U.S. CHAMBER OF COMMERCE

GRGI

Global Risk and Governance Initiative

February 2, 2015

Financial Stability Board
Centralbahnplatz 2
CH-4002
Basel, Switzerland

Re: **Consultative Document: Adequacy of Loss-Absorbing Capacity of Global Systemically Important Banks in Resolution**

To Whom It May Concern:

The U.S. Chamber of Commerce[1] ("Chamber") established the Global Risk and Governance Initiative ("GRGI") to promote modern and appropriate international structures for capital formation, risk management and corporate governance needed by businesses to fully function in a 21st century global economy. We appreciate the opportunity to comment on ***Consultative Document: Adequacy of Loss-Absorbing Capacity of Global Systemically Important Banks in Resolution*** ("TLAC proposal" or "TLAC") published by the Financial Stability Board ("FSB") on November 10, 2014.

The GRGI supports the use of capital standards to promote stability in the financial system and has commented extensively on the impact of capital, liquidity and leverage standards upon the ability of non-financial businesses to raise the resources needed to grow and operate.[2] The GRGI also strongly supports the intent of the

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[1] The Chamber is the world's largest business federation representing the interests of over three million n companies of every size, sector and region. The Chamber represents a broad number of financial and non-financial businesses that may be subject to the systemic risk designation process and enhanced regulation.

[2] *See* June 14, 2011 letter from the Chamber to Federal Reserve Chairman Ben Bernanke on G-SIFI surcharges, October 22, 2012 comment letter to U.S. banking regulators on proposed Basel III regulations, September 19, 2013 letter to the BCBS on the Revised Basel III leverage ratio framework, September 23, 2013 letter to U.S. banking regulators on

TLAC proposal to lessen taxpayer exposure to a resolution of a failed global systemically important bank ("GSIB"). However, we are concerned the TLAC proposal may harm capital formation by raising the costs of capital and immobilizing resources that would have otherwise been used as productive capital for businesses to grow and operate. The GRGI believes that the TLAC proposal cannot be viewed in isolation and must be considered in conjunction with Basel III-related initiatives as well as GSIB surcharges to assess the cumulative impact of similar, multiple regulatory mandates. The Quantitative Impact Study ("QIS"), micro- and macro-economic impact assessments, market survey and historical loss survey (collectively the "TLAC Studies") are an important step and we welcome this as evidence-based process to determine if the holistic approach to capital and liquidity are the right ones or if a different path is needed. The GRGI also believes that in order for a TLAC regime to operate in an appropriate manner, it should be applied consistently amongst different jurisdictions and that it should also await the completion of the Basel III simplification project.

Our concerns are discussed in greater detail below.

Discussion

Capital, liquidity and leverage requirements are important tools to achieve and maintain stability within financial institutions. However, if those standards are too arduous they can have serious, unintended negative consequences for financial institutions and the broader business community.

Taking suitable levels of risk taking and having access to liquid, market-based capital are important elements of banking activity needed to fuel business growth, job creation, and innovation throughout the domestic and global economy. We recognize that providing access to liquid capital markets must be balanced with the need to establish appropriate safeguards to maintain the overall safety and soundness of the financial system. The GRGI supports the FSB's efforts to do so. An integrated

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enhanced supplementary leverage ratio standards, January 31, 2014 letter to U.S. banking regulators on liquidity coverage ratio rules, January 31, 2014 coalition letter to U.S. banking regulators on liquidity coverage ratio rules, May 28, 2014 letter to NCUA on risk based capital, September 11, 2014 letter to Federal Reserve on Capital Plan and Stress test rules and September 19, 2014 letter to Bank of International Settlements on The Net Stable Funding Ratio.

regulatory framework, implemented consistently across jurisdictions, is necessary to provide uniform incentives to mitigate potential systemic risks to safety and soundness.

The GRGI believes that the TLAC proposal may hamper and raise the costs of capital formation for non-financial businesses. This would be true of the proposal when taken in isolation, but is especially alarming when the impact of the TLAC proposal is viewed as part of the whole spectrum of prudential regulations.

