International Banking Federation

Pinners Hall
105-108 Old Broad Street
London EC2N 1EX

tel: + 44 (0)20 7216 8947
fax: + 44 (2)20 7216 8928
web: www.ibfed.org

Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

fsb@fsb.org

10th February 2017

Dear Sir/Madam:

Re: IBFed response to FSB consultation paper, "*Guiding Principles on the Internal Total Loss-absorbing Capacity of G-SIBs ('Internal TLAC')*"

The IBFed[1] welcomes the guidance for home and host authorities to implement internal TLAC so that incentives to ring-fence assets domestically are reduced, thereby allowing consistency with the resolution strategy of the G-SIB, and ensuring the credibility of resolution.

For your consideration, we have provided answers to the consultation questions below.

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)?

The Crisis Management Group (CMG) is the appropriate forum for the decision on identification of material sub-groups, with the home authority unambiguously leading the process in consultation with the host authority based on clear objective criteria designed by the FSB. We strongly believe that host authorities should not seek to impose internal TLAC on subsidiaries if they have not been identified as being material by the CMG by idiosyncratic interpretation of the criteria articulated in Principle 2.

In particular, this should explicitly take into account subsidiaries which despite forming part of the regulatory consolidation (or even accounting consolidation) do not need TLAC given they can be wound down via normal insolvency, and/or doesn't perform critical functions etc.

[1] The International Banking Federation (IBFed) was formed in March 2004 to represent the combined views of a group of national banking associations. The countries represented by the Federation collectively represent more than 18,000 banks with 275,000 branches, including around 700 of the world's top 1000 banks which alone manage worldwide assets of over $31 trillion. The Federation represents every major financial centre and its members' activities take place in every time zone. This worldwide reach enables the Federation to function as the key international forum for considering legislative, regulatory and other issues of interest to the global banking industry. For more information visit: www.ibfed.org

The FSB should provide suggested guidance on how resolution authorities should designate sister entities as material subgroups [where these entities do not form a sub-consolidation group for regulatory or accounting purposes in a jurisdiction]. Our first preference would be for material subgroups to be established based purely on the regulatory consolidation, but also taking into account the resolution strategy.

Additional guidance in this area would help to promote global consistency in the approach to designating sister subsidiaries and on how internal TLAC requirements should be set for sub-groups that contain sister subsidiaries. Where sister subsidiaries are included within a sub-group, we understand the guidelines refer to interdependencies between those entities, but we would expect that the rationale should ultimately be linked to the resolution strategy of the group.

We note that Principle 3 introduces a degree of conditionality into the composition of the subgroup. This conditionality should be eliminated as follows:

> "*Material sub-groups ~~should~~ will only consist of entities in more than one jurisdiction where…"*

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?**

A higher threshold should be required for including non-bank entities within a material sub-group than being "highly connected". It should also be recognised that certain types of entities (e.g. service companies), where rules on operational resilience are already in place or where they are subject to their own resolution regimes, should be excluded.

The FSB should clarify that where an operating entity meets the quantitative criterion to be classified as a material sub-group, any intermediate holding companies located in a different jurisdiction that are in the chain above the operating entity, or group of operating entities, should not be considered to be part of the material sub-group, unless determined necessary for the effective implementation of the internal TLAC mechanism. This would be in line with Principle 3, which outlines that multi-jurisdictional material sub-groups should only be identified in exceptional circumstances.

We oppose a bespoke framework that would introduce regulatory discretion into the internal TLAC process, especially when no resolution regime has been implemented in the host jurisdiction.

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?**

The FSB should provide further guidance on cross-jurisdictional cooperation to ensure the requirements set by host authorities are consistent across different jurisdictions in setting internal TLAC requirements within the 75 – 90% range. We would hope that authorities would not automatically default to the top end of the range and that internal TLAC requirements could migrate to the lower end of the range as experience builds and supervisors have more access to information. Whilst we acknowledge that resources should be distributed commensurate with the risks within the group, it is vital to ensure flexibility as to the location and amount of internal TLAC to be distributed, as agreed within the CMG. In particular banks should have the flexibility to hold excess resources where they see fit, and this should not necessarily be at the holding company level.

