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The voice of banking

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Financial Stability Board
Bank for International Settlements
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2nd February 2015

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Dear Mr Andresen,

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

This is the British Bankers' Association's response to the above consultation paper; we welcome the opportunity to provide our views. The BBA is the leading trade association for the UK banking sector with more than 200 member banks headquartered in over 50 countries with operations in 180 jurisdictions worldwide. Eighty per cent of global systemically important banks are members of the BBA. As the representative of the world's largest international banking cluster the BBA is the voice of UK banking.

Our response identifies the following key points:

- we agree that there must be sufficient loss absorbing and recapitalisation capacity available in resolution to implement an orderly resolution that minimises any impact on financial stability, ensures the continuity of critical functions, and avoids exposing taxpayers to loss with a high degree of confidence;
- on this basis, we support the principle of a common minimum TLAC requirement and the intention to calibrate this against past loss experience. Our analysis leads us to conclude that a Pillar 1 requirement of 16% of RWAs, excluding the combined buffer requirement, would be sufficiently conservative to achieve the aims and objectives behind TLAC. In the interests of clarity and comparability, we recommend that any leverage denominator be expressed as a fixed requirement rather than twice a still to be agreed minimum;
- in contrast to our support for the Pillar 1 minimum, we believe that the proposed Pillar 2 framework risks adding undue complexity without clarity as to how it is intended to operate and interact with going-concern Pillar 2 requirements. If a Pillar 2 regime is introduced we suggest this be used to address firm-specific impediments to resolution which are not captured by Pillar 2 capital and that the application of the regime be monitored through the FSB-led Resolvability Assessment Process;
- we recognise that the location of TLAC resources within a group structure is an important factor in the design of a resolution strategy and that a limited level of pre-positioning can align

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incentives between authorities and be used as a mechanism to support the movement of losses. It is important, however, to prevent pre-positioning from having a negative impact and to use a robust mechanism to identify the subsidiaries where internal LAC should be held. The success of the proposed regime will be enhanced if the FSB provides an explicit recommendation that host authorities should not impose unilateral TLAC requirements;

- the quantum of pre-positioned internal LAC should preserve an incentive for the home and host authorities to work together and should be set in a way that ensures that the sum of the parts is never greater than the consolidated requirement;
- we note that the interaction between pre-positioning and regulatory capital requirements will necessitate an amendment to intra-group capital requirements to ensure that groups with intermediate legal entities are not unduly impacted by the large exposure and leverage regimes;
- in terms of the proposed eligibility requirement, we agree that the guiding principle should be to ensure that liabilities which count towards the TLAC requirement can be credibly exposed to loss but believe that further consideration is required in a number of areas identified in our responses to questions 6 and 9, not least the treatment of Structured Notes which otherwise meet the TLAC eligibility criteria;
- we believe the proposal for a proportion of the Pillar 1 requirement to be met with debt is at odds with other regulatory objectives and note that it could have counterintuitive results. If the expectation is to be maintained then we believe it should provide clarity that all non-common equity tier 1 instruments which meet the TLAC eligibility requirements should be permitted to count; and
- we agree with the logic of using the QIS exercise to inform implementation timing and that this should not be before 2019 at the earliest. The conformance period for banks newly identified as G-SIBs must be commensurate with the scale and impact of what is proposed and in our view should be set at the longer end of the range proposed.

Our answers to the questions raised on the consultative document are enclosed. Please feel free to contact us to discuss any of the points in further detail.

Yours sincerely,

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ANNEX: Responses to FSB questions

Calibration of the amount of TLAC required

1. Is a common Pillar 1 Minimum TLAC requirement that is set within the range of 16 – 20% of risk-weighted assets (RWAs), and at a minimum twice the Basel III leverage requirement, adequate in the light of experiences from past failures to support the recapitalisation and resolution objectives set out in this proposal? What other factors should be taken into account in calibrating the Pillar 1 Minimum TLAC requirement?

