GROUPEMENT NATIONAL DE LA COOPÉRATION

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Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland
baselcommittee@bis.org

Paris, 1 October 2010

Dear Madam, Sir,

Please find enclosed the comments of the Groupement National de la Coopération (representing all the co-operative organisations in France) to your consultative document BCBS n° 174 of August 19 2010 regarding the loss absorbency of regulatory capital at the point of non-viability.

These comments have been drafted by the three French co-operative banking Groups (BPCE, Crédit Agricole et Crédit Mutuel), and should be regarded as a complement to the comments of the French Banking Federation (FBF).

Our remarks aim to demonstrate that the « anti systemic crisis » measures which are advocated are incompatible with the capitalistic structure and functionning principles of French co-operative banks.

The Groupement National de la Coopération (GNC) is at you service to provide additionnal information on the issues adressed in this response and to contibute to reinforcing, through appropriate measures, the stability of the regulatory capital of co-operative banks.

Yours sincerely

President

The Groupement National de la Coopération (GNC) is the apex organisation for the French co-operative movement. Its members are the national federations of the co-operative sectors : agriculture, banking, wholesale, consumers, housing, crafts, production, fisheries, transport, education. France counts 21 000 co-operative enterprises, employing more than 900 000 employees.

24 rue du Rocher, 75008 Paris, France – Tel : 33 (1) 42 93 59 59
E-mail : gnc@entreprises.coop

BPCE Crédit Mutuel CRÉDIT AGRICOLE

<u>Enforcement of « anti systemic crisis » measures to French co-operative banks</u>

The BCBS's consultative document n°174 of August 19 suggests that the contractual terms of capital instruments issued by banks should allow the regulator, in the case of an irreversible bank failure scenario, to decide the writing-off or conversion to common equity of those capital instruments, prior to any injection of public funds in said bank.

The consultative document mainly deals with the criteria that those capital instruments should meet in terms of loss absorbency.

<u>1) Current debates are still underway and are not conclusive</u>

The time frame of this consultation is too restrictive with responses due by October 1st, especially when one considers that this initiative forms an integral part of the wider debate on bank resolution and systemic crisis management, which is currently at the heart of ongoing discussions between regulators and credit institutions around the globe.

2) At this stage, proposals are incompatible with the capitalistic structure and functionning of a co-operative bank

- The capitalistic organisation of a French co-opertaive banking group is based on the existence of local and regional banks which are the parent companies of a Central Institution, usually in the form of a joint stock company, to which they are necessarily affiliated. The appreciation of the solvency can only be considered at the group level in its globality. Indeed, Solvency is secured by contractual and/or legal mecanisms which organise the solidarity of all affiliated banks with the said Central Institution allowing internal rescue operations of defaulting regional banks and of the Central Institution if need be.

- The default secnario envisaged by the consultative document only makes sense at Group level (prudential supervision being enforced on the basis of consolidated ratios) after the supervisor has established that the solvency of the Group is jeopardized and that all available funds, inside the internal solidarity mechanism, are insufficient to meet the risk.

- The meaningfull level to be considered for the issuance of the said capital instruments can therefore only be the national level (which in practice means the Central Institution or, where the Central Institution is not a credit institution, another entity of the Group).

- Allowing the entry into the capital of the Central Institution (or another entity of the Group where applicable) - by way of conversion of capital instruments into common equity - would have as an immediate effect the dillution of the parent companies of the Central institution which are necesssarily affiliated to the Central Institution to ensure the overall cohesion of the Group : in this case the whole functionning of the co-operative banking group would aversely be disorganised in the case of a massive dillution beyond the control cap. This scenario would be unacceptable considering the captilastic structure of a co-operative group (as a rule a Central Institution is mainly held by its regional/parent banks).

- Thus, given the (legal) prerogatives of a Central Institution (power to nominate and revoke administrators, to define the rules of on-going business of the affiliated institutions, their strategy, etc.), loss of control by the regional banks would render the whole Group uncontrollable, not to mention the difficulties linked to the implementation of the solidarity mechanisms after the said conversion : the risk of a Group break up would be high.

3) **<u>The only way forward on this topic would be to come up with a capital instrument whose conversion would not confer to the outside lender the same rights as the parent companies of the Central Institution (no voting rights in particular)</u>**

- The role of this lender would be restricted to to the the supply of capital (a purely capitalist role) without interference in the governance of the Group.

- But it seems clear that the invention of a new category of capital instrument *ex nihilo*, which would necessarily be classified as Core Tier One, and which does not confer all the rights attached to equivalent instruments in classic joint stock companies appears bound to fail.

- However, the Basel Committee has recognised that the capital instruments issued by co-operative banks and which do not meet exactly all criteria are eligible to Core Tier One. As a matter of fact the BCBS consultative document 174 recognises (cf. bullet point 4, pg 4) the possibility to convert debt into an eligible co-operative capital instrument (« *the conversion could be into an instrument deemed to be fully equivalent to common shares in terms of capital quality*….. »). It is important that this possibility be extended to Central Institutions of co-operative banking groups, even if they are set-up in the form of joint stock companies, and/or that an alternative be proposed to adress the unapplicability of this proposal to the co-operative banking world.

- Comments made here above will only apply in case of a *bail-in* by conversion into common stock. Indeed, in case of a simple *write off*, i.e. without compensation (reduction of the nominal value of the instruments so as to absorb loss, cf. pg 6 point 2 of BCBS 174), investors will incur a dead loss on their investments, without obtaining any form of compensation in the form of a conversion of their debt claim into common stock. If this option was to be maintained as part of the proposal it would substantially increase the issuing costs for co-operative banking groups and could lead to restrictions on available funds in tense market conditions. In particular, it should be noted that in order for such an instrument to attract investors it would be necessary to limit the amount on which the *write off* may be applied, reducing accordingly the growth potential of Core Tier One.

<u>Conclusion</u>

The current proposal will in no case be applicable to co-opertaive Groups beacuse it would put their functionning in great peril in times of crisis

It is essential, in order to prevent blatant distorsions of competition, to introduce a tailored regime to adress the situation of co-operative banks which would allow economic rights to be seperated from governance rights upon conversion.

The French co-operative banking groups are prepared to work on this issue with the regulators so as to find a technical solution to the challenges raised by the specific capital structure of co-operatives.