POLISH BANK ASSOCIATION

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Financial Stability Board

Subject: Polish Bank Association response to FSB consultative document on Adequacy of loss-absorbing capacity of global systematically important banks in resolution.

Dear Sirs,

Polish Bank Association welcomes the opportunity to comment the consultative document concerning adequacy of loss-absorbing capacity of global systemically important banks in resolution prepared by the Financial Stability Board. The topic is very important topic for entire banking sector in the world as well as for the world economy because these solutions after implementation will have big impact on situation of financial market, their ability to finance the real economy and in the end on the rate of growth of world GDP.

General comment on the policy proposals

The general proposal of imposing additional high regulatory burdens on banks will bring very serious consequences for nearly all banking institution in the world. Looking at the scope of proposed regulation we can not believe that new requirements will be important only for the largest banks in

the world, in particular only for banking institution placed by the FSB on the list of 30 largest banks in the world. It will have direct strong impact on situation of smaller bank as well. The reasons for this are as follow.

Firstly, the biggest banks have their subsidiaries in many different countries in the world, also in Poland. Until now we have identified several banks in our country which will be treated as the material subsidiaries according to the current standard proposal. These subsidiaries will be obliged in one or in the other way to maintain the internal TLAC. It means that this group of banks will have to meet requirements of proposed standards. This group represents quite significant part of local financial markets.

Secondly, the proposed FSB standard will have to be implemented in EU in the future as the part of the European legislation. The present experience shows us that the EU regulator prefers usually to broaden the scope of banks which have to apply to new prudential rules. The last example of such practice is Bank Recovery and Resolution Directive (BRRD). This regulation applies to all banks domiciled in any of the Member State in EU, whereas the basic rules set up by the Basel Committee of Banking Supervision recommended to apply them to systemic important banks only. This precedent gives us grounds to be afraid that new requirements will apply in the future to all banks set up in Europe.

Thirdly, the substantial amount of additional capital, which, after adoption of this standard, will have to be raised by the group of largest banks, can contribute strongly to destabilization of the situation on capital market. The demand on capital expressed by the largest banking institutions may have the negative impact on the ability of smaller banks to find sufficient resources for their development.

We recommend generally to implement the same rule of additional prudential requirements to single homogenous category of banking institutions – global systemically important banks. However, the regulator has to take into account as well, that some banks systemically important on local level may potentially generate also big risk for stability of financial market, sometimes much higher one than one produced by the subsidiaries or branches of systemically important banks. The adoption of discussed standard may mobilize other regulators to set up similar requirements for other categories of banks. particularly for D-SIFIs.

New proposal of FSB standard relates to the specific area - additional requirements which are to be put on banks for resolution purpose. The regulator has to remember that the resolution is completely new area of regulators' interest. We understand why the resolution is so interesting topic

for regulators keeping in mind the need to minimalize the negative impact of SIFI insolvency on the real economy. We understand also the idea to minimize the application in practice the principle "too big too fail" as much as possible. However, one has to keep in mind that the world experience relating to application of resolution tools is quite limited until now. We recommend therefore the gradual implementation of new requirements in this area for banks and public authorities. The idea to double the level of present quantitative prudential capital requirements in one step can not be seen as gradual imposition of new requirements for banks. Nowadays it is difficult to convince the industry that there is sufficient scale of researches and evidences in the world which can be treated as full justification for proposed level of additional prudential requirements for banks. We strongly recommend to impose all new requirements gradually after presentation of detailed impact assessment of proposal for banks and real economy and justification of proposed level of new burdens.

New prudential burden will have the big impact of banks' possibility to finance the real economy. Since last financial crisis many banks have made big financial efforts to fulfill raising prudential requirements. The big part of them had to limit their level of leverage in order to meet the regulatory commitments. Nowadays new proposal of TLAC forces banks to mobilize additional huge amount of capital. The industry is obliged to do it in rather weak economic environment. The rate of growth of the most developed countries is low or near to zero. The official interest rates are low or below zero and the deflation occurs in many countries. This economic environment can not be regarded as favorable for additional big efforts of banks to collect much higher capital and classified liabilities. The regulator should analyze very carefully the probable impact of this regulation on world economy, particularly in short term. The simple comparison of negative consequences of potential bank crisis on the GDP growth in longer term and the limitations on financing of real economy after implementation of new requirements should not be sufficient justification as well. At the time when new monetary and structural measures are being implemented in economic policy around the world in order to boost the economic growth, the prudential regulators can not impose very heavy new burdens which can easily bring down these efforts. We call for strange and better coordination of different regulatory policies for banks in near future.

