CONFEDERACION ESPAÑOLA DE CAJAS DE AHORROS

POSITION PAPER
February 2008

CECA response to CEBS Consultation paper (CP17):

Draft proposal for a common EU definition of Tier 1 hybrids

CECA, the Spanish Confederation of Savings Banks (Cajas de Ahorros) was created in 1928 with the aim to join its members' forces and represent Spanish Savings Banks Sector. CECA is formed of the 45 Spanish Savings Banks, which are one of the most important players in Spanish financial system: their total assets reached €1.1billions, 24.050 branches in Spain and 124.139 employees in 2007.

Spanish Cajas are credit institutions that act and are organized as private enterprises. They have the legal status of private institutions. Spanish Cajas are independent institutions which compete directly and individually with each other and with other financial institutions, and they are free to decide on their territorial expansion.

As credit institutions with foundational origins, Cajas pursue the following main objectives: (1) universal provision of financial services; (2) economic efficiency; (3) promotion and competition and avoidance of monopolistic practices; (4) contribution to welfare and redistribution; and (5) promotion of regional and community development. From their inception, Cajas are required to channel the surpluses that are not allocated to reserves toward project that fall under their "Obra Social" scheme (community investments projects).

Spanish Cajas are subject to the same legislation that applies to other types of credit institutions (commercial and cooperative banks) in terms of transparency, solvency and consolidation.

Confederación **E**spañola de **C**ajas de **A**horros - C/ Alcalá 27 ■ 28014 Madrid ■ Tel: +34 91 596 50 00 ■ Fax: + 34 91 596 55 56
institucionesinternacionales@ceca.es ■ www.ceca.es

I. Preliminary comments

Sydney's Declaration of October 27th of 1998 (Sydney Press Release, hereinafter "SPR") laid down the conditions for hybrid capital instruments to qualify as Tier 1. However the different national legislations of European Union Member States still show significant differences in their treatment of Tier 1 hybrid capital instruments as eligible own funds, as it is stated in the Committee of European Banking Supervisors (CEBS) document.

The criteria that are being applied by national supervisors to consider hybrids as Tier 1 capital vary widely across the EU. While in some countries the requirements for these instruments to be considered as Tier 1 were very strict, exceeding, by far, the criteria that came from SPR, in many others the required conditions were far less rigid, of minimalist character. Therefore, the differences between national regimes for hybrid instruments are significant.

In this context, Spanish hybrid instruments (denominated "participaciones preferentes") not only fulfill with more demanding requirements than those derived from SPR, but, even, are already quite adapted to most of the conditions that would be required by a hypothetical new regulation inspired by CEBS Document. To confirm this, we can refer to the recent Spanish regulation of "participaciones preferentes" (stated by Law 19/2003 of July 4th , that modified Law 13/1985).

In other EU countries, otherwise, the criteria that hybrids must meet to be eligible as Tier 1 are quite more flexible, and vary substantially from those foreseen in CEBS Draft Proposal.

Therefore, Spanish Savings Banks welcome the general approach of CEBS Draft Proposal, since it will bring a more harmonised environment on the different quantitative limits to consider hybrids as Tier 1. Nevertheless, and as regards the transition period (grandfathering) for hybrid instruments that are currently in the market, Spanish Savings Banks would suggest that CEBS should take into consideration the different Member States legislations, in order to preserve the essential level playing field between credit intermediaries and across countries.

II. Specific comments

Spanish Savings Banks identified some specific concerns and would like to make the following remarks:

II.1. Paragraphs 10, 14, and 64-89 (and others): Permanence

Considering the referred paragraphs and in accordance with the conditions (to consider hybrids as Tier 1 capital) set out by the Basel Committee on Banking Supervision in the SPR, hybrids have to be permanent. However (as it currently occurs) hybrids may be callable, with a prior supervisory approval, after a minimum of five years or after a minimum of ten years if there are incentives for redemption. Also, early redemption will be permitted if a legislative or fiscal change occurs.

