European Banking Federation

Ref.:EBF_012388v7

Brussels, 2 February 2015

Launched in 1960, the European Banking Federation is the voice of the European banking sector from the European Union and European Free Trade Association countries. The EBF represents the interests of some 4,500 banks, large and small, wholesale and retail, local and cross-border financial institutions. Together, these banks account for over 80% of the total assets and deposits and some 80% of all bank loans in the EU alone.

EBF Response to the FSB's consultative document on Total Loss Absorbing Capacity (TLAC)

General Comments

The European Banking Federation (EBF) is supportive of a common standard to ensure that sufficient resources exist to safely resolve all covered banks, without impacting critical functions or using taxpayer funds. Although this is difficult to achieve, we encourage the efforts of the FSB to allow the framework to fit all existing banking structures and the different legal resolution regimes of different jurisdictions (special resolution regime and insolvency hierarchies).

We positively note the indication that the final calibration of the standard needs to be well informed by the concurrent Quantitative Impact Study (QIS) and several market impact studies. Specifically the calibration needs to factor in the broader regulatory reform agenda to ensure that the combined requirements do not place an excessive burden on the financial system and the economy beyond what constitutes a reasonable and affordable layer of loss absorbing liabilities funded by banks. Furthermore, the standard needs to consider local regulatory regimes and accommodate the wide diversity of banking models. We are particularly concerned that the subordination requirements, as currently drafted, would particularly impact EU banks and create distortions between jurisdictions.

The different impact assessment studies before the final calibration should enable regulators to assess how the TLAC requirement will fit in with the whole regulatory framework which has just been deeply strengthened and enhanced, with capital buffers, a leverage backstop and liquidity requirements.

Against this background, we want to stress the following key points:

- The TLAC framework needs to be sufficiently flexible to take into account different legal structures, business models and resolution strategies in systemically important banks, and different regulatory measures that have already been introduced in the respective jurisdictions where the framework will be applied, in order to address "too big to fail".
- In particular, the consistency of the TLAC proposal with the European BRRD and MREL regime must be ensured. The current combination of the proposed TLAC rules, and those of BRRD, mean that few alternatives other than further and heavy issuance of capital instruments are available to many European banks. It is essential that a sufficient range of options to meet the TLAC requirements should be available to all banks.
- The definition of the leverage based TLAC requirement should be clarified. The notion of 'twice the leverage ratio' is concerning, as it refers to a ratio that is still under development and of which the final level is still to be fixed. We suggest that it should be made clear that the leverage requirement

is intended as a backstop, and that to remain coherent with Basel III it should represent an overall restriction, meaning that additional buffers should not sit on top of this requirement.

- We would suggest that this leverage-based requirement be set as a fixed number, i.e. the 6% referred to in the text, rather than as a multiplier of an as yet unknown number. This fixed number should also be fixed in a manner which respects a sensible balance between the RWA-based requirement and the leverage-based requirement, such that banks with different banking models (high or low risk intensity) are given space in which to manage their overall TLAC requirement.
- Eligibility of debt to count towards TLAC: The proposal seems to favour legal structures based on existing "bank holding companies". It may be the case that senior debt provided to bank operating subsidiaries by a non-operating holding company is considered to be structurally subordinated in the US, but this is not necessarily the case in other jurisdictions, including many in Europe. Holding company debt should of course be TLAC eligible if it meets the requirements for TLAC eligibility, but should not be considered 'per se' eligible. The same applies to contractually bail-inable and convertible debt, on condition that it is likely to still be available at the point of entry into resolution. The FSB should seek to build a TLAC framework that is neutral to different corporate structures and funding strategies, in order to avoid forcing certain types of banks to issue large quantities of subordinated debt or to change corporate structure simply to be able to meet TLAC requirements.
- Prepositioning TLAC in cash in material subsidiaries should not be necessary if credible resolution strategies are in place. Prepositioning would further add the disadvantage of forcing deposit-funded banks to increase their leverage. If the FSB decides to take the proposal on prepositioning further, intra group guarantees should be considered as a means to fulfil at least parts of the prepositioning requirement.