Answers to detailed questions

Calibration of the amount of TLAC required

1. **Is a common Pillar 1 Minimum TLAC requirement that is set within the range of 16-20% of risk-weighted assets (RWAs), and at a minimum twice the Basel III leverage requirement, adequate in the light of experiences from past failures to support the recapitalization and resolution objectives set out in this proposal? What other factors should be taken into account in calibrating the Pillar 1 Minimum TLAC requirements?**

Poland has not had many experiences in resolution since the last crisis on financial market. No Polish bank needed any public support and no bank collapsed during last ten years. However, we are not aware of any impact assessment which can justify the level of TLAC requirements proposed in the FSB standard. This assessment is to be prepared later, while the proposal of quantitative requirements has been published. Some recent foreign researches indicate that this level could be in practice much lower. Some of them express the opinion that the level of 13% of RWAs is quite sufficient. Other researches set up this requirement on a slightly higher level. The new requirements should be a compromise between the level of safety of financial sector and its ability to generate profits. We are convinced that lower profitability of banking sector caused by implementation of new prudential requirements could bring difficulties in mobilizing new capital and finding new investors. Such situation can generate the systemic crisis at the end of the day.

We appreciate the idea to link the level of TLAC requirements with risk-weighted assets (RWAs). In our opinion this approach allows in acceptable way to combine level of new requirements with the scale of risk generated by each bank. Of course, this solution is not perfect. There are other important elements of risk generated in banking activity which are outside scope of RWAs. We can mention in this area at least the share of each bank in payment system, but there are many other factor as well. However, the proposed metrics is in our opinion better than the nominal value of total bank liabilities.

The rules of TLAC calibration should be quite simple because any complicated system can generate unexpected loopholes, additional cost for banks and do not ensure the correctness of calibration. There are too many factors that can have the impact on the level of capital necessary in the resolution process. So it is impossible to calibrate these requirements correctly into details.

These short reservations bring us to the simply proposal recommended by us to establish TLAC requirements as for example double level of leverage ratio required in Basel III. This proposal is also mentioned by the FSB as possible method of application of requirements.

When proposing new requirements for TLAC it is necessary to keep in mind the requirements concerning additional capital buffers set up already in Basel III and CRD IV directive in Europe. Taken together, all these prudential requirements for largest banks will be much higher than the level of 16-20% RWA expressed in question 1. As it has been presented in Section 4 of Proposed term-sheet they can be as high as 21-25% RWA or higher. These requirements are indeed very high and we have to remember that they do not yet include the countercyclical buffer.

We are aware that the recommended by us the TLAC level expressed as twice the leverage ratio generates also the problem resulted from calibration of leverage ratio in Basel III. The leverage ratio is additional metrics in Basel III. We therefore believe that a correct interpretation of the FSB term sheet would be that the overall TLAC does not equal the sum of twice the leverage ratio plus buffers. However, this interpretation is not entirely clear in the text of current FSB term sheet. If however, twice the leverage ratio is interpreted as a minimum Pillar 1 requirement, this means that the buffers shall be put on top of the doubled leverage ratio level, which would be at odds with the Basel III capital requirement framework. Under Basel III, the binding capital requirement is higher one of either the leverage ratio requirements or the total capital requirements including buffers requirements and Pillar 2 requirements. From this definition it follows that it would be enough to recapitalize the bank in resolution to the level of the leverage ratio requirement and not leverage ratio plus buffers.

