WKO BANK · VERSICHERUNG

cp33@c-ebs.org

Division Bank and Insurance
Austrian Federal Economic Chamber
Wiedner Hauptstraße 63 | P.O. Box 320
1045 Vienna
T +43 (0)5 90 900-3131
F +43 (0)5 90 900-272
E bsbv@wko.at
W http://wko.at/bsbv

Your reference, Your message of	Our reference, contact person	Extension	Date
	BSBV 188	3137	25 March 2010

CP 33 – CEBS

The Division Bank and Insurance of the Austrian Federal Economic Chamber representing the entire Austrian banking industry welcomes this opportunity to comment on CEBS's Consultation Paper (CP 33) on Implementation Guidelines regarding Instruments referred to in Article 57(a) of the CRD:

General assessment

- ### Excessive interpretation

While we generally welcome a harmonisation in the definitions of capital, the interpretation proposed by CEBS goes too far.

Original own funds under Art 57(a) CRD should also include any and all instruments which are equivalent to ordinary shares in liquidation and which, based on the going concern premise, provide for complete loss absorption just as ordinary shares do.

This could also include instruments containing preferential rights for dividend payment. The definition of original own funds should furthermore comprise all other instruments under a credit institution's statutory terms, taking into account the specific structure of co-operative societies and savings banks, as are considered equivalent to ordinary shares in terms of the quality of their capital, in particular as regards loss absorption.

As is also explained in par. 4, CP 33 is based on Art 63a (6) CRD as amended by Directive 2009/111/EC, which reads: "(6) The Committee of European Banking Supervisors shall elaborate guidelines for the convergence of supervisory practices with regard to the instruments referred to in paragraph 1 of this Article and in Article 57(a) and shall monitor their application."

CEBS has now presented such draft guidelines, which, however, go well beyond the task set forth in the Directive and go beyond CEBS's mandate. The guidelines published for consultation not only provide orientation for the convergence of supervisory practices, but also address national legislators and contain detailed legal requirements for the features of capital instruments that go beyond what is required under the Directive and, in particular, do not relate to the instruments' loss absorbency.

Such far-reaching and drastic changes to banking supervision law by way of interpretation without involving the competent legislative bodies of the European Union are unacceptable.

As a result Europe would be applying a concept of capital devised to ensure international harmonisation prior to any comprehensive analysis of its impact and before completing the international process of coordination for its banks without the involvement of the European Parliament.

This approach gives rise to the following practical problem issues: Basel III content would be brought forward in part and would have to be implemented based on the current state of discussions before any impact studies are available, possibly resulting in duplication of adaptation efforts.

In addition, these parts brought forward will undermine the discussion about necessary transitional periods in relation to the new own funds requirements under Basel.

- **Criterion 2: Financing of own funds (pars. 10, 20, 44)**

  Criterion 2 of the proposal sets forth that, when the issuer provides financing to facilitate the subscription of own funds, such capital cannot be considered capital for regulatory purposes.

  We share the view of CEBS that any abusive generation of own funds should be avoided, but would recommend the following limitations to any outright ban:
  - To be subject to the prohibition, the credit institution providing the financing must be aware of the fact that it is financing an own capital instrument and financing must be provided specifically for the own capital instrument.
  - Any financing provided for the subscription of own capital instruments in the course of a credit institution's normal business operation and comparable with arm's length transactions should be exempted from the financing prohibition in keeping with the provisions of the capital guidelines. With this type of financing, the loss absorbency of these components of own funds would not be affected and hence an exemption would be justifiable.

- **Criterion 4: Deduction from original own funds when redemption or buy-back becomes sufficiently certain (par. 48)**

  In our opinion, this requirement is unjustified, both in economic and in legal terms. As long as the own capital instruments are held by the subscriber, they are fully loss-absorbent. The same applies when a redemption has already been announced. Not until completion of a redemption / buy-back is a deduction from original own funds justified.

We would also like to point out that in some cases banks are willing to buy back the instrument and express their willingness to do so, yet investors do not heed the call or the buy-back is drawn out over months, if not years. In such cases, the guidelines stipulate early withdrawal, even though the relevant components of the own funds would be fully loss-absorbent at all times.

- **Criterion 5: Buy-backs / redemptions are subject to prior approval by the competent authorities**

With regard to pars. 24, 61:

We share the view held by the BCBS that any buy-back of own capital instruments should be governed by rules. However, we would like to point out that, contrary to hybrid instruments, numerous requirements under corporate law already exist at national level, particularly in connection with own shares, and have proven their worth in the past.

In Austria, own shares may only bought back if conclusively determined by the law and requires authorisation by the annual general meeting in most cases. Moreover, the volume of own shares that may be bought back is limited. The Austrian Stock Corporation Act further requires that reserves be created in the amount of acquired shares, thus already taking into account loss absorption. In light of this tight regulatory corset, we believe there is no need for additional prior authorisation by the supervisory bodies.

In specific cases prior regulatory approval does not appear necessary, as when own shares are bought back by listed stock corporations for the purpose of securities trading to be able to meet market needs, in particular if relevant market maker functions are performed. Any prior regulatory approval would make it de facto impossible to trade in own shares.