Answers to Questions

Calibration

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?**

As already mentioned, we welcome the financial impact studies and in particular the historical loss analysis, of which the ambition should be to indeed inform the final calibration. It is of paramount importance that the historical losses and subsequent consequences can be parsed in the light of the new regulatory framework, i.e. the significant increase in capital levels under Basel III rules, and the strengthening of the role of the supervisor in the identification of weaknesses and early intervention.

Although Principle 5 of the consultation states that resolution is not resurrection - an objective which we agree with - we believe that the technicalities described in the Term Sheet (starting by the calibration level) will very likely result in such a restoration scenario. We strongly regret that the Term Sheet does not contain any room for manoeuvre to take into account other measures at the disposal of the G-SIB in crisis times (wind down capacity, recovery). Resolution plans may involve discontinuing or winding down some non-critical functions and/or business lines, rather than continuing the entire business. This would require fewer resources for recapitalisation, to implement the group resolution plan and ensure the continuity of critical functions.

We do support the purpose of a common TLAC standard as providing a guarantee that there will be resources available to absorb losses and support recapitalisation, if necessary, to preserve the critical functions, and only these, of the bank in question. Therefore, the focus should be on recapitalising to a level that systemically important activities can be viable on a standalone basis over time, and that an orderly resolution and restructuring of these systemically important functions could be carried out.

The assumption at the end of Principle 5, that a high level of capital after resolution is needed to ensure that funding will be provided by the markets, should also factor in additional financial safeguards, such as a resolution fund, financed ex ante by banks, which can act as a credible back-up to liquidity facilities available from central banks or other financial stability funds. Such financing arrangements should be capable of ensuring that a resolution of a bank can receive additional liquidity support, if needed, and/or compensate investors and creditors for any potential shortcoming with regard to the NCWOL principle. The existence of resolution funds and financing backstops, within the EU [set up either nationally or within the euro zone through the Single Resolution Fund (SRF) and the European Stability Mechanism (ESM)] will themselves contribute to market confidence, so that a potentially lower level of capital after resolution may suffice for the market to be willing to provide funding.

In addition, given the prevailing evidence on historical losses in connection with bank failure, we think that a minimum level expressed as 16 per cent of Risk Weighted Assets should be more than enough to provide sufficient loss absorbing and recapitalisation capacity.

While, as outlined below in response to question 3, we broadly question the need for an additional Pillar 2 component. If a Pillar 2 approach is agreed by the FSB, then its existence would further support setting the Pillar 1 requirement at the lower end of the proposed range or below 16%, while the Pillar 2 measure should only reflect significant shortcomings in the recovery and resolution planning of the bank. A Pillar 2 requirement on top of a high Pillar 1 calibration designed to recapitalise the entire group as it stands today would risk imposing significantly more TLAC than necessary to achieve its objectives. This imposes costs on the bank, its investors and its customers, with little additional benefit.

The level expressed as twice the leverage ratio, is also problematic for several reasons. One being that the Basel leverage ratio level is still under review and will evolve as a result of the parallel run. In certain jurisdictions it has already been set, subject to certain circumstances, above the currently foreseen Basel III requirement.[1] For many European banks, in particular those with a high proportion of low risk assets on the balance sheet, the leverage based measure would become the actual binding requirement. This would in turn incentivise those banks to increase their risk on the balance sheet. This should not be the consequence of a common global standard on loss absorbing capacity intended to prevent a global systemic financial crisis.

In order to ensure that the requirement on the leverage base actually remains a backstop we suggest it is made clear in the FSB text by referring to a specific number for the Pillar 1 minimum TLAC requirement, i.e. 6% of the leverage exposure, rather than referring to twice a ratio that is still under development, and of which the final level is yet to be decided. The FSB should ensure that there is a sensible balance between the leverage-based requirement and the RWA-based requirement and sufficient room for manoeuvre for banks to manage their exposures within the bounds of the RWA requirement and the leverage requirement.

