Desjardins

Member of the International Co-operative Banking Association

Member of the International Confederation of Popular Banks

Monique F. Leroux, FCA, FCMA
Chair of the Board, President and CEO
Desjardins Group

Lévis, October 1st, 2010

Re: The Basel Committee consultative *Proposal to ensure the loss absorbency of regulatory capital at the point of non-viability* (issued for comments by October 1, 2010)

Dear Members of the Basel Committee on Banking Supervision ("the Committee"):

Desjardins Group, the largest cooperative financial group in Canada and the sixth largest in the world, welcomes the opportunity to comment on the consultative proposals issued for comments ("the Document") and supports the efforts made by the Committee to strengthen the resilience of the financial sector.

We generally agree with the Committee's objective to prioritize the recapitalization of distressed financial institutions before any public sector intervention.

We share the view that, among the options contemplated by the Committee, the proposal that all holders of regulatory capital should contribute to the absorption of losses must be examined.

However, we believe the proposals have a shortcoming on an essential point. The Document appears to have been written without considering the capital of non joint stock companies. It does not address the specific nature of financial cooperative Core Tier 1 capital instruments. Unlike in other institutions, these instruments are not liquid or traded on organized markets. This makes the proposed compensation mechanism very unattractive and even inoperative. As a result, issuing non-equity instruments will cost more for financial cooperatives, placing them at a competitive disadvantage. We therefore believe it is necessary to make amendments to the proposed mechanism.

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Given the significant role played by financial cooperatives in the economy, particularly in underwriting credit to individuals and businesses, we consider it essential that the Committee consult with representative organizations of financial cooperatives to find tailored solutions to this problem. The Desjardins Group will be pleased to contribute to the development of such solutions and makes itself available to the Committee in this respect.

The attached document outlines our concerns and presents our insights and proposals on issues we consider of the highest importance. Not to dilute our message, we focused our comments on measures that are, in our view, overly restrictive, discriminating or impractical to implement.

Last, considering the other mechanisms concerning regulatory capital already proposed by the Committee and the fact that many institutions will consequently need to raise substantial capital, we strongly recommend that a gradual implementation approach be developed, including certain grandfathering and phase-in mechanisms, as appropriate, to facilitate transition for the global financial sector.

We trust the Committee will find our comments useful in developing the final proposals.
Yours truly,

Monique F. Leroux
Chair of the Board, President and Chief Executive Officer
Desjardins Group

Section 1 – Introduction and key elements of the proposal

1.1. Introduction

In December 2009, the Basel Committee on Banking Supervision (the "Committee") released its consultative document "*Strengthening the resilience of the banking sector,*" which proposes an enhanced capital framework. This document mentions that the Committee will continue to review the role that contingent capital and convertible capital instruments should play in the regulatory capital framework.

As part of this review, in August 2010, the Committee published its "*Proposal to ensure the loss absorbency of regulatory capital at the point of non-viability.*"

1.2. Key elements of the proposal

The Committee notes that banks were rescued by the injection of public funds without, in some cases, subordinated debt holders and even holders of non-common Tier 1 instruments having to absorb any losses. The Committee believes that this situation should be rectified and that all regulatory capital instruments must include a mechanism ensuring they will absorb a portion of the loss at the point of non-viability.

In order to achieve these objectives, the Committee has made seven recommendations which represent significant changes for financial institutions. The first three are as follows:

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.

2. Any compensation paid to the instrument holders as a result of the write-off must be paid immediately in the form of common stock (or its equivalent in the case of non-joint stock companies).

3. The issuing bank must maintain at all times all prior authorization necessary to immediately issue the relevant number of shares specified in the instrument's terms and conditions should the trigger event occur.

The two recommendations that follow concern the trigger event. Essentially, this event corresponds to the bank's point of non-viability that justifies public sector intervention. If the trigger event leads to the issuance of new shares, this must be done prior to any public sector injection of capital to prevent any dilution.

The last two recommendations concern the treatment of financial groups and

propose a double trigger event system – one at the parent level and the other at the subsidiary level. The compensation paid may be in the form of common stock of either the parent company or the relevant subsidiary.

Desjardins generally agrees with the objectives of the proposed reform except for some measures that are, in our view, overly restrictive, discriminating or impractical to implement. We believe that some amendments should be made to the proposed guidelines prior to issuance in order to meet the Committee's objectives.

Sections 2 and 3 outline our concerns and present our proposals and insights on issues we consider of the highest importance.

Section 2: Desjardins' recommendations to the Committee

2.1. Specific features of cooperative financial institutions

For many cooperative institutions, Core Tier 1 is made up of cooperative units held by members rather than common stock. These instruments are not traded on organized markets, which contributes to the institution's financial stability. In addition, all members have equal votes at the annual meeting, regardless of the number of units held.

Accordingly, receiving cooperative units as compensation for a written-off debt is much less attractive for investors than common shares of a listed bank, which can either be disposed of to recover all or part of the debt or be kept in order to exercise the underlying rights at shareholders' meetings.

