INSTITUTE OF INTERNATIONAL FINANCE

gfma GLOBAL FINANCIAL MARKETS ASSOCIATION

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Financial Stability Board
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**IIF-GFMA Response to FSB Consultation on *Guiding Principles on the Internal Total Loss-Absorbing Capacity of G-SIBs ("Internal TLAC")***

Dear Sirs:

The Institute of International Finance and the Global Financial Markets Association (the "Associations") appreciate the opportunity to contribute to the discussion of the captioned Consultative Document and look forward to further exchanges with the Financial Stability Board on this important topic.

## General points

The Associations appreciate the ongoing effort of the FSB to finalize and embed all aspects of the Key Attributes regime on an international basis, including internal TLAC. The Associations further support the objectives of ensuring an internal structure in each G-SIB that supports the key objectives of successful resolution. Despite their great appreciation for the very constructive intellectual and policy leadership of the FSB on bank resolution principles to date, the Associations are concerned that the draft Guidance in its present form does not fully achieve the goal of clarifying the Term Sheet and may even tend to undermine coherent, collaborative group approaches to resolution.

Recognizing that the FSB can only provide guidance, and respecting the legitimate concerns of hosts, nonetheless the draft Guidance appears in some areas to provide insufficient emphasis on the group resolution plan agreed through CMGs. The industry would like to see more balance to provide guidance emphasizing a cooperative, group approach to resolution agreed in CMGs and led by home authorities. This in turn would advance the purposes of the FSB's approach to effective, efficient cross-border resolution, reducing the risk of local ring-fencing, fragmentation of approaches, and misallocation of resources as a result of the accretion of unnecessary levels of internal TLAC.

The final Guidance should increase its focus on supporting firms' recovery and resolution strategies, which are now quite robust after lengthy work, debate and review. This applies equally to the SPE approach to recovery and resolution, where the structure aims at assuring

strong group resolution from the top, and to MPE groups, which have been building strong and coherent resolution-entity structures. Section 18 of the Term Sheet includes a statement that internal TLAC should be "distributed as necessary within resolution groups in proportion to the size and risk of exposures of its material sub-groups."[1] This is an appropriate principle to support group integrity and effective resolution, and will ultimately be better in supporting host interests than if hosts appropriate disproportionate internal TLAC for their own entities. For this reason, it would be helpful if the guidance were focused on more collaborative, home-led structures, with guidance aiming at incentivizing cooperative behavior among all relevant authorities, to support the best result for all, avoiding unhelpful competition for resources at any stage.

CMGs should avoid local requirements for excessive downstreaming of resources, which could lead to loss of internal flexibility and misallocation risk, as discussed herein. At the least, the final Guidance might enter into more detail about policies and procedures for home/host consultation and use of CMGs to assure coherence of setting internal TLAC. The goal should be to assure that there is appropriate focus on the broader question of what degree of protection for hosts is appropriate, and how to achieve it in ways that make sense overall. Such a focus should, in turn, aim to avoid the detrimental effects of excessive internal TLAC structures that would work against FSB cross-border objectives. This should be agreed through the CMGs rather than by host authorities' ultimately determining internal TLAC requirements, albeit in consultation with home authorities.

But the draft Guidance in its current form might be misinterpreted in a way that would lead to fragmentation and inefficient use of global resources. FSB guidance on a cooperative group approach focused on the group's resolution strategy would help mitigate this misinterpretation risk. The focus in the current draft on a leading role for hosts may lead to the problems of Superequivalence, misallocation risk, and imperfect balance between home and host concerns, as discussed below.

The final Guidance should acknowledge that resolution planning has evolved since the FSB Term Sheet provisions on internal TLAC were finalized in November 2015 and that the internal TLAC guidance should be implemented in a manner that provides flexibility to authorities and firms as those standards continue to evolve and encourages coordination and cooperation among home and hosts. In short, the final Guidance would be much more useful, and more consistent with the FSB's good work to date, if it would give greater emphasis to the concept of internal TLAC (which is to say, group funding structures) as part of the overall, cooperative resolution planning process.

The final Guidance in sum could do more to promote cooperative effort of home and host authorities in order to assure coherent, effective use of group resources in resolution. This can be achieved through a number of clarifications. Furthermore, the final Guidance would be more helpful to all concerned if it provided for a greater role of the firm in determining the appropriate amount of internal TLAC for its resolution groups by providing its own assessment and

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[1] Financial Stability Board, "Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution: Total Loss-absorbing Capacity (TLAC) Term Sheet." Section 18. November 2015: http://www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf

commenting upon regulatory evaluation of internal TLAC or other issues raised, to be sure that all facts and circumstances are fully taken into account by the authorities in making decisions.

**Consultation Proposal**

In other words, there is a need to revise the Guidance in such a way as to encourage to the maximum extent possible a coordinated group approach toward meeting hosts' concerns. It may be that a specifically focused colloquium among resolution authorities, regulators, law and professional-service firms, and banks on these issues would help to establish the strongest and most constructive guidance that can be devised to assure the best possible results for the international resolution regime.

**Summary of Recommendations**

Here follows a summary of the recommendations made in these comments, in addition to the general comments just given.

- *Superequivalence.* The final Guidance should do more to counter the risk of 'Superequivalence', i.e. the risk that the sum of internal TLAC requirements may exceed appropriate group external TLAC requirements. It seems counterproductive to conclude that there should be no presumption that the host authorities should apply a lower internal TLAC requirement within the FSB recommended range if the sum of internal TLAC requirements exceeds the resolution group's external TLAC. In the view of many members, there should indeed be such a presumption, or at least a presumption that home and host authorities should seek to eliminate the difference, working through the CMGs. Furthermore, there should be a strong presumption against host country authorities increasing internal TLAC requirements during times of stress or calibrating internal TLAC requirements for a stress event, as opposed to meeting the normal requirements of TLAC and the resolution plan.
- *Misallocation Risk.* As the Consultation Paper recognizes, banking groups benefit in robustness and flexibility to the extent they have the ability to deploy resources globally within the group. This is of value to economies and to global stability and should not be discounted. Lack of flexibility to deploy available resources where needed within a group gives rise to misallocation risk. Reducing misallocation risk therefore should be a priority of the FSB in setting internal TLAC requirements.
- *CMGs and Cooperation.* The FSB should set out a fuller framework for home-host cooperation, articulating sound principles for the functioning of CMGs, setting objective criteria to follow when agreeing internal TLAC requirements and contemplating regular reviews and assessments at periodic CMG meetings. The home authority should have the primary responsibility for determining whether internal TLAC at the sub-group level supports the group resolution strategy. Flexibility that allows groups to avoid misallocation risk is important in the interests of the system as a whole.
- *Avoid Ringfencing.* Further guidance to both home and host regulators is needed to make sure that everything possible is done to discourage excessive *a-priori* ring-fencing or fragmentation of group resources. It should be made clear as a policy matter, and in

accordance with the principle of proportional distribution, that host authorities should not seek to command more of the group's resources than is proportionate and necessary to the execution of the group's resolution strategy.