[1] Letter by the Dutch Central Bank (December 2014) requiring the 4 domestic SIBs to have a leverage ratio of 4% in 2018 at the latest.

We also call for a clarification of the Term Sheet on the interplay between the Basel III capital requirements and TLAC in this context. As stated in the FSB consultation document (page 6), "… **The aim is to establish a framework that is consistent with the Basel capital framework** and…" We therefore believe that a correct interpretation of the FSB Term Sheet would be that the overall TLAC does not equal the sum of twice the leverage ratio plus buffers. However, this is not entirely clear in the current drafting of the Term Sheet.

If however, "twice the leverage ratio" is interpreted as a minimum Pillar 1 requirement, this would mean that buffers would sit on top of the doubled leverage ratio level, which would be at odds with the Basel III capital requirement framework. Under Basel III, the binding capital requirement is the higher one of either the leverage ratio requirement *or* the total capital requirement including the capital buffer requirement and the Pillar 2 requirement. From this it follows that it would be enough to recapitalise the bank in resolution to the level of at most once the leverage ratio requirement and not both once the leverage ratio requirement and the combined buffer requirement. Any other interpretation would create confusion about the Maximum Distribution Amount (MDA) framework in Basel III. It then becomes unclear if the MDA will be triggered when the bank's CET1 capital ratio falls below one leverage ratio requirement. If so, the MDA framework in Basel III, i.e. the quartiles of the combined buffer requirement, would not be relevant any more.

Finally, we also want to raise a concern with the increased pro-cyclicality of the current proposals. Upon risk migration and increase in RWA of bank's lending portfolios, the impact will be twice as high as the impact under the current Basel III capital requirements, which already suffer from a great deal of pro-cyclicality. This means that banks will need to increase their capital and TLAC buffers in times of economic downturn (when RWA will increase).

Pro-cyclicality is further increased by the addition of TLAC to the current Basel capital requirements. In the current proposals, market disturbing measures like dividend or coupon payment suspensions are imposed when a bank suffers the slightest drop below the total of the TLAC minimum requirement and regulatory buffers (i.e. potentially 25.5% of RWA). We doubt that investor appetite for additional TLAC paper will be available, if at the same time banks are forced into dividend and coupon suspension. This means that restoring capital buffers may only be possible, either through reduction in lending assets or through organic capital generation. The effect of adding a TLAC requirement to the existing capital requirements can be to accelerate the moment in time at which capital buffers would be breached. Given this acceleration, we advocate a less disruptive approach in case of buffer breaches and a longer restoration period for repairing breaches.

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?**

The general exemption of G-SIBs headquartered in emerging markets seems overly broad. It should be made explicitly clear in the Term Sheet that the exemption only applies for as long as a jurisdiction is deemed to qualify as an emerging market, in order to avoid creating competitive distortions. This could in the long run have very destabilising effects in global financial markets. A transitional clause, phasing out the exemption over a pre-specified time period, should be included in the Term Sheet. At least, it should be ensured that such G-SIBs would be required to fulfil TLAC requirements as soon as their operations become significant (as measured by indicators on both the asset and liability side) outside of their home country.

Moreover, the exclusion of certain G-SIBs is from the international perspective contrary to the FSB's aim to create an international level playing field. If the exemption is justified by different market conditions in EME countries, then it should also apply to foreign subsidiaries of G-SIBs competing in such countries, applying the principle of national treatment by adjusting the external requirements for resolution entities. This would apply to MPE banks in relation to their subsidiaries' external TLAC and to SPE banks in relation to their subsidiaries' internal TLAC.

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

The Pillar 2 TLAC requirement adds further complexity to the proposed framework. It is also not clear how the Pillar 2 TLAC requirement is intended to interact with the Pillar 2 requirement on capital according to Basel III (in the EU, the Pillar 2 requirement emanating from CRR and CRD 4).

Pillar 1 is cleaner, more uniform, and more transparent both for investors and more broadly as a statement on progress made on "too big to fail." Pillar 2 refers to the possibility for national supervisors to impose a wide range of measures (including additional capital and liquidity requirements) on an individual and on a consolidated basis in order to address higher-than-normal risk.