The regulator has also to keep in mind that leverage ratio and RWAs as calculation base have the disadvantages. The use of leverage ratio as base can encourage banks to increase the risk on the balance sheet in order to maximize the profits with the same level of own capital. This potentially very dangerous practice contradicts sharply the principle of standard on loss absorbing capacity set up in order to prevent a global systemic financial crisis and minimize the risk of turmoil in banking sector. On the other hand, assuming the RWAs as calculation base for TLAC may raise concern with the pro-cyclicality of this proposal. These disadvantages are the same as the disadvantages of the metrics in Basel III.

2. **Does the initial exclusion of G-SIBs headquartered in emerging market economies (EMEs) from meeting the Common Pillar 1 Minimum TLAC requirement appropriately reflect the different market conditions affecting those G-SIBs? Under what circumstances should the exclusion end?**

We do not see any reason why the different standard should be applied to banks from different part of the world. Nowadays the largest banks have the possibility to compete globally on worldwide scene. The approval of the different rules for bank originating from different countries will create the unlevel play field on financial market. The regulatory arbitrage can generate the bad incentives to change the place of bank headquarter in the future. This risk should be avoided by regulators.

Lower requirements for some banks can create also the artificial division of assessment made for different main players active on the financial market. The market participants and investors can regard banks with lower requirements as less credible than banks fulfilling higher prudential requirements.

One reason why global systematically important banks could be excluded from the same TLAC requirements is the local character of their activity. As long as these banks are active on domestic market in EMEs only, it could be reasonable to consider if lower TLAC requirements could be set up. But the regulator has to keep in mind that lower requirements can generate higher systemic risk on local market and if this market is big enough it can generate the problems in other countries. We are convinced that bank headquartered in EMEs which are active on international level, should meet the same TLAC requirements and the place of headquarter should not cause any differences in level of prudential requirements. We can however imagine the application of transitional clause, phasing out the exemption over a pre-specified time period.

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

The principles of calibrating any additional Pillar 2 requirements for TLAC purpose should be the same as standard principles concerning calibration of Pillar 2 for other capital requirements under Basel III regulation. From a resolution perspective most of the issues that may be considered as justification of additional Pillar 2 requirements should be covered by the analyzes and requirements made in process of setting up Basel Pillar 2 requirements. In our opinion the additional Pillar 2 requirements for resolution purpose could be limited to significant shortcomings in the bank recovery or resolution planning only.

The additional problem of application of Pillar 2 requirements is indication of proper authorities which are responsible for this calibration. There are two potential candidates: the

supervisory authorities and the resolution authorities. One of them has to be chosen as proper authorities.

Taking into account these problems: responsibility of authorities and the identification of main factors in process of establishing adequate TLAC level, we recommend to limit at this stage the application of Pillar 2 requirements for resolution purpose.

Ensuring the activity of TLAC for less absorption and recapitalization in the resolution of cross-border groups

4. **Should TLAC generally be distributed from the resolution entity to material subsidiaries in proportion to the size and risk of their exposures? Is this an appropriate means of supporting resolution under different resolution strategies? Which subsidiaries should be regarded as material for this purpose?**

   We strongly support the idea of TLAC distribution to material subsidiaries of global systemically important institutions. This solution will for sure support different resolution strategies used for G-SIB, giving the bigger chance for flexible use of resources and application of different strategies. This approach is very important specially for host resolution authorities which are convinced that this solution will allow them to use the resources for resolution purpose of material subsidiaries. Gathering all resources at consolidated level does not guarantee that such approach will be realized and does not automatically mean the possibility of using the resources for resolution of material subsidiary.

   In our opinion the scale and form of requirements set up for each material subsidiary inside the G-SIFI should be exactly the same as the rules indicated for global systemically important banks. Being the part of consolidated structure the recovery plan and resolution strategy should be similar for all material members of group and the requirements should also be similar.

   In our discussion we express the view that the critical question is the definition of material subsidiary. The definition presented in the FSB proposal is quite open but not full. It indicates the subsidiaries which have at least 5% share in total activity of global systemically important banks. Additionally, it is indicated that outside this quantitative criteria the more qualitative one can be applied as well: if the subsidiary provides some critical services for the resolution entity it may be regarded as material irrespective of the size.

