# Consultation Paper on Implementation Guidelines regarding instruments referred to in Article 57(a) of Directive 2006/48/EC (CP 33)

## RESPONSE OF CREDIT AGRICOLE, the BPCE GROUP (CAISSES d'EPARGNE and BANQUES POPULAIRES) and CREDIT MUTUEL

**Introduction**

Co-operative banks play a fundamental role in financing the European economy, as the European Commission has acknowledged[1]. Europe has 4,200 co-operative banks, with a combined market share of around 20%. In France, they represent nearly two-thirds of retail banking business and play a vital local role serving customers and communities. Over twenty million customers of French co-operative banks are also members, enabling them to participate directly in the governance of their bank[2].

Co-operative banks were initially founded as a means of uniting their members around a collective project to satisfy unmet economic needs in a wide variety of sectors (agricultural, housing, workers' and consumers' co-operatives, and mutual insurers).

The impetus for the founding of co-operative banks came from ordinary people getting together to take control over their economic destiny and pool their resources, based on the principle of solidarity between members. The common feature of all co-operatives is their mission of creating a business at the service of their members. This mission, and their legal status, makes local development and service to members an end in itself. The legal status of co-operative banks has now been enshrined in European law thanks to the concept of the "European Co-operative Society"[3]:

The cooperative business is a reality in the European economy, and has its place alongside the non joint-stock companies. It is a legal form in itself, defined by European and national law.

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[1] Consultation paper, published on 26 February 2010, on possible changes to the Capital Requirements Directive: "Non-Joint Stock (NJS) companies such as mutuals, co-operative and savings institutions … play a vital role in the financial system and the EU economy."

[2] Members participate in the annual general meetings of their local bank, regional bank or local savings bank, and elect their representatives.

[3] Commission Regulation (EC) No 1435/2003/EC of 22 July 2003

## The need for business efficiency

Co-operative banks carry on their business, which has a commercial purpose, in a competitive environment and with a view to profit. So like any other business, they need to adopt rigorous management techniques. In France, this approach has led to co-operatives achieving some of the best cost-to-income ratios in the industry (for example, 51% for the Crédit Agricole Regional Banks in 2009). The drive to provide useful services to the customer and to the local community- which is inherent to the status and to the values of the co-operative banks- calls for profitability and business efficiency.

## The need for stability and long-term development

Co-operative banks have two essential features, derived from their legal status:

- They make only limited distributions to members out of profits,[4] and use their undistributed profits to build up reserves to safeguard their future.
- Because of the law on co-operative status, these reserves are inalienable and non-distributable, thereby securing the bank's stability and future.

In normal times, CAC 40 companies pay out more than 40% of their profits to reward their providers of equity capital. By contrast, co-operatives pay out an average of only 15% of their profits, the rest being transferred to reserves. This means that nearly 85% of co-operative banks' profits are used to strengthen their own funds, directly benefiting the regions where the banks are based by increasing their capacity to lend and to finance the local economy.

Thus, co-operative banks show their concern for long-term development and the transmission of their business to the next generation, thereby serving the interests of their members and local communities. This is reflected in particular in their role in providing access to banking services for populations regarded by joint stock banks as insufficiently profitable, and in local initiatives to promote the development of communities and citizens[5].

So the aim of the co-operative model – unlike that of joint stock companies – is not to seek a direct and rapid gain for the providers of capital, and dividend payouts are of secondary importance.

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[4] The limited payouts made by French co-operative banks reflect restrictions imposed by two sources:

- co-operative status (common to all co-operatives), under the terms of Article 14 of law no. 47-1775 of 10 September 1947 establishing co-operative status: payments made to holders of members' shares are capped at the average yield on corporate bonds (3.82% for the second of half of 2009, according to the figures published by the French Economy Ministry in the Official Journal on 6 January 2010).
- provisions contained in regulations or in articles of association stating that "each year… at least three-quarters of surplus revenues shall be appropriated to the formation of a reserve fund".

[5] Initiatives to recruit disabled staff and provide them with training and specially-adapted workstations, introduction of schemes to help and support customers experiencing financial difficulties, etc.

**Stable and sustainable banks, at least as solid as joint stock companies**

In prudential terms, the capital instruments of co-operative banks are of excellent quality because they absorb losses, and rank after all other claims pari passu. They are simple and easy to understand, and their terms and conditions are defined in long-established laws and regulations rather than on a contractual basis.