- *Interaction with Firms.* There needs to be more provision for the authorities and CMGs to interact with firms. Firms should be given the opportunity to comment upon proposals, to correct facts, or to refute inaccurate presumptions, about the level of needed internal TLAC. The need to involve the firm in discussions between home and host regulators on internal TLAC and impacts on capital planning should be recognized.
- *Material Sub-groups of Material Entities.* It should be made clear that material sub-groups consist of material entities, rather than an aggregation of individually immaterial entities that additively could meet the quantitative criteria. Aggregation of "sister companies" that are not otherwise part of an accounting or regulatory consolidation would cause unnecessary governance and risk management problems.
- *Determination of Materiality.* Composition of material sub-groups should be guided by the materiality criteria in the Term Sheet and further guidance on the appropriate process and procedures for defining material subgroups. Determinations on materiality should be supported by information that is made clearly available to the CMGs and the firm, should not result in discrepancy to the requirements that apply to other similar firms in the domestic market, and should be subject to review and, in principle, agreement by the CMG.
- *Distribution of Internal TLAC.* The distribution of internal TLAC should be based on the resolution strategy for the group. Regulatory consolidation could be the starting point, but not all entities in scope of application of the going concern requirements require internal TLAC, in particular those not organized as banks and those that could be resolved through normal insolvency procedures. It should be made clearer that operational continuity solutions, rather than internal TLAC, will be more appropriate in all cases for service-center entities, which have no reason to be capitalized as if they were operating banks.
- *Flow of Internal TLAC.* Firms should be able to justify the flow of internal TLAC resources within the group to their resolution authorities, without needing to conform to the simple paradigms set out in the draft Guidance (e.g. the discussion of Guiding Principle 2 at pp. 10-11 and Annex 1; see also the further discussion of the FSB's question 1 on Guiding Principle 2 below). There should not be a requirement to conform to the simple "direct" and "daisy chain" patterns set out in the draft Guidance (e.g. the discussion of Guiding Principle 10, and internal TLAC should be permitted to be issued to wholly owned subsidiaries. In other words, there should be flexibility as to how internal TLAC is issued and held within a group and no presumption that it must be held at the group or parent holding company level.
- *New Asset and Liquidity Requirements out of Scope.* The Guidance should not introduce an asset side or liquidity requirement related to TLAC as seems to be indicated by the

draft Guiding Principle 7. The suggestions that TLAC might need to be held as High Quality Liquid Assets (HQLA) should be deleted from the Guidelines.[2]

- *33% Debt Expectation out of Place.* It is not appropriate to transpose the 33% debt "expectation" to internal TLAC, which would often unnecessarily limit firms' flexibility in deciding the appropriate funding mix for a given situation while not improving the ability of a material sub-group to absorb losses.
- *Triggers not Automatic.* While the draft Guidance discusses judgment and discretion in using triggers, and therefore implies triggers should not be automatic, it should be stated very explicitly that there should not be features in internal TLAC that would trigger automatically upon specific events.
- *Procedures for Triggering.* More detail on the appropriate procedures and criteria for triggering internal TLAC would potentially be helpful. The industry is concerned about the degree of host control of the process: home-country consent should be a firm requirement, subject to override only in extraordinary circumstances, and only after discussion of such circumstances with the home country (and the firm).

**General Discussion**

Before responding to the FSB's specific questions below, the following general discussion provides an overview of views on the issues raised by the current draft.

**Superequivalence**

The draft Guidance recognizes that the sum of internal TLAC may be greater than overall group TLAC requirements, with the result that the group may be carrying more than the intended and appropriate level of aggregate group TLAC ("Superequivalence"). This becomes more likely the higher the percentage requirement for internal TLAC is set in each subgroup. While there is helpful discussion of this issue, the final Guidance could do more affirmatively to counter this phenomenon.

Overall, there should be clearer indications that lower internal percentages will generally be more appropriate: such guidance would reflect the fact that any Superequivalence is likely to arise from intrafirm exposures to other parts of a well-resourced, resolvable group. As discussed under "Misallocation Risk" and "Level of Internal TLAC – Danger of Fragmentation" below, there are good reasons why unnecessarily high internal TLAC requirements are undesirable. If internal structures are properly designed to support an effective resolution strategy – as the considerable efforts expended by firms and authorities should assure – such intrafirm exposures should have minimal risk impact in resolution. As the FSB has recognized, purely accounting

[2] "For example, home authorities may consider it appropriate for surplus TLAC to be held in the form of assets that can be promptly and easily valued, and which are likely to retain sufficient value in times of market-wide stress." Consultative Document, Guiding Principle 7, p. 16.

issues can also lead to Superequivalence because of consolidation effects, and, as the FSB has also recognized,[3] it would be important to remove Superequivalence effects of such accounting.

One means of accomplishing this objective could be to calculate internal TLAC requirements only on external risks and exposures for the relevant material subgroup. Internal exposures within the same group start as liabilities that are already protected by subordinated internal TLAC in the issuing subsidiary, so there should be no reason to charge additional internal TLAC on the assets owned by the "investing" entity. Requiring internal TLAC in both places is a form of double counting and not necessary or conducive to effective group resolution (see the chart attached as Annex A.)

Moreover, the FSB should review through the colloquium process suggested above how changes in group structures, recovery and resolution planning, and business models since the international TLAC term sheet was first published in 2015 should affect the implementation of internal TLAC, and the finalization of the proposed Guiding Principles. For example, in the US, firms and the authorities have been developing concept of secured capital or support agreements between parents and material subgroups.[4] The European Bank Recovery and Resolution Directive is undergoing extensive revision at the moment. Both the international TLAC termsheet and the final Guiding Principles should provide for updating and revision as needed from time to time to reflect future developments in any jurisdiction.

**Misallocation Risk**

As the Consultation Paper recognizes, banking groups benefit in robustness and flexibility to the extent they have the ability to deploy resources globally within the group. This is of value to economies and to global stability and should not be discounted. Lack of flexibility to deploy available resources where needed within a group gives rise to misallocation risk, viz., the risk that resources within a group may be pre-committed to a subsidiary where they may not be needed, at a time when such resources might better be allocated, whether for safety and soundness or for economic efficiency reasons at another part of the group. Given the difficulty of upstreaming excess resources to the top-company or resolution-group level for reallocation in a time of need such as 2008, unnecessarily cutting off excess resources at any entity that could be used to shore up other group entities as needed can contribute to a loss of resilience and responsiveness. This is important both for the efficient operation of the group and (even more importantly) to enable the internal balancing mechanism of the group to deploy resources where most needed across the globe, thus contributing to financial stability and avoiding undue constraints in local jurisdictions.[5]

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[3] Financial Stability Board, "Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution: Total Loss-absorbing Capacity (TLAC) Term Sheet." Section 18. November 2015: http://www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf

[4] See the parallel letter of The Clearing House commenting on the draft Guiding Principles, regarding the evolution of resolution preparation in the US.

[5] It needs to be kept in mind that, in practice, parents will act long before a subsidiary reaches the point of non-viability and will (with very few exceptions historically, mostly in extraordinary political situations), make every effort to avoid the subsidiary's distress. While resolution authorities must, of course, plan for the worst, they should also keep in mind this fundamental fact of group dynamics.

Reducing misallocation risk therefore should be a priority of the FSB and should be given equal weight with other factors that need to be considered in setting internal TLAC requirements (there is already some language about this, but it could be enhanced). As SPE G-SIBs are resolvable at the top for the express purpose of supporting an effective program for the entire group, local-entity TLAC requirements should be set with the goal of supporting overall top-group resolvability, thereby increasing the resilience of global groups, as a priority. *Mutatis mutandis* the same considerations apply to resolution entities within MPE groups.