We support the principle of a common minimum requirement and the intention to calibrate this against past loss experience to ensure there are adequate resources available to absorb losses and provide recapitalisation to a restructured entity. There are a number of issues we believe should be considered when verifying historic losses:

- failures of monoline regional or national banks are not the most appropriate guide to the losses likely to be sustained by global, diversified G-SIBs. Furthermore, we note that losses in the recent crisis were predominantly related to real estate, and significant improvements in capital and liquidity regulations have since been introduced that would mitigate a repeat;
- whilst losses in the recent crisis were limited by extraordinary public support for the liability side of the balance sheet and could have been greater if widespread firesales had not been limited, this must be offset against much greater levels of going-concern capital in the banking system, new minimum levels of liquidity and the fact that resolution is likely to act as a limit on future firesales. Together this means that the calibration exercise should not assume that the losses under insolvency would be greater than those experienced during the crisis;
- we note Basel Committee analysis has found that the arithmetic mean of historical losses in a systemic crisis is 7% of RWAs (median 3.7%) with figures for peak losses during the recent crisis being 5% (mean) ad 3% (median) respectively[1];
- analysis of losses against RWAs should reflect the significant difference between the calculation of risk weights under Basel II and Basel III. Indeed, we note that the UK G-SIBs have indicated that Basel III/CRD IV will increase their current RWAs by an average of 11.5%[2].

The above leads us to conclude that a minimum Pillar 1 requirement of 16%, or twice the Basel III Pillar 1 minimum requirement excluding the combined capital buffer, would be suitably conservative to achieve the objectives behind TLAC. As the term sheet notes, this would give a minimum requirement of 19.5% of RWA (assuming a 0% countercyclical buffer), well above historical losses especially when considering the surplus quantum of non-operational liabilities that, although not qualifying as TLAC, could be bailed in (i.e. debt of less than one year remaining maturity).

Whilst we understand the rationale for calibrating the recapitalisation element of TLAC against the pre-resolution balance sheet, we suggest that consideration be given to reducing this amount if the resolution plan provides a credible basis for reducing the level of recapitalisation required, such as via a resolution weekend good bank/bad bank split or divestiture.

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[1] BCBS: *Calibrating regulatory minimum capital requirements and capital buffers: a top down approach*, October 2010
[2] See 2013 Annual Reports/Pillar 3 disclosures which reconcile current RWAs to fully-loaded CRD IV end-point definitions

Although we believe RWAs should be the principal basis for determining the consolidated SPE TLAC requirement, as this ensures the requirement is linked to the risk profile of the firm and is relatively closely related to the risk of loss, we accept the proposal for a secondary requirement linked to the leverage ratio numerator. For the purpose of clarity and comparability it would be useful for the FSB to state that the twice leverage requirement relates to the Basel Committee minimum and not any national variant. That being said, the Basel Committee has not yet conducted the final calibration of the leverage ratio requirement. If this was to be set at greater than 3% it would imply a material increase in TLAC requirements. As such, we recommend the FSB agrees a fixed leverage requirement. Doing otherwise will lead to uncertainty as to the final TLAC requirement.

As a final point, we assume that going-concern capital buffers will not be excluded from the numerator for the purposes of the leverage requirement and that this may be satisfied with any TLAC eligible instruments. Furthermore, it should not be necessary to maintain capital buffers in addition to the leverage requirement.

2. Does the initial exclusion of G-SIBs headquartered in emerging market economies (EMEs) from meeting the Common Pillar 1 Minimum TLAC requirement appropriately reflect the different market conditions affecting those G-SIBs? Under what circumstances should the exclusion end?

We recognise there are factors which suggest that G-SIBs headquartered in emerging markets should have longer to comply with the TLAC requirements but we encourage the FSB to propose a timetable over which the exclusion should end. In addition, we suggest that consideration be given to whether such firms with resolution entities operating outside emerging markets should be required to meet internal TLAC requirements or should be subject to any local TLAC requirements.

