FINANSSIVALVONTA
FINANSINSPEKTIONEN
FINANCIAL SUPERVISORY AUTHORITY

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Unrestricted

Basel Committee on Banking Supervision
Secretariat

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

Response of the Finnish Financial Supervisory Authority to the consultative document of August 2010

The Finnish Financial Supervisory Authority (FIN-FSA) welcomes the opportunity to comment on the consultative document regarding the above mentioned topic.

FIN-FSA recognises the need to develop an effective market mechanism, which could help curbing excessive risk taking by banks (i.e. moral hazard) and which could reduce the need for capital injections from the public sector. The proposals would increase the participation in the losses of the holders of capital instruments and, hence, increase their incentives to monitor and control the risk taking behaviour of banks. This would supplement the controls exercised by supervisory authorities. FIN-FSA considers the proposal in principle valid for all banking institutions, not just the major international ones.

While there might be some practical issues embedded in the proposal to be further addressed, FIN-FSA wishes to express support to the idea of having capital instruments that can, at the option of the regulatory authority, be converted to common shares in the event that a bank is unable to support itself in the capital markets. FIN-FSA's understanding is that the conversion would happen only after a bank has failed in collecting additional share capital from the market.

Suggested capital instruments could also be a way to reduce the risk of a failure of a bank without any public sector injection, as they would enhance the loss bearing capacity of the bank.

FIN-FSA supports the conversion to common shares of the capital instrument in question rather than just a write-off against the losses incurred. Besides the fact that a convertible capital instrument adds hard capital to a bank when needed, it might also be more attractive for investors as the investors could maintain upside potential; provided that the conversion rate is high enough. Hence, FIN-FSA would support high number of shares to be issued to the investors i.e. a high conversion rate.

This issue is naturally a question for the actual conditions of the capital instruments, and it might be useful to elaborate further regulatory guidance on this subject.

Finally, while being supportive to the proposal of the Committee, FIN-FSA would like to raise the question regarding the need of the division of Tier 1 capital and Tier 2 capital in the future. It is not clear to us what would be the difference between the Tier 2 capital instrument with contingent capital features and Tier 1 hybrid capital instruments. However, would we perhaps still need two different layers of own funds to indicate the different seniority of the claims, i.e. Tier 2 capital instruments having a higher priority than Tier 1 capital instruments? This issue should be further investigated.

FINNISH FINANCIAL SUPERVISORY AUTHORITY

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