# Guiding Principles on the Internal Total Loss-absorbing Capacity of G-SIBs ('Internal TLAC')

**Consultative Document**

16 December 2016

**Contacting the Financial Stability Board**
Sign up for email alerts: www.fsb.org/emailalert
Follow the FSB on Twitter: @FinStbBoard
Email the FSB at: fsb@fsb.org

**The Financial Stability Board (FSB) is seeking comments on its consultative document: "Guiding Principles on the Internal Total Loss-absorbing Capacity of G-SIBs ('Internal TLAC')".**

In November 2015 the FSB, in consultation with the Basel Committee on Banking Supervision (BCBS), finalised and agreed a new standard on the adequacy of total loss-absorbing capacity for global systemically important banks (G-SIBs) in resolution ('the TLAC standard'). The TLAC standard has been designed so that failing G-SIBs will have sufficient loss-absorbing and recapitalisation capacity available in resolution for authorities to implement an orderly resolution that minimises impacts on financial stability, maintains the continuity of critical functions, and avoids exposing public funds to loss.

The G20 and FSB made a commitment to the timely, full and consistent implementation of the TLAC standard. In its reports to the G20 of November 2015 and September 2016, the FSB committed to develop implementation guidance for the TLAC standard. In particular, the FSB agreed to undertake further work on the implementation of the requirement for internal TLAC, that is, the loss-absorbing resources that resolution entities commit to material subsidiaries.

This consultative document proposes a set of guiding principles to support the implementation of the internal TLAC requirement consistent with the TLAC term sheet.

**The FSB invites comments on the consultative document and the following specific questions:**

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

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

**Responses to this consultative document should be sent to fsb@fsb.org by 10 February 2017.** Responses will be published on the FSB's website unless respondents expressly request otherwise.

# Table of Contents

## Overview

In November 2015 the FSB, in consultation with the Basel Committee on Banking Supervision (BCBS), finalised and agreed a new standard on the adequacy of total loss-absorbing capacity for Global Systemically Important Banks (G-SIBs) in resolution ('the TLAC standard').[1] The TLAC standard comprises a set of principles on the loss-absorbing and recapitalisation capacity of G-SIBs in resolution, and a term sheet that implements those principles.

A key objective of the TLAC standard is to provide home and host authorities with confidence that G-SIBs can be resolved in an orderly manner without putting public funds at risk. This should diminish any incentives on the part of host authorities to ring-fence assets domestically, either ex ante or ex post in a resolution, and thereby avoid the adverse consequences of such actions, including global fragmentation of the financial system, and disorderly resolutions of failed cross-border firms.

Principle (vi) of the TLAC standard states that host authorities must have confidence that there is sufficient loss-absorbing and recapitalisation capacity available to subsidiaries in their jurisdictions with legal certainty at the point of entry into resolution. To this end, there must be sufficient flexibility to use loss-absorbing capacity within a G-SIB where needed and credible mechanisms in place to allow losses and recapitalisation needs to be passed with legal certainty to the resolution entity or entities. A resolution entity should act as a source of loss-absorbing and recapitalisation capacity for its subsidiaries where those subsidiaries are not themselves resolution entities.[2]

*Internal TLAC* is the loss-absorbing capacity that resolution entities have committed to material sub-groups. It provides for a mechanism whereby losses and recapitalisation needs of material sub-groups may be passed with legal certainty to the resolution entity of a G-SIB resolution group, without entry into resolution of the subsidiaries within the material sub-group.

A *material sub-group* consists of an individual subsidiary or a group of subsidiaries that are not themselves resolution entities and that, on a solo or sub-consolidated basis, meet certain quantitative criteria specified in Section 17 of the TLAC term sheet, or are identified by a firm's Crisis Management Group (CMG) as material to the exercise of the firm's critical functions.[3]

Under Section 18 of the TLAC term sheet, each material sub-group must maintain internal TLAC of 75% - 90% of the external Minimum TLAC requirement that would apply to the

---

1 See "Principles on Loss-absorbing and Recapitalisation of G-SIBs in Resolution" and "Total Loss-absorbing Capacity (TLAC) Term Sheet" (http://www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf), November 2015.