Furthermore, we recommend that – to promote a level-playing field – subsidiaries of developed country G-SIBs operating in EME countries should not be subject to internal TLAC requirements and resolution entities of developed country (MPE) G-SIBs based in EME countries should not be subject to the external TLAC requirement. As such, we suggest that the impact assessment be used to assess the impact of the proposed exemption on G-SIBs based in developed markets but operating in emerging markets. In particular, the requirement on such firms with MPE strategies to raise external TLAC in these markets as well as the impact on SPE firms required to downstream internal TLAC to subsidiaries in these markets.

3. What factors or consideration should be taken into account in calibrating any additional Pillar 2 requirements?

We believe that the proposed Pillar 2 framework adds undue complexity to the regime. Whilst we understand that the Pillar 2 component is intended to reflect firm-specific resolution factors (although this would benefit from clarification), we do not consider there are great differences between G-SIBs in this regard. By their nature, all provide critical economic functions which must be preserved and therefore be in a position to continue to operate immediately following an initial resolution weekend. Nor is it transparent how the Pillar 2 component interacts with Pillar 2 of the Basel framework. If capital held to meet going-concern Pillar 2 requirements is excluded from satisfying the Pillar 1 TLAC requirement then it is not evident why there is a need for an additional Pillar 2 component to TLAC.

If a Pillar 2 TLAC component, however, is to be required then this should be limited to addressing firm-specific impediments to resolvability which it is within the competence of management to address, and which are not captured by Pillar 2 capital. For example, it would be inappropriate to penalise a firm due to shortcomings in the resolution laws of the countries in which it operates. We strongly support the recommendation that any Pillar 2 element should be discussed and agreed by the firm's Crisis Management Group (CMG). Furthermore, in the interests of promoting consistent application of the framework, we recommend that the FSB-led Resolvability Assessment Process (RAP) be used to identify any diverging approaches to the application of Pillar 2 requirements. If the RAP identifies a need then the FSB should provide further guidance to national authorities to promote consistent application.

As a final point, we encourage consideration of whether the Pillar 2 component could be used to incentivise firms to enhance their resolvability. For example, resolution authorities could be given flexibility to use the Pillar 2 component to encourage firms to address specific impediments to resolution. It follows that there would be an expectation that any Pillar 2 component would reduce and be eliminated as such concerns were addressed.

Ensuring the availability of TLAC for loss absorption and recapitalization in the resolution of cross-border groups

4. **Should TLAC generally be distributed from the resolution entity to material subsidiaries in proportion to the size and risk of their exposures? Is this an appropriate means of supporting resolution under different resolution strategies? Which subsidiaries should be regarded as material for this purpose?**

We agree that the location of TLAC resources within a group structure is an important factor in the design of the resolution strategy. Furthermore, we acknowledge that pre-positioned resources can align incentives of home and host authorities by providing an assurance that there will be resources available to support the continued operation of critical economic functions. It is, however, important to guard against any pre-positioning requirement exacerbating the fragility of a resolution group by, for example, restricting the ability of the parent to direct group resources to the entity which has suffered losses.

Limiting internal TLAC requirements to certain subsidiaries based on the size and risk of their exposure together with a link to the resolution strategy has the potential to balance the benefits of pre-positioning with the costs and risks. It does, however, require the exercise of judgement to govern the identification of material subsidiaries. We recognise that the first three criteria proposed in section 21 of the term sheet achieve this, but feel the fourth criteria is too broad for the purpose of TLAC and would therefore recommend that it be reviewed to focus on the identification of the most significant subsidiaries. In this context, we suggest that the Basel Committee's criteria for the identification of D-SIBs would be the most appropriate basis for deeming a subsidiary material beyond the initial three criteria. Therefore, it is not sufficient that a given subsidiary represents more than 5% of the resolution group's balance sheet, but more importantly that the subsidiary is significant in its jurisdiction. After all, TLAC is intended to counter systemic risk. So, perhaps the FSB can put in place a two-part test: (i) the subsidiary represents 5% of the group based on the proposed criteria; and (ii) the subsidiary is considered systemic in the host jurisdiction. Moreover, any test should be based on a three year average reviewed annually to avoid anomalies

A pure operational subsidiary should be exempt from internal TLAC requirements, even if they support the exercise of the firm's critical economic functions, since its business model and balance sheet are inherently less risky.