From a resolution perspective, however, most of the issues that might be considered to justify Pillar 2-type TLAC additions are already covered by Basel Pillar 2 capital requirements, resolvability assessments, the TLAC analysis, or the Basel capital and buffers, and the way in which TLAC comes on top of those requirements.

Given the very high level currently envisaged for Pillar 1 TLAC, the FSB should make it clear in the Term Sheet that additional Pillar 2 requirements are not to be misused, for e.g. further elevation of existing capital requirements at the national or regional level. If an additional Pillar 2 requirement is introduced, it should be limited only to those cases where there are significant shortcomings in the recovery and resolution planning of the G-SIB. It follows that the level of any Pillar 2 charge would be expected to reduce over time as such impediments were resolved. That would allow authorities to adjust the overall TLAC to existing specific national circumstances, e.g. in jurisdictions where existing capital levels are extremely high in an international comparison. Furthermore, if a Pillar 2 component is introduced, then the Term Sheet should make it explicitly clear that a G-SIB's capital used to meet any Pillar 2 capital requirements can be used to satisfy the TLAC requirement. In any case, it should be clarified in the Term Sheet that Pillar 2 is not required for subsidiaries that are not a point of entry in resolution.

Prepositioning

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?

In principle, if credible group resolution strategies and plans are agreed and in place and there are robust arrangements for cooperation between national authorities, there should be no need for prepositioning in the form of cash lending. If pre-positioning is considered necessary as a vehicle to ensure loss-transmission within a group or to enhance the credibility of the resolution plan then we agree there needs to be an agreed basis for resolution authorities to identify the material subsidiaries which should be subject to the requirement.

We therefore support the concept of a minimum threshold (5% seems reasonable) to identify the material subsidiaries for the resolution plan. We believe that the internal LAC should also only be applicable in case where material subsidiaries are carrying on activities that are considered critical economic functions globally and are contained in regulated operating financial institutions, i.e. material in the context of the resolution group.

Finally, we believe that there are some circumstances where prepositioning of TLAC is not necessary under any circumstances, not even in exceptional cases. This would e.g. apply to a single jurisdiction or where a legal cross-border framework exists with clear common rules for bail-in and for legal recognition, allowing an orderly resolution.

Where TLAC is required as a loss transmission vehicle to move losses up to a resolution entity, this can be achieved by other methods (such as guarantees) than the provision of cash funding.

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?**

We acknowledge that, in the limited circumstances quoted above (absence of credible resolution strategy, recovery situation), requirements on prepositioning could increase confidence of host authorities. However, an internal LAC requirement should be set as low as possible - and considerably lower than the range suggested in the term sheet - according to the resolution strategies adopted by the group, which are indeed defined by the host and the home authority jointly**.**

The sum of 75-90% of the standalone TLAC requirements might well exceed the 100% TLAC requirement for the consolidated balance sheet. The reason for this is that a banking group will typically hold legal entities with different characteristics. For some leverage will be the constraint, others will be more geared towards higher RWA lending, some might have a natural need for external debt instruments whereas others might have funding surpluses. By applying all constraints that apply to TLAC (e.g. higher of leverage and RWA) also to the internal LAC requirements for business units, the sum of these requirements might well exceed the consolidated standalone external TLAC requirement (even after the 10-25% haircut is applied). Our members believe this to be a virtual certainty and this should be examined through the forthcoming QIS. This would of course become an even greater problem if internal TLAC requirements were based on RWA's including inter-company trades. Since intercompany trades are captured in existing subsidiary capital requirements any internal prepositioned internal LAC should be distributed based on 3rd party RWA excluding intercompany.

The real issue is a lack of trust across different regulators and resolution authorities, and what is really needed is a well-functioning framework for cross-border cooperation. Prepositioning leaves host regulators with an adverse incentive to draw the internal TLAC too early, to the detriment of the consolidated situation. Therefore, a more limited level of prepositioning would better balance the incentives between jurisdictions. In addition, in jurisdictions where material subsidiaries are subject to the same resolution authority as the resolution entity to which they belong to (no home- host issues), no internal TLAC should be required.