In addition, our co-operative models have build in very important stabilising mechanisms:

- The inalienability of reserves and the modest return paid to providers of capital ensure that a substantial proportion of profits strengthen own funds.
- The decentralised structure of our banking networks, combining full-service Regional Banks with the powers of the central body, ensures good risk awareness at a local level, responsible decision-making and overall controls at consolidated level.
- Our intra-group solidarity mechanisms, and the various levels of control that these mechanisms require, contribute to the financial stability of co-operative banks[6].

The robustness of the co-operative model is widely recognised, as is the contribution of the co-operative banks to financial stability during the crisis. For example, the International Labour Organisation report on "The Resilience of the Co-operative Business Model in Times of Crisis", published in 2009, concludes that "*future regulations or legislation that may result from this crisis should clearly recognize that co-operative financial institutions have not been the source of these problems, have been significantly less affected by the economic fallout and should not be punished by inclusion in a series of new rules designed to correct a problem they have not caused*".[7]

**Governance founded on democratic principles**

Joint stock companies operate on the principle that voting rights are proportional to the interest held in the capital. By contrast, co-operatives either apply the democratic principle of "one man, one vote" or, if each share carries one vote, they have a mechanism to cap the total number of voting rights held by any one member (at 0.25%, for example). Consequently every member is treated equally at general meetings, irrespective of the percentage interest they hold in the capital. It is at these annual general meetings that the directors of local and regional banks are required to submit themselves for election. This electoral system, which is fundamental to the governance of co-operative banks, allows members to exert control over the business by exercising the political rights attached to cooperative shares. For example at

[6] The central body stands surety for the liquidity and solvency of each bank within the network, and for the network as a whole (Article L. 511-31 of the French Monetary and Financial Code), and can take all necessary measures to fulfil this obligation. In co-operative groups, this legal guarantee – which offers a high degree of protection to savers and customers – is backed up by a number of intra-group contractual arrangements. The interplay between these various provisions means that the central body and its affiliated Regional Banks are in financial terms jointly and severally liable in respect of all their customers and creditors.

[7] Johnston Birchall and Lou Hammond Ketilson, International Labour Organization, 2009

Crédit Agricole, 10% of the members – or 500,000 people – participate in the annual general meeting every year, a higher participation rate than among shareholders of listed companies. The same applies to the BPCE Group (Caisses d'Épargne and Banques Populaires) and to Crédit Mutuel.

## I- General comments

Like all French banks, the co-operative banks share the same objectives of financial stability as drive the thinking of government and central banks. However, some of the trends that seem to be emerging from current work in prudential regulation at Basel and at a European level give cause for concern, and raise a number of questions.

As regards the work on the definition of capital, we share the objective of the supervisors, who want to improve the quality of banks' own funds by applying tougher eligibility criteria for Core Tier 1 capital. However, we are concerned that insufficient account has been taken of the specificities of the co-operative model, and that this risks inflicting collateral damage on the capital instruments of co-operative banks. On this point, we need to remind that unlike the hybrid securities that have recently been developed, usually on a contractual basis, the form of the securities comprising the capital of French co-operative banks is defined in long-established laws and regulations.

In terms of the work of the CEBS, we note that the CEBS has explicitly taken into account the specificities of co-operative banks (points 9, 23, 27, 29, 33, 42, 58, 71, 77, 80 in the consultation paper) in assessing the eligibility of capital instruments for inclusion in Core Tier 1 capital. We appreciate the willingness of the CEBS to provide a satisfactory response to the concerns of co-operative banks, and would like to thank them for taking these concerns into account.

We would also like to thank the CEBS for the opportunity to contribute to the process by participating in the consultation on CP 33. We have a number of general comments to make, and would also like to suggest a number of amendments that would prevent the implementation guidelines proposed by the CEBS from weakening the capital of the co-operative banks (cooperative shares and co-operative certificates) because of the possibility that some criteria may fail to take account of the principles and practice of co-operative capital instruments.

### *I-1. A specific legal form of company should not be the benchmark for all legal forms*

We believe that the work of the European prudential bodies should respect the principle of neutrality between different legal forms and organisational structures, and hence should not weaken co-operative models purely as a result of collateral damage inflicted by definitions based solely on joint stock companies, with no prudential justification. On this point, it is worth remembering that co-operative status is fully enshrined in the *acquis communautaire*.

However, the CEBS (in paragraphs 17 and 34) makes ordinary shares the benchmark for assessing the eligibility of other instruments issued by joint stock or non joint stock companies as capital instruments. This appears to be a very narrow reading of Article 57(a) of Directive 2006/48/EC, the text to which the CEBS implementation guidelines apply. We believe this reasoning to be flawed: prudential criteria alone should serve as the benchmark, rather than a specific legal form.