While giving assurances to hosts is important, the effectiveness and efficiency of resolution across the group in accordance with the resolution plan is the primary concern. As a general matter, a significant portion of the resources derived from the proceeds of TLAC should be allowed to remain at the group (or resolution-entity) level for use as determined by the group where most needed.

A further element that could support the goals of effective resolution at the Resolution Entity level while providing comfort to host authorities would be to eliminate the current linkage between the composition of internal TLAC and external TLAC, as described in Section 18 of the Term Sheet. There is already some flexibility specified in the text here, but it is restricted to provide relief for consolidation effects "only" and does not indicate how that might be achieved. However, there are other legitimate issues beyond consolidation effects that can arise in group structure, and developments in this area are evolving rapidly (for example the construction of secured support agreements in the US RRPs).

We believe that it would be far wiser to avoid a presumption of direct linkage between external TLAC and the sum of internal TLAC, as these tools are designed to address different specific issues. We suggest to remove this language, and replace it with broad deference to the home regulator, subject to providing comfort to host regulators. This would allow a group to provide comfort to hosts without having an unnecessarily direct effect on external TLAC issuance requirements. Such an approach would help reduce the effects of misallocation risk, and mitigate the issue of super-equivalence. This approach supports not only the key objective of improving bank resolvability, but it also improves internal flexibility which can reduce the likelihood of bank or entity failure in the first place. Lastly, we believe that a less prescriptive approach is prudent at this time, considering the rapidly evolving nature of bank structures in this area, and is therefore likely to be more durable.

The present draft does not cover the case of solidarity structures implemented within cooperative groups (although this point is mentioned in the TLAC Term Sheet). To avoid misallocation risk and adding complexity to a tried and true model, it should be made clear that internal TLAC would not be imposed within the perimeter of such solidarity arrangements, which provide another means of assuring solidity within such groups. The Associations' relevant members would be pleased to provide additional information as needed.

**Level of Internal TLAC: Danger of Fragmentation**

In accordance with the Term Sheet, "TLAC generally should be distributed as necessary within resolution groups in proportion to the size and risk of exposures of its material sub-groups."[6] The distribution of internal TLAC should therefore follow the principle of proportional distribution throughout the group, which should be reiterated in the Guiding Principles. Proportional distribution has the benefit of providing a simple, common-sense rule that can help reduce any incentives for regulators to compete for resources within the group.

The current draft is questionable in treating material sub-groups as if they were standalone G-SIBs, rather than focusing on proportional allocation of resources in accordance with the group's structure and recovery and resolution planning.

Although the discussion of Guiding Principle 5 appropriately mentions the 75-90% range of external minimum TLAC set by the Term Sheet, the draft Guiding Principle itself states that "host authorities should ensure that there is <u>sufficient</u> internal TLAC to <u>cover</u> the loss-absorption and recapitalization needs of the material sub-group <u>and support</u> the resolution strategy for the Group" (emphasis added). This is perhaps only a question of language, but, so stated, the proposed principle could be misread as going contrary to the established objective of supporting the group resolution strategy. The crucial sentence of the principle should be rewritten to say "host authorities should assess the amount of internal TLAC necessary to support the resolution strategy of the group" to avoid misinterpretation.

Excessive internal TLAC requirements may reflect preemptive ring-fencing of resources that is inefficient and unnecessary under most circumstances. As some jurisdictions already set their internal TLAC at the high end of the 75-90% range, the Associations are concerned that other host regulators may feel induced unnecessarily to ring-fence material subsidiaries without the requisite consultation and cooperation with home authorities. As noted in the second paragraph of the Overview of the draft Guidance, a key objective is to "diminish any incentive on the part of the host authorities to ring-fence."

The discussion of Guiding Principle 5 appropriately considers the risk that the sum of internal TLAC may exceed the group's external TLAC requirement (Superequivalence), but does not address it effectively. It is therefore necessary to include further *ex-ante* guidance as to how to manage this discrepancy by home and host authorities and adjustment of any internal TLAC requirements that are in excess of external TLAC requirements by the CMG.

Moreover, it seems counterproductive to conclude, as that discussion now does at page 14, that there is no presumption that the host authorities should apply a lower internal TLAC requirement if the sum of internal TLAC requirements exceeds the resolution group's external TLAC. The Associations are concerned that this statement may be harmful and, in fact, in the view of many members there *should* indeed be such a presumption, or at the least a presumption that home and host authorities will work together through the CMG to eliminate any excess requirements. If the

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[6] Financial Stability Board, "Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution: Total Loss-absorbing Capacity (TLAC) Term Sheet." Section 18. November 2015: http://www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf

FSB is not willing to state such a presumption, then at least the unnecessary and misleading reverse presumption should be deleted, and additional guidance should be given on the importance of weighing avoidance of creating misallocation risk in the group in coming to an appropriate result.

Furthermore, there should be a strong presumption against host country authorities increasing internal TLAC requirements during times of stress or calibrating internal TLAC requirements for a stress event.

It's appropriate to say that the host should be fully apprised of the home authorities' views on the impact of internal TLAC decisions that would increase misallocation risk in the group, as the last paragraph now does. But it would be even better to mandate more active engagement of both home and host authorities throughout the analysis (which should be made more balanced by adding further discussion of misallocation risks as stated above). To this end, the FSB should set out a fuller framework for home-host cooperation, articulating sound principles for the functioning of CMGs, setting objective criteria to follow when agreeing internal TLAC requirements and contemplating regular reviews and assessments at each periodic CMG meeting.

The determination of internal TLAC requirements is ultimately a modeling exercise that depends upon its assumptions and a full view of the inputs. While the draft says that the home authority should "coordinate" the host authorities' assessments and provide necessary information (Guiding Principle 6), the final Guidance should go further and provide for consistency in modelling across the group, under the supervision of the home authority.

Guiding Principle 19 gives hosts the authority to define recapitalization levels. It should be stated clearly, however, that such requirements should be defined *ex-ante* as part of a resolution plan for the G-SIB group (subject to periodic review); the Guidance should further stress the importance of avoiding hosts' setting moving targets that could make effective resolution of the group more difficult.

Guiding Principle 5 refers to calculating internal TLAC from a *hypothetical* range of external TLAC, as if it were a standalone entity. The purpose of TLAC, however, is to ensure successful resolution, so in most cases, reference to the *actual TLAC requirements* of a consolidated G-SIB group (or resolution group) would be important in determining internal TLAC, consistently with Section 18 of the Term Sheet, which calls for appropriate and proportionate distribution of group consolidated resources. For G-SIBs required to demonstrate to their home regulators that their material entities have sufficient resources for successful resolution, currently effective requirements should be the denominator of the 75-90% determination. Only if there is no such regime would the hypothetical approach currently in Guiding Principle 5 remain appropriate. In short, proportional distribution of actual external resourcing requirements would be the clearest and most appropriate approach, built around the lower end of the 75-90% range so that misallocation risk is minimized. See also the discussion of Guiding Principle 6 below.

As the system is embedded and confidence grows between home and host authorities, there should be scope for internal TLAC requirements to be managed down over time, in the interest of the efficiency of the global market.

