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Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
SWITZERLAND
Email: fsb@bis.org

Dear Sir/Madam,

Adequacy of loss-absorbing capacity of globally systemically important banks in resolution

The Australian Bankers' Association (**ABA**) appreciates the opportunity to provide feedback on the Financial Stability Board's (**FSB**) Consultative Document, *Adequacy of loss-absorbing capacity of globally systemically important banks in resolution*.

The ABA is the industry association representing the Australian banks. Our members include the domestic systemically-important banks (**D-SIBs**), other Australian "internationally-active banks" and banks which are active in the domestic market.

The ABA supports the FSB in driving this G20 initiative to enhance the loss-absorbing capacity of global systemically important banks (**G-SIBs**) in resolution. The ABA recognises the role that loss absorbing capacity has to play in ensuring the credibility of resolution as well as promoting trust and confidence between home and host authorities. The ABA also notes the impact additional loss-absorbing capacity will have on reducing the perception of an implicit government guarantee and the accompanying market distortions this creates, as well as the reduced burden on taxpayer funds in the event of a bank's default. Finally, the ABA acknowledges that additional loss-absorbing capacity will be credit positive for unsecured senior lending not subject to bail-in. The ABA therefore offers our firm support for the "guiding principle" outlined in the paper.

In supporting these total loss-absorbing capacity (**TLAC)** proposals, which are aimed at improving the stability of the banking sector, the ABA agrees with a key sentiment of the TLAC proposals that this can be done through mechanisms other than holding further Common Equity Tier 1 (**CET1**) capital. The broader definition of TLAC strikes an appropriate balance between ensuring stability while not adding significant cost which would be passed onto bank customers.

The ABA would also like to express support for conceptual underpinnings of the International Banking Federation (**IBFed**) and the Institute of International Finance (**IIF**) submissions, as we are broadly aligned as an industry with the key messages expressed in their submissions, and indeed a number of our member banks have participated in their development.

The ABA would like to provide some additional technical comments which fall into two categories:

1. Although none of the Australian banks are G-SIBs and therefore the TLAC proposals are not intended to directly apply to them, the proposals and the consequential increase in capital levels will affect all banks which compete for capital and funding in international markets. The recent Australian Financial System Inquiry (**FSI**) Final Report to the Australian Government recommended the adoption of a framework for loss-absorbing and recapitalisation capacity in line with emerging international practice. Therefore, we comment both on matters which are likely to impact all banks; and

2. On matters which are likely to affect the Australian banks in the particular context in which they operate.

1. Matters affecting all banks

The ABA makes the following observations:

- The TLAC proposals will require an increase in capital levels for the G-SIBs as well as all banks which compete against the G-SIBs for capital and funding in international markets, as investors inevitably compare capital levels of banks seeking to raise funds. As net importers of capital, Australian banks must consider global standards to be viewed as relatively strong in the international context. Therefore, in setting the TLAC range, consideration should be given not just to the end result for the G-SIBs but also for the non-G-SIBs. One way to do so would be to set a single, lower TLAC requirement so that non-G-SIBs will not be forced by market dynamics to hold higher levels. To the extent that it is appropriate for a particular G-SIB to hold higher levels of capital, then this should be imposed by their relevant regulator through Pillar 2.
- From the perspective of the absolute amount of TLAC to be raised, the TLAC proposals have a greater impact on banks which have significant mortgage portfolios (such as the Australian banks) than banks which are able to securitise their mortgages in large volumes (often via Government support programs). Consideration should be given to the business model of banks in a particular jurisdiction when setting the TLAC requirement for those banks – the ABA believes this principle should be articulated in the common standard.
- The proposed TLAC requirement is the greater of 16% to 20% of risk-weighted assets or double the Tier 1 leverage ratio requirement. Both should be calculated based on the application of the Basel framework rather than the national implementation of the framework which could include national discretions and therefore lead to higher TLAC requirements. The leverage ratio requirement should remain a backstop measure and be calibrated such that it supports, but does not void, the merits of the risk-sensitive, risk-weighted asset measure.
- Prior to the publication of the TLAC proposals, there had been discussion in regulatory and market circles about FSB support for a broad bail-in of all bank liabilities. The discussion has led to volatility in capital and funding markets. The ABA believes that the TLAC proposals more appropriately address the issues sought to be addressed by the previous proposals for a broad bail-in. To minimise future market volatility, the ABA believes the FSB should provide assurance that, once the TLAC proposals are settled, there is no intention to pursue other bail-in mechanisms.
- The interaction of the TLAC proposals with other regulatory rules needs to be considered to avoid unintended consequences, including the ability of the banks to raise TLAC. For example, the

deductions associated with bank holdings of TLAC instruments, compounded with the potential restrictions in investor mandates towards bail-in instruments due to the possible conversion to equity, leave open the question of how the anticipated supply of TLAC will be absorbed by the markets. There may need to be a market making exemption from the proposed deductions regime.

- CET1 capital in excess of minimum requirements and buffers should be fully included in TLAC, as this provides additional capacity to absorb losses in times of stress. The requirement for at least 33% of TLAC to be non-CET1 capital should be a guiding principle, rather than a strict requirement. As non-equity instruments would convert upon non-viability, there should be no differentiation between additional CET1 capital and these convertible instruments.
- The ABA would welcome further consideration of the 2.5% RWA limit specified in Condition 13 in order to: 1) clarify the specific circumstances in which this restriction would apply (thereby avoiding possible unintended consequences); and 2) evaluate whether 2.5% is an appropriate level.

2. Matters affecting the Australian banks

Given the current recommendation of the Australian Financial System Inquiry (FSI) the ABA makes the following technical comments on matters which may affect Australian banks in the future:

- The appropriate length of the transition period for meeting any new TLAC requirements should be given careful consideration in order to ensure that the transition occurs in an orderly manner. This is particularly important for Australian banks that raise a proportionally higher volume of their capital and funding from international markets relative to banks in many other jurisdictions. In addition, the Australian banks have significant mortgage portfolios which mean that the absolute amount of TLAC they may be required to raise will be significant. Australian banks would have to come to the market at the same time as the G-SIBs and other banks, and there is a risk that they would not be able to raise their whole requirement at once or at acceptable pricing at once.
- Similarly, for the Australian banks, there needs to be further consideration towards the intended investor set for TLAC instruments. TLAC instruments being sold to a more concentrated class of investors is further support for the need for adequate implementation and transition timeframes. Moreover, a reduction in banks' ability to hold each other's senior debt could further skew Australian funding offshore, potentially increasing swap and general funding costs.
- The Australian implementation of the Basel framework includes significant national discretions which, if used to calculate the TLAC requirement, would require Australian banks to hold significantly higher amounts of TLAC than international peer banks. Consequently, it is important that the TLAC requirement be calculated based on the application of the Basel framework rather than national implementation – the ABA believes this principle should be articulated in the common standard and should be accompanied by a standardised template for disclosure.
- The Australian banks have subsidiaries which conduct significant businesses in New Zealand. New Zealand is not a member jurisdiction of either the FSB or the Basel Committee on Banking Supervision and has implemented some regulatory reforms differently. While the ABA agrees that the Australian banks will have to hold loss-absorbing capacity for risks posed by their New Zealand businesses, additional TLAC should only be required to be held at the parent level in circumstances where the home regulator does not recognise the resolution framework in the country in which the subsidiary operates.

Thank you for taking our comments into consideration and I would be pleased to discuss them further at your convenience.

Yours sincerely,

Aidan O'Shaughnessy