We would not want an exception to be made for our capital just because a single (and debatable) benchmark is used. An exception largely based on a national assessment raises the issue of legal security, on which we cannot accept any uncertainty.

***I-2. From a prudential standpoint, the capital instruments of co-operative banks are as solid as those of listed joint stock companies.***

The capital instruments issued by co-operative banks (cooperative shares and co-operative certificates) are of excellent quality from a prudential standpoint because they absorb losses, ranking after all other claims pari passu. They are simple and easy to understand and their terms are defined in long-established laws and regulations rather than on a contractual basis.

Under the combined terms of the 1947 law and the Monetary and Financial Code, cooperative shares and co-operative certificates are capital instruments. They are the most subordinated securities that a co-operative can issue. This is explicitly reflected in Article 19 of the 1947 law, which states that on liquidation, “distribution of the residual assets after settlement of the liabilities and redemption of effectively paid-up capital shall be decided upon by the general meeting…”. In the event of liquidation, the liquidators will be required to realise the assets, settle the liabilities, and finally to redeem the capital as much as possible?). Consequently, the capital (comprising cooperative shares and co-operative certificates) cannot be redeemed until all liabilities, including subordinated liabilities, have been extinguished.

The capital instruments – cooperative shares and co-operative certificates – are redeemed pari passu and in proportion to the interest in the capital they represent.

In terms of permanence, our capital base is stable and expanding.

We therefore believe that our capital instruments offer the same quality in prudential terms as ordinary shares, and as such should be placed on the same footing as ordinary shares. Consultation paper CP 33 should therefore be amended on this point, since it stipulates new specific conditions that are not required by Article 57(a), which CP 33 seeks to apply. Unless this amendment is made, the position adopted by CP 33 would be in conflict with the position consistently adopted by banking supervisors, who have never questioned the prudential quality of co-operative capital instruments. For example, in early 2008 the CEBS affirmed that: "*from a prudential standpoint, there is no reason to question the current treatment of cooperative shares issued by co-operative banks as regulatory capital. Within the CEBS, there is also general agreement that cooperative shares of co-operative banks constitute Core Tier 1 capital".*[8]

Meanwhile the European Commission, in its consultation paper (published on 26 February 2010) on possible changes to the Capital Requirements Directive, stated that "*where the quality of NJS* [non joint stock] *companies' capital instruments is of the highest quality, the Commission services consider it appropriate that they be recognised as Core Tier 1 capital*". Similarly, the French parliament argued in its recent report entitled "Towards a financial sector at the service of the economy"[9] that "the new definition of banks' own funds (Core Tier 1) should continue to take account of the specificities of co-operative and mutual banks".

***I-3. The principles set out in CP 33 seem to go beyond the mere interpretations of Article 57(a) of Directive 2006/48/EC.***

An instrument is classified as capital within the meaning of Article 57(a) of CRD 2 if it absorbs losses in going concern situations and ranks after all other claims in the event of liquidation. CP 33 goes beyond these two principles, introducing an additional criteria based on the recommendations of the Basel Committee. We would argue that conditions which do not refer to the two criteria defined in Article 57(a) would need to be addressed in future changes to the directive, rather than in a technical guidance document.

**We are seeking proper recognition of our co-operative model: the status of all co-operative capital instruments (cooperative shares and co-operative certificates) as Core Tier 1 capital should be fully recognised by the bodies that are currently working on the definition of capital by placing these capital instruments on an equal footing with ordinary shares, rather than by merely raising the possibility of allowing an exception on a purely national basis. While appropriate technical solutions could no doubt be developed on this basis at national level, such an approach is far from ideal**

[8] Letter from the CEBS to the European Association of Co-operative Banks, 12 February 2008
[9] Information Report no. 2208 of the Legislative Commission of the National Assembly, December 2009

**in terms of legal security within the internal market. Such solutions would effectively alter the organisational model of co-operative groups, which we would strongly argue represents a complete and balanced alternative to the joint stock company.**

**Furthermore, the criteria based on the entitlement to a claim on residual assets and on the prohibition of caps on payments to capital instruments are undoubtedly highly relevant to the capital of joint stock companies, but are inappropriate for the capital instruments of co-operatives. These capital instruments should therefore be exempted from these criteria. Similarly, it is not appropriate to effectively prohibit, via the new requirements set out in this document, the co-existence of different capital instruments within co-operatives without explaining the prudential disadvantages of such arrangements.**

