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Dear Sir or Madam

Standard & Poor's Ratings Services ("S&P Ratings Services") welcomes the opportunity to comment on the Financial Stability Board's consultative document "*Adequacy of loss-absorbing capacity of global systemically important banks in resolution*" ("*the consultative document*"), released on Nov. 10, 2014.

Standard & Poor's believes that the Financial Stability Board's recent proposal for total loss-absorbing capacity (TLAC) requirements for global systemically important banks (G-SIBs) will likely increase the credibility of bail-in strategies in the recovery and resolution of failing institutions. Combined with other regulatory initiatives underway in a number of jurisdictions, it may represent a credible alternative to government support, although the resolution through bail-in of a global complex bank and the possible related contagion risks are still largely untested. We consider that the proposed minimum TLAC requirements would have been generally enough to cover the government-funded recapitalization needs of G-SIBs in the recent crisis, and that they have been calibrated to instill market confidence regarding their sufficiency. Adequate disclosure will be key to establish as deep as possible an investor base for TLAC instruments and ensure an orderly resolution process as a bank breaches nonviability.

I have attached to this letter an article that S&P Ratings Services published today in response to the consultation, entitled "All In On Bailing In? The FSB Weighs In, With A Proposal On Global Banks' Total Loss- Absorbing Capacity", which expands on the above themes and addresses selected questions of the consultative document.

This letter and the article have been prepared by S&P Ratings Services' Financial Institutions ratings group. I trust that the comments made therein are helpful and of relevance to the Financial Stability Board. S&P Ratings Services is committed to continuing its dialogue with the Financial Stability Board. Should you have any questions regarding the contents of this letter or the article please contact me or my colleagues listed in the article.

Yours faithfully,

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RESEARCH

All In On Bailing In? The FSB Weighs In, With A Proposal On Global Banks' Total Loss-Absorbing Capacity

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All In On Bailing In? The FSB Weighs In, With A Proposal On Global Banks' Total Loss-Absorbing Capacity

*(**Editor's Note:** The following is Standard & Poor's Ratings Services' response to the Financial Stability Board's consultative document "Adequacy of loss-absorbing capacity of global systemically important banks in resolution," issued Nov. 10, 2014. The views expressed in this response represent those of Standard & Poor's Ratings Services and do not address, nor do we intend them to address, the views of any other affiliate or division of Standard & Poor's Financial Services, LLC. We intend our comments to address the analytical needs and expectations of our credit analysts as well as the questions we receive from investors. Our current ratings criteria are not affected by our comments on the consultative document.)*

Standard & Poor's believes that the Financial Stability Board's recent proposal for total loss-absorbing capacity (TLAC) requirements for global systemically important banks (G-SIBs) will likely increase the credibility of bail-in strategies in the recovery and resolution of failing institutions. Combined with other regulatory initiatives underway in a number of jurisdictions, it may represent a credible alternative to government support, although the resolution through bail-in of a global complex bank and the possible related contagion risks are still largely untested. The TLAC proposal therefore represents in our view a key component of the regulatory jigsaw to address the "too-big-to-fail" dilemma, ensure that taxpayers don't bear the costs of bank failures, reduce any subsidy of bank funding costs stemming from market expectations of an implicit government guarantee, promote market discipline, and minimize moral hazard. (Watch the related CreditMatters TV segment titled "Standard & Poor's Response To The TLAC Consultation: All In On Bailing In?" dated Feb. 2, 2015.)

In light of regulatory developments regarding recovery and resolution--such as Dodd-Frank's Orderly Liquidation Authority and the EU Bank Recovery and Resolution Directive--we believe that potential extraordinary government support available to banks' senior unsecured bondholders will likely diminish within the next couple of years in a number of jurisdictions. At the same time, we believe that the proposed TLAC rules mean that some debt instruments could reduce the default risk of a bank's senior unsecured creditors beyond what is currently reflected in our stand-alone assessments on these banks. We therefore recently published an article soliciting public comments on our proposed approach to analyzing banks' additional loss-absorbing capacity (see "Request for Comment: Incorporating Additional Loss-Absorbing Capacity (ALAC) Into Bank Rating Methodology," published Nov. 24, 2014, on RatingsDirect and box 1 below).