I. Adverse Consequences for Capital Formation and Economic Growth

Under the TLAC proposal, GSIBs would have total loss absorbing capacity equal to as much as 20% of their risk weighted assets. This is in addition to a 2.5% capital conservation buffer and a bank-specific GSIB capital surcharge. The TLAC provisioning would be used in a resolution situation to provide the resources to recapitalize a firm or to assist with the wind-down. A GSIB can meet its TLAC requirement in a variety of ways primarily through a combination of retained earnings, distribution of securities, or issuance of certain forms of debt.

Main Street businesses use a diverse and complex system to meet their daily cash needs and provide resources for long-term growth. These needs are met through the debt markets, equity markets, short term financing and liquidity providers such as investment banks, commercial banks, private equity firms and many others. This system works if markets are open and appropriately regulated to ensure an even playing field, and to provide useful information which allows participants to make decisions on how to best deploy or acquire capital. Rules, though well intentioned, that harm liquidity or skew the decision making process will distort the flow of capital, ultimately jeopardizing the ability of domestic and global economies to grow while undermining the very goal of financial stability that regulators seek to achieve.

The GRGI believes that the TLAC proposal may reduce the capital available for businesses, raise the costs of capital formation, and hamper the ability of the capital markets to operate in an efficient and necessary manner.

While retained earnings and securities issuances are a means of meeting the TLAC requirements, they are also the vehicles for financial institutions to raise the resources needed for capital requirements and buffers. Accordingly, as financial institutions are striving to meet these targets, there is a limit as to how much retained earnings and securities issuances can be used to meet these goals, as well as meeting the requirements of TLAC.

This in turn will require a significant amount of debt issuance for GSIBs to meet their TLAC targets. Under the TLAC proposal, debt instruments used for TLAC provisioning will be junior in subordination to other excluded liabilities. Reports indicate that the amount of debt to be raised to meet the TLAC proposal could range between $480 billion to well over $1 trillion dollars.[3]

Such an intervention in the debt markets can stress and strain the capital formation process for the overall business community in several ways. Capital markets are finite markets. Debt issuances of this scale required by the TLAC proposal, outside the ordinary course of business, by financial institutions will reduce the ability of non-financial firms to access the debt markets. By creating supply and demand pressures, the amount of debt financing available to non-financial businesses will decrease, while the cost of that debt will increase.

Therefore, the TLAC proposal may siphon off capital by sidelining resources until they are needed for a GSIB recapitalization or wind down. This is the equivalent of removing hundreds of billions dollars of productive capital, normally used by the business community, from the global economic circulatory system. A reduction of productive capital on this scale will have negative consequences and undermine the ability of the global economy to achieve the economic growth as envisioned by the G20 Brisbane Summit communique.

[3] *See, Euro Banks Ready TLAC Fight Back*, Reuters, and November 14, 2014.

In response, the business community will be faced with a series of unattractive options. Businesses will need to plan for longer time horizons for financing at higher costs, engage in risker financing with higher costs and a greater down-side, or simply to build cash reserves which is an inefficient and unproductive use of resources for businesses and the macro-economy as a whole. None of these choices are good ones for businesses, and economic growth will suffer as a result.

Risk, like energy, cannot be destroyed but only transferred. These alternatives for the business community will push risk to the outer edges of the financial system, making our capital markets less stable and more inefficient. Such an outcome would defeat the purpose of the TLAC proposal.

The GRGI is concerned that our members are already facing higher costs and less liquid markets. This is happening even during a period of extraordinarily accommodative monetary policy. While we agree with the objectives of the TLAC proposal, we believe they have largely been met through previous rulemakings and that the accelerating costs have begun to outweigh the benefits.

II. TLAC Studies

The FSB, in conjunction with the Bank of International Settlements ("BIS") and Basel Committee on Banking Supervision ("BCBS"), will undertake a QIS and assess the micro-economic and macro-economic effects of the TLAC minimum requirements for GSIBs. The FSB, BIS and BCBS will also study how markets and investors will be impacted. In previous comment letters, we have called for a comprehensive study of various regulatory initiatives as well as the impacts of those initiatives on the broader global economy and the capital formation system that is the linchpin for growth.