The FSB should furthermore consider how internal TLAC affects the domestic competitiveness of G-SIBs' entities in host countries. As discussed above, the recognized problem of "Superequivalence" is dealt with in the draft Guidance, but could still receive more development to provide useful guidelines to avoid problems. To the extent G-SIBs end up with more than 100% of their normal TLAC requirements on a consolidated basis as a result of totaling internal TLAC requirements, they would be at a competitive disadvantage vis-à-vis domestic banks or D-SIBs not subject to equivalent requirements.

An additional, related concern is that this problem is already developing in some jurisdictions in ways that could be deemed to raise competitive problems. The consultation document implies that a 5% subsidiary (material sub-group entity) should have to carry internal TLAC *regardless* of what the level of local standalone requirements would be set for it if it were not a group affiliate of a G-SIB. In some jurisdictions, the local TLAC or equivalent requirements have been reduced possibly even to zero for competitors of about the same size as a G-SIB's material sub-group entity (cf. the Swiss and US cases), reflecting domestic policy choices regarding resolution resourcing and decisions on D-SIB designations. Yet this ignores the fact that a subsidiary has the possibility of parent support not available to a stand-alone local bank. Host regulators should be requested by CMGs to justify why a different resolution path or TLAC requirement should be imposed for subsidiaries of G-SIBs relative to what is required for local banks of comparable size and risk profile. This competitive issue should be spotlighted by the final Guidance for analysis and discussion among home and host authorities during the process of setting internal TLAC.

**Roles of Home and Host Authorities**

The discussion of Guiding Principle 2 is an example of undue constriction of the definition of the role of the home authority. Although the Term Sheet provides for determination by the host regulator (which we will take for a given at this stage), the Guidance construes too narrowly the Term Sheet's requirement that host authorities should act "in consultation with the home regulator."

The last paragraph describing the host of a material sub-group should be able to *explain* how its analysis is consistent with the resolution strategy is appropriate as far as it goes, but it doesn't go far enough: the home authority (and the CMG depending on the circumstances) should be closely involved throughout the assessment process outlined in the discussion of Guiding Principle 3.

The discussion of Guiding Principle 1 sets a much more appropriate pattern for the roles of home and host authorities than that of Guiding Principle 2. Guiding Principle 5 appropriately stresses the need for host/home consultation in its first sentence, but the remaining discussion seems unbalanced against the role of the home authorities.

The home authority should have the primary responsibility for determining whether internal TLAC at the sub-group level supports the group resolution strategy, contrary to the implication of the second sentence of Guiding Principle 1. The flexibility that allows a group to avoid

misallocation risk is important in the interests of the system as a whole.[7] Over the longer term, host jurisdictions will benefit from the participation of resilient, flexible global groups in their markets, and from the diversity of financial service providers and improved competition in finance that foreign banks bring.

Further Guidance to both home and host regulators by the FSB is needed to make sure that everything possible is done to discourage excessive *a-priori* ring-fencing or fragmentation of group resources. The FSB – in its role as a global standard setter and guardian of financial stability – should consider rebalancing the final Guidance between hosts and homes to the extent possible: the current draft could lead unnecessarily to hosts precipitating crises in cross-border groups. Although the FSB surely recognizes the risk, it should be made clear as a policy matter, and in accordance with the principle of proportional distribution, that local authorities should not seek to command more of the group's resources than is proportionate and necessary to the achievement of the FSB resolution goals.

The first bullet under "Additional Factors" in Guiding Principle 5 implies that hosts would have information on other sub-groups in order to make comparisons. But is this correct? Should they expect to have such information? There may be circumstances where sharing such information would be inappropriate. This point requires further examination: while hosts are not likely to have such information, reinforcing the role of the home regulator and of the expected level of cooperation should mitigate this potential information gap.

Guiding Principle 6 appropriately stresses home regulators' role in "ensuring that internal TLAC does not exceed external Minimum TLAC" (i.e. to avoid Superequivalence and misallocation risks as discussed above), and calls for appropriate cooperation and information sharing. As discussed above, there should be a presumption of adjustment of inconsistent internal TLAC requirements or if aggregate internal requirements exceed external TLAC. We also believe that some adjustment of the equivalence assumption between internal and external TLAC should be applied in the final version. External TLAC has been developed in a robust and careful manner: amounts contributed or promised to protect local hosts need not give rise to a direct, mechanical increase of external resources. The final Guidance should provide further analytical direction to avoid such mechanical increases. Furthermore, more formal mechanisms at the level of the CMG to resolve potential issues between home and host regulators would be helpful and should be introduced.

**Interaction with Firms**

There needs to be more provision for the authorities and the CMGs to interact with firms. Firms should be given the opportunity to comment upon proposals, to correct facts, or to refute inaccurate presumptions about the level of needed internal TLAC if need be. In discussions between home and host regulators on internal TLAC, impacts on capital planning and the need to involve the firm should be recognized. Effective ways of structuring such interactions with firms might be a subject for the type of colloquium proposed in the introduction to these comments.

[7] See the discussion of misallocation risk above.

**Branches**

The draft Guidance is not explicit enough on the treatment of foreign branches. Although the FSB can't abridge local law, the final Guidance should reiterate the point made in Section 18 of the Term Sheet that internal TLAC does not apply to branches.

**Service Centers**

The draft Guidance is generally helpful on entities that provide essential support services to groups. But it should be made clearer that operational continuity solutions, rather than internal TLAC, will be more appropriate in all cases for service-center entities, which have no reason to be capitalized as if they were operating banks. Minimum debt requirements in internal TLAC are highly questionable, as discussed elsewhere in these comments, but would make no sense whatever for Service Centers, which do not operate on the same basis or with the same funding as operating subsidiaries.

**Flow of Resources Within Groups**

The current discussion, in particular under Guiding Principles 9 and 10, is somewhat simplistic and does not reflect the actual flow of resources within groups. Among other things, members believe it is not sufficiently clear that the top company will as often be an operating company as a holding company. There will often be benefits from indirect issuances of internal TLAC that are overlooked here. Issuance patterns within groups need not be linked to formal ownership structures (i.e. the identified patterns "direct issuance" and "daisy-chain" are not the only possible models), provided CMGs are satisfied that the structure meets the requirements of the Term Sheet, without leading to a change of control of the sub-groups, if that is an issue under the facts and circumstances of the group. Firms should be able to issue internal TLAC to wholly owned subsidiaries of the group.

Formal ownership structure is not relevant to the availability of TLAC for write-down and the focus should be on certainty that the resources are in place and available, rather than on any specific structural requirements. Firms should be able to justify the flow of indirect resources within the group to their resolution authorities, without needing to conform to the simple paradigms set out in the draft Guidance (e.g. the discussion of Guiding Principle 2 at pp. 10-11 and Annex 1; see also the further discussion of the FSB's question 1 on Guiding Principle 2 below). External TLAC and internal TLAC are seldom linked 1:1, as the draft Guidance seems to assume.

Accounting transfers upon TLAC conversion occur at the level of the subsidiary for internal TLAC; the parent's issuance of external TLAC may help it absorb the write-down or conversion of TLAC owed to it by the subsidiary, but the one result is not directly related to the other action. Therefore, the issue is one of accounting capacity, not of direct relationship of internal and external TLAC. These issues are especially important where operating companies are top

companies or issue external TLAC: some of the discussion seems to assume clean holding company structures that are not required in many cases and should not be presumed.

