and without replacement (as well as Tier 2 instruments) at any time.

Major banks or bank holding companies are at the same time issuer and lead manager/underwriter in a syndicate for placing hybrid Tier-1 instruments in the capital market. The lead manager of a transaction is expected to be able to make a market in instruments which are placed. Should the market making exception go away, the investors would be subject to a potential substantial bid-ask spread volatility and therefore not reliable pricing. This is particularly the case as capital instruments tend to have been placed with large funds which can take up 10-15% of an issue. If such a fund needs to unwind, it increases the volatility in the capital markets.

As a consequence to the above consideration, limiting the amount of repurchase affects indirectly the possibility to re-access the market with new issues.

The Consultation paper takes the view that competent authorities should not be prevented from permitting limited buy-back activities for market making or for market smoothing purposes.

We believe that the final paper should be more prescriptive in this respect as the current wording of paragraph 73 may result in introducing a national discretion whereas the objective of the proposed guidelines is precisely to achieve convergent practices across the EU.

In any case, should the above proposal be rejected, we suggest better clarifying if the limited activities for market making or market smoothing purposes, provided for in the aforementioned provision of paragraph 73 of CP27, is subject to the prior approval of the competent authorities.

B. Flexibility of payments

Paragraph 78

CEBS states that flexibility of payments is closely interlinked with loss absorbency. The conditions of the instrument must enable the financial institution to cancel coupon/dividend payments, in stressed situations, on a non-cumulative basis in order to increase the capacity of the instrument to absorb losses on an ongoing basis.

Moreover, paragraph 78 states that "payments of coupons or dividends on hybrids can only be paid out of distributable items". We deem necessary to underline that the statement is not clear. If "distributable items" refers to items distributable to shareholders (i.e., profits plus distributable reserves), hybrids may be dilutive to ordinary shareholders, assuming that the wording "paid out of" means that once a payment is made on hybrids, the corresponding amount of distributable items will no longer be available for distributions to shareholders. Such a requirement may cause accounting and tax issues, and may not be viable in the direct-issue Tier 1 structure, used by Italian issuers recently, forcing them to adopt more complex structures.

Thus, we propose either to delete the aforementioned statement or to modify the text as follows: "payments of coupons or dividends on hybrids can only be paid if there are distributable items. For these purposes, if (and to the extent) the dividend is booked as an interest expense or as a cost in the issuer's P/L, the amount of this dividend is considered as a distributable item". We note that the cancellation of this statement would not influence the quality of capital of a Tier 1 instrument in any event.

Paragraph 79-81 Supervisory request for the cancellation of payments -

Article 63a (3) of the amended CRD provides that the competent authorities may require the cancellation of such payments based on the financial and solvency situation of the credit institution.

Many investors in hybrid capital securities analyse likelihood of coupon payments when investing in such instruments, taking into account publicly available information, and their estimation of an institution's earnings and capital strength and therefore their ability to pay coupons on hybrid Tier 1 instruments.

Therefore, all mechanisms that give regulators the power to force non-payment of coupons based on criteria not pre-defined and nor transparent (for example, stress tests based on criteria and methodologies either not disclosed or not well understood by investors), could harm market access for issuers wishing to sell hybrid capital instruments, as investors could be unable to assess coupon payment likelihood.

Credit rating agencies have already voiced concerns about the additional powers given to regulators and lawmakers to directly influence payments on hybrid capital instruments, and have stated that they consider hybrid capital securities by issuers in countries where they consider this effect to be particularly strong as riskier.

Given the above points, we suggest that a more narrow interpretation of the aforementioned Article 63a (3) of the CRD has to be taken. In particular:

- competent authorities could be permitted to require payments to be suspended only if the circumstances described in paragraph 81a (solvency data before and after payment or other foreseeable events) would increase the risk of a breach of capital adequacy in the near future;

- for the avoidance of doubt, this approach would not preclude regulators from relying on their general ability to set capital requirements for issuers, and give institutions the flexibility to determine how to meet such requirements (be that through capital preservation from non-payment of coupons, or other means).

Paragraph 81.

The translation of the financial and solvency situation of the credit institution into point *b) and c)* is probably beyond the scope of the CRD's intent. If the information and the evaluation under points b) and c) drive the competent authorities to believe that the capital adequacy of issuer is insufficient, coupon cancellation on hybrids is not probably the correct instrument to recapitalize the issuer. The capital that the issuer can raise from a coupon cancellation could be insufficient to recover the capitalization and on the other hand could prevent future access to hybrid market.