2 A resolution entity is an entity to which resolution tools will be applied in accordance with the resolution strategy for the G-SIB. A G-SIB may have one or more resolution entities, depending on whether the resolution strategy is based on a 'single point of entry' resolution, in which resolution powers are applied to the top of a group by a single resolution authority, or a 'multiple point of entry resolution' in which resolution tools are applied to different parts of the group by two or more resolution authorities acting in a coordinated way. See "Recovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Developing Effective Resolution Strategies" (http://www.fsb.org/wp-content/uploads/r_130716b.pdf), July 2013.

3 See Annex 3 for the sections of the TLAC term sheet that relate to internal TLAC.

material sub-group if it were itself a resolution group. The actual requirement in that range is to be determined by the relevant host authority in consultation with the home authority. The triggering of internal TLAC at the point of non-viability by the host authority (subject to home authority consent, where required) passes losses and recapitalisation needs of entities within the material sub-group to the resolution entity, without entry into resolution of the subsidiaries within the material sub-group.

While the TLAC term sheet sets out the core features of internal TLAC in relation to quantum, triggers and eligibility of instruments, CMG authorities will need to consider a number of technical and practical issues as they develop and implement internal TLAC mechanisms.

This consultative document proposes a set of high-level guiding principles to assist CMG authorities in the implementation of internal TLAC mechanisms consistent with the TLAC standard.

The guiding principles cover:

- the process for identifying material sub-groups, the composition of material sub-groups, the distribution of internal TLAC within material sub-groups, and the treatment of unregulated or non-bank entities (Section I);
- the role of home and host authorities and the factors to be considered when determining the size of the internal TLAC requirement (Section II);
- practical considerations relating to the issuance and composition of internal TLAC (Section III);
- features of the trigger mechanism for internal TLAC (Section IV): and
- cooperation and coordination between home and host authorities in triggering the write-down and/or conversion into equity of internal TLAC (Section V).

Home and host authorities within CMGs are expected to take these guiding principles into account as they identify material sub-groups and formulate requirements for internal TLAC mechanisms for their G-SIBs. The FSB will continue to monitor and report on the implementation of the TLAC standard, including internal TLAC, through the Resolvability Assessment Process. The FSB will also undertake a review of the technical implementation of the TLAC standard by the end of 2019.

## I. Material sub-group identification and composition

*Guiding Principle 1: Material sub-group identification*

**Host authorities should identify material sub-group(s) in their jurisdiction, in consultation with the home authority and the CMG. The home authority should initiate and coordinate the process for identifying material sub-groups (and the annual review of the list of material sub-groups) with the host authorities and the CMG.**

Host authorities in the CMG should make a proposal to the home authority on the material sub-group(s) they have identified in their jurisdiction. In their consultation with the home authority, they should provide the rationale for their identification and explain how the criteria in Section 17 of the TLAC term sheet are met and how the provision of internal TLAC to the material sub-group(s) is consistent with the resolution strategy for the resolution group. Host authorities not represented in the CMG are also able to make such a proposal to the home authority, although the expectation should be that host authorities of subsidiaries that meet one or more of the criteria in Section 17 of the TLAC term sheet would already be CMG members.

The home authority should initiate and coordinate the process and, with its access to group-level information, confirm the subsidiaries in host jurisdictions that meet the criteria in Section 17 of the TLAC term sheet. If the home authority identifies subsidiaries in a host jurisdiction not represented on the CMG, the home authority would be expected to engage with the relevant host authority.

The list of material sub-groups should be drawn up following consultations amongst the home authority and the host authorities of the material sub-groups, within the CMG. The list of material sub-groups and their composition (see guiding principle 2) should be shared with CMG members and reviewed in the CMG on an annual basis consistent with Section 17 of the TLAC term sheet. In cases where sub-groups have been identified as material based on a determination that they exercise critical functions for the group as a whole, their inclusion in the list requires the agreement of the CMG.[4]

The determination that a sub-group is no longer material mirrors the process described above for the determination of the materiality of a sub-group. It would generally follow from the annual review of the list and composition of material sub-groups in the CMG.

The home authority, with its access to group-level information, may provide evidence to the host authority in the annual review within the CMG that the sub-group is no longer material; for example, because it no longer meets the quantitative criteria in the TLAC term sheet or because it is no longer material to the exercise of the firm's critical functions. The host authority would have the opportunity to provide the rationale to the contrary, and the decision should subsequently be finalised following discussion between the home and host authorities and, in the case of sub-groups that had been designated as material to the exercise of critical functions, with the agreement of the CMG.