Finally, we would welcome an explanation of how the criteria in part 21 of the term sheet are intended to interact with the statement in section 20 that the principles do not limit a host authority's power to impose external or internal TLAC requirements. Whilst this is self-evident, we believe it would be beneficial if the FSB provided leadership through an explicit recommendation that host authorities should not impose unilateral TLAC requirements; although of course they should have input through the CMG process. It should be clarified that, instead, only the home authority should be able to make such a designation, based on its legal framework and the group's resolution strategy, and given the home country's overall supervisory responsibilities. Otherwise, there is a risk that uncoordinated designations by hosts could disrupt resolution planning or the efficiency and effectiveness of actual resolution strategies.

5. **To what extent would pre-positioning of internal TLAC in material subsidiaries support the confidence of both home and host authorities that a G-SIB can be resolved in an orderly manner and diminish incentives to ring-fence assets? Is a requirement to pre-position internal TLAC in the range of 75-90% of the TLAC requirement that would be applicable on a stand-alone basis, as set out in the term sheet (Section 22), appropriate to satisfy the goals of the proposal and ensure that TLAC is readily and reliably available to recapitalize subsidiaries as necessary to support resolution? Can this pre-positioning be achieved through other means such as collateralized guarantees?**

As noted in answer to question 4, we acknowledge the role that internal TLAC could play in promoting cooperation between home and host authorities but also the need to avoid reducing the ability of a resolution group to respond to a stress. We welcome therefore the fact that the proposed range of 75-90% implicitly recognises these facts but believe that the requirement will need to be set at no more than the lower-end of the range to mitigate the impact of consolidation effects which will mean that for many SPE groups the sum of the parts will be greater than the consolidated requirement. We understand that the final requirement will be informed by the QIS to be undertaken in 2015. We recommend that this be informed by the following considerations:

- the pre-positioned amount should never be greater than the amount of TLAC that has to be held on a consolidated level against the RWAs that the subsidiary contributes to the resolution group's consolidated RWAs;
- the level of pre-positioning should be consistent for all entities within the resolution group and be agreed by the CMG; and
- internal limits should not prevent the pre-positioning.

We welcome the opportunity to explore supplements to pre-positioning to satisfy the internal TLAC requirement, as we believe that in many cases it will be in the interests of the host country for the group to retain flexibility to downstream resources to a stressed subsidiary if and when necessary. The viability of legally binding collateralized guarantees from the perspective of the parent entity will be impacted by the capital treatment, legal duties on directors and standalone treatment of the entities. An alternative would be to give the subsidiaries at which internal TLAC was to be required a legal claim to a portion of a central pool. Such commitments might be structured as 'keep well' arrangements or intragroup guarantees.

As a final point, we note that there are a number of questions regarding the interaction between pre-positioning requirements and regulatory capital requirements of individual entities within a consolidated group. In an SPE model, there may be instances where funding is downstreamed to material entities via an intermediate entity which has standalone capital requirements. Depending on the form of TLAC that is passed on to the material entity, the intermediate legal entity will attract capital charges on its funding exposures to the material entities below it. Capital charges may be in the form of RWAs (Large Exposure and leverage would also be a consideration) or in the form of capital deductions depending on the instrument features. It would be helpful for the FSB to consider how the regulated entity should treat its exposures to the material entities for capital purposes in such circumstances. Should it be as an RWA or as capital (or connected funding of a capital nature)? If capital, should any deduction be offset by the regulated entity's capital issuance to the Holding Company? Given the pre-positioning is mandatory, we believe it would be appropriate to provide an exemption from intra-group capital requirements for such exposures.