Overview

- The proposal for total loss-absorbing capacity (TLAC) requirements for global systemically important banks (G-SIBs) will--combined with other regulatory initiatives underway--likely increase the credibility of bail-in strategies in the recovery and resolution of failing institutions.
- We consider that the proposed minimum TLAC requirements would have been enough to cover the government-funded recapitalization needs of G-SIB in the recent crisis, and that they have been calibrated to instill market confidence regarding their sufficiency.
- Adequate disclosure will be key for investors so that they can establish as deep as possible an investor base for TLAC instruments and ensure an orderly resolution process as a bank breaches nonviability.
- We estimate that G-SIBs would potentially need to issue in excess of $500 billion in TLAC instruments in the next four to five years as a result of the proposal, using the lower end of the 16%-20% proposed range with reference to regulatory RWA.

We consider that the proposed minimum TLAC requirements--despite our view of shortcomings in regulatory capital metrics--would have been enough to cover the government-funded recapitalization needs of G-SIBs in the recent crisis, and that they have been calibrated to instill market confidence regarding their sufficiency. That said, the adequacy of the proposed requirements (including the requirement of TLAC representing at least 16%-20% of regulatory risk-weighted assets [RWA], plus other buffers such as the 2.5% capital conservation and G-SIB buffers) will, in our view, also depend to some extent on the progress that will be made in improving the consistency and comparability of regulatory RWA globally. We note that a number of significant regulatory initiatives are underway to address this lack of comparability. The proposals also establish the Basel 3 leverage ratio as a backstop requirement (TLAC would need to represent at least twice the leverage ratio requirement). Given that addressing the current shortcomings of regulatory RWA will likely be a protracted process, we agree that there is a need for more than one regulatory capital metric. However, we note that Basel leverage ratio minimum requirements are not finalized yet. If the minimum level that will be decided exceeds the proposed 3% threshold, we expect that this metric could become the main driver of TLAC requirements for a number of institutions. This could in our view have unintended consequences. For instance, it could encourage bank management teams to undertake riskier strategies to offset increased funding costs. Under our proposed ALAC framework, we use our Standard & Poor's RWA that we calculate using our risk-adjusted capital framework--which we view as a more globally consistent, risk-sensitive measure--to assess the potential uplift for senior creditors.

Incorporating ALAC Into Bank Ratings

The proposed criteria changes in "Request For Comment: Incorporating Additional Loss-Absorbing Capacity Into Bank Rating Methodology," published on Nov. 24, 2014, will allow us to better reflect the reduced likelihood of default that operating company senior unsecured creditors could face as a result of the bail-in of contractually, structurally, or statutorily subordinated instruments in the event of a bank resolution. New resolution frameworks are adding to the riskiness of instruments that are first in line to be bailed in (risk that we capture in our revised criteria, "Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions," published Jan. 29, 2015). However, the bail-in of these subordinated creditors could partly or wholly offset the heightened risks for operating company senior unsecured creditors that are becoming less likely to benefit from government bail-outs.

The RfC proposes that ALAC be recognized as a basis for elevating the issuer credit rating (ICR) on a bank (along with related issue credit ratings) above the stand-alone credit profile (SACP), in a similar way to the uplift currently applied due to our view of how extraordinary government or group support may reduce a bank's default risk. We would consider uplift for ALAC in cases where banks are subject to resolution mechanisms enabling recapitalization of a bank through bail-in as it approaches nonviability (and not in situations when loss absorption only occurs in the bankruptcy process of a failed bank). We propose to use ALAC instead of TLAC because TLAC can, in certain circumstances, include senior unsecured obligations whose likelihood of default determines the ICR we assign to a bank.

Standard & Poor's proposed ALAC concept includes bail-inable hybrids (and senior unsecured obligations issued by a bank's NOHC). By comparison, the FSB's proposed TLAC concept also includes common equity, and allows under certain conditions the inclusion of a proportion of other senior unsecured obligations and resolution funds. Generally speaking, TLAC looks at total loss-absorbing capacity, while ALAC considers the additional loss-absorbing capacity, that is, the benefit to senior unsecured creditors in addition to what is already reflected in our SACP. For details, see "Request for Comment: Incorporating Additional Loss-Absorbing Capacity (ALAC) Into Bank Rating Methodology," published Nov. 24, 2014.