**This is the substance of the detailed proposals we make below.**

## II- Our proposals

### A- Definition of capital within the meaning of Article 57(a) and Recital 4

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| Criterion 1 | The instrument should be equity capital contributed by legal owners under national law. It must also be recognized as equity under relevant accounting standards and insolvency law. |
| Criterion 2 | Capital instruments must be fully paid. When the issuer provides financing to the shareholder or other proprietor to facilitate the subscription of capital, either directly or indirectly, the instrument cannot be considered as capital for regulatory purposes The instrument shall ensure an effective permanent supply of capital. |
| Criterion 3 | The instrument shall be directly issued. |
| **Question 1** | **1.1 Are the guidelines in relation to the features of capital instruments sufficiently clear, or are there issues which need to be elaborated further? Please provide concrete proposals as to how the text could be amended.**<br>**1.2 Are there any circumstances under which indirect issuances would be justified? Please provide evidence.** |

As indicated above, the CEBS makes ordinary shares the benchmark (points 17 and 34) for assessing the eligibility of instruments issued by joint stock or non joint stock companies as capital instruments, which appears to be a debatable interpretation of Article 57(a). We regard the reasoning as flawed and unsatisfactory. Only the prudential criteria specified in the directive should serve as the benchmark, rather than a specific legal form. The French co-operative banks do not want their capital arrangements to be accommodated by allowing an exception, while the framework is in itself debatable.

**Our proposal**

⇨ **Preferred option: delete paragraphs 17 and 34**

⇨ **Alternative option: amend paragraphs 17 and 34 to include a stipulation that the capital instruments of co-operative banks (cooperative shares, co-operative certificates) should constitute the benchmark for co-operative banks, along the lines of Recital 4 of CRD 2.**

| *Consultation Paper CP 33* | *Our proposed amendment* |
|---|---|
| **17.**<br>**"Ordinary shares should be the benchmark for assessing the features of instruments issued by joint stock or non joint stock companies that may be** | **17. "Ordinary shares, <u>or capital instruments of non joint stock companies equivalent in terms of capital qualities within the meaning of Article 57(a) of Directive 2006/48/EC</u>, should be the** |

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| **included under Article 57(a).”** | **benchmark for assessing the features of instruments issued by joint stock or non joint stock companies that may be included under Article 57 (a)”** |

| *Consultation Paper CP 33* | *Our proposed amendment* |
|---|---|
| **34.** “**CEBS considers, therefore, that ordinary shares should be the benchmark for assessing the features of instruments issued by joint stock or non joint stock companies that may be included under Article 57(a).”** | **34. “CEBS considers, therefore, that ordinary shares, <u>or capital instruments of non joint stock companies equivalent in terms of capital qualities within the meaning of Article 57(a) of Directive 2006/48/EC</u>, should be the benchmark for assessing the features of instruments issued by joint stock or non joint stock companies that may be included under Article 57 (a)”** |

Turning to the other provisions proposed made by the CEBS in this section, we would make the following comments: in accordance with the accounting standards applicable to all banks, capital instruments and equity instruments are identified as such in the balance sheet of the bank’s annual accounts. In cooperative banks, payments made on cooperative shares and dividend payments (which the general meeting has sole authority to approve) are identified as such in the co-operative’s accounts, and paid promptly to the holders of the instruments.

It is moreover in recognition of all the characteristics described above, and of the texts governing the cooperative shares of co-operative banks, that the French legislator, by an order issued on 22 January 2009, amended Article L.512-1 of the Monetary and Financial Code to make it clear that “cooperative shares in mutual and co-operative banks are included in the share capital”.

B- **Permanence**

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| Criterion 4 | The capital instrument is perpetual and no terms shall enable redemption by the issuer outside liquidation (setting aside discretionary repurchases or other means of effectively reducing capital in a discretionary manner that is allowable under national law.) The holder shall not be a position to require redemption. |
| Criterion 5 | Neither the contract nor marketing conditions shall provide any expectation that the capital instrument will be bought-back or redeemed. Buy-backs or redemptions are subject to prior approval by the competent authorities. |
| **Question 2** | **2.1 Are the guidelines in relation to permanence sufficiently clear or are there issues which need to be elaborated further? Please provide concrete proposals as to how the text could be amended.** **2.2 Are there any circumstances under which prior approval of competent authorities for redemptions and buy-backs would not be justified? Please provide evidence.** |

The proposed criteria for determining the permanence of a capital instrument are only really meaningful in the case of companies whose shares are traded on a market, where the unavailability of redemption is compensated for by the fact that the holders can sell their shares.