Furthermore, the requirements in the TLAC Term Sheet should be sufficiently flexible on the features of eligible internal LAC instruments, taking into consideration operational difficulties to issue debt within certain jurisdictions. For example, the competent authority's mandate to require that internal LAC eligible instrument fulfil certain characteristics, should be limited and foreseeable, in order to ensure a level playing field and an appropriate degree of legal certainty.

Furthermore, prepositioning should be achievable by off-balance guarantee structures to exclude the additional leverage and suboptimal balance sheet structures within the same group. A specific and appropriate accounting, capital and leverage treatment should be provided.

We therefore propose that the FSB considers how the use of guarantees could pose an alternative method to fulfil a potential requirement on prepositioning, in order to facilitate the distribution of funds to material entities.

Eligibility

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

No, we do not believe that they properly and sufficiently reflect the different ways the FSB Key Attributes have been implemented in the different jurisdictions. We are in particular concerned that the combination of currently worded TLAC eligibility requirements and the current wording of BRRD closes many avenues to EU G-SIBs seeking to reach TLAC requirements, be it via structural, statutory and to a lesser extent contractual subordination, as many continental European banks will have no other choice than to issue Tier 2 instruments. Our opinion is that the criteria set out in the FSB proposal are not neutral to different banking models and corporate structure because they overly consider a holding company at the top of the group structure as a preferred model.

Thus, the TLAC discriminates against banks who currently have an operational company at the top of the corporate structure, and those which are required by competent authorities to hold very high levels of CET1 capital in relation to convertible instruments. While we understand that the composition of TLAC must be as ascertainable as possible and unquestionably bail-inable, there is no reason to exclude from TLAC senior debts that are *pari passu* with other senior liabilities in the insolvency hierarchy, but subject to a statutory bail-in regime. This is precisely the case for the definition of MREL and bail-in eligible liabilities in the European BRRD regime, with which the requirement for subordination under TLAC enters into conflict.

The statutory subordination regimes today applicable in Europe are not compatible with the eligibility requirements expressed in the TLAC term sheet, meaning that this form of subordination is not accessible for European banks.

Section 13 of the proposed Term Sheet permits senior unsecured debt, which is not subordinated according to points 13. a-c., to be counted towards TLAC for 2.5% if the authorities are satisfied that such liabilities could be written-down without a material risk of successful legal challenge or valid compensation claims. If the authorities are satisfied that they would be able to cope with NCWOL restrictions, then it is not clear why the inclusion of senior unsecured debt should be limited.

If it does become essential for debt to be subordinated in order to qualify as TLAC, the FSB should bear in mind that many European G-SIBs have covenants in their existing Tier 2 debt that makes it impossible for them to issue any form of 'less subordinated' or Tier 3 debt. Moreover, the current wording of BRRD makes it extremely difficult to reconcile 'contractual bail-in instruments' with the TLAC requirement in the form of anything other than Tier 1 or Tier 2 capital instruments. We do believe that the FSB intends that TLAC requirements be met with such capital instruments, but that may currently be the consequence of the interaction between TLAC and BRRD.

The FSB TLAC's Term Sheet point 9 states that "All regulatory capital instruments issued by the resolution entity or resolution entities of a firm and held by third parties are eligible to satisfy the minimum TLAC requirements". The "third party" concept is not clear whether it refers to the resolution group or the whole group. For an MPE banks, the parent should be considered a third party from the resolution standpoint to all subsidiaries that are resolution entities. Therefore, we consider that any additional Tier 1 and Tier 2 instruments should count towards the subsidiary's TLAC irrespective of whether it was issued to the parent or to another investor.

