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The Financial Stability Board
Centralbahnplatz 2
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By email: fsb@fsb.org

Zurich, 9 February 2017

Re: Consultative Document "Guiding Principles on the Internal Total Loss-absorbing Capacity of G-SIBs ('Internal TLAC')"

Dear Sir / Madam

We refer to your consultation on the "Guiding Principles on the Internal Total Loss-absorbing Capacity of G-SIBs ('Internal TLAC')" of 16 December 2016.

UBS agrees to a specific, well-balanced amount of pre-positioned internal TLAC as an important mechanism to pass on losses and recapitalization needs of material entities. However, as already stated in our response to the FSB TLAC consultation in February 2015, **internal TLAC should not limit the CMG's flexibility to move resources to restore the viability of a particular subsidiary in need**. Therefore, the FSB should ensure that the CMG has sufficient flexibility in moving resources to cover significant losses. **A too rigid approach with regards to size, composition, issuance, location or triggers will actually make it more difficult to respond to an emerging crisis** in one of the material sub-groups and arguably will increase the risk that a G-SIB cannot cope with a severe crisis and recover on its own, but rather be subjected to a resolution proceeding.

UBS appreciates the additional guidance provided by the FSB to assist CMG authorities in the implementation of internal TLAC mechanisms consistent with the TLAC standard. We would like to offer the following considerations that are of particular importance to us and, therefore would appreciate due consideration by the FSB:

- **Application of internal TLAC primarily for regulated bank entities**: Only material entities that could be subject to bail-in measures under their local law should be required to hold internal TLAC, i.e., specifically banks. If nevertheless the requirement in exceptional cases is extended to non-regulated entities this should only apply to entities that perform material critical functions in the host jurisdiction.
- **Introduction of formalized mechanisms to resolve issues between home and host regulators**: While UBS in principle agrees with the process to determine material sub-groups and their internal TLAC requirements outlined in principles 1 and 5, formalized mechanisms at the level of the CMG to resolve potential issues between home and host regulators should be introduced. This will be particularly important when the combined internal TLAC requirements of the various material entities exceed the external TLAC requirement.

Accordingly, we do not agree with the view that host authorities are not expected to reduce their internal TLAC requirements in such an instance. We strongly believe that home and host regulators should be required to agree at the CMG effective measures to ensure a reduction of the relevant internal TLAC requirements, thereby avoiding an excessive amount of TLAC at Group level.

- **Calibration of internal TLAC to create incentives for home and host authorities to cooperate in a crisis**: As some key jurisdictions already set their internal TLAC at the high end of the 75-90% range, we are concerned that other host regulators may have a strong incentive to ring-fence material subsidiaries without cooperating with the home authority. This will likely result in trapped assets of a G-SIB in one subsidiary when these assets may be needed for recovery measures and in particular the recapitalization of another subsidiary, whilst also possibly impeding the ability of the home regulator to act where needed to preserve the critical functions of the G-SIB in a resolution scenario based on the single-point of entry strategy (SPE), i.e., top-down recapitalization and restructuring of the group.
- **Flexibility to hold surplus TLAC within the group:** UBS concurs with the FSB that external TLAC that is not pre-positioned ('surplus TLAC') should be readily available to recapitalize the resolution groups' subsidiaries. The current wording included in principles 5, 6 and 7 implies that surplus TLAC needs to be maintained by the resolution entity, which in our view is neither necessary nor required by Section 18 of the TLAC Term Sheet. The FSB should clarify that a banking entity or intermediary holding company at levels below the resolution entity can hold surplus TLAC, as long as it is ensured that such surplus TLAC is readily available.
- **Introduction of debt requirement for internal TLAC would unduly limit funding flexibility:** We do not agree that the minimum debt requirement for *external* TLAC should be extended to *internal* TLAC as proposed in principle 8. Such a requirement would unnecessarily limit the firms' flexibility in deciding the appropriate funding mix for a given situation, while not improving the ability of a material sub-group to absorb losses.
- **Definition of specific information protocols to ensure information of home regulator and CMG members:** In case there are no alternatives to restore the material sub-group's viability and thus triggering of internal TLAC becomes necessary, we agree that early communication is essential (principle 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). In addition to the guidance provided by the FSB, detailed communication protocols for CMGs should be defined 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.
- **Determination of grace period to restore compliance on a case-by-case basis:** UBS objects to the maximum 24 month grace period to restore compliance with the internal TLAC requirements (principle 19). Proposing such a period would represent an undue constraint as the bank will likely not only face the challenge to restore internal TLAC, but would likely need to deal with additional financial and operational challenges as a result of the loss in one of its material sub-groups (specifically if a bail-in occurred at the resolution entity). In addition, market conditions also need to be considered in determining an appropriate period. We therefore propose that the time to restore the internal TLAC should be determined on a case-by-case basis between home and host authorities or at the level of the CMG, taking into account the specific circumstances.

