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

The International Banking Federation[1] ('IBFed') welcomes the opportunity to respond to the consultative document on the above topic.

The publication of the proposal marks an important milestone in the completion of the work programme established by the G20 to restore stability to the financial system. The finalisation of the TLAC proposal together with the other initiatives identified in the progress report[2] published on 12th November 2014 will significantly enhance the likelihood that all globally systemically important financial institutions are resolvable.

As noted in our letter dated 2nd September 2014, IBFed recognises the role that loss absorbing capacity has to play in ensuring the credibility of resolution as well as promoting trust and confidence between home and host authorities. We therefore offer our firm support for the 'guiding principle' outlined in the paper.

The proposed principles and term sheet indicate that much thought has gone into the design of the framework. The proposal looks to strike a broadly appropriate balance between achieving the objective that GSIBs meet consistent loss absorbency standards but in a manner which recognises the reality that the jurisdictions in which they are headquartered have differing legal and resolution structures with markets at different stages of development, as well as institutions with different business models.

Calibration of the amount of TLAC required

[1] The International Banking Federation (IBFed) is the representative body for national and international banking associations from leading financial nations around the world. Its membership includes the American Bankers Association, the Australian Bankers' Association, the Brazilian Federation of Banks 'FEBRABAN', the Canadian Bankers Association, the European Banking Federation, the Japanese Bankers' Association, the China Banking Association, the Indian Banks' Association, the Korean Federation of Banks, the Association of Russian Banks, and the Banking Association of South Africa. This worldwide reach enables the IBFed to function as the key international forum for considering legislative, regulatory, and other issues of interest to the banking industry and to our customers.

[2] *Towards full implementation of the FSB Key Attributes of Effective Resolution Regimes for Financial Institutions* (FSB)

Our earlier letter offered support for the concept of a minimum framework for loss absorbing capacity within which crisis management groups had the flexibility to tailor requirements to the individual circumstances of each GSIB. We therefore support principle 2 which integrates the proposal with recovery and resolution planning and offers the ability to tailor requirements to individual GSIBs.

We recognise the logic of calibrating the minimum requirement in light of past loss experience and welcome the decision not to finalise the quantification until the completion of the multifaceted impact assessment. That being said, our analysis leads us to conclude that a minimum requirement of 16% of RWAs would be more than sufficient to absorb losses sustained in the past and to provide resources to support recapitalisation should this be necessary to maintain critical economic functions. This view is informed by the fact that the industry is subject to much higher going-concern capital requirements in terms of both quantity and quality, that regulatory capital already includes some gone concern instruments, that recovery options (including quick wind down capabilities) should also be available to rebuild capital before bail-in and that, as practicable in light of applicable legal resolution regimes, estimates of future loss should reflect losses assessed on the basis of resolution rather than insolvency.

We understand the reason for the proposed twin denominator but are concerned that setting the leverage requirement at twice the still to be determined Basel minimum will result in uncertainty and could lead to an unexpected significant increase in the minimum requirement if set at a level above 3%. We therefore recommend that the leverage test be set at a fixed specific level in proportion to the RWA requirement as this will retain parity between the two requirements.

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

The location of loss absorbing capacity can act as a powerful incentive for cooperation between home and host authorities. We therefore support the proposal to require external TLAC at each point of entry for a resolution group and the objective of identifying a process for allocating an element of this to material entities. The TLAC requirement at each point of entry should be based on the local regime established by the host authority with similar characteristics to the local entities, thus maintaining the level playing field in the local markets.

We are not, however, convinced by the criteria proposed for the identification of material subsidiaries and note that they are different to the Basel Committee's guidelines for the identification of DSIBs. We suggest that subsidiaries should be determined as material only if both of these two criteria are met, i.e. the subsidiary exceeds the proposed 5% threshold and the subsidiary is identified as a D-SIB. If this is not possible, then we recommend that the thresholds of 5% be increased. We believe the FSB should provide clear guidance to host authorities that they should not seek to impose internal TLAC on subsidiaries if they have not been identified as being material by the CMG.