Paragraph 84

It seems that for CEBS there is a strict link among negative information/evaluation, hybrid coupon cancellation and, restriction on payments on common shares.

Pillar 2 should lead to a self-assessment about the financial resources that an issuer can put in place without a direct intervention by the competent Authorities on the choice of instruments to be used.

Question 3:

Are the guidelines in relation to dividend pusher or stopper sufficiently clear or are there issues which need to be elaborated further? Please provide concrete proposals how the text could be amended?

What would be the impact of the restriction on the use of dividend pusher and stopper? Please provide evidence.

According to the Consultation Paper, dividend pushers are acceptable in order to preserve the subordination between shareholders and hybrid investors. Nevertheless, they must be waived should any of the following events occur between the date the coupon is pushed and the date it is to be paid:

i) the credit institution no longer complies with the capital requirements; and
ii) the competent authorities require the cancellation of such payments based on the financial and solvency situation of the credit institution.

Under conditions (i) and (ii) above, payment of the coupon on hybrids will be forfeited and the coupon shall no longer be due and payable by the issuer. They should also be waived if the major part of the dividend to shareholders is not paid in cash but in shares.

In order to preserve the rank of subordination between shareholders and hybrid instrument holders, we believe that paragraph 83 should be modified as follows.

With reference to the fact that only the "major part" and not the entire dividend is paid in shares under the circumstances described above, we propose to rephrase the text of the mentioned sentence as follow: "They should also be suspended if the entire dividend to shareholders is not paid in cash but in shares". Otherwise, shareholders might receive a cash payment while holders of hybrid capital, a more senior instrument, would potentially receive nothing.

As an alternative, the entire sentence ("they should also be waived if the major part of the dividend to shareholders is not paid in cash but in shares") should be deleted.

C. Loss absorbency

Question 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?

Question 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?

The new CRD provisions require that hybrid instruments be able to absorb losses on a going-concern basis and in the case of liquidation, without further explanation of these principles. The CEBS Consultation Paper gives some additional guidance to identify the characteristics of the possible loss absorbency mechanism and on the requirement of "not hinder the recapitalization".

Hybrid instruments can provide for different loss absorbency mechanisms having different relevance depending on the actual situation of a financial institution. For example, CEBS states that subordination is most important in liquidation to ensure that hybrid holders' claims are not met before all more senior claims are satisfied and, on the other hand, the write-down of principal or the conversion of hybrids into ordinary shares at an appropriate trigger point enables loss absorbency as a going concern and may help the institution to recover.

The CEBS Consultation Paper provides that, in respect of subordination, hybrid instruments are collectively senior only to capital instruments and asks respondents to comment on whether different levels of subordination among hybrids would allow sufficient transparency regarding the ability of these instruments to cover losses in liquidation (question 5.4).

Moreover, regarding their capacity to prevent insolvency, hybrid instruments shall have the following characteristics:

- permanence: in particular, in stress situations the redemption of principal must not be permitted;
- flexibility to cancel the coupon/dividend payment;
- the holder must not be in a position to petition for insolvency;
- instrument would not be taken into account for the purposes of determining whether the institution is insolvent.

In relation to flexibility, the CEBS Consultation Paper states that even though the principal amount of hybrid instruments is available to the financial institution and the terms provide the issuer with flexibility to stop the payment of coupons, this may not be sufficient to restore the financial situation of the institution or to attract new shareholders (and thus may hinder recapitalisation), because hybrid holders in general are being granted some form of preferential right, such as a coupon or a dividend payment. As a result of these preferential rights, hybrid holders may, after a recapitalisation, profit from it by immediately recovering the right to the full principal amount as well as to full coupon/dividend payments.

It is much easier to attract new capital if it can be shown that, due to their intervention, new shareholders will benefit significantly from the return of their investment after the financial institution becomes profitable again.

As a consequence, hybrid instruments must contain a meaningful statutory or contractual mechanism that will make the recapitalisation more likely. Possible mechanisms include:

- the possibility of writing down the principal permanently at a trigger point;
- the possibility of writing down the principal temporarily at a trigger point. During the write-down period, the coupon should be cancelled and dividend stoppers and pushers should operate in a way that does not hinder recapitalisation; and
- the conversion into a capital instrument at an appropriate trigger point.