However, looking from stability point of view the materiality of subsidiary depends not only on its share in consolidated balance sheet of banking group but also on the significance of subsidiary for stability of local financial market. We strongly recommend to take into account this factor as well preparing the final version of standard. The share of G-SIB subsidiary on the level of at least 5% assets of local banking sector should be added as second principal factor indicating the materiality of subsidiaries.

We would like also to submit under consideration the idea expressed in the proposal that the G-SIFI should identify its parts which should be treated as material subsidiaries. In our opinion the similar right should be granted to the supervisory authorities and this decision should be made together by the home and host supervisory authorities.

5. **To what extent would pre-positioning of internal TLAC in material subsidiaries support the confidence of both home and host authorities that a G-SIB can be resolved in an orderly manner and diminish incentives to ring-fence assets? Is a requirements to pre-position internal TLAC in the range of 75-90% of the TLAC requirement that would be applicable on a stand-alone basis, as set out in the term sheet (Section 22), appropriate to satisfy the goals of the proposal and ensure that TLAC is readily and reliably available to recapitalize subsidiaries as necessary to support resolution? Can this pre-positioning be achieved through other means such as collateralized guarantees?**

As we mentioned above, the creation of internal TLAC support bigger confidence of host authorities. In our opinion application of this approach should not have any negative impact for home authorities. But the final result can however depend on the form how the internal TLAL is collected by the members of G-SIB. If the required capital is collected directly by the material subsidiary the level of confidence of home authorities can be a little lower because they do not have the direct impact on meeting the requirements by the subsidiaries. The home authorizes have the possibility to demand G-SIFI to fulfill all requirements on consolidated basis if subsidiary does not meet its requirements. In our opinion the most important is the creation of mutual trust and cooperation between different resolution authorities.

The requirements to pre-position internal TLAC in the range of 75-90% of the TLAC requirement that would be applicable on a stand-alone basis is generally correct. However, as we indicated earlier, we recommend to treat the material subsidiary in the same way as

independent body, so the right level can be in the range of 90-100% of TLAC requirements for subsidiary.

We do not think the collateralized guarantees are the best tools. We recommend to mobilize the material subsidiaries to colect their internal TLAC directly from external investors. If this solution fails, the mother company can deliver the internal TLAC and at that moment the collateralized guarantees can be applied.

Determination of instruments eligible for inclusion in external TLAC

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

The eligibility criteria are generally clear. However, there are two unclear issues. Firstly, what is the role of FSB Resolvability Assessment Process in calibration and composition of firm-specific TLAC? In our opinion the rules should be the same for all G-SIBs. Individual process of calibration and composition of TLAC liabilities will be contradictory to the principle of equal rules existing for all banks and principle of the level playing field.

Secondly, the status of credible ex-ante commitments is unclear. This commitment is included in the part of the FSR proposal concerning instruments eligible for external TLAC (Section 8 of term sheet) but simultaneously it is indicated as industry contributions to level of 2,5% RWA or more. We understand that it is the commitment of banks to finance the contribution to an external fund which will be managed by resolution authorities. This idea should be cleared in proposed standard.

We want to raise the problem of maturity restrictions. This topic should be in our opinion carefully reviewed. The effect of the current proposal would be the incentive for banks to redeem funding with a residual maturity lower than one year.

7. **What considerations bear on the desirability of an expectation that a certain proportion of the common minimum Pillar 1 TLAC requirements consists of (i) tier 1 and tier 2 capital instruments in the form of debt plus (ii) other eligible TLAC that is not regulatory capital?**

The Section 9 of proposed term-sheet indicates that this rule concerns only entities within a resolution group which are not resolution entities. Nevertheless, thinking about the scope of entities required to include tier 1 and tier 2 capital in total TLAC requirements, the expectation of division of minimum TLAC between different categories of capital and liabilities will cause additional growth of burden for banks.

The expectation that 33% of the requirements should be met with debt, may become restrictive if outstanding senior debt can not be used to fulfill it. In theory, this provision would have the effect that supervisors could come to the conclusion that even though a bank may hold enough core capital to fulfill the quantitative level of the TLAC requirements, the bank may be treated as fulfilling requirements because it does not have enough debt corresponding to this 33% criteria. Therefore, this FSB expectation should not be the hard requirements.

