To
Financial Stability Board

Subject
ING response to the FSB consults on proposal for a common international standard on Total Loss-Absorbing Capacity (TLAC) for global systemic banks

Date 2 February 2015

General comments

The recent financial crisis violently kicked in when professional institutional investors decided to withdraw their funding from banks, sparked by fear for credit losses and unmanageable capital requirements in most notably the investment portfolios of these banks. For ING, but for many other banks alike, the core banking franchise proved to be solid which allowed us to perform what we believe is our main mission: offer customers an attractive outlet for their savings and cash, and support the real economy by lending out to those customers in need of credit.

ING is committed to preserve its core banking franchise and took the necessary measures during and post crisis to strengthen its going concern balance sheet by virtue of a lower risk profile, a larger capital base and a more liquid and better quality investment portfolio.

At the same time, steps were taken to better prepare for the event of a gone concern situation: recovery plans and resolution plans were drafted by banks and regulators respectively.

For G-SIBs, on top of these plans, additional loss absorbing capacity is needed to ensure that, in case of a default, these financial institutions can be resolved in an orderly manner without taxpayer support. Although we understand and support the concept of bail-in debt to increase banks' gone concern loss absorption we are concerned about extent to which the going concern balance sheets of banks is impacted by gone-concern considerations.

A retail bank like ING, which is meeting the Basel III capital and liquidity requirements and sees that reflected by a great deal of trust witnessed by a large and diversified customer deposit base, does not need additional professional funding to finance its going concern franchise. If the new TLAC regulation forces banks to raise professional funding for which they have no immediate employ this seems to run counter to the intention of TLAC. We are concerned about these unintended consequences of TLAC and look forward to work with the FSB to come to a more appropriate calibration.

Response to 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?

ING believes that Basel III buffers (countercyclical, SIFI, and capital conservation buffers) should be recognised and count as part of the 16% -20% TLAC requirements. As such, they should not come on top of the requirements as currently being proposed. Breaching these buffers will not be accepted in the market. Investors will shy away from a company which is in breach with its buffer requirements and consequently restoring the buffers will become a challenge, which will only increase the risk of the bank reaching the PONV. In case the buffer requirements are not included in the TLAC requirements, the currently envisaged 16-20% range should be lowered to avoid double counting and overlap of buffer requirements.

In the opinion of ING, the suggested range of 16-20% of RWA would result in more than ample buffers to support recapitalization and resolution objectives. At the same time, we believe such wide range is undesirable and may distort the global level playing field. The end state requirement should be calibrated towards the lower end of the envisaged spectrum, i.e. 16%. This is supported by evidence from the most recent ECB stress test under which common equity Tier 1 ratios for a select group of well diversified banks would fall by less than 3% in the adverse scenario. Exceptionally higher losses will most likely come from less diversified banks with activities concentrated around a small number of activities.

The leverage ratio is a transparent but simple ratio that does not give insight about the risk profile of a bank. As a consequence, it is not useful as a measure for the adequacy of available loss absorbing capital versus the bank's activities. For that reason, ING would advice not to use the leverage ratio as the basis of the TLAC requirement.

The amount of additional eligible professional funding is calibrated to be twice the amount of the going concern capital requirement. The reasoning for this is that banks should be able to recapitalize in full after the entire going concern Basel III capital base is wiped out. This is however based on simplified and conservative assumptions and does not take into account that banks coming out of a crisis (i.e. after recovery and resolution plans have been executed) will be smaller in size and less risky[1]. The TLAC requirement should at least take account of the risk reduction that will be the result of recovery measures and as a consequence the reduced capital that is needed during resolution.

Finally, local leverage requirements may be set at a higher level than envisaged in the Basel III standard, reflecting differences in business models and local funding practices. We note however that this will further distort the global level playing field and we would advice not to consider this as the basis to determine TLAC requirements. ING recommends the leverage requirement, if implemented, is equal to the harmonized CRD IV leverage ratio 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?

This exemption should be clearly phrased in a way that determines exactly what an EME is. In addition rules should be set on how (and when) the exclusion will end. The risk of regulatory arbitrage should be minimized to the extent possible. It is unclear what is meant by 'initially'.