With regard to par. 58:

The approval procedure required by CP 33 for the redemption of capital and the buy-back of shares is not practicable with all legal forms. The regular fluctuation in the membership of co-operative banks would be a case in point. The annual approval provided in par. 58 is excessive, since the number of acceding members usually exceeds that of outgoing members, resulting in a net increase in ordinary share capital. Even if the opposite were the case, it would still be excessive for small amounts.

A reasonable materiality limit would have to be established, as this has not been done sufficiently by par. 56 (contradiction between clauses 2 and 4).

- **Criteria 6 and 7: Discretion to determine amount of dividend (pars. 26, 27, 28, 65 -72)**

  - According to par. 65 a), the bank must have full discretion to determine the amount of dividend payouts. Pars. 70 and 71 are in the same vein, prohibiting any pre-indication on the dividend levels as well as any caps.

  - However, any prohibition of caps or the required discretion cannot be deduced from CRD 2. Criteria 6 and 7 are a problematic issue of brought-forward Basel III implementation.

- The body of rules will also have to be discussed with regard to Basel III, as it will be difficult to place participation certificates (and preferred shares without voting rights and without maturity) on the market without any prior indication of a specific amount to be paid out as dividend.

- Furthermore, limitations on dividend payments under statutory terms might actually be desirable under regulatory law.

- According to criterion 6, investors have no right to claim distribution of dividends and non-payment is not allowed to trigger an event of default. According to criterion 7, the level of distribution must not in any way be tied or linked to the amount paid at issuance.

  We agree with CEBS that it must be at the bank's discretion to pay dividends even if distributable profits are reported. We welcome the provision that capital instruments with preferential rights to dividend payment over other holders of capital may be added to the original own funds in line with Recital 4 CRD II.

  Based on the present proposal, any indication of dividend levels would be impermissible.

  It is also essential to permit the issue of instruments that comprise a dividend indication. A dividend indication could easily be provided in such a way that the payment is at the issuer's discretion and may be made only if covered by net profit after allocation to reserves. In no case would there investors have a legal right to dividend payment in case of (adequate) profit available for distribution. The features could be conveyed to the investor in a transparent manner.

  An outright prohibition as described above is considered far too strict, since it does not improve the quality of the capital instrument. We therefore recommend reducing the prohibition to cover only capped capital instruments that grant investors a legal right.

- The principles developed by CEBS to enhance the quality of a credit institution's original own funds must be applicable irrespective of the legal form. Should an exception be granted to admit caps for original own funds instruments, this must apply to all credit institutions.

• Level playing field

- Recital 4 of CRD 2 expressly emphasises that the specific form of co-operative societies should be taken into account. Accordingly, CP 33 reiterates in par. 33 that instruments issued by co-operative societies should be included if they are deemed equivalent to ordinary shares in terms of "capital qualities" (cf. also Basel Committee). Of special relevance in this regard is the criterion of loss absorbency and permanence.

- As far as **permanence** is concerned, CP 33 in pars. 22 and 23 (and in par. 54) specifically provides that, while it is possible to return shares to issuing institutions, the permanence criterion is met only if the co-operative bank has the option of turning down the request for redemption (in particular in times of crisis) (cf. also IFRIC2 - Interpretation of IAS 32). The purpose behind this – as has been stipulated in the Basel document – is to prevent collective withdrawal of capital by outgoing members in times of crisis.

This requirement is indeed understandable. However, in our opinion, instruments other than the payment blockage demanded by CEBS could serve the same purpose.

- Notice period and call-in date: Withdrawal is only possible subject to a notice period (at least four weeks, at times significantly longer under statutory terms) and only with effect from year-end (Sec. 77 (2) Cooperatives Act [GenG]).

- Blocking period: Called shares may not be redeemed prior to expiration of one year from the effective date of withdrawal (Sec. 79 (1) GenG); at times, longer payment blockage periods are provided under statutory terms.

- Nominal value principle: Generally, there is no direct incentive for withdrawal due to limitations on compensation at the nominal value.

- **Eligibility of preferred shares as core tier 1 capital**

First of all, we need to point out that preferred shares under Austrian law are not identical with preferred shares under British law.

Preferred shares under Sec. 12 of the Austrian Stock Corporations Act (öAktG) are part of the share capital.
Unlike preferred shares in the Anglo-American legal system with its multitude of features (such as maturity, etc.), these preferred shares are subject to capital maintenance provisions under stock corporations law, they have not maturity, and are therefore perpetually available so that there is no redemption option.

Such preferred shares fully absorb losses in going concern situations just like ordinary shares. They are also subject to the same provisions as ordinary shares regarding capital reduction. What is more, there is no preferential satisfaction in case of liquidation.

The only difference to ordinary shares is that they do not carry voting rights. By law, this absence of voting rights is balanced out by a re-margined preference in profit distribution.

Just as with ordinary shares, dividends are paid out only if there is a of distributable balance sheet profit.

In the absence of distributable profit, neither ordinary stockholders nor preferred stockholders will be paid out any dividend. In this phase, a preferred stockholder will merely be entitled to exercise a voting right in analogy to an ordinary stockholder.

As with ordinary shares, preferred shares therefore are fully qualified for loss absorption and constitute original own funds of the highest quality

The requirement of preferred shares for eligibility as core tier 1 capital has therefore been met.

Sincerely,

Dr. Herbert Pichler
Managing Director
Division Bank & Insurance
Austrian Federal Economic Chamber