The RfC period has now finished. This article is based on the ALAC proposal as published only and does not provide any insight into what the final criteria may look like.

We also note that groups almost exclusively funded by customer deposits--or having large subsidiaries with such funding profiles--could be particularly constrained under this framework. In general, the FSB's quantitative impact study will in our view be critical to understand possible implementation issues and ensure that the framework does not have unintended consequences and does not unwittingly penalize certain business models.

We believe that the proposal could accommodate various resolution strategies (multiple versus single point of entry) and corporate structures (existence of holding company or not), although a number of technicalities--in the TLAC proposal and recovery and resolution regulations--still need to be addressed. That said, at the moment, we believe that groups with holding company structures will potentially have a wider range of instruments at their disposal to meet the proposed TLAC requirements. In addition, banks and supervisors will need in our view to be mindful of the maturity of TLAC instruments. As instruments with residual maturities of just over one year may be fully included in TLAC, in a stress situation where a bank's access to capital markets may become severely restricted for such instruments, we see a risk of rapid erosion in the TLAC buffer in the event of excessive concentration in the one-to-two year time bucket, therefore accelerating loss of access to funding.

Adequate disclosure will be key for investors so that they can establish as deep as possible an investor base for TLAC instruments and ensure an orderly resolution process as a bank breaches nonviability. Disclosure will need to highlight clearly the pecking order of the various types of liabilities within resolution entities, and not just at consolidated group level. Investors will need details on the maturity profile of the various TLAC instruments to understand any possible longer-term liquidity considerations. Without detailed, ideally standardized, additional disclosure, we believe it will be very difficult for investors to assess the different instruments of a consolidated group's different entities, whose risk profiles will increasingly diverge, in our view.

Will capital markets be able to absorb banks' TLAC needs globally? We believe that a key consideration regarding the workability of the proposed framework will be the depth of the potential investor base for what we will see as instruments that will act as contingent capital if we believe regulations meet their objectives. We estimate that for the 30 G-SIBs alone (excluding three entities based in emerging market economies that the FSB proposes to exempt from TLAC requirements initially) in excess of $500 billion in TLAC instruments would need to be issued in the next four to five years using the lower end of the 16%-20% proposed range with reference to regulatory RWA to determine total needs. The requirements could double in our view by using the upper end of the proposed range. Our rough estimates don't consider, for instance, scheduled maturities of existing instruments, assume no changes in regulatory RWA, exclude potential intragroup TLAC requirements exceeding consolidated solo calculations, and ignore the leverage ratio backstop requirements, but they don't consider the proposed eligibility within TLAC--under certain conditions--of some operating company senior instruments and resolution funds. All in all, required amounts under the proposal would likely exceed these estimates. Also, in addition to the issuance by G-SIBs, we expect that regulators in specific jurisdictions will apply similar requirements to domestically important institutions, which will thus increase the amount of TLAC-eligible instruments that banks globally—not just G-SIBs—will aim to issue in the coming years. Given the amounts likely to be at play, we believe that preliminary rules need to be finalized rapidly to give banks strong incentives to start filling TLAC gaps as early as possible--even if some details may have to be settled at a later stage.

Our Responses To Selected Questions From The FSB's Consultation

Here, we give our responses to several questions, some of which we have grouped together, that we have selected from the FSB's consultative document. The numbers on the questions below are the same as in the FSB paper.

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

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?

We believe that recovery and resolution legislations, once passed and fully implemented, together with the proposed TLAC framework, will likely increase the credibility of bail-in strategies in the recovery and resolution of failed (or failing) systemically important banks in certain jurisdiction--although such resolution strategies are still largely untested and possibly prone to contagion risk.

The proposed overall calibration would in our view generally allow a systemically important bank--through TLAC bail-in--to reconstitute a common equity Tier 1 (CET1) buffer sufficient to be viewed as viable from a regulatory point of view after depletion of a substantial part of its existing CET1 capital base. We consider that the proposed minimum TLAC requirements would have been enough to cover the government-funded recapitalization needs for G-SIBs in the recent crisis, and that they have been calibrated to instill market confidence regarding their sufficiency.