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

Pillar 2 relates to the possibility for 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,

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[1] ING had EUR 343bn in RWA at EOY 2008 versus EUR 279bn at EOY 2012 ; KBC decreased from EUR 155bn to EUR 102bn over the same period ; Socgen showed a decrease from EUR 346bn to EUR 324bn while RBS dropped from GBP578bn to GBP460bn.

most of the issues that might be considered to justify Pillar 2-type additions are already covered by Basel Pillar 2 requirements, resolvability assessments, the TLAC analysis, or the Basel capital and buffers, and the way in which TLAC comes on top of those requirements. Resolution authorities should therefore refrain from imposing additional Pillar 2 requirements.
In addition the inclusion of Pillar 2 requirements for TLAC would not be advisable from a practical point of view, since this hampers a thorough and consistent capital planning process because these requirements can be unpredictable and volatile.
Last but not least, pillar 2 requirements are not transparent nor disclosed in most jurisdictions, which is considered to be an important element to safeguard market confidence. Consequently, it will be impossible for investors to judge whether or not a bank is in breach of its TLAC requirements. Pillar 1 is much cleaner, more uniform, and more transparent both for investors and more broadly as a statement on progress made on addressing the too-big-to-fail issue.

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?

For banks applying a Single Point of Entry (SPE) strategy, where bail-inable debt instruments are typically held at the holding company, it is important that the regulation is drafted in such a way that it makes the group stronger as a whole. For this reason ING is not in favor of prepositioning/internal TLAC as being proposed. In our opinion diversification benefits are important and should be recognized. Having sufficient external TLAC at the holding company for all subsidiaries together offers more comfort and flexibility than a relative small fixed amount at every subsidiary. In addition, too much prepositioning (above local capital requirements) hampers the flexibility of allocating capital and should be avoided. (Especially in times a subsidiary is in trouble, reallocation of capital could be an issue).

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?

The adverse effects of too a high level of additional loss absorbing capacity are further exacerbated when pre-positioning is introduced. We have 4 reservations with prepositioning.

a) First, by cascading down TLAC requirements to constituent entities, the concept of TLAC, which is intended to arrange the 'too big to fail' conundrum for GSIB's, will trickle down to banking entities that on a standalone basis would not qualify as a GSIB. These entities will be put at a competitive disadvantage vis-à-vis local peers that don't have to carry the cost of prepositioned TLAC instruments.

b) Second, pre-positioned TLAC for a banking subsidiary would need to be at 75-90% of the standalone TLAC requirement of that banking entity. Although we certainly agree with the concept of intra-group diversification when it comes to realization of losses, we argue that the discount of 10-25% is actually too small and risks to be wiped-out under its current design: the sum of 75-90% of the standalone TLAC requirements might well exceed the 100% standalone 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 entities 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 for TLAC (higher of leverage and RWA, 33% minimum holding in non CET1 capital also to the internal TLAC 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 being applied).

c) Third, pre-positioning could lead to crowding-out part of the existing funding base. This is especially the case for banks with a strong Loan-to-deposit ratio, who need to replace part of their existing funding base with professional funding. This will also put pressure on the intermediation role of a bank, as it will need to be more selective and less attractive for certain deposit holders.

d) Finally, pre-positioning should facilitate the execution of the resolution plan. Allocation keys based on going concern relevance of the different legal entities (% of total BS or RWA) are not in line with the spirit of TLAC. The problem is that a too explicit reference to the resolution approach, to determine the appropriate prepositioning of capital and quasi-capital among legal entities, will give wrong incentives and hamper the functioning of the institution in a going concern situation. This however, does not justify the current generic approach to require internal TLAC (based on generic thresholds in terms of RWA, revenues, etc).

In addition, ING is concerned about the internal requirements in an economic downturn. In the absence of a well-functioning framework for cross-border co-operation, national regulators may be tempted to trigger the bail-in option too early, to the detriment of the consolidated situation. As a result it will hamper the bank's intermediation role in a wider European context whereby excess funding in one country can be deployed in areas where economic activity is required; this is in contradiction with the basic principles of the creation of a single European market, aimed at the free movement of capital.

If pre-positioning is nevertheless maintained, we believe that prepositioning should not be required within the banking union where there is both a single supervisory and a single resolution authority (i.e. no pre-positioning requirement for European subs of a European GSIB).

Furthermore, the discount for internal TLAC should be in the range of 35-50%, higher than the proposed 25-10%, as due to the current design the effective discount will be much lower.

A specific and appropriate accounting, capital and leverage treatment should be provided (i.e. if a holdco would need to downstream capital, it has to provide a subordinated loan to its subsidiary; a subordinated loan requires a certain level of capital on holdco level (stand-alone), requiring it to hold more capital / TLAC).

Finally, pre-positioning should be achievable by off-balance guarantee structures to prevent the additional leverage and suboptimal balance sheet structures within the same group. Therefore, rules should be created to neutralize these adverse effects. The pool of collateral should be sufficiently broad and not be restricted to central bank eligible assets only.

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?