Determination of instruments eligible for inclusion in external TLAC

6. Are the eligibility criteria for TLAC as set out in the term sheet (Sections 8-17) appropriate?

We agree that it is important to ensure that liabilities which count towards the TLAC requirement can be credibly exposed to loss without disrupting the provision of critical economic functions or giving rise to a material risk of successful legal challenge or compensation claims. On this basis, we broadly agree with the eligibility criteria proposed. Notwithstanding this, we identify the following points:

- the restriction on maturity may give rise to cliff effects. We urge the FSB to consider an approach analogous to the Basel III treatment of Tier 2 capital, under which the qualifying amount is gradually amortised down during the period between a year and six months to reduce the incentive for firms to issue rolling debt, i.e. an approach conceptually similar to that for the treatment of Available Stable Funding under the NSFR;
- the assessment of remaining maturity for callable securities should be based on the contractual maturity date and not the first possible call date, given that regulators will be required to approve any call prior to maturity. It will be important for regulators to have well-defined processes and capacity to governing such approvals for TLAC eligible securities to enable effective market timing and pricing of a call, and the FSB should clarify that the requirement for regulatory approval prior to a call does not have to be a contractual term of the instrument;
- we disagree with the proposed prohibition on the eligibility of structured notes, which are a materially important liability class in the funding structures of many G-SIBs and have a role to play in ensuring a diversified investor base for TLAC. We suggest that structured notes should be permitted to count towards the requirement if the firm can demonstrate that the notes can credibly be subjected to bail-in;
- it would be helpful for the FSB to confirm that legacy, non-Basel III compliant capital is eligible to count towards TLAC as otherwise this could be a source of cross-border disagreement between authorities. We note that the European Banking Authority has

recently proposed guidance on the (equal) treatment of legacy capital in a bail-in[3] and recommend that this should be reflected in the term sheet; and
- the Holding Company restrictions should be reviewed as the current drafting could preclude senior unsecured debt issued from the Holding Company from being eligible for TLAC as holding companies do inevitably have other senior creditors such as tax liabilities. This is discussed further under question 9.

7. What considerations bear on the desirability of an expectation that a certain proportion of the common minimum Pillar 1 TLAC requirement consists of (i) tier 1 and tier 2 capital instruments in the form of debt plus (ii) other eligible TLAC that is not regulatory capital?

The proposal that a proportion of the Pillar 1 requirement be satisfied by long-term debt is at odds with other regulatory objectives which seek to maximise the extent to which firms maintain high CET1 ratios. Furthermore, it would be counterintuitive if a firm was to be penalised for meeting its TLAC requirements with equity. We note for example that an MPE subsidiary located in a market where deposit funding is the norm (i.e. with a loan to deposit ratio <100%) might be forced to leverage its balance sheet or change business strategy. If such an expectation is to be imposed then we believe the term sheet should permit all non-common equity tier 1 instruments which satisfy the other TLAC eligibility criteria to count towards the requirement, including instruments such as equity-accounted AT1 (which are legally debt) and preference shares.

Given that on-balance sheet internal LAC requirements can be met via collateralized guarantees, should the term sheet should be read as implying that the debt expectation does not apply to internal LAC?

8. Are the conditions specified in the term sheet (Section 8) under which pre-funded commitments from industry-financed resolution funds to provide resolution funding contribute to TLAC appropriate?

We have no comments on the proposal given it appears to relate to a specific jurisdiction, but would like to make clear that we do not support the concept of pre-funding articulated in the proposal.

9. Is the manner in which subordination of TLAC-eligible instruments to excluded liabilities is defined in the term sheet (Section 13) sufficient to provide certainty regarding the order in which creditors bear losses in resolution, and to avoid potentially successful legal challenges or compensation claims? Where there is scope for liabilities which are not subordinated to excluded liabilities to qualify for TLAC, are the transparency and disclosure requirements set out in section 13 and 24 sufficient to ensure that holders of these instruments would be aware of the risk that they will absorb losses prior to other equally ranking but excluded liabilities? If not, what additional requirements should be adopted?