The consultation paper provides that a combination of the above mechanisms or other mechanisms may be applied provided that the competent authority is satisfied that the mechanism is capable of achieving the objective set out above.

The sentence "it is much easier to attract new capital suppliers/owners/shareholders" is in contrast with the CRD proposal for a capital breakdown with hybrids accounting up to 50%. This breakdown assumes a base of hybrid investors similar to the shareholder one so that the characteristics of this class of investors and the possibility to access them for the recapitalization must be considered. Reversing the seniority order between shareholders and investors in hybrid instruments could permanently affect the possibility to access present hybrid market and force the creation of a new market segment thereby widening the equity investor base.

Moreover, problems can arise from the opportunity provided by CEBS to identify other loss absorbency mechanisms not hindering the recapitalisation. Indeed, the CEBS' interpretation may give rise to different approaches being adopted by EU countries, thus reducing the level playing field between European financial institutions.

We suggest pointing out in the aforementioned provision that CEBS could identify, from time to time, new mechanisms which are consistent with the objective of the regulation and coordinate the implementation of these mechanisms in order to ensure equal standing in all jurisdictions

With respect to the question related to different ranking between hybrids, we believe that this issue is to be left to individual issuers, for the reasons described below.

On the one hand, most issuers will naturally want to maintain a transparent capital structure easily understandable for investors, as Italian banks have done in the past, and therefore not introduce different ranking between hybrid Tier 1 instruments. On the other hand, there may be certain circumstances (in particular recapitalisation scenarios following a crisis), where it may be desirable that there be different rankings between hybrid Tier 1 instruments (for example, one tranche of hybrid Tier 1 instruments issued under exceptional circumstances ranks subordinated to another tranche of hybrid Tier 1, but both of them are junior to all depositors, senior and subordinated debt, and senior to equity).

Therefore, in order to avoid "hindering recapitalisation" we believe that there should not be a specific rule regarding different ranking within Tier 1 instruments, provided that each security by itself meets the overall subordination requirements (junior to depositors, general creditors and subordinated debt, and senior only to Article 57(a) capital instruments).

D. Limits

Question 6:

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.

6.2 Do you believe that the conditions imposed to mandatory convertible are proportionate and balanced? Would you propose any other options?

The CEBS Consultation Paper clarifies the set characteristics of those hybrid instruments that may be included beyond the 35% limit. In particular, only convertible instruments that cannot be redeemed in cash but can only be converted into capital instruments will be included in the 50% bucket.

The conversion shall become effective: i) as a mandatory requirement during emergency situations, and ii) at any time at the discretion of the competent authority, based on the financial and solvency situation of the issuer.

An emergency situation is defined by CEBS, for example, as the breach of regulatory limits set by the competent authorities (i.e. 4% Tier 1 capital ratio, 8% total capital ratio).

The optional conversion may be requested by a competent authority if a financial institution meets the Pillar 1 minimum requirements but the financial institution's own funds do not adequately cover the risk assessed under the Pillar 2 framework.

Furthermore, the issuer should have the flexibility to convert at any time and an investor should not be prevented from converting at any time.

Hybrids shall be converted within a predetermined range. The mechanism of conversion may reduce the number of instruments to be delivered if the share price increases, but will not increase the number of instruments to be delivered if the share price decreases.

Firstly, we would underline that the conversion at any time at the option of the issuer would not be appreciated by investors. Moreover, no conversion option by investors is mentioned.

In respect of limits as discussed above, we would also point out that the conversion mechanism suggested by CEBS seems to be excessively severe for an investor who is exposed to all aspects of the risk associated with the bank. In other words, should the value of the bank decrease, the hybrid investor will absorb all losses to the same extent as the shareholders.

For the above reasons, we believe that, when CEBS will discuss guidelines on the definition of Article 57(a), it should consider accepting those instruments as Core Tier 1 capital, without any limits as Core Tier 1 instruments, on the ground that they have the ability to absorb losses on an ongoing basis and during a liquidation in a manner highly similar to ordinary shares.

Paragraph 130

Finally, we would point out that this paragraph sets out a strong link between regulators' evaluation of the issuer present and prospective capital adequacy and the payments due to hybrid shareholders. Historically, hybrids payments are linked to financial situation (presence of earning and dividend) and solvency (capital ratio as art 75).

Introducing pillar 2 only for hybrids potentially results in these issues: (i) investors could forecast a breach in capital ratios better than the evaluation of a regulator; (ii) others capital instruments do not have these links.