In the opinion of ING, all opco senior unsecured term debt should count towards TLAC. In our view, legislation should provide the necessary legal clarity and should ensure that bail-in of senior debt instrument should not give rise to material risk of successful legal challenge or valid compensation claims. In the EU this would imply that either opco senior should be subordinated by statute to other senior debt instruments or that preference of all excluded liabilities in the TLAC term sheet should be arranged via the BRRD ex ante. It should not be at the discretion of the relevant authority to determine if these instruments should qualify for TLAC or not.

Also, by taking in consideration opco senior debt as eligible instrument, there is no preference for any legal structure across different jurisdictions. The result is a larger pool of eligible instruments which in itself reduces refinancing risk in case markets are (temporarily) closed for certain specific capital instruments.

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?

We view a company should be free to choose to fulfill the TLAC requirements with 100% CET1. This would be sufficient to absorb losses calibrated by the minimum capital requirements and to end up at the required capital levels. It would enable banks to go into an orderly resolution in a way that minimizes any impact on financial stability, ensuring the continuity of critical functions, and avoiding exposing taxpayers to losses.

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 question the appropriateness of this measure as it might potential distort the level playing field. For example, is the size of the fund in one jurisdiction sizeable enough to cover for multiple bank failures, so is it realistic to assume this can be included and does it not create moral hazard?

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?

These FSB principles can only provide legal certainty if they are properly implemented in the applicable national laws, see also our response in relation to question 7.

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?

CRR/CRD IV lays out the minimum regulatory requirements for a going concern while BRRD and TLAC lays out the principal requirements to meet an 'adequate' capitalization going into resolution. Consequently, ING believes CRR/CRD IV minimum capital requirements and required capital buffers should be met first. Any surplus common equity Tier 1 should subsequently be used to meet TLAC requirements.

It follows from the above that we are not supportive of the proposed 'hierarchy' in this consultation as it could cause a bank, that is not able to refinance debt due to market circumstances, to run into MDA restrictions in spite of the fact that its (going concern) CET1 capital is sufficient.

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 investors' mind between TALC debt and non-TLAC bail-inable debt.

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?

We support the view that G-SIBS should not be holders of each other's TLAC instruments.

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?

The implementation date needs to be determined by taking into consideration the time it takes for TLAC requirements to be effectively implemented in law within the separate jurisdictions. This process may vary per continent as different regulators are involved.

Secondly, the actual timing may also be impacted by the type of instruments that will be included and consequently the average duration of these instruments. A five year period post final proposals should be sufficient in general.
In terms of conformance period we think, in case senior opco debt will be included, a 24-36 months would be more appropriate following the identification as a G-SIB. In case senior opco will not be included, we advocate a substantially longer phase-in period. In addition, identification as a G-SIB should be treated with care in order to avoid that Banks qualify as G-SIB in year 1, fall off the list in year 2 etc.

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?

While we are supportive of increasing the loss absorbing and recapitalization capacity in order to make G-SIBs resolvable we think the calibration is too conservative. It will force a bank like ING to raise funding for which we have no immediate employ. This means that either the investment portfolio of the bank will grow or customer deposits will be crowded out by wholesale funding. In either case the bank will be less resilient on a going concern basis. We therefore look forward to the QIS and work on a more appropriate calibration together with the FSB.

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

Next to the obvious substantial higher funding costs related to requiring higher loss absorbing capacity in G-SIBs, there will most likely also be material additional funding costs caused by the uncertainty around the creditor hierarchy. The resolution regulations and TLAC requirements still embed substantial discretion for resolution authorities. The outcome may in the end be inconsistent with the debt waterfall that would be expected in case of an insolvency. Uncertainty for investors inevitably leads to additional funding costs for G-SIBs and will go at the cost of the efficiency of the banking system. G-SIBs will try to pass this foreseen material increase in their overall funding costs to the real economy. We clearly foresee large negative consequences for the already lagging credit demand which will be detrimental for future economic growth. Smaller banks simply do not have sufficient resources to take over the inevitably decreasing credit provision resulting from these new regulations.

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

Next to the absolute increase in capital or capital-like instruments 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 3 capital requirements, which already suffer from a great deal of pro-cyclicality. This means that banks will need to increase their capital as well as their TLAC buffers in times of economic downturn (when RWA will increase).

Pro-cyclicality is further increased by the proposed consequences of TLAC buffer breaches. In the current proposals, market disturbing measures like dividend or coupon payment suspensions are already imposed from the slightest drop below the TLAC minimum and regulatory buffer minimum (ie. 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 will only be possible, either through reduction in lending assets or through organic capital generation. We advocate a less disruptive approach in case of TLAC buffer breaches and a longer restoration period for repairing breaches.

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

There has been a lot of speculation about the question whether there is sufficient investor appetite to absorb all of the new debt that needs to be issued by GSIBs. Needless to say that this could be an issue, in which case the cost of the framework to the wider economy, that we referred to in some of our answers above, would increase further.