The CEBS addresses this issue in paragraph 54, stating that where there is a right under law for holders to demand redemption of their instruments by the issuer (as is the case with co-operative banks), this should not be considered as a put option under the CEBS guidelines on condition that redemption is subject to an approval process which provides the issuer with the option to refuse the holder's request with regard in particular to its prudential situation.

We understand this paragraph to mean that the principle of redemption of cooperative shares in co-operative banks is not affected. The French law gives answers to this principle : the redemption of cooperative shares must be authorised by the Board of Directors of the co-operative and ratified at a general meeting. We would like our interpretation to be expressly confirmed in the final version of CP 33, especially as we feel it is necessary to promote the maximum possible convergence between accounting standards and prudential standards.

French co-operative banks have further mechanisms governing the redemption ofcooperative shares.

- The issuer has an unconditional right to refuse to redeem cooperative shares[10].

[10] Commission Regulation (EC) No 1073/2005 of 7 July 2005, amending Commission Regulation (EC) No 1725/2003 of 29 September 2003 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council, as regards IFRIC 2.

- The Monetary and Financial Code allows co-operative groups – directly in some cases, and in others by reference to the articles of association – the option to defer redemption where there is a business relationship between the bank and the member, or where the member is still a debtor of the bank[11].
- It is also impossible to carry out redemptions that would reduce the share capital below the level required for co-operative banks[12].

We consider that these mechanisms, especially the powers given to the Board, are largely enough and that competent authorities can intervene a posteriori only. We suggest that paragraph 55, which is accurate for joint-stock companies, does not apply to cooperative banks, which have such mechanisms.

Moreover, we recall that co-operative banks are, as any other bank, subject to banking law on minimum capital requirements, and to prudential rules on capital ratios, thereby enabling the supervisor to assess the level and quality of their own funds.

Moreover, while French co-operative banks may redeem capital subject to certain conditions, their reserves are non-distributable and can never be appropriated to the members beyond the nominal value of their shares, either in a going concern situation or on liquidation. In the event of liquidation, the law requires the members – once all the losses have been absorbed – to distribute the reserves either to another co-operative or to other public-interest causes. By contrast, in an ordinary joint stock company the reserves may be distributed, and hence disappear from the balance sheet. This difference supports our argument that ordinary shares issued by joint stock companies cannot be used as the benchmark, given that this model is clearly weaker than the co-operative model in terms of the permanence of capital.

Finally, we would point out that the French co-operative banks did not withstand important capital losses during the crisis, and that the mechanisms governing redemption of cooperative shares were not activated. Indeed, the capital of French co-operative banks remained stable, or even increased, during the crisis.

In light of these arguments, we propose aligning the prudential treatment on the accounting treatment, by standardising the relevant definitions based on the concept of the unconditional right of the issuer to refuse redemption of the instrument.

[11] Article L. 512-26 of the Monetary and Financial Code.
[12] Article 13 of the law of 10 September 1947 that established co-operative status.

**Our proposal**

⇨ **For co-operative banks, insert into criterion 4 (permanence) the principle of the unconditional right of the issuer to refuse redemption of the capital instrument.**

| ***Document de consultation CP 33*** | ***Nos propositions de modification*** |
|---|---|
| **54- When there is a right under the law for the holders of shares to return their shares to the issuing institutions (in particular cooperative and mutual banks or similar institutions), this right is not considered as a put option under these guidelines. This is under the condition that this redemption is subject to an approval process which provides the institution with the option to reject the holders' request with regard in particular to the prudential situation of the institution.** | **54- When there is a right under the law for the holders of shares to return their shares to the issuing institutions (in particular cooperative and mutual banks or similar institutions), this right is not considered as a put option under these guidelines. This is under the condition that this redemption is subject to an approval process which provides the institution with the option to *unconditionnaly* reject the holders' request (with regard in particular to the prudential situation of the institution).** |

**C- Flexibility of payments**

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| Criterion 6 | There is no right for the holders of capital instruments to claim distribution. |
| Criterion 7 | Payments of dividends are paid out of distributable items and are not cumulative. The level of distribution is not in any way tied or linked to the amount paid in at issuance. |
| **Question 3** | **3.1 Are the guidelines in relation to flexibility of payments sufficiently clear or are there issues which need to be elaborated further? Please provide concrete proposals as to how the text could be amended.**<br>**3.2 Are there any circumstances under which the restrictions on payments (in particular those related to non-fixed amounts and caps) would not be justified? Please provide evidence.** |

French co-operative banks have two categories of capital instrument: cooperative shares and co-operative certificates. The payments made on cooperative shares are limited and capped (Article 14 of the 1947 law establishing co-operative status).