We can imagine that this debt requirements may cause unintended consequences for highly capitalized and deposit-funded banks. The hard requirement concerning the proportion of TLA requirements may generate the conflict between prudential policy and resolution policy in that sense that it can create the incentives for banks to reduce the scale of CET 1 own capitals and to increase the debt issued by bank.

8. **Are the conditions specified in the term sheet (Section 8) under which pre-funded commitments from industry-finances resolution funds to provide resolution funding contribute to TLAC appropriate?**

   As we have mentioned above, the idea of resolution funds is unclear for us. Are these funds to be set up in resolution entities or in resolution authorities? We understand the general purpose of creation of funds, but the rules of their activity remain unclear. We ask for bigger clarity in final version of standard.

9. **Is the manner in which subordination of TLAC-eligible instruments to excluded liabilities is defined in the term sheet (Section 13) sufficient to provide certainty regarding the order in which creditors bear loss in resolution, and to avoid potentially successful legal challenges or compensation claims? Where there is scope for liabilities which are not subordinated to excluded liabilities to qualify for TLAC, are the transparency and disclosure requirements set out in section 13 and 24 sufficient to ensure that holders of these instruments would be aware of the risk that they will absorb losses prior to other equally ranking but excluded liabilities? If not, what additional requirements should be adopted?**

   Generally, in our opinion the proposal provides certainty regarding the order in which creditors bear losses and is sufficient to ensure holders that they are aware of the risk they take.

We understand the intent to restrict TLAC to debt that clearly absorbs losses in resolution and that the requirement for subordination is a way to secure that this purpose is achieved. Under the BRRD in the EU un-preferred bail-inable senior un-secured bonds with longer maturity (remaining maturity longer than one year) are fully eligible for the MREL (Minimum Requirements for Eligible Liabilities and Own Funds). The rationale behind this is bail-in of senior un-secured bonds governed by the laws of the EU member states. In the FSB proposal such senior un-secured bonds may only be treated as eligible TLAC instruments under certain circumstances and to very limited amount. Indirectly, the term sheet therefore could imply that senior bonds are not effectively bail-inable under the BRRD, as they are not eligible towards TLAC. We believe that the FSB should recognize senior debt and other investment liabilities without limitation, provided that the jurisdiction has a credible bail-in regime in place. For example, the BRRD provides that corporate deposits with maturity longer than one year can be included in MREL.

Interaction with regulatory requirements and consequence of breaches of TLAC

10. Do you agree that the TLAC requirements for G-SIBs should be integrated with Basel III such that the minimum TLAC requirements should be met first, and only after TLAC is met should any surplus common equity tier 1 (CET 1) be available to meet the Basel III buffers?

As we expressed our view above, we recommend to integrate TLAC requirements with Basel III as strong as possible. However, the proposed form of integration is not the most favorable for us. In our opinion the basic prudential requirements for banks should come from Basel III. This regulation sets up the necessary condition which have to be fulfilled by each bank in order to start the banking activity and provide services to clients. That is the reason why we recommend to accept other general principle. First all prudential requirements coming from Basel III (including capital buffers) should be fulfilled and later any surplus in capital can be regarded as instruments belonging to TLAC. In our opinion the capital buffers included in Basel III should be treated as the measures which allow the bank to survive less successful times without going directly into process of resolution. The buffers can prevent the further step – necessity of going to bank resolution.

Transparency

11. What disclosures (in particular in terms of the amount, nature and maturity of liabilities within each rank of the insolvency creditor hierarchy) should be required by resolution

entities and material subsidiaries to ensure that the order and quantum of loss absorption in insolvency and resolution is clear to investors and other market participants?

The order and quantum of loss absorption in insolvency and resolution is difficult matter. We do not believe it is good method to inform all investors about the risk they bear. The unique solution is to oblige banks to inform clients that the determined instruments is out of scope of loss absorption. The proposal of standard does not deliver any information concerning the hierarchy in the process of loss absorption. We understand the lack of information is caused by the fact that the hierarchy is determined today in national law and there is no common approach used in this area worldwide until now.

Limitation of contagion

12. What restriction on the holdings of TLAC are appropriate to avoid the risk of contagion should those liabilities be exposed to loss in resolution?