That said, we continue to believe that the comparability and consistency of regulatory RWA across both countries and banks remains weak. But we note that a range of regulatory initiatives--from the Basel Committee and other international standard setters and regulators--are underway to address these inconsistencies, which could lead to some improvement by the time the TLAC proposal becomes effective. The adequacy of the requirement, once finalized, will to some extent be influenced by any future movements in regulatory RWA as a result of the regulatory initiatives currently underway.

We see benefits in the proposed inclusion of the leverage ratio in the TLAC calibration as a backstop measure, due to the current shortcomings of regulatory RWA. However, we note that the Basel 3 leverage ratio threshold of 3% is only a proposal at this stage. Given the ongoing discussions on this topic, and the TLAC requirement of at least twice the Basel 3 leverage ratio requirement, it is possible that the TLAC proposal could make the leverage ratio the primary ratio to be considered, rather than this metric remaining a backstop measure (see "The Basel III Leverage Ratio Is A Welcome Addition, But Not A Substitute For Risk-Weighted Capital Metrics," published on Sept. 20, 2013).

For instance, certain historically low-risk retail banks could be particularly constrained by the leverage ratio requirement in the event of a higher one than in the current 3% proposal. This is because the requirement could become the driving constraint. Should such entities also benefit from customer deposits exceeding loans, their limited needs for wholesale funding would also compound their needs for TLAC issuance.

In light of the current inconsistencies in regulatory RWA, we continue to favor our own risk-adjusted capital framework, which we consider more globally consistent and propose to use as the reference for our own proposed ALAC framework (see "Request For Comment: Incorporating Additional Loss-Absorbing Capacity Into Bank Rating Methodology," published on Nov. 24, 2014).

Our RfC proposes that ALAC be recognized as a basis for elevating the ICR on a bank (along with related issue credit ratings) above the SACP, in a similar way to the uplift currently applied due to our view of how extraordinary government or group support may reduce a bank's default risk. We would consider uplift for ALAC in cases where banks are subject to resolution mechanisms enabling recapitalization of a bank through bail-in as it approaches nonviability (and not in situations when loss absorption only occurs in the bankruptcy process of a failed bank). The proposed criteria require a quantity of ALAC that is commensurate, in our assessment, with material reductions in default risk of an issuer's senior unsecured obligations, once authorities have triggered the conversion or write-down of ALAC instruments. The minimum requirement we have proposed for a one-notch elevation of an ICR on a bank is ALAC equivalent to 5% of a bank's RWA, as determined in reference to our RAC framework. The minimum requirement for a two-notch elevation of an ICR is 8% of Standard & Poor's RWA. The use of Standard & Poor's RWA is consistent with our assessment of bank capitalization.

We believe that a 16%-20% level of TLAC to Basel 3 RWA should be generally sufficient to recapitalize a failed (or failing) bank, particularly considering that this figure excludes the capital conservation buffer and G-SIB buffer, which could be up to 5% of additional capital (even higher for some U.S. banks pending a proposal to establish higher G-SIB buffers), thus providing loss-absorbing or recapitalizing capital of up to 21%-25% of regulatory RWA. Although our Standard & Poor's RWA tend to be higher than regulatory RWA (on average by in excess of 60% for the 30 entities currently classified as G-SIBs), the proposed minimum levels would materially reinforce banks' ability to withstand a substantial stress scenario even after a material capital depletion. We deem an amount of capital equaling 8% of Standard & Poor's RWA as sufficient to withstand an 'A' (substantial) stress scenario (see "Understanding Standard & Poor's Rating Definitions," published June 3, 2009). Including the capital conservation buffer and banks' respective G-SIB buffer, the 16% to 20% requirement with reference to regulatory RWA would in our view lead to material buffers of equity or instruments convertible into equity in excess of the level we deem sufficient for a bank to withstand a substantial 'A' stress scenario.

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 don't see a strong rationale for the initial exclusion of G-SIBs headquartered in EMEs, although we understand that the depth of capital markets in certain jurisdictions and excess of customer deposit funding for certain entities could represent additional constraints. Importantly, we also believe that governments' propensity to provide support to banks in case of need diverges in certain jurisdictions.