[4] Material sub-groups designated as material to the exercise of the firm's critical functions are to be identified by the CMG (TLAC term sheet Section 17d).

A sub-group that ceases to be material would no longer be subject to an internal TLAC requirement as required by the TLAC standard. In practice, this could mean that internal TLAC instruments are not rolled over at maturity and, where necessary, are substituted with other forms of intra-group funding. However, the sub-group may continue to be subject to local TLAC or other requirements imposed by the host authority as part of domestic regulation, which will need to be taken into account when internal TLAC instruments are called or redeemed.

*Guiding Principle 2: Material sub-group composition and distribution of internal TLAC*

**Host authorities of a subsidiary or subsidiaries that (together or individually) meet the criteria in Section 17 of the TLAC term sheet should determine, in consultation with the home authority and the CMG, the composition of the material sub-group and the distribution of internal TLAC between the entities that form the material sub-group. The composition of the material sub-group and the distribution of internal TLAC should support the resolution strategy by facilitating the stabilisation of the relevant entities within the material sub-group through the passing of losses and recapitalisation needs to the resolution entity.**

Consistent with the TLAC term sheet, the composition of material sub-groups should be determined by the relevant host authority, in consultation with the home authority within the CMG. In determining material sub-group composition, host authorities should consider the existing scope of regulatory or accounting sub-consolidation, as appropriate for the specific jurisdiction, as a starting point. Regulatory or accounting sub-consolidation scopes should provide a reference for CMG discussions and determining the internal TLAC requirement of the material sub-group (e.g., because there are existing regulatory capital requirements that can be used to determine the necessary recapitalisation amount, or because there is an existing RWA calculation that can be used to calibrate the internal TLAC requirement).

When determining the distribution of internal TLAC between the entities that form the material sub-group, the host authority should take into consideration:

- the contribution of each entity in the material sub-group to the quantitative criteria in Section 17 of the TLAC term sheet;
- the systemic importance of each entity in the material sub-group (e.g., with regard to the presence of critical functions); and
- the strategy for each entity in the material sub-group under the resolution strategy for the resolution group and the appropriate location of internal TLAC in light of that strategy (i.e., whether internal TLAC should be pre-positioned at each entity in the material sub-group, only in some entities of the material sub-group or whether some or all internal TLAC should be maintained at the 'top-tier' entity of the material sub-group).

The composition of a material sub-group and the distribution of internal TLAC could result in a number of cases, including:

- an intermediate holding company that consolidates the G-SIB's subsidiaries in the host jurisdiction, with internal TLAC maintained at the intermediate holding company and/or provided to the subsidiaries of the material sub-group (case one);
- the grouping of sister subsidiaries, with internal TLAC provided to each sister subsidiary in the material sub-group on the basis of their combined balance sheet or RWAs (excluding exposures between them) (case two);
- a single material subsidiary and one or more of the subsidiaries under its control, with internal TLAC maintained at the top-tier subsidiary and/or provided to the subsidiaries under its control (case three); or
- a single material subsidiary, with internal TLAC provided to the material subsidiary (case four).

These examples are considered further in Annex 1. If internal TLAC is held at a single entity (e.g., an intermediate holding company or top-level subsidiary), the host authority should ensure that there are no operational or legal barriers to the availability of internal TLAC to recapitalise the subsidiaries in the material sub-group, consistent with the requirement for non-pre-positioned TLAC in Section 18 of the TLAC term sheet. If such barriers exist, the host authority should pre-position internal TLAC at the level of the relevant individual subsidiaries in the material sub-group.

The host authority of the material sub-group should be able to explain to the home authority and the CMG how the composition of the material sub-group and the distribution of internal TLAC is consistent with the resolution strategy for the resolution group and how the composition and distribution support the passing of losses and recapitalisation needs of the entities within the material sub-group to the resolution entity through the triggering of internal TLAC. This means that the material sub-group should have a coherent structure, and not consist of a collection of disparate entities grouped together solely to meet the criteria in Section 17 of the TLAC term sheet.

