THE HONG KONG ASSOCIATION OF BANKS
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Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Dear Sirs

Consultative Document on Proposal to ensure the Loss Absorbency of Regulatory Capital at the Point of Non-Viability

We refer to the consultative document, "Proposal to ensure the loss absorbency of regulatory capital at the point of non-viability" published by the Basel Committee on Banking Supervision ("BCBS") in August 2010. On behalf of our members, we set out our views on the proposals in the consultative document:

General comment

We welcome the consultation process on the proposal to ensure the loss absorbency of regulatory capital at the point of non-viability.

We generally support the proposal that requires all regulatory capital instruments to be capable of absorbing losses in the event that a bank is unable to support itself in the private market.

Our comments on the proposal are as follows:

1. **Grandfathering of existing non-common Tier 1 and Tier 2 capital instruments**

   The proposal does not address the treatment for non-common Tier 1 and Tier 2 capital instruments which are already issued by Authorized Institutions.

   We recommend that grandfathering rules are introduced whereby all non-common dated Tier 1 and Tier 2 capital instruments which were issued before the proposals were originally published are exempt from the rules and amortization rules are introduced for non-qualifying perpetual capital instruments.

2. Additional clarification on write-offs/conversions

The proposal suggests that the triggering event which is the earlier of :(1) the decision to make a public sector injection of capital; and (2) the decision that a write-off, without which the firm would become non-viable is determined by the relevant authority.

We request additional clarity on whether all or part of the non-common Tier 1 and Tier 2 capital instruments will be written down or converted once the trigger event occurs and whether general guidance will be provided in terms of the conversion rate into ordinary equity.

3. Expectations of public sector injections

In order to remove expectations of a public sector injection that might lead to other unintended consequences, we suggest that the trigger should simply rely on the decision that a write-off/conversion, without which the firm would become non-viable, is necessary, as determined by the relevant authority.

4. Increased costs

We are concerned that the proposal will increase the costs of non-common capital instruments for large internationally active banks which are perceived to be subject to a public sector guarantee. As these capital instruments will not have the benefit of the dividend income paid to ordinary equity but will incur the risk of being written off or converted into ordinary shares, we are concerned that the cost of such capital instruments will exceed that of ordinary equity. This may reduce the incentive for large banks to issue such capital instruments and may have an impact on insurance companies and pension funds which ordinarily hold these long dated capital instruments for managing their risk profile.

5. Break-up of banking groups

We are also concerned about the consequences if conversion is triggered from capital issued out of subsidiaries which could create minority interests or result in a change of control in relation to a subsidiary. Therefore, in theory the option, similar to any insolvency or resolution procedure could lead to the break-up of a group. If the national supervisor and/or public sector wanted to avoid the change in control, it could, in addition to the minimum requirements set out in the proposal, set a cap on the amount of common stock to be issued on the trigger event or it could require a simple write-off without a conversion.

Another option suggested in the proposal would be to have the subordinated debt convert into common stock of the parent, which is typically the level that has issued publicly traded stock. However, there may be difficulties with this option if the parent is not a listed company, or the parent's jurisdiction does not permit the conversion of a subsidiary's capital instruments into the parent's ordinary shares.

6. **Cross-border issues**

In addition, for parents with foreign subsidiaries, there are many legal, accounting and tax issues which need to be taken into account when considering whether the proposals are workable across jurisdictions.

The home and host regulators must co-operate and work together in implementing the proposals, especially when the capital instruments are recognized at both the solo level and the group level.

7. **Additional capital surcharges for systemically important banks**

Finally, in addition to these proposals, we note that there are also proposals being discussed by the BCBS for additional capital and liquidity surcharges for banks that are deemed systemically important. We believe that the latter will not be necessary as the loss absorbency proposals will effectively increase capital costs for such banks. We suggest that this proposal should be considered in conjunction with all other proposals in the BCBS consultation to ensure that there is no overlap of capital requirements.

If you have any questions or require any clarification, please do not hesitate to contact us.

Yours faithfully

Rita Liu
Secretary

c.c. Ms. Karen Kemp, Executive Director (Banking Policy), Hong Kong Monetary Authority