In this context, the concept of "surplus TLAC" in Guiding Principle 7 needs to be dropped or revised. It would be useful to follow the Term Sheet and add to the bold-font language at the beginning of Guiding Principle 7, language to remind all parties of the purpose of the exercise, which is "... **to ensure that it is readily available to recapitalize any direct or indirect subsidiary as necessary *to support the execution of the resolution strategy,* as required …".**

The proposal indicates at Guiding Principle 7 that surplus TLAC would be held at the "resolution entity." As indicated above, there should be more flexibility about where internal TLAC (surplus or not) is held. In particular, it should be permitted to be held in accordance with the group's resolution strategy, for example, at an Intermediate Holding Company or other group entity, which may or may not be in the direct line of ownership to the relevant material sub-group. See also the discussion of the FSB's question 7, below.

As discussed further under question 7, Guiding Principle 7 also needs to be refocused on internal TLAC per se to avoid confusion between TLAC and the use of proceeds of TLAC and therefore an implication of setting new asset or liquidity requirements that would be outside of the scope of the Guidance. There is a clear distinction between loss absorbency and liquidity and TLAC is not designed to provide liquidity per se. Any implication that internal TLAC requirements should lead to additional requirements to hold High Quality Liquid Assets should be removed.

Overall, it should not be necessary to develop guidance that will be read prescriptively for the various possible structures; rather, robust discussion within the CMG would be a better way to ensure that resolution architecture is well adapted to local conditions and can be updated as circumstances change. This is a topic that the colloquium suggested above could well address.

**Composition of Internal TLAC**

Guiding Principle 8 makes important statements about the need for home-host consultation on the impact that the composition of internal TLAC relative to external TLAC could have on the credibility and sustainability of the resolution strategy. The guidance about taking care to consider the composition of a material sub-group's existing internal TLAC instruments to ensure that there is not a requirement to issue additional internal TLAC beyond appropriate requirements is appropriate.

As noted above, however, this requires close and specific analysis of the group's and the subsidiary's structure, balance sheet and the composition of its internal TLAC, avoiding simplistic assumptions about 1:1 relationships of external and internal TLAC. It should be possible for any entity within a group (including a special-purpose financing entity), whether it is a resolution entity or not, to hold internal TLAC for the benefit of a resolution entity, so long as losses of the group are appropriately up-streamed as needed, as discussed under "flow of resources."

In this connection it is not appropriate to transpose the 33% debt “expectation” to internal TLAC. External TLAC may be defensible on grounds it provides for market monitoring by external debt holders, but this argument does not apply to internal TLAC. The same monitoring function can be performed in other ways by regulators and resolution authorities for material sub-groups (and there is no market oversight), so there is no reason to constrain funding choices by such an “expectation” of a debt requirement. Unlike external TLAC, the equity and debt holder of internal TLAC may be the same entity, minimizing the need for the separate debt requirement if sufficient equity capital is held in the form of internal TLAC.

Additionally, certain subsidiaries may already hold sufficient equity capital to meet the internal TLAC requirements; a debt requirement would impose additional costs without an apparent benefit to resolvability.

In conclusion, stating an expectation that would often become a requirement would unnecessarily limit firms' flexibility in deciding the appropriate funding mix for a given situation while not improving the ability of a material sub-group to absorb losses. It is quite possible that firms will choose to include debt in their internal funding mixes to some extent for tax or other reasons, but, as a point of principle, firms should have the ability to decide on the appropriate funding mix for their corporate structures.

Guiding Principle 9 has helpful discussion about the possibilities of use of collateralized guarantees to satisfy internal TLAC requirements. As the FSB recognizes, use of guarantees to provide internal TLAC capacities in appropriate cases is important, notably because it alleviates the problem of deposit–funded banks where on-balance-sheet TLAC would necessarily lead to the addition of supplemental assets, creating more risks and increasing leverage.

With respect to the concept of a “specific pool” of collateral, the Guidance seems to intend that dedicating a pool would be only an option, but the point should also be made that a “specific pool” should be considered necessary *only* when clearly indicated by the facts and circumstances of the case. As a general matter, specific pools (especially if there are multiple pools) would increase complexity and undermine flexibility, increasing misallocation risk, and so should not be encouraged. A group ought to be able to maintain, and manage, a common pool of collateral sufficient to cover all its obligations for internal TLAC. Clause (d) of Guiding Principle 9 should therefore be interpreted to permit common pools, provided of course the group maintains sufficient collateral, after haircuts, to meet all obligations.

Guarantees clearly need to meet the conditions of Guiding Principle 9: ‘*will credibly and feasibly pass losses and recapitalisation needs to the resolution entity….*’, but if this condition is met, there is no particular reason why these guarantees should necessarily be collateralized. Collateralization introduces rigidities in the management of financial groups, for no apparent advantage other than that of reassuring a host authority of the intention of the home authority to force respect of the guarantee. This runs contrary to the spirit of international cooperation that the FSB seeks to promote.

It is recognized that the Term Sheet does not provide for uncollateralized guarantees, and thus the point goes beyond the formal scope of the present consultation, but it ought to be within the

ken of specific home/host negotiations to allow partially or wholly uncollateralized guarantees where they make sense both for the group and for achievement of resolution goals, and therefore this flexibility should be reflected in the final Guidance. There should be room for a rethink here (especially in light of current EU proposals to permit partially collateralized guarantees to meet MREL requirements), and no need to continue a point of rigidity that only serves to constrain firms and their authorities (home and host) in making appropriate funding decisions that provide adequate assurances to hosts without undue burdens on the group.

Guiding Principle 9, like the Term Sheet, requires that any collateral provided must meet the maturity requirements of external TLAC, i.e. have a maturity of over 12 months. Normally collateral is drawn from a list of acceptable assets, and can be rotated in and out, provided that all times there is enough, as the Guiding Principle recognizes; however, it is not clear why, for internal TLAC purposes, the maturity condition should be maintained, provided processes exist to make sure the guarantee is always collateralized. Collateral of sufficient quality to satisfy demanding host authorities, and with residual maturity of over 12 months could well prove to be scarce in the market. The Associations suggest that the FSB give further attention to the size of the pool of collateral available for such purposes. For these reasons, and in light of the significant progress on recovery and resolution planning since the Term Sheet, this important detail should be revisited.

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**The FSB's Formal Questions**

1. What factors should the relevant authorities take into account when determining the composition of material sub-groups and the distribution of internal TLAC between the entities that form the material sub-group (guiding principle 2)?

Composition of material sub-groups should be guided by the materiality criteria within the Term Sheet[8] and further guidance on the appropriate process and procedures for defining material subgroups; further, regulators may make a determination of materiality based on different criteria, but such determinations should be supported by information that is made clearly available to the CMGs and the firm, should not result in discrepancy to the requirements that apply to other similar firms in the domestic market, and should be subject to review and, in principle, agreement by the CMG. In particular, firms should be given an opportunity to feed into this process – for example, providing supplementary evidence or data that may support or disprove the materiality of the sub-group for the firm's critical functions.