Please find detailed answers to the questions of the consultative document in the appendix. Our response should be considered complementary to the letter of the Joint Associations Group (IIF-GFMA Joint Comments) to which UBS also contributed and which UBS supports.

We would be happy to discuss with you, in further detail, any questions you may have.

Yours sincerely,
UBS Group AG

Markus Ronner Head Group Regulatory & Governance	Steve Hottiger Head Governmental Affairs

Appendix - Response to the questions of the consultative document

> 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)?*

- In principle we agree with the proposed aspects outlined in principle 2 that should be taken into consideration by the host authority when determining the composition of the material sub-group and the distribution of internal TLAC between the sub-groups. However, we believe that **G-SIBs should be free in their decision regarding the composition of material sub-groups** as long as it does not result in any legal or operational barriers to the availability and access of internal TLAC.
- We in general agree that the presence of critical functions in an entity should be considered in the distribution of internal TLAC within the sub-group. **However, the FSB should define a materiality threshold as only entities which host material critical functions should be subject to internal TLAC requirements**. Moreover, the relevant entity needs be subject to resolution measures, specifically bail-in, in the host jurisdiction.
- Entities in the *host* jurisdiction that mainly provide critical functions to *home* jurisdiction entities should not be considered as a material sub-group alone for the reason of providing such services and consequently not be subject to internal TLAC requirements.

> 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?*

- We concur with the FSB that the **designation of non-bank entities as material sub-groups should only be considered in exceptional cases**, where no other alternative arrangement can be found to achieve continuity in resolution.
- In principle, we are of the view that internal TLAC requirements can only apply to regulated legal entities that are licensed or authorized as banks or regulated entities or unregulated entities which are subject to bail-in by relevant resolution requirements by a specific legislative act (e.g. unregulated holding company, unregulated service company). **Consequently, bail-in and hence internal TLAC requirements can only apply to relevant entities that are subject to such rules. For the avoidance of doubt, mere branches should not be subject to any internal TLAC requirements**. This is already implied by the 2015 Term Sheet based on multiple references to "institutions" or "subsidiaries.
- **The inclusion into a regulatory or accounting consolidation is not per se sufficient to include an unregulated entity into the material sub-group** and make it subject to internal TLAC requirements (as outlined in the examples provided on p. 12/13). In our view, this is only possible where an explicit legal basis exists for that purpose. The same applies in relation to the other examples stated.
- If a regulated non-bank entity is determined as a material sub-group the host authority **should take into account any existing capital and liquidity requirements** for that entity when scaling the **internal TLAC requirements**. Also, the FSB should specify that internal TLAC requirements **should not result in a preferential treatment of third party service delivery models vs. an intra-group service provider**.
- As outlined in our response to the FSB consultation "Adequacy of loss-absorbing capacity of global systemically important banks in resolution" we suggest that the calculation of internal TLAC requirements **should either be based only on RWAs or only on the leverage ratio denominator for all material subsidiaries**, but not on both requirements at the same time. Otherwise, the risk that cumulative internal TLAC requirements exceed the external TLAC requirements could be amplified.