We recognise that TLAC must provide confidence that resolution can be undertaken without disruption to critical economic functions and that to achieve an orderly resolution the resolution authority must be satisfied that it can expose the eligible instruments to loss without material risk of successful legal challenge. We accept therefore the rationale for ex ante subordination of TLAC to

[3] EBA, *Consultation on guidelines on treatment of liabilities in bail-in*: 1st October 2014

operating liabilities but believe also that there must be flexibility over how individual firms and jurisdictions achieve this objective.

It is therefore welcome that the term sheet proposes a number of ways in which subordination might be achieved. The three alternatives look to be broadly appropriate. That being said, and as mentioned in response to Question 6, we believe the structural solution (c) sets an unrealistic bar in preventing TLAC from ranking pari passu or senior to any unsecured liabilities at a Holding Company, which would include tax liabilities. We suggest this be reworded to state that for the purposes of this requirement excluded liabilities arising in the ordinary course of business of a Holding Company can be disregarded, at least within a specified value limit.

We agree that transparency is an important consideration when determining the extent to which liabilities subject to a statutory bail-in power but ranking pari passu with excluded liabilities should be permitted to count towards satisfying the TLAC requirement. Such subordination offers important flexibility for jurisdictions to tailor their rules to the requirements of the term sheet. A comparable approach which would moderate the challenges associated with the transition to the TLAC regime would be for jurisdictions to statutorily subordinate senior debt to operating liabilities. We note, for example, the proposed Canadian bail-in regime provides statutory subordination of newly-issued long-term senior.

Interaction with regulatory capital requirements and consequence of breaches of TLAC

10. Do you agree that the TLAC requirement for G-SIBs should be integrated with Basel III such that the minimum TLAC requirement should be met first, and only after TLAC is met should any surplus common equity tier 1 (CET1) be available to meet the Basel III buffers?

We welcome the intention to integrate the proposed TLAC framework with Basel III and recognise the logic of requiring only CET1 in excess of that required to satisfy the minimum regulatory capital and minimum TLAC requirements from counting towards regulatory capital buffers. We assume that this requirement is limited to the Basel III buffers – capital conservation, G-SIB and countercyclical – and that if a jurisdiction has imposed a higher buffer requirement, the excess above the Basel minimum will be permitted to count towards the TLAC requirement.

We disagree with the expectation that breaches or likely breaches of the Pillar 1 requirement should ordinarily be treated in the same way as breaches of minimum capital requirements. In our view, this will add yet further complexity to the already complex and often poorly understood going-concern framework which will act as a source of market uncertainty as to the progressive constraints faced by banks and the circumstances in which these may be triggered. We recommend that this issue be considered together with the risk-weighted (Pillar 1 and 2) and leverage constraints under Basel III and new approaches to stress testing. We suggest that the outcome should be that a breach or likely breach of minimum TLAC should trigger a dialogue with the firm's regulators as to how the requirements will be satisfied over a specific timeframe, but without any automatic restrictions on dividends. It should be noted that the current proposal is also likely to require banks to hold material management buffers as insurance against breaching the requirements.

Transparency

11. What disclosures (in particular in terms of the amount, nature and maturity of liabilities within each rank of the insolvency hierarchy) should be required by resolution entities and material subsidiaries to ensure that the order and quantum of loss absorption in insolvency and resolution is clear to investors and other market participants?

It would be helpful for the FSB to provide an indicative timeline for the disclosure framework. We note that the document currently states that disclosure will be provided prior to the suggested effective date but does not indicate how soon. Firms will require sufficient time to implement new requirements.

Limitation of contagion

12. What restrictions on the holdings of TLAC are appropriate to avoid the risk of contagion should those liabilities be exposed to loss in resolution?