The distribution of internal TLAC should be based on the resolution strategy for the group and although regulatory consolidation could be the starting point, not all entities in scope of application of the going concern requirements require TLAC (entities which are not considered material or which do not provide critical economic functions or entities which would be resolved separately or put through normal insolvency regimes, for example, as the draft Guidance

[8] Cf. Section 17 of the Term Sheet.

recognizes); similarly, entities that are not subject to regulatory capital requirements should not be brought into scope of internal TLAC.

It would be helpful if the FSB would expand upon the process and requirements for determining the composition of internal subgroups, in Principles 1 and 2. As a related matter, the "relevant authorities" for Guiding Principles 1 and 2 may include hosts that are not members of the CMG. Although the text of Guiding Principle 1 says that such hosts should be able to make proposals to the home regulator, the principle should be given more stress and there should be procedures for CMGs' finding ways for such hosts to participate more fully when relevant to their concerns.

When a sub-group is determined to be material, the group should have a reasonable period of time in which to adjust to the new requirements resulting from such determination. Continuation of local internal TLAC requirements different from those determined in accordance with FSB principles and this Guidance should be discouraged (contrary to the last sentence of General Principle 1).

While the systemic importance of each entity is an important criterion, it is not necessarily equivalent to the "presence" of critical functions in the entity. A function that is critical at a group level may only be exercised marginally in a given entity. The simple presence of a group critical function should not be sufficient to qualify an entity as material. The extent of participation of the entity in critical functions may be immaterial or easily replaceable. In any case, there should be a good justification for inclusion of any entity on "systemic" grounds, which justification should be accepted by the relevant home authority and the CMG.

For clarity's sake, we also note that entities providing critical services in support of critical functions should normally not be required to have internal TLAC but instead should be able to demonstrate appropriate operational continuity measures, as discussed with respect to Service Centers above. Internal TLAC is not appropriate for such entities. It would artificially attract RWA and create leverage where none was before, inflating the overall balance sheet.

The second bullet on page 11 and in Annex 1 of the draft Guidance raises serious questions. The idea of a "grouping of sister companies" is quite vague. Unless reflected in a normal sub consolidation maintained for other purposes, the idea of a *"grouping of sister companies,"* which could apparently be designated arbitrarily to meet the criteria of General Principle 2, would add a great deal of complexity. Such an ad-hoc grouping would not be subject to a firm's normal management controls, raising issues for data reporting and responsibility. Importantly, it is not at all clear what the point of non-viability would be for an ad-hoc grouping of sister subsidiaries. Therefore, this point should be clarified to refer to existing sub-consolidations and avoid the implication that ad-hoc groups could be created by host regulators.

Moreover, it should be made clear that material sub-groups consist of material entities, not an aggregation of individually immaterial entities that additively could meet the numerical criteria. Given that the objective of orderly resolution, and therefore TLAC requirements is to maintain the continuity of critical functions, subsidiaries should only be included within a material sub-group to the extent that they provide critical functions.

Guiding Principle 3 addresses the issue of multi-jurisdictional material sub-groups, but, because of the inherent complexity of such groups, designation should be subject to meeting both of the criteria in the bullets of the sub-group (i.e. the two bullets should be joined by "and" not "or"). It should be clarified that where an operating entity meets the quantitative and other criteria to be classified as a material sub-group, any intermediate holding company or companies located in different jurisdictions in the chain above the material sub-group or relevant operating entity should not normally be considered part of the material sub-group. This would be in line with Principle 3, which makes clear that multi-jurisdictional material subgroups should only be identified in exceptional circumstances, as discussed under that Principle.

Furthermore, as suggested above in discussing the level playing field, the comparability of local TLAC or equivalent requirements for competitors should be taken into account in determining whether local, internal TLAC is necessary. If similarly sized standalone domestic banks would not be required to have TLAC, then there should be a presumption against requiring internal TLAC of a G-SIB's subsidiaries, absent a very compelling reason agreed to by the home regulator and the CMG.

A specific issue arises for certain firms that have partially owned subsidiaries that may fall within the scope of the 5% threshold. It should be made clear that resolution entities should not have to provide internal TLAC to absorb losses beyond their ownership interests, with the result that such subsidiaries should be treated the same as stand-alone entities in the relevant local jurisdiction.

2. What are your views on the treatment of regulated or unregulated non-bank entities as set out in guiding principle 4? If such entities were included within a material sub-group, how should the relevant authorities calculate an internal TLAC requirement?

Guiding Principle 4 is generally helpful in stating that "alternative arrangements" should be considered first. The preference for alternative arrangements set out in the second full paragraph on page 13 is also helpful. For material service entities (as opposed to an operating entity), the concern is to have sufficient resources consistent with the FSB's operational continuity guidnce to ensure continued operation to the extent necessary in accordance with the resolution plan. As the draft recognizes, mandating internal TLAC would generally not be appropriate or relevant.

However, it should be made clearer that internal TLAC will often be unworkable – and, for entities that are not prudentially regulated, undesirable because of the resulting balance-sheet inflation as discussed above – for non-bank entities that are not structured like banks (cf. the comments herein above about service companies) or could be wound down through normal insolvency procedures not requiring TLAC. The bullets on page 13 are appropriate for firms that have somewhat bank-like balance sheets; however, it would also be appropriate to develop in further detail why and how alternative arrangements (such as contingency planning, pre-positioned capital resources structured around the actual needs of the entity, guarantees or other devices would be more appropriate for other types of entities, especially service companies or other non-financial entities (see the discussion of Service Centers, above). Asset management companies, for example, require relatively limited capital.

3. Do you agree with the roles of home and host authorities in relation to the host authority's determination of the size of the internal TLAC requirement, as set out in guiding principles 5 and 6? What additional factors, if any, should the host authority take into account when setting the internal TLAC requirement?

See the general discussion above. To reiterate a few specific points covered above, the final Guidance should be revised to meet the concern that the current draft is excessively biased toward the role of host authorities. It is important to incorporate the proportionality principle in the final Guidelines. Internal TLAC requirements for a material sub-group should generally not exceed such requirements for equivalent local banks. It should also be made clearer that branches of a resolution entity are not in scope for internal TLAC, being part of the same legal entity as the resolution entity. The firm should be given a chance to submit comments or evidence to assist reaching appropriate determinations, including as necessary to rebut assumptions and preliminary conclusions.

In line with earlier suggestions on the collaboration in CMGs [9] it would be useful to consider, perhaps through the colloquium suggested above, whether some form of formal dispute-resolution or mediation procedures at the level of the CMG to resolve potential issues between home and host regulators could be provided for in the final Guidance, recognizing that some authorities may have difficulty accepting mandatory dispute resolution.

4. How should TLAC at the resolution entity that is not distributed to material subgroups ("surplus TLAC") be maintained to ensure that it is readily available to recapitalize any direct or indirect subsidiary, as required by the TLAC term sheet (guiding principle 7)?

See the discussions re. flow of funds and misallocation risk above. External TLAC per se of course cannot be distributed as such; the use of *proceeds* of external TLAC is a different matter. The Guidelines should avoid any implication of a need to do "dollar-tracing" or imposing undue constraints on the designation or form of funds within the group.

As a general matter, as much of TLAC resources as possible should be allowed to remain at the appropriate entity in the group as for use as determined by the group where most needed provided the CMG can be satisfied that the "readily available" test can be met on a reasonable basis.