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?*

- While UBS in principle agrees with the roles of the home and host authority in the process of determining the size of the internal TLAC requirement, **we strongly recommend the introduction of formalized mechanisms** at the level of the CMG **to resolve potential issues** between home and host regulators.
- In our view, this will become especially **important for situations when the combined internal TLAC requirements will exceed the external TLAC requirement of the resolution entity.** The risk for such a situation increases if further jurisdictions set their requirements at the top end of the 75-90% range similar to the US regulation or the EU proposals. Such a mechanism will also be necessary to ensure that the **SPE resolution strategy is not negatively affected or penalized** due to an overcapitalization at the level of the resolution entity.
- **Therefore, we object to the presumption that host authorities are not expected to lower their requirements** in such an instance. Instead the FSB should state an expectation that home and host regulators should agree at the CMG effective measures to ensure a reduction of the relevant internal TLAC requirements, thereby avoiding an excessive amount of TLAC at Group level.
- Regarding any additional requirements to be considered in setting the size of the internal TLAC requirement, the host authority should also take into account, **in conjunction with the business model of the material subsidiary, its actual amount of equity which will serve as 'first stop-loss level'**. Furthermore, the fact that the parent will support a material subsidiary due to its own commercial interest and seek to recapitalize it prior to any measures having to be taken in connection with the internal TLAC, needs to be considered.

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 recapitalize any direct or indirect subsidiary, as required by the TLAC term sheet (guiding principle 7)?*

- UBS concurs with the FSB that external TLAC that is not pre-positioned ('surplus TLAC') should be readily available to recapitalize the resolution groups' subsidiaries. In a crisis, this provides the necessary flexibility to restore the financial situation of individual subsidiaries in need. This flexibility is of particular importance as it is difficult to **predict the location of potential large future losses**. Thus, from a global recovery and resolution perspective, a low pre-positioning requirement is preferable.
- The current wording in principle 7 **implies that surplus TLAC would need to be maintained by the resolution entity,** which in our view is neither necessary nor required by Section 18 of the TLAC term sheet. The FSB needs to be cognizant of the fact that aside resolution aspects, commercial, treasury and tax aspects also need to be taken into account. Therefore, a banking entity or intermediary holding company **at levels below the resolution entity should be allowed to hold surplus TLAC**, as long as it is ensured that such surpluses can be used and down-streamed to material entities where losses have occurred. This should be clarified by the FSB throughout its final guidance.

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?*

- Whilst UBS acknowledges the argument against the risk of excessive leverage, we do not believe that the requirement to hold a minimum amount of *external* TLAC as debt should be generally extended to *internal* TLAC, as proposed in principle 8.
- In our view such a requirement would **unnecessarily limit the firms' flexibility in deciding the appropriate funding mix** for a given situation while it would not improve the ability of a material sub-group to absorb losses. We agree, however, that where internal TLAC is passed on through daisy-chaining, the lending entity should not be allowed to pass on

more internal TLAC than it had received from the entity above in the chain or the resolution entity.

- The question of incongruity of financial flows addressed on p. 16 is less an issue of the form of equity or debt, **but rather the need to avoid an incongruity of commercial terms such that balanced cash flows can be ensured throughout a daisy chain**, depending on the structure of the group. For example, there will be more flexibility where on-lends in the form of internal TLAC are undertaken by an operating subsidiary.
- For the reasons stated above, it is also **not important that internal TLAC instruments are of the same capital quality as external TLAC**. This should specifically not be the case where local regulatory capital requirements are satisfied. For example, where the external TLAC requirements is met with a regulatory capital instrument such as an AT1 instrument, the on-lent internal TLAC does not have to be in the same regulatory capital quality, but can simply comply with the additional requirements for loss absorbing capacity.

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?*

- UBS strongly supports the proposal of the FSB as outlined in principle 10 **to apply a zero-risk weight to internal TLAC** when its issuance relies on the daisy chain approach (i.e. distribution of internal TLAC follows the existing chain of legal entity ownership). However, the zero risk weight **should also apply to any difference between internal TLAC issued and internal TLAC invested**, i.e. any excess/residual internal TLAC held at the level of that material subsidiary, as these resources are held for the specific purpose to cover losses where needed at entities further down the chain. It is also important that, in addition to the zero-risk weighting, the deduction mechanism ensures there is no double-counting **in case that the leverage ratio is the binding constraint**.
- We do **not agree with the statement that an entity in a daisy chain would need to have itself for its own balance sheet** to set aside internal TLAC. We believe it is more important to state that the entity must not pass on more internal TLAC than what it has issued to its parent up the chain. Then the intermediate issuing banking entity may not need any internal TLAC on a stand-alone basis. This should be specified in the final guidance.