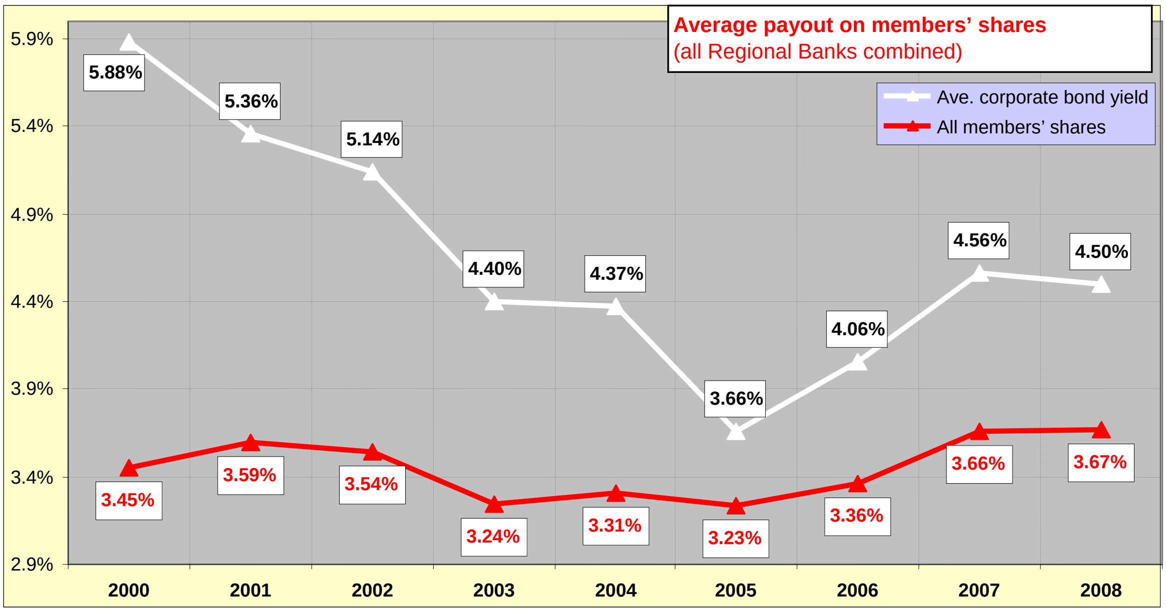
Points 27 and 71 of consultation paper CP 33 rule out any possibility of capping payments made on capital instruments, arguing that this can be viewed by the market as an obligation to pay the capped amount. We note that an exception has been allowed for co-operatives (non joint stock companies), but only where the cap is applicable to all eligible instruments so that it does not create privileges.

We believe that the question of the cap on payments on co-operative capital instruments needs to be clarified in order to avoid any misunderstanding. The existence of a cap does not of itself pose any problems from a prudential standpoint. On the contrary, by limiting the amount distributed, the cap serves to raise the proportion of earnings retained by the bank, and hence to increase the bank's own funds. The cap undeniably constitutes a guarantee of stability, and not a risk factor from the prudential point of view.

Moreover, we regard the reference to market perception as inappropriate for instruments such as cooperative shares. Because cooperative shares are not listed, there is no organised market for this type of instrument.
These shares are the only way for co-operative bank customers to become members of their bank, and to play a role in the life of their bank; they are not motivated solely by financial considerations.

Indeed, the assertion that the existence of a cap would tend to encourage banks to make payments on the instruments concerned up to the level of that cap (in the absence of any legal obligation to do so) or might be interpreted in that way by holders of the instruments, is not only unfounded, but also belied by the practices of our banks.

For example, the chart below shows that the payout on cooperative shares made by the Crédit Agricole Regional Banks has over a long period been substantially below the cap specified by the 1947 law (the average yield on corporate bonds). The average payout on cooperative shares out of 2008 profits was 3.67%, compared with an average yield on corporate bonds of 4.50%.