We are convinced that the limitation proposed in section 18 of term sheet is very restrictive because it is similar to the solution included in Basel III. We understand the reason why the proposal has been prepared in this way – it should allow to minimize the risk of contagion. But being consistent with this idea we should add additional limit. The TLAC instruments should not be bought by smaller banks as well, not only by G-SIBs. The lack of this limitation can generate the risk of contagion in whole banking sector if the smaller banks decide to have in their portfolio significant share of assets regarded as TLAC by G-SIBs.

Conformance period

13. Should G-SIBs be required to conform with these requirements from 1 January 2019? Why or why not? What, within the range of 12 to 36 months following the identification as a G-SIB, should be the conformance period for banks identified as G-SIBs at a future date?

The proposed date of 1 January 2019 is in our opinion the earliest possible date of conformance of TLAC requirements. We recommend to postpone this date because the earliest date of adoption of the TLAC standard by the FSB can be the end of 2015. The banks need to have enough time in order to collect the sufficient part of required TLAC without the risk of causing big turbulence on capital market. All largest banks in the world will be obliged to create TLAC in the same period and the total demand for capital may grow rapidly in this period. The gradual implementation of requirements will help avoiding big volatility of prices

on capital market. The proposed range of 36 months should be set up in standard in order to give the possibility of gradual TLAC building in banks. This proposed period should be sufficient.

The open question is the conformance period for banks identified as G-SIBs in the future. We can imagine that big bank which can be treated in near future as G-SIB is aware of its position and it can start to build TLAC capital before it will be formally indentified as G-SIB. Thus for such bank the conformance period can be shorter as for the initial group of banks.

Market impact and other aspects

14. How far is the TLAC proposal, if implemented as proposed, likely to achieve the objective of providing sufficient loss-absorbing and recapitalization capacity to promote the orderly resolution of G-SIBs?

The proposal requires creation of much bigger capital buffers in largest banks which may allow these banks to maintain the activity of their crucial functions after the implementation of resolution process. But the proposal does not solve the problem of the functioning of bank after reconstruction. The new, limited bank will not meet all prudential requirements (for example TLAC requirements). This bank can meet only basic capital requirements coming from Basel III but it will not meet requirements of additional buffers and requirements for resolution purpose. The standard should deliver the road map for banks after resolution how quickly they will have to meet all prudential requirements.

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

The result of new requirements seems to be clear. They will increase cost of banking activity and the cost of services delivered by these institutions to their clients will be higher. As consequence, the regulation can limit the access of some potential clients to the credit. For banks new requirements will generate the lower profitability of their activity, lower return for investors and one of the consequences of this change can be more serious problems for banks to find the investors ready to invest their money in this sector of economy.

The issuance of long term debt which can be transformed later in shares will also require higher cost paid for investors for taking this risk. The good idea to minimize this cost could be to make the attempt to find the link between TLAC requirements and long term liquidity

requirements (NSFR). If the same instruments could be used in order to fulfill both requirements by banks the total amount of these liabilities could be lower and the cost for banks could be lower.

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

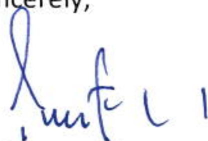
We expect the result of the proposal will be lower access to financing by the part of real economy. We have to remember that the biggest banks have the biggest share in financing of big projects, for example infrastructure projects. It is difficult to imagine that such projects can be financed by small banks. The additional prudential requirements will cause higher cost of funding for banks and for their clients. It will limit access to credit for some clients and contribute to lower rate of economy development. This consequence is particularly important at present day when the big part of most developed countries is close to recession. Higher prudential requirements may cause that the tools of monetary and fiscal policy referred to strengthen economic growth may be completely inefficient, because their potential positive impact will be strongly reduced by the additional prudential requirements set up for banks.

In longer term, assuming the first resolution process conducted with use of TLAC instruments occurs successful in terms of financial market stability and continuation of financing economy, the risk of strong negative consequences for real economy and for balance of public finance caused by turbulence in the banking sector will be much lower. In that situation the benefits can be higher than cost incurred.

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

We have no comments in this area.

Yours sincerely,



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