Furthermore, each group should be allowed to determine the way in which it meets the "readily available" requirement, to the satisfaction of its CMG and relevant authorities. TLAC itself is not an asset which can be used to meet liabilities; it is a loss absorbency mechanism which consists of instruments that, in case of distress, can be written off or converted into equity. This loss absorbency applies across all of the assets of the entity which issues the TLAC and, where such assets include internal TLAC issued by a subsidiary of that entity, the combined mechanism operates to pass losses incurred in the subsidiary on to holders of TLAC issued by the parent.

[9] See our comments under "Level of Internal TLAC," "Roles of Home and Host Authorities," and on Guiding Principle 11.

When TLAC is issued, the proceeds of issuance are applied within the group in the same way as the proceeds of any other debt issuance, and there is no reason to treat them otherwise – the loss absorbency characteristics of TLAC are unconnected to the use to which the proceeds of issuance are put. In a clean holding company structure, the proceeds of TLAC are typically downstreamed to operating companies that make sense given the group's recovery and resolution planning. Where the resolution entity is an operating company, the relationship is less direct, but the principle is the same. In either case, the principal concern should be that TLAC can be written off or converted as needed, recapitalizing material sub-groups or critical subsidiaries, rather than that particular assets acquired with the proceeds are to be applied.

The FSB should remove any suggestion of asset-side or liquidity requirements that would be created by Guiding Principle 7, which are out of scope of the principles of TLAC as understood under the Term Sheet, and not relevant to loss-absorbing capacity. In particular, the final version should remove the requirement that home authorities consider the corresponding assets of surplus TLAC and the reference to such assets' needing to be easily valued and able to retain value under market-wide stress.

In conclusion, The FSB needs to be cognizant of the fact that, aside from resolution aspects, commercial, treasury and tax concerns also need to be taken into account in group funding. Banks therefore believe that any entity within the group should be allowed to hold surplus TLAC, as long as it is ensured that such surpluses can be down-streamed to material entities where losses have occurred, in accordance with the group resolution plan. See the discussion of Flows of Funds above.[10]

5. What are your views on the composition of internal TLAC, as set out in guiding principle 8? In particular, should there be an expectation of the inclusion within internal TLAC of debt liabilities accounting for an amount equal to, or greater than, 33% of the material sub-group's internal TLAC?

As discussed under the discussion of composition of internal TLAC above, the 33% debt expectation should not be transposed into internal TLAC requirements.

The benefits of a debt requirement for external TLAC – including market monitoring (with the resulting de-facto "triggering" function for resolution) and encouraging faster management action – do not apply to intra-group funding, as internal instruments are not traded in the market and an important goal of internal TLAC is to avoid triggering resolution at the sub-group level, but rather to support continued operation or orderly wind-down of such entities. Instead such a requirement could unnecessarily limit firms' flexibility in deciding the appropriate funding mix for a given situation while not necessarily improving the ability of a material sub-group to absorb losses.

In addition, such a minimum debt requirement in effect penalizes highly capitalized subsidiaries, and would in effect inflate the balance sheet and introduce further leverage into the system if imposed as part of internal TLAC. There are jurisdictions where regulatory capital prohibits non-

[10] See our comments under "Flow of sources within groups."

equity items or is set higher than the Basel requirements, and as such the 33% would be very difficult to achieve and would require non-essential issuance to the subsidiary, adding to its leverage and needing to be deployed to earn a return.

6. What are your views on the potential benefits or drawbacks of different approaches to the issuance of internal TLAC instruments as set out in guiding principle 10, and what steps could be taken to mitigate the drawbacks that you have identified?

As discussed under "flow of resources" above, what are called "direct" and "daisy-chain" structures that assume direct linkages are not the only possibilities: there should be no prescriptive presumptions about how internal TLAC should be structured; rather, the firm should be able to demonstrate to home and host regulators how the structure actually used by the firm meets resolution objectives. In many cases, it should be entirely consistent with the goals of internal TLAC and effective resolution strategies to allow issuance of internal TLAC by a material sub-group indirectly to the resolution entity through wholly owned affiliates that are outside the formal chain of ownership. It may, however, be appropriate for the relevant CMG to require that the overall control structure would not be changed as a result of any bail-in of internal TLAC, however held.

7. Should the FSB conduct further work on the need for a deduction mechanism for internal TLAC, as proposed in guiding principle 10?

The FSB proposes further consideration of deduction mechanisms, but firms will need guidance on this point sooner rather than later because this may have a substantial effect on the design and structure of relevant instruments.

We fully agree that the interaction of internal TLAC with other prudential requirements needs to be addressed – for example, zero weighting for internal TLAC investments to avoid impacts on stand-alone capital requirements; and interactions with the NSFR (see the response to question 8, below).

When the FSB does turn to such further work, the Associations stand ready to contribute as best they and their members can to the analysis. Such work should take into account the group-resolution perspective advocated in these comments.

To the extent the result of such review is a conclusion that deductions to avoid double-counting at each level for internal TLAC purposes are unnecessary and counterproductive, the Guidance should focus on the overall effective availability of internal TLAC resources to support the group's recovery and resolution planning.

8. Do you agree with the obstacles to the implementation of internal TLAC mechanisms set out in guiding principle 12? How should G-SIBs and authorities address those obstacles and what additional obstacles, if any, might arise?

Guiding Principle 12 raises a number of important considerations. The industry is especially concerned to work with the regulatory community to deal with the issues about large exposures

that are raised: appropriate administrative or legislative corrections to such issues should be prioritized where necessary.

In addition, it should be recognized that a resolution entity making internal TLAC commitments will artificially inflate its own stand-alone requirements (e.g. solo NSFR, RWA and LRE-based capital requirements) unless internal TLAC is exempted from the NSFR and leverage ratio calculations, and zero-weighted for RWAs. It might be helpful to consider here the type of colloquium or conference for regulators, resolution authorities, banks and law firms suggested above, to look for practical and feasible solutions to issues that are identified.

9. Do you agree with the key features of contractual trigger language for internal TLAC, as set out in guiding principle 13 and in Annex 2? Should authorities consider the use of contractual triggers for internal TLAC in the form of regulatory capital instruments, including in cases where statutory point of non-viability powers exist in relation to such instruments?

While the draft Guidance discusses judgment and discretion in using triggers, and therefore implies triggers should not be automatic, it should be stated very explicitly that there should not be features in internal TLAC that would trigger automatically pursuant to specific quantitative or other tests. As the FSB no doubt recognizes, any trigger in a debt instrument that would provide for mandatory conversion or write down would be highly problematic, as it would exclude any other recapitalization measures that may be feasible in the circumstances, by the resolution entity or its home regulator, and may trigger counterproductive tax or other consequences that should be avoided. However, as discussed in the response to question 10, it is also important to balance this with as much clarity as possible as to the likely terms and conditions of triggers.

Furthermore, contractual write down provisions may not be required where the statutory regime allows regulatory action to take place at the Point of Non Viability (PONV) as determined by regulators.

It should also be noted that – as the FSB has recognized in its recent peer reviews – that significantly more transparency on the criteria that authorities will use to determine the PONV is needed in order to ensure *ex-ante* coordination of expectations.

10. Do you agree with the process for triggering internal TLAC in Section V? In particular, what are your views on the timeframe for the home authority to decide whether to consent to the write-down and/or conversion into equity of internal TLAC?