The same applies to the banks in the BPCE Group:

| Payout on cooperative shares | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Payout to members | Payout made from 2001 profits in 2002 | Payout made from 2002 profits in 2003 | Payout made from 2003 profits in 2004 | Payout made from 2004 profits in 2005 | Payout made from 2005 profits in 2006 | Payout made from 2006 profits in 2007 | Payout made from 2007 profits in 2008 | Payout made from 2008 profits in 2009 |
| BP | 3.90% | 3.59% | 3.29% | 3.35% | 3.26% | 3.37% | 3.62% | 3.66% |
| CEP | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% | 3.75% | 3.85% |

And for Crédit Mutuel,

| | Payout on cooperative shares | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | **2000** | **2001** | **2002** | **2003** | **2004** | **2005** | **2006** | **2007** | **2008** |
| **Crédit Mutuel Total Regulatory perimeter** | **2,95%** | **3,35%** | **3,31%** | **3,23%** | **3,09%** | **3,06%** | **2,68%** | **2,88%** | **3,36%** |
| **Ave corporate bond** | **5,88%** | **5,35%** | **5,14%** | **4,40%** | **4,36%** | **3,66%** | **4,06%** | **4,56%** | **4,50%** |

Most importantly, removing the cap on payments on cooperative shares is counter-productive in prudential terms, since it would have the effect of limiting growth in the own funds of co-operative banks. It also raises an important political problem: removal of the cap is contrary to the principles of the co-operative movement, and hence would be perceived as a first step towards demutualisation. The existence of a legal cap on payouts for French co-operatives derives from the founding principles of the international co-operative movement, which established that members should enjoy only limited compensation on their capital[13].

Finally, no prudential justification is advanced for the condition proposed by the CEBS in point 71, which would require the same cap to be applicable to all instruments eligible under Article 57(a). This would threaten the co-existence of the two categories of co-operative shares that were introduced into French legislation with the 1947 law establishing co-operative status and that have remained in place ever since, with no explanation of why co-existence creates a problem from a prudential standpoint (in particular, whether the CEBS is concerned to protect the holders of these instruments).

For all these reasons, we believe the cap criterion to be inappropriate.

[13] Statement on the Co-operative Identity, International Co-operative Alliance, 1938

**<u>Our proposal</u>**

**⇨ Amend paragraphs 27 and 71**

**Preferred option:**

| ***Consultation Paper CP 33*** | ***Our proposed amendment*** |
|---|---|
| **27 and 71. "A cap related to the payment on the instruments is not acceptable since it can be viewed by the market as an obligation to pay this capped amount. There is an exception for non-joint stock companies if, resulting from a provision under national law, the cap is applicable to all instruments eligible under Article 57a, so that it does not create privileges."** | **27 and 71. "A cap related to the payment on the instruments is not acceptable since it can be viewed by the market as an obligation to pay this capped amount. There is an exception for non-joint stock companies. ~~if, resulting from a provision under national law, the cap is applicable to all instruments eligible under Article 57a, so that it does not create privileges."~~** |

Alternative option:

| ***Consultation Paper CP 33*** | ***Our proposed amendment*** |
|---|---|
| **27 and 71. "A cap related to the payment on the instruments is not acceptable since it can be viewed by the market as an obligation to pay this capped amount. There is an exception for non-joint stock companies if, resulting from a provision under national law, the cap is applicable to all instruments eligible under Article 57a, so that it does not create privileges."** | **27 and 71. "A cap related to the payment on the instruments is not acceptable since it can be viewed by the market as an obligation to pay this capped amount. There is an exception for non-joint stock companies if, resulting from a provision under national law, (i) <u>a</u> cap is applicable to all instruments eligible under Article 57(a) <u>or, (ii) such cap is only applicable to some instruments eligible under Article 57(a) and not all, and it does not create privileges</u>."** |

## D- Loss absorbency

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| Criterion 8 | The instrument takes the first and proportional share of any losses as they occur pari passu with other instruments included under Article 57 (a) |
| Criterion 9 | Capital instruments must be pari passu among themselves and have the most subordinated claim in liquidation. They are entitled to a claim on the residual assets that is proportional to their share of capital and not a fixed claim for the nominal amount. |
| Criterion 10 | Capital instruments must not be provided with guarantees, pledges or other credit enhancements that legally or economically enhance their seniority. |
| **Question 4** | **4.1 Are the guidelines in relation to loss absorbency sufficiently clear or are there issues which need to be elaborated further? Please provide concrete proposals as to how the text could be amended.**<br>**4.2 Are there any particular issues CEBS should consider regarding Loss absorbency features, both in going concerns and in liquidation? Please provide evidence.** |

1- Claim on residual assets

Criterion 9 requires that capital instruments be entitled to a claim on residual assets on liquidation. The prudential justification for this criterion is not apparent to us, because we do not see how entitlement to a claim on residual assets in a liquidation provides any security from a prudential standpoint. In terms of the legal and economic logic underpinning ordinary shares, such an entitlement is a trade-off for loss absorbency. But in the co-operative model, cooperative shares are governed by a different economic logic, whereby cooperative shares can co-exist with other capital instruments without there being any difference in loss absorbency.

