

Mr Andrea Enria, Chairperson
Ms Isabelle Vaillant, Director Regulation
European Banking Authority
25 Old Broad Street
London
EC2N 1HQ
United Kingdom

17 January 2012

Dear Sirs,

Proposals relating to the EBA Termsheet for Buffer Convertible Capital Securities

Introduction:

The ICMA¹ is a pan-European self-regulatory organization and an influential voice for the global capital market. It has a membership of over 400 firms and represents a broad range of capital market interests, including global investment banks and smaller regional banks, as well as asset managers, issuers, exchanges and other venues, central banks, law firms and other professional advisers. The ICMA's market conventions and standards have been the pillars of the international debt market for over 40 years.

We refer to the "EBA Recommendation on the creation and supervisory oversight of temporary capital buffers to restore market confidence" proposed by the European Banking Authority ("EBA") and agreed by the European Council on 26 October 2011, which, *inter alia*, requires banks to build up additional capital buffers to reach a level of 9% Core Tier 1 ratio by the end of June 2012² (the "**Capital Exercise**").

We understand that the stated objective of the Capital Exercise is to create an exceptional and temporary capital buffer to address current market concerns over sovereign risk (the "**Stress Capital Requirement**"). We note that the Stress Capital Requirement is in addition to existing capital requirements and to the proposed Basel III capital requirements to be implemented within the EU under the Capital Requirements Regulation ("**CRR IV**"). We also note that the Stress Capital Requirement is expected to be temporary.

You have indicated that, as a means to meet the Stress Capital Requirement to the extent required by the Capital Exercise, banks should first use private sources of funding, such as retained earnings, reduced bonus payments, new issuances of common equity and very strong newly-issued buffer convertible capital securities ("**BCCS**"), provided that the conditions of any such BCCS are consistent with the "Buffer Convertible Capital Securities Common Term Sheet" as published by the EBA on 8 December 2011 for these purposes (the "**Termsheet**"). We assume that the BCCS would be capable of being placed with investors either on a new issue basis or through a liability management exercise over existing capital securities.

¹ For more information regarding ICMA, please go to <https://www.icmagroup.org/home.aspx>

² After the removal of the prudential filters on sovereign assets in the Available-for-Sale portfolio and prudent valuation of sovereign debt in the Held-to-Maturity and Loans and receivables portfolio.

Under our auspices as a representative of issuers, intermediary parties and investors, we conducted a survey on the marketability of the BCCS among major market participants, in which we asked a series of questions comparing the market impact of BCCS with an Additional Tier 1-style host with otherwise identical BCCS with a Tier 2 host.

The terms of this letter are representative of the views of the survey participants, the results of which are attached hereto.

General:

One of the key advantages of issuing BCCS to meet the temporary Stress Capital Requirements is that it gives issuers access to the fixed income investor base to raise EBA Core Tier 1 eligible capital. It is widely considered that, particularly in current market conditions, there is not enough appetite in the equity markets in isolation to be able to provide issuers with the capital requirements induced by the Capital Exercise, and therefore the possibility of using BCCS to tap supplementary investor sources for Core Tier 1 capital is welcomed.

However, in order for the BCCS to be fit for purpose, we consider that as well as achieving the regulatory objectives, the characteristics of the host instrument should be sufficiently attractive and marketable to relevant investors.

Regulatory Objectives:

We understand that the BCCS are designed to meet the following prescribed minimum requirements:

- *Regulatory Capital* – the BCCS have to be fully funded and constitute regulatory capital of the issuer with the purpose of protecting depositors and general senior creditors of the issuer in the event of insolvency or liquidation.
- *Viability Event* – to prevent or at least mitigate the effect of a situation where the institution becomes non-viable, on a Viability Event (as defined in the Termsheet) the BCCS should mandatorily fully convert into ordinary shares of the issuer as envisaged by the EU resolution framework currently in preparation.
- *Contingency Event* – in a situation where the EBA Core Tier 1 ratio (as defined in the Termsheet) breaches a pre-defined trigger level (7%), the BCCS should also mandatorily fully convert into ordinary shares of the issuer.

The ordinary shares of the issuer into which the BCCS are mandatorily converted due to the occurrence of a Viability Event or a Contingency Event comprise Core Tier 1 capital for the purposes of the issuer's Stress Capital Requirement, and therefore the BCCS achieve these regulatory objectives.

Characteristics of the instrument:

It has been suggested that although the form of the BCCS before the occurrence of the Viability Event or the Contingency Event (the "**host**") is less important for stress capital and stress testing purposes, it is of vital importance to the issuer in terms of marketability and, therefore, the amount of capital they can raise in order to meet their Stress Capital Requirement.

According to the results of our survey, it is widely considered that, in times of stress such as these, it may be difficult for issuers to place the BCCS with an Additional Tier 1-style host (being a perpetual security with deferrable coupons; each, a "**T1 Characteristic**"). However, the survey suggests that a BCCS with a Tier 2 host (being a dated security which carries non-deferrable coupons; each, a "**T2 Characteristic**") would still meet the EBA Buffer Contingent Capital minimum requirements, and would be a more widely accepted form of capital. It

should be noted that the non-deferral of coupons would not contradict the regulatory objectives outlined above.

Further, we understand that the final technical provisions for Additional Tier 1 capital under CRR IV are subject to further review within the EU. There is a perceived danger that this may lead to inconsistencies between a BCCS with an Additional Tier 1-style host and Additional Tier 1 instruments as envisaged under CRR IV, for instance with regards to Mandatory Coupon Cancellation and its corresponding definition of "Distributable Items". However, a BCCS with a Tier 2 host, the T2 Characteristics of which are familiar to market participants, would not give rise to any such inconsistencies, giving issuers more certainty on future eligibility under CRR IV.

In addition, the EBA has stressed that the Stress Capital Requirement measures set out in the Capital Exercise are temporary in nature, to be re-assessed once the deployment of the new EFSF capacity becomes effective in addressing the sovereign debt crisis. In view of this, the "dated" T2 Characteristic of a BCCS with a Tier 2 host would seem to be more consistent with the temporary nature of the Stress Capital Requirement than the "perpetual" T1 Characteristic. Further in this regard, a call exercisable by the issuer on any such reassessment (subject to approval of the national regulator) might be worth considering.

Conclusion:

The results of the survey indicate that assigning an Additional Tier 1-style host to the BCCS with T1 Characteristics will limit the investor base significantly for issuers, in particular lower-rated issuers who would benefit from issuing such BCCS, and is likely to make the costs of issuance prohibitive for many issuers.

However, assigning a Tier 2 host to the BCCS with the T2 Characteristics would allow issuers access to a broader fixed income investor base, either on a new issue basis or through a liability management exercise, without compromising the loss absorption characteristics required in the event of a regulatory stress event (i.e. a Contingency Event or a Viability Event). Moreover, the "dated" T2 Characteristic is also more consistent with the temporary nature of the EBA Stress Capital Requirement than the "perpetual" T1 Characteristic and would provide issuers with more certainty around future eligibility under CRR IV. In light of these findings, we would therefore propose that the EBA reconsiders the form of the host for the BCCS.

Independent of the host format, it would remain the intention that the BCCS with a Tier 2 host would meet the "EBA Buffer Contingent Capital minimum requirements" in line with EBAs initial objectives.

We hope that these proposals are constructive, and would welcome the opportunity to discuss this and the other proposed terms to ensure that the final requirements are appealing to a broader investor base and all the stakeholders participating in the Capital Exercise. We remain available to discuss our findings and proposals at your convenience.

Yours faithfully



Katie Kelly

Director – Market Practice and Regulatory Policy