We welcome the principle that host authorities should recognise that internal TLAC requirements will have implications for the resolution group So host authorities should be fully mindful of home authorities' overall approach to promoting a successful resolution strategy for the group, and should take this into account when setting internal TLAC requirements within the 75 – 90% range provided in the TLAC term-sheet. The guidelines should state that home and host authorities ensure that the sum of internal TLAC requirements does not exceed the resolution group's external TLAC requirement.

In this context, we strongly recommend the introduction of formalized mechanisms at the level of the CMG to resolve potential issues between home and host regulators to avoid an excess of the external TLAC on the consolidated level.

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

We do not support the statement in (ii) that "*some TLAC to be held at the resolution entity"*. There should not be a presumption that banks will hold surplus TLAC over and above the sum of requirements for the material sub-groups. Furthermore, banks should be allowed sufficient flexibility for any surplus or voluntary management buffer to be held anywhere in the group as long as it is readily available to absorb any losses, recognising the fungibility of the proceeds from external issuances. Whilst the pre-positioning of TLAC can support cooperation, it is important to avoid an excessive requirement that would reduce the flexibility of a group to respond to a stress situation by allocating resources itself as and when necessary to absorb the shock.

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?**

We agree that the composition of internal TLAC relative to external TLAC should support the resolution strategy and the passing of losses and recapitalisation needs from the material sub-group to the resolution entity. However, we note that for highly capitalised banks the expectation that a third of TLAC be met by debt may result in a conflict between prudential and resolution policies that might result in a requirement for banks to increase leverage or reduce the deposit base. It is unclear as to why a 33% restriction is needed for internal TLAC especially since this was not included within the TLAC Term sheet. If retained, it is necessary to give consideration to how this will impact the capitalisation and funding structures of material subsidiaries and indeed capital restructuring costs of meeting such a requirement. 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. We recommend that the requirement for a third of TLAC be met with debt not apply to internal TLAC (as implicitly understood given the possible use of guarantees), though the option to include debt in its composition should be preserved

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?

We support the two internal issuance approaches outlined in the consultation, either directly from a material sub-group to the resolution entity or indirectly to the resolution entity through the ownership chain, which should be permitted where they support the resolution strategy. However, we believe that limiting internal issuance to these two approaches is overly restrictive and does not recognise that other internal issuance strategies can credibly support a G-SIB's resolution strategy and the passing of losses to the resolution entity.

The FSB should amend Principle 10 to recognise other approaches to issuing internal TLAC; for example issuance by a material sub-group indirectly to the resolution entity through wholly owned affiliates that are outside of the direct ownership chain. This would recognise the complexity of large international banks that need the flexibility to fund their material sub-groups efficiently across global structures[2]. The FSB should acknowledge that, where a bank can demonstrate that an approach to issuing internal TLAC supports the passing of losses to the resolution entity, these are eligible approaches to issuing internal TLAC.

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

We support the FSB conducting further work on deduction mechanisms, recognising there may be potential jurisdictional differences in how internal TLAC deductions to regulatory capital may work in practice. However it necessary to gain clarity on this sooner rather than later, as the deductions approach may have a significant impact on overall issuance levels required.

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?

We support internal TLAC being excluded from large exposure limits. Additional challenges to consider are the possibility of double leverage constraints due to subordination requirements, for example where externally issued TLAC is supporting internally downstreamed regulatory capital e.g. Tier 2. It will therefore be necessary to give consideration to any implications where the form of internal TLAC does not reflect or mirror external TLAC.

---

[2] The current proposals implicitly assume that groups are pyramidal and the ultimate parent company is a non-operating entity. In many instances, large groups structures differ from this theoretical design (e.g. mutual banks, operating ultimate parent company).