Whilst the pre-positioning of TLAC can support cooperation, it is important to avoid an excessive requirement which would reduce the flexibility of a group to respond to a stress situation by allocating resources as and when necessary to absorb the shock.

Determination of instruments eligible for inclusion in external TLAC

We agree that the eligibility of instruments for inclusion in external TLAC must be prefaced on the extent to which they can be exposed to loss in resolution without disrupting the operation of critical functions or imposing other barriers to resolution.

In principle, we understand that liabilities eligible for TLAC should be clearly subject to bail-in. The requirements for subordination, however, will require careful study during the impact assessment and due consideration of the different legal applicable resolution regimes (insolvency versus special regime). It would also be helpful for the FSB to clarify that senior debt issued by Holding Companies satisfies the eligibility requirement proposed by part (c) of section 13 of the term sheet.

There is logic to the recommendation that a proportion of TLAC be held in instruments which can be guaranteed to be available to absorb losses in resolution. The quantification of any such expectation, however, will need to play close regard to the differing characteristics of markets and the business models of firms. We note that for highly capitalised firms the expectation that a third of the Pillar 1 TLAC requirement be met by debt would result in a conflict between prudential and resolution policy which might result in a requirement for firms to increase leverage or reduce the deposit base. We recommend that consideration be given to how this will impact the capitalisation and funding structures of material subsidiaries as well. This concern is particularly acute in emerging market economies with nascent local capital markets, which make it less likely that adequate debt for TLAC purposes could be raised locally. It is also the case with markets which are small sized and developing. In such cases, we propose the 'expectation' should be regarded as a guide for the authorities rather than a mandatory requirement. Notwithstanding the above points, we believe that any non-common equity tier 1 instruments should be acceptable to meet this requirement. If the proposed expectation is maintained then we recommend that the Term Sheet provide clarity that it does not apply to internal LAC (as implicitly understood given the possible use of guarantees).

Interaction with regulatory capital requirements and consequence of breaches of TLAC

We support the proposal to integrate the TLAC proposal with Basel III and acknowledge the logic of limiting the degree to which CET1 can count towards the requirement to only that in excess of what is required to comply with the regulatory buffers. It would be useful if the term sheet clarified that CET1 held above that required to meet the Basel combined buffer for the purpose of satisfying national buffers should be eligible for TLAC. It should be clarified that the combined buffers can be used without incurring consequences other than those provided in the Basel text (restrictions on distributions, not resolution).

We are concerned that the proposal to treat a breach or likely breach of minimum TLAC requirements as severely as that for regulatory capital will require firms to hold management buffers which will result in a material increase in the de facto minimum requirement. This issue should be considered as part of the impact assessment used to calibrate the minimum requirement. As an alternative, we recommend that a breach of TLAC should be a trigger for a dialogue between the bank and supervisor/resolution authority as to how compliance will be restored over a set period.

Transparency

We agree that the market will require disclosure from institutions on the nature, location and size of TLAC. We recommend that the Enhanced Disclosure Task Force – which acted as a forum for discussion among the authorities, investors and banks on topics such as the disclosure of asset encumbrance – should be asked to work with the Basel Committee to design a disclosure which meets the needs of investors in a manner which is practicable for GSIBs.

Limitation of contagion

Whilst we understand the desire to limit the possibility of contagion during a crisis, it is important to balance this with the need to ensure the liquidity of TLAC instruments. We therefore recommend that at a minimum consideration be given to a market-making exemption from the proposed deductions regime given that the existing large exposures regime already acts to limit contagion.

Conformance period

The conformance period must be informed by the impact assessment. We suggest, however, that consideration be given to a period over which the rules are phased-in.

Market impact and other aspects

The TLAC calibration and subsequent QIS are vitally important. We look forward to a comprehensive quantitative impact assessment (QIS) that looks at these issues alongside the individual bank impact. In particular, the QIS should review the impact on: developed and emerging market economies; international banking products; the depth of debt markets; the willingness of investors to buy this type of debt; the base of retail deposit funding; the primary and secondary market implications (including brokerages), refinancing risks, and financial interconnectedness.

Yours sincerely,

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