22 September 2009

# Public hearing on CEBS's Consultation Paper on Hybrid Capital Instruments (CP 27)

## Note of meeting

London, 8 September 2009

The Committee of European Banking Supervisors (CEBS) held a public hearing on 8 September 2009 to present its draft proposal for implementation guidelines on Hybrid Capital Instruments. The hearing was chaired by Thomas Huertas (Chair of the Expert Group on Prudential Regulation) and David Guillaume (Chair of the 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 hybrid capital instruments, in particular regarding their inclusion into institutions' original own funds. The Consultation Paper responds to the request in Article 63a (6) that CEBS shall elaborate guidelines for the convergence of supervisory practices regarding hybrid instruments.

## 2. CEBS' draft proposal on Hybrid Capital Instruments

After an introduction by Thomas Huertas, David Guillaume explained the main objectives of CEBS's draft proposal on Hybrid Capital Instruments[1] and detailed proposed guidance related to the five main parts of the paper: (i) permanence (ii) flexibility of payments (iii) loss absorbency (iv) limits and (v) SPV issuances. After the presentation, participants were asked for comments. The main questions and comments are briefly summarised below.

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

### 2.1. On permanence

Some participants questioned the prior supervisory approval needed for buy-backs, as well as the need to introduce a five-year minimum holding period before buy-backs would be undertaken given that the prior supervisory approval is needed in all cases.

CEBS stressed the importance that is attached to the criteria of permanence. In this regard, buy-backs are in prudential terms equivalent to redemptions. So the supervisor must not only have to give consent to buy-backs, in particular to ensure that the bank will have sufficient capital after the buy-back to meet its capital requirements over an extended time period, but there should also be minimum holding period for instruments eligible as original own funds.

### 2.2. On flexibility of payments

Participants expressed concerns about the constraint introduced on Alternative Coupon Satisfaction Mechanisms (ACSM) in the draft proposal, as well as provisions on dividend pushers/stoppers. Another issue raised was linked to the possibility of supervisors cancelling payments at any time since this may conflict with contractual terms of issuances.

CEBS reaffirmed that ACSM are acceptable only if they have the same effect as a cancellation of payments. Hybrid instruments must be able to absorb losses, meaning that regulators must have the ability to cancel payments. The terms would have to make provision for cancellation of coupons required by regulators.

### 2.3. On loss absorbency

One of the participants questioned the fact that conversion effectively helps the recapitalisation of a bank, based on recent experiences, and suggested that the bank should have the possibility to activate the conversion instead of making it automatic and mandatory.

### 2.4. On limits

One participant questioned the obligation to keep an instrument incorporating an incentive to redeem (‘innovative’ instrument) into the 15% limit once the call date has expired without redemption. This is because the instrument was originally marketed as an instrument with an incentive to redeem. It is likely that investors would expect the instrument to be redeemed at the earliest opportunity after the step-up date.

### 2.5. On SPV issuances

Some participants required clarification on the way SPV issuances could be taken into account in the context of solo consolidation. It was explained that the Directive criteria in article 70 would have to be met.

## 2.6. On grandfathering

Some participants asked about the potential publication of more detailed guidance on grandfathering, expressing concerns about the need for CEBS to ensure convergence among supervisors and monitor closely the implementation.

CEBS reminded that transitional arrangements for the new regime on capital instruments are already provided by the CRD. CEBS does not consider at this time issuing specific guidelines on grandfathering. Nevertheless, CEBS may consider indicating how the instruments not compliant with the new regime should be included in the different sets of limits.

## 3. Basel work on capital

Concerning the articulation between CEBS's and BCBS's work, CEBS has underlined that there is close cooperation between the two organisations and that the G20 has instructed regulators to press on. There are different stages in the discussion but the work currently led by the BCBS was not considered in the short term to bring radical changes to the implementation of CEBS' guidelines on hybrids.

Participants to the hearing were encouraged to send their written comments to the CP27 by 23 September 2009. 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 by the end of 2009 and will be published on the CEBS website.