In our view, ongoing initiatives in certain regions around recovery and resolution, combined with the TLAC proposals, may represent a credible alternative to government support for systemic institutions. However, not all jurisdictions are as advanced in embracing bail-in principles. Many jurisdictions in Asia-Pacific and Latin America are taking more gradual steps, if at all, in adopting guidelines on resolution regimes. In most countries in those regions, we may continue to believe that government support remains predictable enough for systemic institutions, in case of need, for us to continue to include notches of uplift to the ratings. For more details on the progress with resolution schemes in Asia-Pacific, see "Asia-Pacific Major Banks' Basel III Hybrid Securities Issuance May Grow To US$350 Billion By 2019," published on Nov. 21, 2014.

We believe that excluding such G-SIBs from the proposed framework will lead to an implicit subsidy to the benefit of these institutions compared to other global peers. Excluding these entities from the TLAC requirements could also represent a missed opportunity to strengthen market discipline, such as the requirement to maintain a material buffer of subordinated debt that would be exposed to losses in a period of stress.

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?

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

readily and reliably available to recapitalize subsidiaries as necessary to support resolution? Can this pre-positioning be achieved through other means such as collateralized guarantees?

We believe the proposed approach leaves the door open to different resolution strategies. It should generally allow the resolution entity to act as the source of loss-absorbing capacity, while facilitating a transfer of losses from material subsidiaries within this group or subgroup.

However, we would see material prepositioning requirements as further evidence of the ongoing fragmentation of the banking system, leading to trapped capital and liquidity for global banks. We believe that there is a risk of widespread requirements by local regulators of meaningful prepositioning, even for relatively small subsidiaries of foreign groups. The ensuing reduced fungibility of capital and liquidity, for a given aggregate amount of capital and liquidity, could lead to reduced resilience by such a group to external shocks. Ultimately, systematic and material prepositioning needs would in our view increase capital and liquidity needs for these groups, with possible unintended macroeconomic consequences. We see prepositioning requirements to some extent as a consequence of recent high-profile international bankruptcies, such as that of Lehman Brothers, and the possible lack of trust among regulators that international cooperation will prevail over national interests in similar crisis situations.

The resilience of entities subject to TLAC regulation would in our view benefit from being able to maintain a degree of flexibility in terms of distribution of regulatory TLAC across their subsidiaries globally in order to reallocate buffers if needed as risks emerge within particular entities of a group. This flexibility, though, should be considered along with ensuring that an adequate amount of TLAC is prepositioned in the major subsidiaries, so that local regulators do not start to ring fence the local entity, which would impair the facilitation of an orderly wind-down.

We consider that the proposed definition of "material subsidiaries" (at least 5% of the group's consolidated RWA or revenue or total leverage exposure, or identified by the G-SIB's crisis management group as material to the exercise of critical functions) is relevant and transparent enough. An alternative approach could draw on some of the indicators of the Basel Committee's G-SIB classification to determine a subsidiary's systemic importance to its host country. However, this would make the overall framework more complex, in our view. In any case, we believe that the proposal for intragroup TLAC distribution should not distract supervisors globally from advancing the important global agenda for "home-host" supervisory cooperation.

We note ongoing initiatives to improve home-host cooperation and preparedness for the resolution of systemic entities. However, we believe that it is likely that some jurisdictions will insist on a degree of prepositioning of TLAC in material subsidiaries not only to facilitate loss transfer and absorption through the group, but also to provide tangible evidence that resolution cooperation will not be empty words.

The Quantitative Impact Study will be key in our view in determining which prepositioning requirements would be appropriate while limiting unintended consequences for groups' overall resilience and the economy. Depending on the definition of "material subsidiaries," we expect that the 75%-90% range could lead in some cases in materially larger TLAC requirements for a group when aggregating these requirements than if requirements were calculated solely on the basis of the consolidated group--particularly as the basis for the requirements (RWA versus leverage) may vary from one group entity to another, and funding structures may differ materially.

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

We believe that the eligibility criteria are generally appropriate.

We consider that it is important for a systemically important bank to maintain a sufficient buffer of TLAC liabilities even in period of financial stress and unfavorable economic conditions when reduced investor appetite may constrain its ability to continue issuing TLAC liabilities for a prolonged period. For that reason, the maturity profile of eligible TLAC may be almost as important as its size.

