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CORPORATE GOVERNANCE FORUM

Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 BASEL
SWITZERLAND

Amsterdam, 30 September 2010

Our ref: B2010.063
Subject: Eumedion response to Basel committee's proposal to ensure the loss absorbency of regulatory capital at the point of non-viability

Dear Sirs, dear Madams,

Eumedion welcomes the opportunity to comment on the Basel committee on banking supervision's consultation document on the proposal to ensure the loss absorbency of regulatory capital at the point of non-viability, which was published on 19 August 2010. By way of background, Eumedion is the Dutch based corporate governance forum for institutional investors. Our 70 Dutch and non-Dutch participants combined have more than EUR 1 trillion assets under management. They invest for their clients and their beneficiaries and in listed companies worldwide.

Some of the themes touched in the consultation document are outside Eumedion's objective. Therefore, our response is confined to the issues that are directly or indirectly relevant for institutional investors investing in both shares and bonds of listed banks.

In the consultation document the Basel Committee notes that the public sector capital injections and other support measures have had the indirect consequence that in many instances holders of regulatory capital instruments have not taken any losses at all. The Basel Committee is of the view that a public sector injection of capital needed to avoid the failure of the bank should not protect investors in regulatory capital instruments from absorbing the loss that they would have incurred, in the case the public sector had not chosen to rescue the bank. Therefore, the consultation document sets out a proposal based on a requirement that the contractual terms of the regulatory capital instruments will allow regulatory authorities the option to write off of these instruments or to convert them to common shares in the event, that a bank is unable to support itself in the private market in the absence of such conversions.

Eumedion acknowledges that the impact of the financial crisis would have been greater and more disastrous if national governments had not taken rapid and adequate measures at systemically

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important banks that were in trouble. This pubic sector intervention is highly commendable and institutional investors with their extensive investments in both shares and bonds, have generally benefited from the measures, as have other stakeholders.

Eumedion generally concurs with the Basel Committee that public sector intervention at banks is not primarily meant to serve the interests of investors but to protect the financial stability as a whole. The Committee's proposal for contractual terms and conditions to write off (debt) capital instruments issued by banks and/or convert these instruments in equity, might be an effective instrument to impose losses on these capital instruments in the occurrence of a bank expecting to become non-viable which is ultimately also in the interest of investors. We also believe that the proposal is in line with the characteristics of traditional debt instruments paying a fixed rate of return in normal times but giving a variable return (like equity risk) under extreme circumstances, e.g. situations of liquidation and restructuring.

Having said this, we note some concerns relating to the proposal. The proposed conversion/write off option may cause some difficulties for investors, including:

- It is not crystal clear what circumstances would trigger the write off/conversion instrument, which may hamper investors' confidence. In our view the contractual terms and conditions should clearly define which threshold would trigger the write off/conversion option.
- There seems to be insufficient protection against the risk of execution of the conversion/write off instrument prematurely, for instance when a banking authority is following some kind of 'just to be sure approach'. A banking authority should only be permitted to use the conversion/write off instrument in cases where the non-viability of a bank is inevitable, a public sector intervention is likeable, and regular, less drastic, tools no longer provide a remedy.

We believe these difficulties in combination with the proposed higher capital requirements for banks and the upcoming resolution tools under which investors may temporarily lose their (shareholder) rights, may further negatively affect banks' attractiveness as investments for institutional investors. Resulting, investors may charge a higher price for their investments in banks. It would be wise to give serious consideration to these aspects when the exact conditions of the mechanism are finally being set.

If you would like to discuss our views in further detail, please do not hesitate to contact us.

Yours sincerely,

Rients Abma

Executive director

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