We disagree with the proposed prohibition on the inclusion of structured notes in TLAC, where these satisfy all requirements otherwise applicable to eligible TLAC instruments. Structured notes are not conceptually different from plain vanilla instruments with hedges such as currency swaps or fixed/floating swaps. A structured note is equally capable of being written down or converted as a vanilla note, as both are unsecured claims on the balance sheet. It is not logical to give a higher ranking to structured notes than vanilla notes. We recognise that some features of structured notes may make them appear more operationally complex to bail-in, and suggest that they should be permitted to count towards the requirement if the bank can demonstrate that the notes can be readily written down without giving rise to valuation or legal uncertainty. This would also contribute to enhancing the pool of investors in TLAC-eligible debt.

Also, maturity restrictions should be very carefully reviewed, since they could create a cliff effect in funding markets (Term Sheet point 11). The effect of the current proposal would appear to be to incentivise banks to redeem funding with a residual maturity of less than one year. Consideration should be given to means of alleviating such cliff effects. An alternative might be to allow no more than a concrete percentage of a firm's TLAC requirement to be met by instruments that have a remaining maturity of less than 12 months or apply a haircut to those liabilities following the same philosophy as the NSFR (Net Stable Funding Ratio), for example a 50% haircut. We would also urge that the FSB analyse the market impacts of using the same 12 month cut-off in both TLAC and NSFR.

Finally, the requirement for supervisory approval before eligible external TLAC can be redeemed is overly broad (Term Sheet point 15). The requirement that banks must receive supervisory approval when redeeming eligible external TLAC (except when replacing eligible TLAC with liabilities of the same or better quality, and when the replacement is done under conditions which are sustainable for the income capacity of the bank) gives rise to a concern that institutions may be put in the position of constantly having to seek regulatory approval for ordinary course events (general retirements, calls, tender) in relation to plain vanilla debt.

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 expectation that 33% of the requirement should be met with debt, may become restrictive if outstanding senior debt cannot be used to fulfil it. In theory, this provision would have the effect that supervisors could come to the conclusion that even though a bank may hold enough core capital to fulfil the quantitative level of the TLAC requirement, the bank may be deemed "non-compliant", because it does not have "enough" debt corresponding to this 33% criteria. The idea that there might be circumstances where it is better to have debt rather than equity as loss absorbing capital is very hard to justify. Everything else equal, it should always be better to have loss absorbing capacity in the form of equity. Therefore, the FSB should consider abolishing this proposal or at least being clear that this expectation should not be a hard requirement. It should also be clarified that this expectation does not apply to internal LAC (which is implicit given the option to provide guarantees).

Moreover, the 33% debt requirement may have unintended consequences for highly capitalised and deposit-funded banks, especially in emerging markets. This requirement sets up a conflict between prudential policy and resolution policy in that it would create incentives for them to reduce CET1 and increase reliance on debt, a result that seems odd in light of traditional prudential concepts and policies. If authorities do not allow banks to reduce the CET1, they may be forced to leverage their balance sheets artificially or to reduce their deposit funding base.

There will be cases where, for various business or regulatory reasons, it makes sense to maintain the entity on a highly capitalised basis rather than resorting to debt. This is the case, for example, for MPE subsidiaries located in financial systems funded mainly with deposits (loan-to-deposit <100%), often located in emerging markets, where the subsidiaries may be forced to leverage their balance sheets or be driven to a riskier "yield searching" strategy.

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 propose that the FSB rephrases the exemption, so that it better fits the different jurisdictions to which the TLAC proposal is envisaged to apply. For example, ex ante financed resolution funds already exist in several jurisdictions, and in the banking union area of the EU a Single Resolution Fund (SRF) is being set up, and is expected to facilitate the orderly resolution of banks.

Resolution funds which are sufficiently pre-funded by banks and can guarantee back-up funding by central banks and/or have access to financial stability funds, represent a credible financial resource to support resolution. Therefore, the EBF recommends that these pre-funded commitments should be taken into consideration when setting the final TLAC requirement.

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 loss 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?**

As said before, we understand the intent to restrict TLAC to debt that clearly absorbs losses in resolution, and that the requirement for subordination (structurally, contractually or statutorily) is a way to secure that this objective is met. Nevertheless, this requirement does not take into account the local resolution regimes.

