L.S.

As an investor, we would like to make the following remarks/observations with regard to the *Proposal to ensure the loss absorbency of regulatory capital at the point of non-viability*, released in August 2010:

1. *All non-common tier 1 instruments and tier 2 instruments at internationally active banks must have a clause in their terms and conditions that requires them to be written off on the occurrence of the trigger event.*
   - We would propose to consider the inclusion of the clause in the documentation of all banks. Recent history has shown that banks that do not meet the 'internationally active banks' requirement have been rescued by national governments as well.
   - Inclusion of the clause across all banks would increase the transparency and comparability and maintains a level playing field between banks operating in the same jurisdiction, especially if these clauses are standardised across all jurisdictions involved.
   - The current proposal contains a ‘write off’, a ‘conversion’-mechanism or a mix of both which places the holder of the tier 1 and tier 2 securities at a disadvantage compared to shareholders. Under a standard resolution regime, shareholders are usually wiped out[1] before bondholders faces losses in a distressed debt-for-equity swap. In such a regime, former equity holders do not benefit at all from a recovery potential as opposed to the converted bondholders. In our view, loss absorbency should try to mimic the strict priority of creditors as close as possible. In that regard one could consider two options:
     1. ‘Write off’ of nominal value for mutually-owned banks. The ‘write off’ should differ dependent on the type of security (i.e. tier 2 or tier 1) and should be a fixed percentage of the nominal value of the bond.
     2. ‘Conversion of nominal value into equity’ for listed banks. The conversion should take place at the share price prevailing during a certain period after the announcement by the regulator that a bank is considered non-viable. In that way, you achieve that dilution of the existing shareholder is maximised, in effect achieving the ‘wipe out’ mentioned. The amount that is converted depends on the type of the security (i.e. tier 2 and tier 1).
2. *The trigger event is the earlier of (1) the decision to make a public sector injection of capital, or equivalent support, without which the firm would have become non-viable, as determined by the relevant authority; and (2) a decision that a write off, without which the firm would become non-viable, is necessary, as determined by the relevant authority.*
   - The definition of equivalent support should be specified more clearly and should include liquidity support (i.e. the establishment of government guaranteed funding) and other government-driven support measures (i.e. government guarantees on asset portfolios). Academic literature shows that since 1971, financial crisis have more often occurred due to wholesale liquidity bank runs (i.e. unwillingness of wholesale funding markets to fund a bank) than due to solvency issues. However, these issues tend to be linked to one another and therefore support measures in general should be included in the definition of the trigger event.

     One possible way to define support more clearly would be to link it to specific parts of the required capital ratios (capital preservation buffer) and to levels of the proposed liquidity coverage ratio (LCR) and net stable funding ratio (NSFR):
     1. One may argue that viability of bank will get questioned once a bank has to preserve capital by not paying dividend. While this might be too harsh for bondholders to accept, one could consider a certain percentage of this buffer as a trigger point for a bank to be considered non-viable.

[1] By the term ‘wipe out’ we do not mean the expropriation of shareholders’ rights.

2. Liquidity dropping as measured by the proposed ratios below a certain specified level.

- The trigger event needs to be defined as transparent as possible to enable investors to be able to adequately price the additional risk that will occur in these securities. Greater transparency and a clear definition should also enable rating agencies to assign ratings to the securities that contain a ‘write off’-clause, which makes it more likely that the securities will be included in fixed income benchmarks enabling the development of a liquid market in this type of securities.
- Loss absorbency can be considered a resolution tool. In that regard, it should be stressed that the decision to use such a tool should only be taken after careful consideration of all the interests involved. This argues in favour of a situation in which the decision to use a resolution tool is not solely dependent on the judgment of a supervisory national or European authority for banks but involves other organisations as well, such as supervisory authorities for the financial markets whose tasks include safeguarding investors’ protection[2].

[2] See http://www.eumedion.nl/page/downloads/Response_EC_communication_banking_sector_Jan_10.pdf.