Accordingly, we welcome these TLAC Studies and hope it takes the broad and comprehensive approach that we have advocated for in the past. A comprehensive review of the initiatives impacting business capital formation illustrates:

- The Leverage Ratio Framework materially increases the minimum capital requirement by product relative to Basel III. Additionally, the Leverage Ratio Framework and the proposed Net Stable Funding Ratio penalizes many low-risk activities that may harm the ability of non-financial businesses to access markets to prudently mitigate risk or manage cash and liquidity;

- The Liquidity Coverage Ratio creates disincentives for financial institutions to offer certain products and services to businesses even though those activities were not the cause of the financial crisis;

- GSIB Capital Surcharges will force large internationally active banks to withdraw additional capital from productive capital formation streams;

- The complex regulatory regimes envisioned by the final Volcker Rule, and the proposed Vickers and Liikanen Rules are expected to impact the ability of non-financial businesses to enter the debt and equity markets by raising costs and creating barriers of entry to the capital markets;

- Money Market Fund reforms will harm the ability of non-financial businesses to access the short-term commercial paper markets and manage cash; and

- If the Volcker, Vickers and Liikanen Rules and Money Market Fund reforms hamper capital formation, the next alternatives are commercial lines of credit; however, Basel III creates disincentives for banks to provide businesses with commercial lines of credit.[4]

[4] This list is by no means an exhaustive list of regulations and capital initiatives that should be reviewed with such a study. This list is illustrative of the types of initiatives that should be studied.

The combination of all of these initiatives could lead to an underperforming financial sector and create barriers to capital formation. The inability of businesses to be able to engage in normal capital formation activities, efficient cash management and effective risk management will raise costs and create inefficiencies, adversely impacting economic growth.

Therefore, we believe that the TLAC Studies should determine: 1) how all of these initiatives will interact and work together, 2) determine the impacts of these initiatives upon the broader macro economy, and 3) use modeling techniques to "war-game" these new regulatory structures, identify faults and shape comprehensive fixes. This information will be invaluable to the shaping of a final TLAC and would help mitigate potential unintended consequences with the other initiatives discussed above.

The GRGI believes that the information derived from the TLAC Studies will be critical for the TLAC proposal and how it should be molded to avoid potential harm to the ability of businesses to raise the resources needed to expand and operate.

III. Inconsistent Regulation Across Jurisdictions

As the TLAC proposal is - to a degree - an outgrowth of Basel III, the GRGI believes that it should be viewed through the prism of those initiatives.

The TLAC proposal attempts to create a uniform international system of loss absorbency for GSIBs. However, we believe that Basel III is illustrative in noting the significant concerns the GRGI has with the increasing number of differences arising in regulatory reforms across major jurisdictions. For example, a comparison of the Leverage Ratio Framework and Liquidity Coverage Ratio, as issued by the Basel Committee and finalized by U.S. banking regulators, illustrates important differences in the minimum capital requirements across product types. Such inconsistencies may introduce competitive disparities, operational and enforcement uncertainties, and systemic inefficiencies. All of this could lead to greater systemic risks, adversely impact economic growth and impede cross-border capital flows needed for businesses to operate on a global basis.

The GRGI believes that these differences with Basel III implementation may lead to inconsistent implementation of a final TLAC proposal.

The Chamber recognized the need for and called for comprehensive regulatory reform before the 2007-2008 financial crisis. However, the TLAC proposal and Basel III can only be true international standards if their interpretation, application and enforcement are the same across the board. Greater effort is required to minimize the further fragmentation and inconsistencies arising across jurisdictions in capital, liquidity and leverage frameworks, as well as other regulatory reform initiatives such as resolution authority and derivative regulations. We encourage the FSB to aggressively pursue coordination efforts to achieve consistent implementation of a uniform regulatory framework. The GRGI also believes the regulatory reforms related to capital, liquidity and leverage require further evaluation for international consistency.