Consequently, we do not think entitlement to a claim on residual assets is relevant as a criterion for eligibility. Our preferred option would be to delete the reference to entitlement to a claim on residual assets from criterion 9 ("*They are entitled to a claim on the residual assets that is proportional to their share of capital and not a fixed claim for the nominal amount.*").

2- Going concern

As regards loss absorbency in a going concern, point 77 addresses the specific situation of co-operative banks. Holders of cooperative shares that do not give access to reserves can at best receive the amount initially paid for the shares (the nominal amount). Given that these shares are loss-absorbent, their holders will recover less than the nominal amount paid if the losses are absorbed by the capital once the reserves have been extinguished.

However, point 77 requires this limitation on access to be applicable pari passu to all eligible capital instruments: "*This is under the condition that the reserves are not owned by some shareholders and not all, and that the limitations relating to the access to reserves are applicable pari passu to all instruments eligible under Article 57a, so that it does not create privileges*".

The drafting of paragraph 77 raises difficulties in interpretation for co-operative banks that have capital instruments with differing rights of access to reserves. Although the text gives a very good description of how the mechanism works, it omits an essential point: when several categories of capital instruments co-exist, rights of access to reserves are never given up in favour of holders of any capital instruments of whatever category.

3- Liquidation

As regards loss absorbency in liquidation, CP 33 requires capital instruments to have a claim on the residual assets that is proportional to their share of the capital and not a fixed claim for the nominal amount.

Point 80 of CP 33 addresses the specific situation of co-operative and mutual banks, where holders of capital instruments receive only the nominal amount paid for their shares, with the remainder of the reserves being distributed to public-interest causes. However, this point also refers to the same condition as point 77, i.e. that this limitation must apply to all other capital instruments.

If this approach (which we regard as debatable) were to be retained, then the wording adopted by the CEBS should focus on equality of treatment of all capital instruments in terms of loss absorbency and subordination in the event of liquidation, without prejudice to differences in the entitlement of each category of capital instrument to a claim on residual post-liquidation assets (given that such differences have no effect on either loss absorbency or subordination). We therefore think it important that the final version of the CEBS document should eliminate any ambiguity that might arise from the issues raised above.

**<u>Our proposal</u>**

⇨ delete the reference to entitlement to a claim on residual net assets from Criterion 9

| ***Consultation Paper CP 33*** | ***Our proposed amendment*** |
|---|---|
| **Criterion 9: Capital instruments must be pari passu among themselves and have the most subordinated claim in liquidation.**<br>**They are entitled to a claim on the** | **Criterion 9: Capital instruments must be pari passu among themselves and have the most subordinated claim in liquidation.**<br>**~~They are entitled to a claim on the~~** |

| | |
|---|---|
| **residual assets that is proportional to their share of capital and not a fixed claim for the nominal amount.** | **~~residual assets that is proportional to their share of capital and not a fixed claim for the nominal amount.~~** |

**On the issue of the co-existence of different categories of capital instrument:**

**1- Amend the final sentence of paragraph 77**

| ***Consultation Paper CP 33*** | ***Our proposed amendment*** |
|---|---|
| **77. "(…) This is under the condition that the reserves are not owned by some shareholders and not all, and that the limitations relating to the access to reserves are applicable pari passu to all instruments eligible under Article 57(a), so that it does not create privileges. "** | **77. "(…) This is under the condition that the reserves are not owned by some shareholders and not all and <u>that the limitations relating to the access to reserves, if applicable to some shareholders and not all, do not create privileges among holders of instruments eligible under Article 57 (a).</u>"** |

**2- Amend the final sentence of paragraph 80**

| ***Consultation Paper CP 33*** | ***Our proposed amendment*** |
|---|---|
| **80. (…) Such a cap relating to the amount paid in liquidation is acceptable if it is applicable to all instruments eligible under Article 57(a), so that it does not create privileges (see also paragraph 77).** | **80. (…) Such a cap relating to the amount paid in liquidation is acceptable if it is applicable to all instruments eligible under Article 57(a), <u>or, if such a cap is only applicable to some instruments, it does not create privileges (see also paragraph 77)</u>.** |