More detail on appropriate process in Guiding Principle 13 would potentially be helpful. Members are concerned about the degree of host control of the process: home-country consent should be a firm requirement, subject to override only in extraordinary circumstances, and only after discussion of such circumstances with the home country (and the firm).

While it is understood, as discussed in the response to question 9, that not all circumstances that might require triggering internal TLAC can be foreseen, and that automatic triggers may be undesirable, there should be a stronger presumption in favor of greater clarity in contractual terms, with a further presumption that stated terms will be followed (subject to exceptions in

appropriate circumstances). This is important not only to create as much clarity as possible between home and host authorities, as the Consultative Paper suggests, but also because it may affect the group's disclosures to the market about its resolution plans and prospects, and therefore may affect the market for its paper, and overall market confidence.

Guiding Principle 15 appropriately stresses the need for host authorities to keep home authorities aware of any issues that might cause the triggering of internal TLAC.

Guiding Principle 16 is correct in stating that internal TLAC should only be triggered as a "last resort" option, and that effects on the rest of the group (and potentially on wider financial stability) should be taken very seriously.

Guiding Principle 17 is similarly appropriate: hosts must not trigger internal TLAC because of resolution actions elsewhere in the group. The principles of the ISDA Protocol should apply equally to internal TLAC decisions of hosts. By the same token, the information requirements of Guiding Principle 17 are also correct.

Guiding Principle 18 is helpful in setting out the principles for home-country consent, but, again, home-country consent should be deemed to be an affirmative requirement, except in the most extraordinary circumstances. The current language at the bottom of page 24 on the host's choices and the need to avoid contravening home-country consent is helpful, but the principle could be made more emphatic that consent should almost always be understood to be a sine-qua-non for host-country action, subject only to extreme exceptions.

The Associations consider that it would be appropriate to define detailed communication protocols for CMGs to be followed as a prerequisite for triggering internal TLAC. This would ensure that the home authority and CMG members are adequately informed and can take the preparatory steps on their side. While the protocols should specify the necessary steps to ensure that the home authority and CMG members are informed early in the process they should not predetermine specific measures that could otherwise limit the flexibility of the CMG to react to a specific situation.

The proposed maximum 24-month grace period to restore compliance with the internal TLAC requirements (Guiding Principle 19) is not required by the Term Sheet, Section 21 (which refers to such a period only at the G-SIB level), and seems inadvisable. Setting a maximum period could result in a material constraint as the bank will likely not only face the challenge to restore internal TLAC but might face additional financial and operational challenges during post-resolution rebuilding. In addition, market conditions would also need to be considered. We therefore propose that the time to restore the internal TLAC should be determined on a case-by-case basis between home and host authorities or at the level of the CMG should more than one material sub-group have suffered material losses.

11. Are there any other actions that should be taken by G-SIBs and authorities to support the implementation of the internal TLAC requirement, consistent with the TLAC term sheet?

It would be helpful if home-country authorities would take a proactive role in accordance with the Guidance, subject to the comments made here, to do as much as possible to obtain assurances

that resolution responses will be guided as much as possible by coherent, group-wide views, respecting hosts' needs and concerns, but maintaining consistency and effectiveness.

While we accept the concept of internal TLAC, the main basis for trust among authorities – and therefore the willingness to refrain from unilateral actions in a crisis – should be the existence of broader structures of cooperation, more consideration should be given to prioritizing effective cooperation between the CMG members. Pre-positioning TLAC can only support but not replace true cooperation, which would be supported by the development of such agreements. To the extent possible, cooperation protocols should ensure that home and host regulators adhere to the proposed FSB guidance on material entities, common external Pillar 1 TLAC, and level of prepositioning.

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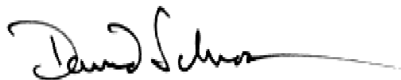
Finally, the Associations would like to reiterate their overall support for the FSB's fine work on cross-border resolution over the years and hope that these comments are constructive toward finalising the Guidance on internal TLAC. The Associations stand ready for any further engagement with the FSB that may be helpful to that end or toward facilitating effective implementation and international coordination of the final Guidance. If you would like to discuss any of these comments further, please contact Oliver Moullin (oliver.moullin@afme.eu) or David Schraa (dschraa@iif.com).

Very truly yours,



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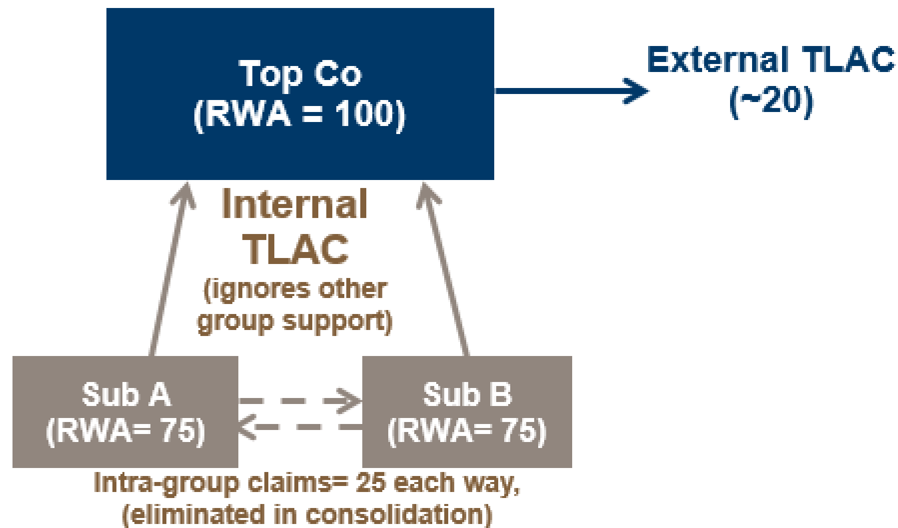
# Annex A




**Consider the following example of a stylized / simplified banking group:**

- The group has two subsidiaries. Each sub has 50 of external positions plus 25 in claims on the other Sub. The total assets (and RWA) in each sub is 75.
- The Top Co is "clean" with no external positions of its own. Top Co Consolidated assets/ RWA = 100 (eliminating intra-group claims). It issues external TLAC of 20.
- Subsidiary A & B each issue internal TLAC to TopCo, to provide assurance to host regulators (on top of general group support).
- Sub B is exposed to losses from external positions. However its senior claim and risk of loss on Sub A is already protected by (subordinate) internal TLAC issued by Sub A, as well as by the overall resources of the group. Requiring Sub B to issue internal TLAC to support intercompany positions issued by Sub A would be double counting.
- Eliminating intra-group exposures for any host internal TLAC calculations is an simple way to address consolidation effects. This approach would also reduce the pressures of super-equivalence and misallocation risk
    - For example, if a high (90%) internal TLAC requirement was imposed on both subsidiaries on gross exposures (75), then the internal TLAC for each sub would be 13.5 (20% x 90% x 75). The sum of Sub A and B would therefore be 27, well above the external requirement of 20.
    - Such a case would lead to super-equivalent external TLAC if external TLAC is directly linked to internal TLAC (as per S18). Such a case would also not leave any "surplus TLAC" in the group for flexible allocation
    - The text of our letter suggest several tools that could be used to address this.