EACB position paper
FSB Consultative Document on Adequacy of loss-absorbing capacity of global systemically important banks in resolution

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The EACB is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 28 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks‟ business model. With 4.200 locally operating banks and 63.000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 160 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 50 million members and 750.000 employees and have a total average market share of about 20%. For further details, please visit http://www.eurocoopbanks.coop/

General remarks

The European Association of Co-operative Banks takes note of the objectives of the Financial Stability Board (FSB) aiming to increase the stability of the financial markets and considers stable financial markets as generally beneficial. Our comments below are meant to make a contribution to some fundamental aspects.

We remind that various measures relevant to the loss-absorbing capacity of G-SIBs have already been adopted both at global and European level. Therefore, it should be considered whether the introduction of the TLAC requirement is needed in the light of the recent reforms in EU, including CRD/CRR, BRRD and the SRM. It is suggested instead that the effects of those reforms be firstly analyzed in order to assess the necessity of further measures.

By all means the design of the TLAC should be carefully projected so as to avoid any possible spill-overs and replication of the rules and frameworks on a reduced scale. In this light, we note the FSB itself acknowledges that the TLAC requirements would have far-reaching consequences, more specifically in the funding structure of the institutions. It should be taken into consideration that the requirements regarding the seniority of TLAC-eligible instruments, along with the quantitative requirements, could possibly lead to market distortions, by diminishing the level of flexibility in the financing business operations. Furthermore, the requirement of subordination favors holding-structure companies and does not give due regard to the corporate organization of the cooperative banking groups. It is our understanding that this approach could considerably compromise the diversity of the available business models.

Finally, TLAC requirement should reflect the fact that resolution does not mean resurrection of the whole failing bank but ensuring the continuity of its critical functions, as provided in its resolution plan.

Calibration of the TLAC

The main objective of TLAC is to ensure that the G-SIBs have loss absorbing and recapitalization capacity so that in case of resolution critical functions can continue without requiring taxpayer support or threatening financial stability. In this context, the adequate assessment of the quantitative TLAC requirements should not be made in accordance with the operational activities of the institution or group of institutions before the resolution. Right on the contrary, in the calibration of the TLAC only the subset of “critical functions” of the resolution entity should be encompassed, i.e. the ones that have been identified as such in the resolution plans and needed to be preserved.

Against this background, we suggest that the level of the projected calibration of the minimum Pillar 1 TLAC requirement is too high, as it seems not to give regard to all possible resolution scenarios. It is of utmost importance that the TLAC requirement does not follow any possible changes to the RWA requirements or respective increases in the leverage ratio, but rather be subject to a separate analysis, ensuring that it remains calibrated to actual resolution requirements based on the resolution plan.

It should also be considered that besides the TLAC, the institutions will have to apply additional (systemic) capital buffer under Basel III, which would ultimately result in even higher levels of loss-absorbing capacity. In this context, we shall note that the common minimum requirement should not

exceed the level of 16 %. Any excessive calibration would jeopardize key critical lending activities of the real economy such as SME or consumer lending.
Furthermore, we note that leverage based TLAC requirement is not fully nclear. The FSB's reference to "at least twice the Basel III Tier 1 leverage ratio" does not provide much guidance, since this ratio is still under consideration and the exact level is unknown. It is our understanding that the leverage ratio should remain as a backstop measure and should not be used for the determination of the TLAC. By all means, if referred to, the level of leverage requirement should give due regard to the relationship between the two components, RWA-based requirement and the leverage-based requirement, to allow effective management of the TLAC requirement by institutions with different business models.

Cross-border groups

The EU is a single jurisdiction. Therefore, there is no need for the prepositioning within a homogenous recovery and resolution regime, as established by the BRRD. Moreover, the requirement to set internal LAC in material subsidies could be ultimately interpreted as distrust of the functioning of SRM.

Instruments eligible for inclusion in external TLAC

Eligibility Criteria

In order to avoid possible legal uncertainties and material distortions in competitiveness, while achieving full recognition of the purposes of TLAC and of the MREL- eligible subordinated liabilities, we suggest that the criteria set out in sections 8-17 of the TLAC Term Sheet be adjusted to the criteria applicable to the BRRD bail-in-able liabilities, or MREL, respectively[1]. Such an interaction would ensure consistency between the legal frameworks. In this context, we note that it remains incomprehensible why liabilities that qualify as bail-in-able under the BRRD, should be provided with additional subordination to be TLAC-eligible.

Furthermore, we are particularly concerned about the fact that the criteria do not give due regard to the corporate structures of the cooperative banking groups, thus not creating a level playing field. The FSB definitions allow banks that are organized in a holding-company structure to resume their TLAC-eligible liabilities in the form of senior unsecured debt, as the subordination is achieved through the corporate structure. In contrast, some cooperative banking groups do not operate as consolidated units, and will be forced to ensure contractual subordination of the debt, which will lead to significantly higher funding costs for the latter. The envisaged favorable treatment of certain business models leads to significant competition disadvantages to the cooperative banking groups.[2]

Composition of Common Pillar 1 Requirement

We are particularly concerned about FSB's requirement that at least 33% of TLAC should not be regulatory capital. As currently stated, one could presume that the banks would be required to issue subordinated debt, irrespective of their current capitalization. The rationale behind this proposal remains unclear because in any case it is better to have a loss absorbency capacity exclusively composed of CET1 rather than the same capacity composed of convertible which are of lower quality.

[1] See Section 5, *Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms.*
[2] See FSB Consultative document – *Location of TLAC within group structures* and sections 8-17 of the TLAC Term Sheet.

At the same time, however, it significantly extends the present regulatory capital framework in a way that neglects the cooperative banking groups, which capitalize most of their profits and have therefore much CET1 and little convertible or hybrid debt. It should be noted that for banks with significant holdings of CET 1 instruments, the latter would count towards the minimum TLAC requirement. It needs to be clear that this could apply to holdings of CET1 instruments above the minimum Basel III requirements (incl. Buffer requirements). It is not comprehensible that the FSB wants to make well capitalized banks to increase their debts so as to fulfill the TLAC requirements.

In the light of the aforementioned, we shall note that more flexibility is necessary to accommodate specific business models and capital structures, as well as the CET1 expectations of the relevant supervisors and the affordability of the hybrid debt market. Thus, there should be no unnecessary restrictions on firms' flexibility in deciding on the appropriate funding mix for a given situation.

Interaction with regulatory capital and consequence of breaches of TLAC

We are of the opinion that the FSB's approach regarding the integration of the TLAC with Basel III is not on the right line. It is our understanding that CET1 should first be used to fulfill the minimum requirements of Basel III (regulatory capital). The minimum TLAC requirements should be covered either by CET1, or by Additional Tier 1, Tier 2, or "other eligible liabilities", which are TLAC-eligible. Only in cases where the given institution does not have sufficient Additional Tier 1, Tier 2 or "other eligible liabilities" that are eligible for recognition as TLAC, the outstanding part would have to be met by CET1. In addition, it should be made clear that only the components of the CET1, which go beyond the regulatory capital under Basel III, could be fully included in the capital buffer requirements.