We note that the proposed minimum maturity of at least one year would allow for significant maturity concentration. While we understand that authorities should ensure that the maturity profile of TLAC liabilities is "adequate," we believe that there could be inconsistent application of this objective in the absence of more explicit guidance around what an adequate profile would be. This could lead to some banks being exposed to high redemptions of TLAC liabilities during a period of stress, resulting in a material proportion of the TLAC buffer disappearing ahead of an intervention from the authority. In our ALAC RfC, we propose to cap the contribution of instruments with a maturity of 12 to 24 months. Rapid reduction in the size of the TLAC buffer may itself limit the ability of the authorities to look for various recovery options.

We believe that clarification would be necessary regarding whether structured notes would be listed within excluded liabilities.

Given the importance of the changes introduced with resolution regimes, we place strong emphasis on any effort to provide greater clarity to investors regarding the nature of the risks they bear. We understand that there is significant room for confusion regarding the nature of different instruments, including the difference between senior and subordinated instruments, and the different implications of contractual, statutory, or structural subordination.

The lack of differentiation among funding instruments and contingent capital instruments may itself be a source of confusion in the market. This is relevant in the case of a nonoperating holding company when it accounts for a substantial part of group funding. As mentioned earlier, it can be exacerbated depending on whether the maturity profile is biased toward the medium or short term (although above 12 months).

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

We see some benefits in having a significant proportion of the Pillar 1 TLAC requirements consisting of contingent capital instruments that can be drawn upon in case of need. While being less expensive than common equity, these non-common equity instruments may play a stabilizing role when common equity is depleted.

We believe that in most cases, banks will naturally meet this expectation, in part to minimize overall costs. In cases where the existing liability structure of a group may represent more of a constraint, it would be useful to understand under what circumstance regulators could tolerate an exception to this "expectation."

We understand that some banks maintain higher common equity regulatory ratios than their peers, but we believe that these ratios are not necessarily comparable given differences among jurisdictions and among banks in the way risks are assessed. While authorities are aware of these differences, initiatives to cope with them have been uneven.

We view one of the purposes of the introduction of new standards regarding loss-absorbing capacity as providing financial resources to restore capital ratios when common equity has been absorbed by losses. For the same reason, we have issued our ALAC Request for Comment, which proposes to reflect the potential benefit of extraordinary intervention when non-equity instruments issued by the bank have the capacity to generate common equity through conversion or write-down when a bank is failing.

We understand that, for some institutions, compliance with TLAC minimum may result in a need to raise non-equity instruments in the market in the absence of any funding needs. We believe, however, that having additional capacity to generate common equity could in some cases stabilize the creditworthiness of these institutions in a period of stress.

10. Do you agree that the TLAC requirement for G-SIBs should be integrated with Basel III such that the minimum TLAC requirement should be met first, and only after TLAC is met should any surplus common equity tier 1 (CET1) be available to meet the Basel III buffers?

We agree with the proposal because it ensures that TLAC requirements are equally constraining as minimum regulatory capital requirements.

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?

We believe that clarity regarding the pecking order of a bank's liabilities under an orderly liquidation is paramount for an orderly liquidation process to work smoothly, and avoid contagion issues.

As a rating agency, transparency regarding the pecking order of liabilities is essential in assigning debt ratings. We have specified this requirement as one of our key three hurdles for the implementation of the U.S. Orderly Liquidation Authority: "Providing clear and transparent guidelines about how different securities will be treated under an SPOE (single point of entry) resolution approach at both the holding company and operating company level to sufficiently quell market uncertainty, which often contributes to panic and potentially contagion." (See "U.S. Banks: Government Support Is Fading But Not Gone--Yet," published Aug. 4, 2014).

We suggest that with the implementation of TLAC, bank financial statements should be revised to reflect the order of seniority of all liabilities, clearly demarcating those liabilities that are inclusive and those that are exclusive in TLAC. The table needs to be constructed in a manner such that it is clear if certain operating subsidiary's liabilities are more senior than their other liabilities or those of holding companies, if such a structure is in place. We suggest that financial statements also disclose whether the pecking order of the debt is due to contractual, structural, or statutory reasons. The disclosure should also clarify what liabilities are excluded from bail-in.

We would like to be able to determine from the disclosure whether the debt outstanding is redeemable, and if so, whether regulators would have to approve the redemption. We expect to be able to see the rolling maturities of the banks' liabilities, with particular focus on TLAC, and with additional disclosure beyond one year (for example, redemption of TLAC instruments between 12 and 24 months). This will help clarify not only why certain liabilities are excluded from TLAC, but also show the amount of issuance needed over the coming year to comply with TLAC.