Under the EU Bank Recovery and Resolution Directive, BRRD, un-preferred bail-inable senior un-secured bonds with longer maturity (remaining maturity longer than one year) are fully eligible for the MREL (Minimum Requirement for Eligible Liabilities and Own Funds). The rationale behind this is that the resolution regime under the BRRD provides a credible and legally enforceable mechanism to statutorily bail-in of senior un-secured bonds governed by the laws of the EU Member States. In the FSB proposal, however, such senior un-secured bonds may only be counted as eligible TLAC instruments under certain circumstances and to a very limited amount, i.e. 2.5% of a G-SIB's RWAs (see also under question 6). We believe that the FSB should recognise senior debt and other investment liabilities without limitation, provided that the jurisdiction in question has a credible bail in regime in place to call on these instruments to absorb losses.

The proposal that banks with a Holding Company (HoldCo) structure can use existing/or issue senior unsecured bonds to meet the TLAC requirement, whereas other banks will either need to establish a HoldCo or issue new TLAC compliant instruments from their Operating Company (OpCo) creates an unlevel playing field for banks which currently do not have an established HoldCo structure, or which have a HoldCo structure from which they have not issued debt in the past. Banks without HoldCo's would face considerable legal and tax constraints on the creation of a HoldCo.

Banks with a HoldCo but little existing issued debt will also face the costs of re-issuing existing OpCo debt through their HoldCo structure, or engaging in a liability management exercise, and are likely to face a cost premium for HoldCo debt, especially if it needs to be downstreamed in subordinated form to count as internal TLAC at the OpCo level. Overall, this introduces disproportionate costs for EU banks to implement TLAC, versus banks already structured with a HoldCo issuance model, as they either face costly restructuring or issuance of expensive subordinated debt or untested "Tier 3"-like instruments (which may not be available to most European banks given existing debt covenants). In this context, consideration should be given by the FSB to clarify that the Term Sheet already allows debt issued by SPV structures to qualify as TLAC. This option is not simple, and will require in-depth analysis to make it workable under TLAC rules. However, the option to allow 'Holdco-like' issuance without imposing the creation of a holding company structure should be acknowledged.

The FSB has, to date, stated it is neutral as to the legal structure of banks and evidence from the BIS, IMF, ECB and others has shown that diversity in banking structures can be a strength in a systemic crisis. To ensure that the TLAC proposals – per the stated aim of the FSB – create a level playing field, they should be structure-neutral. If an individual bank is determined to need legal or structural changes to be fully resolvable, this is a matter for its crisis management group. This measure should only be taken where proportionate and necessary to address barriers to resolution. By recognising HoldCo senior debt and excluding senior debt from operating parent companies, even under the same bail-in regime, the FSB is effectively prescribing that banking groups should change their legal structure from a sibling structure to a HoldCo structure. Given the magnitude of that implication we believe the final Term Sheet should take full account of the evidence obtained through the QIS and impact assessment of the additional costs of subordination for different banking models.

Also, it is not clear how a HoldCo structure would work in practice in a resolution situation. We would ask the FSB to encourage clarity from national resolution authorities as to whether or not internal debt issued by an OpCo to HoldCo would be treated *pari passu* with external debt of the same class issued by the OpCo.

We therefore advocate that instruments which are expected to be bailed-in, e.g. issued in an environment with statutory bail-in, should be considered in the FSB Term Sheet as equivalent to those with a contractual bail-in clause. Investors would then know that the instrument could be bailed-in and would treat the instrument as if the contract would specify it as available for bail-in.

Interaction with regulatory capital requirements

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?

According to Principle 7, in the Term Sheet, a bank which meets the part of the TLAC requirement above the minimum capital requirements, with mostly debt, but may (due to market conditions) not be able to replace this debt as it matures, will become subject to restrictions on dividend payouts, because it will need to use capital to replace the matured debt and may therefore breach its capital buffers. In our view, the breach of the buffer requirement under such particular market conditions, leads to a *de facto* elevation of the capital requirement. We recommend the FSB reconsider the consequences that are outlined of a breach of the TLAC requirement.