Spanish Savings Banks believe that permanence does not seem to be an essential condition for hybrids (to be considered as Tier 1), since this characteristic will not necessarily contribute to improve the financial soundness. The objective of a sound hybrids regime should be to design a set of requirements that could be equivalent to those applicable to ordinary share capital. According to this, hybrids must be able to absorb losses and to suspend payments (as shares do). However, and since ordinary shares are not *per se* subject to permanence rules, hybrids instruments should not be subject to such requirements.

For that reason, in our opinion, the criterion of permanence for hybrids could be reconsidered.

II.2. Paragraphs 31: Conditions to consider any hybrid instrument as eligible for Tier 1

This paragraph states that the conditions that any hybrid must meet in order to be considered as eligible for Tier 1 capital, are applicable to all hybrid instruments, regardless of their denomination, the category and the form of their issuance. It is also said that all the conditions must be fulfilled at the same time.

In our opinion, it would be necessary to clarify this last requirement, taking into consideration that some of these characteristics (for example: step-ups cases) may not be accumulative, either alternative.

II.3. Paragraphs 36: Replacement with capital of the same or better quality

According to paragraph 36, the instruments can be callable but only at the initiative of the issuer, always with supervisory approval and "under the condition that it will be replaced with capital of the same or better quality, unless the supervisor determines that the institution has capital that is more than adequate for its risks."

It is important to highlight that not all credit institutions are joint stock companies. For instance, Spanish Savings Banks, as many other European Savings Banks, have the legal nature of private foundations, so they do not have equity (they do not have "capital", *strictu sensu*). For that reason, and accordingly to paragraph 36, it could be understood that this kind of credit institutions would not be able to replace hybrids.

Therefore, we would like to suggest replacing the expression of the paragraph 36 of the Draft Proposal as follows: "under the condition that it will be replaced with **instruments** of the same or better quality".

II.4. Paragraphs 44: Guarantee of the issuance

Accordingly to this paragraph, hybrids must neither be secured nor covered by a guarantee of the issuer or a related entity. In our opinion this rule is unnecessary. In Spain many preference shares have the guarantee of the issuer, and this circumstance does not imply a lower quality of the instruments. Moreover, the experience in the issuance of hybrids in Spain confirms that investors would not perceive

as positive special purpose vehicles (SPV) without the guarantee of the parent company. Therefore, we would suggest that CEBS should reconsider this requirement or, at least, establish a special transition period (grandfathering) in order to implement it.

II.5. Paragraphs 48: Contradiction with paragraph 43

Paragraph 48 is confusing and contradicts paragraph 43, and so it should be rewritten or removed. As hybrids are senior only to ordinary share capital, it seems difficult that if the bank goes into liquidation the hybrid holder will have a claim for the full principal amount (since that amount would have already been written down due to the financial crisis of the issuer).

II.6. Paragraphs 45-50: Absorption of losses

Paragraphs mentioned above refers to the way in which hybrids should absorb losses of the institution in the case that Tier 1 ratio falls below 2%, establishing that the principal of the instruments can be partially or fully written down, in the proportion of the corresponding losses.

Although the requirement of absorption of losses is not in principle in dispute, it have been established without taking into account that not all credit institutions are joint stock companies, as said above (it seems that this requirement was conceived with the idea that hybrids would only be issued by institutions with ordinary shares, i.e. when it refers in paragraph 45 (ii) "the instrument can be converted into ordinary shares"). Therefore, we would suggest redrafting the above mentioned paragraphs, in order to include other types of corporate governance structures (for example: cooperative banks and banking foundations).

II.7. Paragraphs 159: Grandfathering

This paragraph states the transition period (grandfathering) applicable to hybrids instruments that are currently included in Tier 1, if the instrument do not qualify as such under the new requirements. Obviously, the existence of a grandfathering means that the issuers would not be obliged to review the hybrid issuances that are already in the market.

Transition periods stated in the Draft Proposal are extensive enough, in general terms. However, taking into account the differences among hybrids instruments that are currently in the market would be welcome, as it was mentioned above with regard to the eligibility for hybrids to be considered as Tier 1 capital.

In this sense, in countries, like Spain, in which the current requirements for the issuance of hybrid instruments are really demanding and in close proximity to the conditions that are recommend by CEBS Draft Proposal, the alternative of "permanent grandfathering" should be granted to national supervisors for current hybrid instruments.