The proposed term sheet requires G-SIBs to deduct from their own TLAC or regulatory capital exposures to eligible external TLAC liabilities issued by other G-SIBs in a manner parallel to the existing provisions in Basel III for similar deductions. We recommend that, in line with Basel III, the FSB sets out a safe harbour threshold for TLAC deductions such that deductions apply to exposures which exceed, for example, 10% of a G-SIB's CET1. Exposures that exceed the 10% threshold should be deducted using the Basel III corresponding deduction approach.

The FSB should note that further protection against contagion is provided by the Basel Committee's April 2014 final standard on Large Exposures which, in addition to imposing a general 25% limit on a bank's exposures to a single counterparty or group of connected counterparties, imposes a much tougher limit of 15% on a G-SIB's exposures to another G-SIB.

Inhibiting the ability of G-SIBs to make markets in TLAC instruments is likely to decrease market liquidity, widen bid/ask spreads and increase volatility. We believe there should be specific carve-outs, for market-making and underwriting activities, from the proposed requirement that a G-SIB deducts from its own TLAC or regulatory capital exposures to others G-SIBs' eligible instruments. One suggestion would be to leverage the existing five day exemption provided under the CRR.

Conformance period

13. Should G-SIBs be required to conform with these requirements from 1 January 2019? Why or why not? What, within the range of 12 to 36 months following the identification as a G-SIB, should be the conformance period for banks identified as G-SIBs at a future date?

We agree that the time for the application of the requirements should be determined by the QIS and should be no earlier than 1st January 2019. We do, however, believe there is a strong case in favour of extending this beyond 2019, and/or with a gradual phasing in of requirements, to provide sufficient time for transition and grandfathering thereby avoiding issuance pressures and providing investors with certainty as to the bail-in hierarchy and process. Again, phasing in the requirements would be a way of managing expectations in the market.

We consider the scale and impact of the proposed requirements to be such that the conformance period for banks newly identified as G-SIBs should be set at the longer end of the 12 – 36 month range proposed. Equally, the timeframe for rebuilding TLAC following a resolution event or drawdown of TLAC resources should be similar.

Market impact and other aspects

14. How far is the TLAC proposal, if implemented as proposed, likely to achieve the objective of providing sufficient loss-absorbing and recapitalization capacity to promote the orderly resolution of G-SIBs?

As noted above, we consider that the TLAC proposal provides a robust basis for ensuring that G-SIBs hold sufficient loss-absorbing capacity and as such satisfies the FSB's objective of promoting the orderly resolution of G-SIBs. Whilst the significance of the TLAC proposal should not be underestimated, it will be important for the FSB and member jurisdictions to complete the work programme identified by the FSB November 2014 progress report[4]. In particular, we encourage further work to be conducted to (i) promote clarity over the order in which creditors would suffer loss in resolution and (ii) to promote cross-border cooperation.

15. What will be the impact on G-SIB's overall funding costs of the adoption of a Pillar 1 Minimum TLAC requirement?

We recommend that the following points be assessed when estimating the impact of the Pillar 1 proposal on funding costs:

- The shortfall analysis should reflect the fact that the proposed Pillar 1 TLAC range of 16-20% is a minimum and will not include regulatory buffers, Pillar 2 requirements in certain jurisdictions and management buffers which could result in a range closer to 25-30% (management buffers are likely to be material as a result of the rules for breaching minimum TLAC, heightened by the maturity restrictions)
- The potential for the two times leverage ratio requirement to act as a binding constraint for firms with certain business models
- Impact of future changes to how RWAs are calculated
- The impact on deposit-funded points of entry, which can not necessarily be replaced by senior debt
- Impact of a blanket exclusion for structured notes

16. What will be the impact on the financial system and its ability to provide financing to the real economy?

We suggest that the following points be considered when assessing the impact of the proposal on the financial system:

- Impact of G-SIBs preparing for compliance well ahead of the deadline (on all areas of the proposals) given this is likely to rapidly become a market expectation

[4] *Towards full implementation of the FSB Key Attributes of Effective Resolution Regimes for Financial Institutions*: 12 November 2014

- Impact of D-SIBs anticipating compliance with similar requirements in the future or being held to similar standards by the market (or their local regulators) as GSIBs
- Impact of EU banks preparing for compliance with MREL requirements
- Potential 'cliff' effect of 12 month minimum maturity requirement
- Potential depth and liquidity of a much larger market for new capital instruments, especially whether constraints to sale or purchase will be in place across international jurisdictions
- Potential geographically constrained markets for TLAC

17. Do you have any comments on any other aspects of the proposals?

We recommend that the TLAC economic impact assessment should consider the following aspects of the proposals:

TLAC calculation and composition

- Relative costs and barriers to establishing holding companies and the degree to which the requirement for 'clean' holding companies impacts existing structures and adds complexity elsewhere in a bank group
- Impact of using Basel versus local leverage ratio requirements for the TLAC calculation
- Impact of future changes to minimum leverage ratio requirements
- Impact of divergent approaches to determining total TLAC requirements, including the option to recognise 2.5 percentage points of liabilities pari passu with excluded liabilities and the setting of systemic buffers at higher levels than the global standard
- Impact of divergent approaches to Pillar 2 developing in different countries
- The quantum of capital no longer eligible as TLAC due to the maturity requirement, but still available to absorb losses in resolution
- Impact of instruments being eligible for regulatory capital but not for TLAC (e.g. because of the 12 month minimum maturity requirement)
- To assess the expected impact on funding banks may need to make assumptions about rating changes that could result from the implementation of the proposals (especially in terms of the relative differences between raising funding at a Holding Company vs Operating Company)

Internal TLAC requirements

- The impact of internal TLAC on capital fungibility
- Impact of internal TLAC requirements on the effectiveness of SPE resolution strategies Impact on asset prices in local markets
- Ability for banks to meet internal TLAC requirements arising from consolidation effects with double leverage, given Basel III liquidity requirements
- Role of existing capital buffers and Pillar 2 in internal TLAC
- Consistency of internal TLAC definitions
- Impact of internal TLAC requirements, specifically increased requirements on firms that already have sufficient TLAC at group level
- Impact of having to meet internal TLAC requirements by holding large pools of cash at parent level that cannot be efficiently deployed

- Impact of substantial flows into local markets to meet internal TLAC requirements through downstreaming on an ex ante basis including both the potential impact of the move from deposit funding to wholesale funding, and the potential impact on asset prices as funds are deployed
- Whether a waiver from capital requirements for intragroup lending is appropriate where TLAC is downstreamed through an intermediate entity

Emerging markets exemption

- Impact on emerging market headquartered G-SIBs of phased commitment to TLAC requirements, and impact of that phased commitment on G-SIBs headquartered outside but operating in emerging markets, including both requirements for MPE firms to raise external TLAC in these emerging markets and the impact on SPE firms required to downstream internal TLAC to subsidiaries in these markets.
- Impact of internal TLAC requirements not applying to overseas operations of emerging market headquartered banks

Other issues

- The potential for differing national perceptions of the level of NCWOL/litigation risk to result in differing approaches to the recognition in TLAC of up to 2.5 percentage points of liabilities pari passu with excluded liabilities, with consequent implications for global consistency of application and for market discipline
- The impact assessment should take a holistic view of the proposal and consider cumulative impact rather than each element of the term sheet individually
- Impact of restrictions on holdings of other GSIBs' TLAC eligible liabilities on liquidity and the ability to conduct market-making activities
- Determination as to whether the TLAC requirements will change the binding constraints in normal economic situations, (the other usual binding constraints will be RWA to Tier One capital, and the Leverage Ratio)
- Impact on banks' funding plans due to the disconnect between minimum maturity requirements for TLAC and NSFR