We think it will be informative for the market to breakdown the TLAC holding not only on a consolidated basis but also for the key subsidiaries, to ensure greater stability in a period of stress.

Quarterly disclosure would be ideal, with semiannual disclosure a strict minimum, depending on the existing frequency of a bank's financial statements.

Banks should also disclose the amount of TLAC instruments they are holding that can be used for bail-ins of other banks.

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

We believe that the concept of TLAC will likely make certain instruments more akin to capital than funding instruments in terms of risk profile. To avoid contagion risk and make the resolution through bail-in of a G-SIB more practicable, we agree that material regulatory requirements should be imposed on the holdings of TLAC by banks--not only G-SIBs but also smaller institutions.

However, we believe that the market depth for TLAC instruments is a key consideration for the workability of this framework. In this respect, it would be useful for the quantitative study to consider the impact of the proposed restrictions on the holding of TLAC on the depth of the market and market liquidity, not only for all subordinated debt instruments, but also for holding company senior debt and possibly in some cases, senior operating company debt if included in TLAC.

More generally, rather than relying on multiple restrictions on holdings of these instruments by specific investor classes, we believe market participants should be put in a position to assess the risks through clear structures and sufficient disclosure.

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?

Rather than a firm date of Jan. 1, 2019, the determination of a final date of compliance with TLAC should be based on the date that local regulators put a final rule in place so that a bank has time to build to the required levels.

We believe this timeframe should be over a four-year period--in line with capital phase-in requirements--with the percent of TLAC required, broken down proportionately over the four years.

Given the intent of the resolution framework to transfer the burden of recapitalization of systemically important banks on investors, we believe it is important for banks to maintain stable access to funding that senior investors have sufficient visibility on the expected buffer of subordinated liabilities that will rank behind them in resolution.

We note, however, that once final rules are in place, banks may still need to adjust issuance plans depending on the magnitude of changes to regulatory RWA, given the related regulatory initiatives currently underway.

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

TLAC requirements will likely put some additional pressure on revenues, besides that arising from low interest rates that are likely to remain so for several years, although issuance needs will likely vary considerably among institutions. For a number of institutions, issuance needs will be contained as a result of the ability to reshuffle wholesale funding issuance among types of instruments and within the group over the next four to five years. However, some institutions (for example, groups with funding needs matched by deposits) will likely need to issue much larger amounts of debt to meet the requirements, without the need for additional funding. For such entities, the impact will depend to some extent on how the proceeds will be invested.

Based on a rough estimate of G-SIBs' existing instruments that could be included in TLAC under the proposal (excluding any maturities), and basing the requirements on a minimum level of 16% of consolidated RWA (plus capital conservation and G-SIB buffer; using the latest fully loaded RWA where available), we estimate that additional debt issuance for the G-SIBs (outside EME) could well exceed $500 billion. We estimate that that 16 G-SIBs domiciled in Europe would account for around three-quarters of this figure. We estimate that issuance needs would double, if the minimum used were 20% of regulatory RWA.

We believe the relatively narrow credit spreads on the subordinated instruments that would contribute to TLAC are likely to widen with the prospect for increased issuance in the coming years and increased clarity on their ranking in resolution--and therefore regarding their risk. While the current appetite for yield may help banks to constitute buffers at reasonable costs, these spreads may widen if fundamentals were to worsen. This additional cost would, however, help ensure that banks can maintain access to funding in period of stress and therefore retain trust and confidence in the absence of government support.

Related Criteria And Research

Related criteria

- Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- Request For Comment: Incorporating Additional Loss-Absorbing Capacity Into Bank Rating Methodology, Nov. 24, 2014

Related research

- Credit FAQ: A Closer Look At The Proposed Criteria On Bank Additional Loss-Absorbing Capacity, Dec. 19, 2014
- All In On Bailing-In? Global Resolution Regimes Take A Mixed View May 5, 2014
- Credit FAQ: The Rating Impact Of Resolution Regimes For European Banks April 29, 2014
- The Basel III Leverage Ratio Is A Welcome Addition, But Not A Substitute For Risk-Weighted Capital Metrics, Sept. 20, 2013