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

- We would welcome further work by the FSB to establish a deduction mechanism that would apply a zero-risk weight for all eligible internal TLAC instruments. To ensure an **equal treatment of all TLAC eligible instruments** the proposed zero-risk weight would need to be applied **to both non-regulatory capital and regulatory capital instruments**. Otherwise banks would be penalized if they would use regulatory capital instruments to meet the internal TLAC requirements for their material sub-groups.

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 agree that authorities and **G-SIBs should jointly address any legal, regulatory or operational obstacles** that may arise from the implementation of internal TLAC.
- In this context we would especially **encourage the FSB to help establishing rules to amend the regulatory framework**, e.g. to exclude internal TLAC instruments from large exposure limits (comparable to the treatment of exposures that are deducted from capital under the Basel Committee's large exposures framework).

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 only partially agree with the statements in section 13**. The important point in this context is that **there should not be regulatory capital triggers or similar features** in internal TLAC that would trigger automatically upon a specific event. This is already the case for external TLAC (except where external TLAC is regulatory capital, such as AT1). Any trigger that requires a mandatory conversion or write down would be highly problematic, as it would exclude any other recapitalization measures by the resolution entity or its home regulator. Moreover, such automatisms would likely require the competent home regulator/authority to order statutory resolution measures at the level of the material subsidiary. **This would be contrary to the purpose of the internal TLAC mechanism**, which is to recapitalize the material subsidiary at PONV without requiring statutory resolution measures (with actual resolution measures, if any required, being taken at the level of the resolution entity in its home jurisdiction).
- We find it important and agree that any trigger is dependent on the material subsidiary reaching the PONV as outlined in clause (a)(i) in Annex 2, as internal TLAC is solely a resolution instrument (and not occurring in recovery). Whilst we agree that the second condition should be the absence of adequate measures undertaken by the resolution entity and its home regulator respectively, we believe the relevant condition should be further specified and clearly state that a write-down or conversion should only occur as a last resort in absence of timely action, such as, for example recapitalization (equity), asset transfer or debt forgiveness by the resolution entity and its home regulator respectively.
- Where the **PONV definition under the laws of a material subsidiary is materially different** from the one in the home jurisdiction, there should be additional requirements, for example, that at least one other material subsidiary in another jurisdiction or the resolution entity itself is also in PONV before the trigger could occur (similar to FRB rule).

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?*

- UBS supports the view of the **FSB that early communication is essential** should a host authority intend to trigger internal TLAC as a "last resort" option (principles 15) and **the home authority should be given sufficient time** to decide whether to consent with the write-down and/or conversion (principle 18).
- In addition to the guidance provided by the FSB **we propose to define detailed communication protocols for CMGs** that need to be followed as a prerequisite for triggering internal TLAC. This would ensure that the home authority and CMG members are adequately informed and can take the preparatory steps on their side. While the protocols should specify the necessary steps to ensure that 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.
- **UBS objects to the maximum 24 month grace period** to restore compliance with the internal TLAC requirements (principle 19). Proposing such a period would **represent an unduly constraint as the bank will likely not only face the challenge to restore internal TLAC** but would likely need to deal with additional financial and operational challenges as a result of the loss in one of its material sub-groups (specifically if a bail-in occurred at the resolution entity). In addition, market conditions also need to be considered in determining an appropriate period. We therefore propose that the time to restore the internal TLAC should be determined on a case-by-case basis between home and host authorities or at the level of the CMG, taking into account the specific circumstances.

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?

- While we support the concept of pre-positioned internal TLAC, the **main basis for trust** among authorities – and therefore the willingness to refrain from unilateral actions in a crisis – **is the existence of binding cooperation agreements between the CMG members**. Pre-positioning TLAC can therefore only support but not replace the development of such agreements. On the contrary, over time as trust increases, the regulatory requirement for internal TLAC should diminish and management flexibility should increase. Binding cooperation agreements will also ensure that home and host regulators adhere to the proposed FSB rule set on material entities, common external Pillar 1 TLAC and level of prepositioning.