Furthermore, the International Lending Supervision Act ("ILSA") encourages regulators to work with their international counterparts to establish consistent supervisory policies and practices including the establishment of minimum capital requirements. The G-20 has clearly made consistent capital requirements and buffers a priority to be addressed in the wake of the financial crisis.[5] While we understand that the depth and structure of markets may require different levels of response, we are concerned that the TLAC proposal creates greater inconsistencies within the international framework that frustrate the intent of the ILSA.[6]

An integrated regulatory framework, implemented consistently across jurisdictions, is necessary to provide uniform incentives and disincentives to mitigate potential systemic risks to the safety and soundness of the financial system. We believe that the FSB is uniquely situated to undertake an effort to ensure consistency in the TLAC approaches globally.

IV. Basel III Complexity and Simplification

As previously mentioned, the TLAC proposal is built upon the foundation of the Basel III capital regime. Many regulators have joined investors and other commenters in raising concerns that the Basel III capital framework is too complex.

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[5] The GRGI, on June 5, 2014, sent a letter to the Australian Government with pro-growth proposals for the G-20 Brisbane Summit to be held in November, 2014. The letter can be found at: http://www.centerforcapitalmarkets.com/wp-content/uploads/2014/06/2014-6.5-GRGI-Australia-G20-Agenda.pdf

[6] *See* October 22, 2012 letter from Chamber commenting on regulations implementing Basel III capital standards and need for international consistency.

Part of the concern is that complexity may cause opaqueness and confusion, frustrating the goal of safety and soundness by hampering the ability of regulators and investors to understand the health of individual banks or to compare the soundness of different banks. As a result, the BCBS released the Basel III capital simplification paper to achieve a better understanding of the complexity of capital requirements and how to simplify or provide transparency of them to better achieve stability in financial institutions. The Chamber submitted a comment letter on Basel III capital simplification paper on October 11, 2013.[7]

Basel III is the foundation for the system of capital, leverage, and liquidity requirements that global regulators have been building upon since the 2008 financial crisis. Regulators have moved forward in building such a system in multiple jurisdictions, including in the United States. In certain jurisdictions, regulators have moved in an aggressive manner to put in place tougher requirements than other nations have, while others have sought relaxed capital requirements. While robust capital rules may be called for, when balanced with other considerations raised previously in this letter, we must question further movement along these lines as the foundation for this system has been called into question.

Initiatives to regulate systemic risk and systemically important firms, particularly non-bank financial institutions, have not yet been fully implemented or finalized. It would be prudent for these enhanced tools to be completely developed before finalizing the TLAC proposal that some banking regulators will toughen beyond the standards set by international agreement.

Conclusion

The GRGI believes that a balanced approach to capital, leverage and liquidity requirements is a pro-growth means of addressing over-leveraging and providing stability in a risk-based free enterprise system. We have expressed concerns with how leverage ratio, liquidity coverage ratio and net stable funding ratios meet this goal. We have more serious concerns with the TLAC proposal as we believe that it has the potential to deprive businesses of the resources needed to grow as well as drive up the

[7] Chamber letter can be found at: http://www.centerforcapitalmarkets.com/wp-content/uploads/2014/09/2013-10-11-Risk-Sensitivity.pdf

costs of capital formation for market participants. This will cause stress and strain upon the capital markets, hampering the ability of domestic and global economies from reaching their growth potential. Less growth will have obvious deleterious impacts upon the real economy, as well as undermining the goal of financial stability that the FSB and other regulators are striving to fulfill.

The GRGI applauds the TLAC Studies and hopes the FSB will use the studies as an opportunity to understand the impacts of the TLAC proposal on capital formation and the economy in a comprehensive way. In our view the TLAC studies are an important means to advance evidence-based regulation by casting a light on unintended consequences before the TLAC proposal is finalized or implemented, thereby giving the FSB an opportunity to take corrective action in the proposal stage. Once the studies are completed, we believe the FSB should make them public and allow for review and comment on the TLAC proposal in light of the results.

Thank you again for the opportunity to comment upon the TLAC proposal and we are happy to discuss these issues and concerns in greater detail at your convenience.

Sincerely,

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