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?

We are concerned that the inclusion of contractual triggers may have unintended consequences on how these instruments may be recognised for regulatory capital purposes.

We do not believe contractual terms are necessary for internal TLAC. Specifically given material sub-groups are in most circumstances likely to reside in the same location it is likely that instruments will be covered under local laws and regulations which should set out a statutory resolution powers. As a result, the host resolution authority should have sufficient powers to convert/bail as a result of the local resolution laws and regulations. It is only if local laws do not provided for such a statutory resolution approach, that contractual triggers are required.

Additionally, it is necessary that there is sufficient differentiation between the point of non-viability where regulatory capital instruments absorb losses and the point at which internal TLAC absorbs losses, since we would expect AT1 and T2 to be converted/written down ahead of internal TLAC.

Finally, as we agree with FSB that internal TLAC is a last resort option, the trigger should ensure that this instrument is used as a complementary tool only after shareholders and capital instruments have absorbed losses and/or partially recapitalised the failing entity.

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?

We support the assertion that triggering of internal TLAC should be a 'last resort' and that there should be no automatic triggering of internal TLAC. The guidelines should also be amended to ensure that banks are included in the consultation of alternative actions before triggering internal TLAC in order to enable these actions to be implemented effectively.

We further support the host authority being required to provide information to the home authority on PONV determination to assist in group resolution strategies. We also agree that early communication is essential (principles 15) and that the home authority should be given sufficient time to decide whether to consent with the write-down and/or conversion (principle 18). Instead of fixing an absolute time-frame, it would be more important that detailed communication protocols are defined at the level of the CMG that need to be followed before internal TLAC can be triggered. While the protocols should specify the necessary steps to ensure that home authority and CMG members are informed early in the process, they should not predetermine specific measures which could otherwise limit the flexibility of the CMG to react to a specific situation.

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?

Part I. Guiding Principle 1 should be complemented with the following precision:

> "In addition to dealing with cross-border internal TLAC, the TLAC Term sheet states as well a possibility for the home authority to identify Material sub-groups within the jurisdiction of the resolution entity.
>
> To prevent gold plating of capital protection, entities that are already within the scope of a cooperative mutual solidarity system that protects the solvency and liquidity of the affiliated cooperative banks and institutions would not be targeted by internal TLAC and hence not be identified as material sub-group for Internal TLAC purposes."

Indeed, cooperative mutual solidarity system are already mentioned in the TLAC term sheet and consistency should be ensured all the way through the consequences on entities within the perimeter of a solidarity system, which can secure even more solvency than internal TLAC.

It is necessary to consider the interaction between the trigger point for internal TLAC and Tier 2 regulatory capital. It is expected that Tier 2 regulatory capital will absorb losses ahead of any other TLAC, and as per existing requirements would be converted or written down at the point of non-viability (PONV). If however the intention is for internal TLAC to absorb losses and be triggered ahead of entry of the subsidiary into resolution, it is necessary to clarify whether the trigger for internal TLAC is intended to occur at PONV or after PONV but before resolution. This differentiation is vital to preserve the creditor hierarchy and to ensure that investors have certainty and clarity as to when losses are to be absorbed across the different types of liabilities.

We also believe it is important to gain clarity on timelines to put in place internal TLAC. In particular, we note that the approach for internal TLAC deductions could have an impact on the overall levels of external TLAC required.

Finally, for a successful resolution of cross-border groups we believe it is to have cooperation agreements between resolution authorities or national legal acts enacting mutual recognition.

Conclusion

We understand that further study is required for the FSB principles, so we would appreciate the opportunity to participate in any ongoing discussions.

Yours sincerely

Ms Hedwige Nuyens	Ms. Debbie Crossman
Managing Director	Chair of the Prudential Supervision
IBFED	Working Group of the IBFED