Furthermore, given that banks will need to renew debt instruments for TLAC more frequently than what can be expected for capital instruments eligible for capital requirements, banks will have to manage the refinancing risk of their TLAC instruments. In practice therefore, we think it is very likely that banks will adopt a "management buffer" well above the TLAC minimum (and buffers) to avoid the risk of temporarily being unable to refinance. This is in addition to regulatory tools suggested elsewhere in the Term Sheet to avoid this risk. We recommend the FSB also carefully analyses this aspect in the QIS.

In addition, the methodology requires the application of capital buffers to mitigate systemic risk also at national and regional level as well as in the Pillar 2 requirements in many jurisdictions. We believe that the requirement that TLAC shall be used to rebuild "buffers" should apply only to the Basel III Pillar 1 buffers (i.e. the capital conservation buffer and the countercyclical buffer), and to the G-SIB surcharge. This needs to be explicitly stated in the Term Sheet.

See also the response to Question 1 regarding the interplay between TLAC and Basel III capital framework where twice the leverage ratio requirement is used as a constraint for the minimum TLAC requirement. We strongly believe that the FSB needs to clarify that CET1 held towards buffers would count towards the TLAC leverage requirement. Otherwise, this would be inconsistent with the Basel III framework. This would also create confusion about its interpretation and exacerbate the risk the leverage ratio becomes a new binding constraint instead of – as intended – a backstop. Consideration should be given to, for the purpose of calculating the part of TLAC envisaged as a backstop, establishing a sensible balance between RWA based requirements and leverage-based requirements.

Transparency

11. What disclosures (in particular in terms of the amount, nature and maturity of liabilities within each rank of the insolvency creditor 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?

The Basel Pillar 3 requirement ensures that the features of capital instruments are disclosed. For senior debt, a general information on the amount of debts subject to bail in should be sufficient to avoid confusion in investor's mind between TLAC debts and non-TLAC bail-inable debts.

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?

It is essential that allowance be made, if TLAC is to benefit from a liquid market, for market making activities. Restrictions on holdings of TLAC should not be more severe than those already in place under the Basel framework of deductions (for capital instruments) or under large exposure rules.

Should the deduction be applied, it would be necessary to exclude them being applied also to indirect holdings of TLAC.

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?

It is difficult at this stage to assess what conformance periods are necessary. The new rules on TLAC are to be applied and implemented in many different jurisdictions around the world. The regulatory process differs from jurisdiction to jurisdiction, and so does the timeframe in which regulatory proposals can be implemented and enforced.

Nevertheless, the impact assessment should inform the final deadline. In particular, if numerous G-SIBs have to issue TLAC instruments at the same time, a phase-in period should be envisaged to ensure that institutions have sufficient time to space out these issuances.

Concerning EU head-quartered banks in particular, their ability to satisfy TLAC requirements may be dependent on legislative or regulatory evolution, given the recent entering into force of BRRD. The delays necessary to clarify the regulatory and legal back-ground before building a TLAC capacity should be taken into account. When it comes to the topic of newly identified G-SIBs, we believe that a 24-36 months conformance period would be more appropriate.

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?

The historical loss analysis should inform the appropriate level of loss-absorbing and recapitalisation capacity.

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

The funding cost will depend on the amount of new TLAC debts to be issued, the market depth and There is no doubt that issuing debt under new conditions will affect the funding costs of European G-SIBs negatively. In particular, the subordination feature will lead to a substantial increase of funding costs when huge amounts of subordinated debt have to be absorbed by limited investor base in a short space of time.

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

The final calibration of the TLAC requirement should be guided by the concurrent Quantitative Impact Study (QIS). The calibration needs to factor in the broader regulatory reform agenda to ensure that the combined requirements do not place an excessive burden on the financial system and the economy beyond what constitutes a reasonable and affordable layer of loss absorbing liabilities funded by banks. An excessive calibration would jeopardise key critical lending activities of the economy such as SME or consumer lending.

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

The EBF has no further comments.