Comments of the Austrian Federal Ministry of Finance, Financial Market Authority and Oesterreichische Nationalbank to the

Basel Committee's on Banking Supervision
Consultative Document

"Proposal to ensure the loss absorbency of regulatory capital at the point of non-viability"

General remarks

Austria strongly supports the efforts of the Basel Committee on Banking Supervision (BCBS) to ensure loss absorbency of non-common Tier 1- and Tier 2-instruments at the point of non-viability. The introduction of contractual loss absorbency mechanisms is a desirable option which is also more quickly available than an international bank resolution framework.

Permanence of write-offs

Austria shares BCBS's view. Only permanent write-offs prevent the unintended consequence of bailing out the capital instrument holders due to prior public sector injection of capital.

Conversion to common stock

BCBS's Consultative Document allows either a write-off or conversion to common stock on the trigger event. BCBS does not propose a single method of calculating the number of shares to be issued. Austria recognises that the method should be appropriate to the particular national context. Nevertheless, effective loss absorbency would be diminished by using a method calculating the number of shares obtained based on market prices at the date of conversion. Austria therefore suggests requiring conversion features bearing a fixed conversion rate.

Moreover Austria appreciates that the problem regarding holders of capital instruments who are not permitted to own shares is mentioned in the Annex of the consultative document. From our point of view such mechanisms are important to ensure the marketability of capital instruments.

Trigger event

BCBS defines the trigger event as the earlier of (1) the decision to make a public sector injection of capital without which the firm would have become non-viable and (2) the decision that a write-off is necessary to avoid the firm becoming non-viable. Austria shares the concern of BCBS that direct reference to a public sector injection of capital could give rise to expectations of such an outcome.

Apart from this, there does not seem to be any material difference between both options: As para. 5 states, the issuance of any new shares as a result of the trigger event must occur prior to any public sector injection of capital. Therefore, the decision to make a public sector injection of capital without which the firm would have become non-viable presumes the decision that a write-off is necessary to avoid the firm becoming non-viable. In our view, it seems to be sufficient to refer solely to the decision that a write-off is necessary to define the trigger event.

Group treatment

For Tier 2 capital issued by subsidiaries in foreign jurisdictions the trigger event will be the earlier of the trigger event occurring at the home jurisdiction and the host jurisdiction (in case of consolidated supervision). Austria welcomes this approach.

Para. 7 of the Consultative Document allows the trigger event to lead to conversion into shares of the parent company of the group as an alternative to shares in the subsidiary bank. Austria supports this approach as in many cases shares of subsidiaries are not publicly traded while questions of company law have to be taken into account when solutions are to be explored.

Implementation

Within the consultative document there is no reference if the implementation of loss absorbency for Tier 1 and especially for Tier 2 capital instruments will be aligned to the other amendments regarding regulatory capital. This information would be essential to further enhance legal certainty and enable banks to start adjusting their capital structure.