Cooperative institutions will be disadvantaged as they will have to either exclude compensation or offer unattractive compensation. As a result, the cost of their non-common Tier 1 instruments will increase, and more importantly, will be higher than those of their non-cooperative competitors.

We consider it essential that the Committee consult with representative organizations of financial cooperatives to find tailored solutions to this problem.

2.2. Alternative proposal

We share the Committee's view that it is preferable to maintain regulatory capital in a form other than cooperative shares, particularly for banks that do not take on excessive risk and which use these instruments to diversify their sources and cost of capital.

Since, on the one hand, a write-off without compensation would make issues of subordinated instruments very costly and therefore of no interest, and, on the other, compensation in the form of cooperative shares would not have any real interest for investors, we propose that the Committee consider the following mechanism, as an example of a possible solution:

> *Should a trigger event occur, non Core Tier 1 instruments would be transformed such that their features, in particular, capital quality, permanency, subordination and loss-absorption capacity, deemed to be fully equivalent to those of cooperative shares recognized as Core Tier 1. The main difference, compared to a conversion into cooperative shares, is that these instruments would remain tradable on markets, which is essential for investors and for ensuring reasonable prices.*

Rationale: Our proposal is in line with the Committee's intention to strengthen the quality and quantity of regulatory capital. Considering the significant role played by financial cooperatives in the economy, it is important to allow them to continue to raise regulatory capital and promote credit underwriting at reasonable and competitive prices. To do so, it is essential to implement a compensation mechanism acceptable to investors, and in our view, this requires that the instruments be tradable on organized and liquid markets. At a practical level, the cooperatives' supervisory authority will be responsible for ensuring that the clauses concerning the transformation of the features of subordinated instruments are such that these instruments become equivalent to Core Tier 1 instruments should a trigger event occur.

2.3. Other considerations

a) In our view, the process used by the supervisory authorities to decide whether or not an institution is no longer viable should be as objective as possible in order to avoid excessive differences in approaches between jurisdictions. The greater the apparent subjectivity of the trigger event, the higher the coupon rates required by investors. Also, credit agencies might be reluctant to rate such instruments if the trigger events seem too subjective. Obviously, a lack of ratings would have a negative impact on investors' appetite for such securities and on their cost for institutions.

   Also, a lack of objective factors underlying the decisions of supervisory authorities could lead to litigation on the part of aggrieved investors, depending on applicable bankruptcy law in the different jurisdictions in which financial institutions operate.

b) We understand the advantages, for financial groups, of double trigger events – one at the subsidiary level and the other at the parent level. But this system might penalize an acquirer of a subsidiary as it would not be able to recognize the capital of the acquired institution at its level. We recommend that mechanisms be included in the final proposal, such that in the case of an acquisition of an institution with instruments other than Core Tier 1 that are recognized as regulatory capital at both the subsidiary and parent levels, the parent of the acquirer may benefit from a sufficiently long transition period during which these instruments are also recognized as capital at its level.

Section 3: Transition and grandfathering

We are concerned that, combined with the December 2009 proposals, the proposed rules would lead to a significant increase in the volume and cost of equity of financial institutions, possibly resulting in credit contraction, which could be detrimental to the economy as a whole.

Given that economic conditions remain weak, transitional provisions should be carefully assessed and developed to prevent the economy from sliding back into recession.

It is therefore critical, in our view, that grandfathering provisions apply to existing instruments other than Core Tier 1.

Section 4 - About Desjardins

Desjardins Group is the largest cooperative financial group in Canada and the sixth largest in the world, with overall assets of CAD 174 billion. It comprises a network of financial service cooperatives – caisses and credit unions, and some twenty subsidiary companies in life and general insurance, securities brokerage, venture capital and asset management.

Because of our cooperative nature, we work for the economic and social well-being of our 5.8 million members, and not just for the enrichment of a select few investors. Because of our cooperative nature, we protect the interests of our members and clients by offering them profitable and secure financial products and services and always prioritize sustainable development. Furthermore, for 40 years now, we have been providing technical support and investment services in developing countries through our subsidiary, Développement international Desjardins (DID).

Mission: To contribute to improving the economic and social well-being of people and communities within the compatible limits of its field of activity by:

- continually developing an integrated cooperative network of secure and profitable financial services, owned and administered by the members, as well as a network of complementary financial organizations with competitive returns, controlled by the members;

- educating people, particularly members, officers and employees, about democracy, economics, solidarity, and individual and collective responsibility.

Fundamental cooperative values: Self-help, self-responsibility and responsibility for others; democracy; equality, equity and solidarity. Cooperative members respect ethical values of honesty, openness, social responsibility and caring for others.

Desjardins Group values: Money serving human development, personal commitment, democracy in action, integrity and discipline in the cooperative enterprise, and community involvement.

Desjardins Group figures
Information as at June 30, 2010

Total assets	*CAD 173.5 billion*
Number of member caisses	*481*
Number of service centres	*903*
Membership	*5,8 million*
Number of elected officers	*6,258*
Number of employees	*42,273*
Surplus earnings after taxes and before member dividends (6 months)	*CAD 789 million*
Tier 1 ratio	*16.7%*