*Guiding Principle 3: Multi-jurisdictional material sub-groups*

**Material sub-groups should only consist of entities in more than one jurisdiction where there is a single resolution regime covering those jurisdictions or a high degree of cooperation and coordination between the host authorities in those jurisdictions.**

Consistent with the TLAC term sheet, material sub-groups may consist of subsidiaries incorporated in multiple jurisdictions ("multi-jurisdictional material sub-group") where the CMG agrees that this is necessary to support the agreed resolution strategy and ensure that internal TLAC is appropriately distributed within the material sub-group. A multi-jurisdictional material sub-group is likely to encounter a number of challenges, particularly in relation to the process for triggering internal TLAC and in satisfying the financial stability objectives of host authorities. It is therefore expected that a multi-jurisdictional material sub-group would only be designated in exceptional circumstances where, in addition to the conditions of the TLAC term sheet, there is:

- a common authority responsible for the triggering of internal TLAC within the multi-jurisdictional material sub-group under a common resolution regime; or

- a high degree of cooperation and coordination between the relevant authorities, as evidenced by, for example, the existence of cooperation agreements, memoranda of understanding, other mechanisms for cross-border cooperation or historical evidence of cooperation.

The composition of a multi-jurisdictional material sub-group should also conform to the expectations in guiding principle 2 that material sub-groups should have a coherent structure and support the resolution strategy by facilitating the stabilisation of the material sub-group through the passing of losses and recapitalisation needs to the resolution entity.

*Guiding Principle 4: Regulated or unregulated non-bank entities*

**Regulated or unregulated non-bank entities should be designated as or included in material sub-groups only to the extent that the inclusion of such entities is necessary to ensure that the resolution strategy for the resolution group is credible and feasible, and that continuation of the entities, or of the services they provide, cannot be achieved through alternative arrangements (e.g. a sector-specific resolution regime or other prudential framework).**

The decision to include (or not include) any regulated or unregulated non-bank entity in a material sub-group should be based on the resolution strategy for the resolution group and an assessment of the risk that the entity could generate unexpected losses that would require loss-absorbing and recapitalisation capacity.

Authorities should also consider first whether alternative arrangements would be more appropriate to achieve continuity in resolution, even if those arrangements do not include formal requirements for additional loss-absorbing capacity. For example, unregulated non-bank entities providing critical shared services such as IT infrastructure and software-related services to the resolution group could adopt arrangements that would support the operational continuity of those services in resolution.[5] Non-bank financial entities, such as insurance companies, may operate under sector-specific regimes that may provide for regulatory tools and resolution measures with respect to those entities.[6]

Cases where it could be deemed necessary to include a non-bank entity in the scope of a material sub-group might encompass scenarios where:

- the entity has been identified by the firm's CMG as material to the exercise of the firm's critical functions and alternative arrangements of the type discussed above are not in place;
- the entity is highly interconnected with another entity or entities of the material sub-group and/or the G-SIB as a whole; or

[5] See "Arrangements to Support Operational Continuity in Resolution" (http://www.fsb.org/wp-content/uploads/Guidance-on-Arrangements-to-Support-Operational-Continuity-in-Resolution1.pdf), August 2016.

[6] See "Developing Effective Resolution Strategies and Plans for Systemically Important Insurers" (http://www.fsb.org/wp-content/uploads/Final-guidance-on-insurance-resolution-strategies.pdf), June 2016.

- the entity forms part of an existing regulatory or accounting consolidation that is being used as the basis for the material sub-group.

In all cases the material sub-group should meet the criteria in Section 17 of the TLAC term sheet and the continuation of the services provided by the non-bank entity should be maintained in a manner that is consistent with the resolution strategy for the resolution group.

If a non-bank entity is included in the scope of a material sub-group, home and host authorities should discuss how to calculate the contribution of such an entity to the internal TLAC requirement of the material sub-group, taking into account the potential difficulties. Such difficulties may arise where the entity falls outside the regulatory scope of consolidation and where the nature of its activities, assets, risks and operations differs from those to which the Basel framework is designed to apply. Therefore, it is preferable to capture such entities through alternative arrangements. However, if a bespoke RWA or leverage ratio exposure (LRE) measure has to be created for these entities in order to apply an internal TLAC requirement, a potential starting point could be:

- for exposures that are captured under an industry-specific regulatory framework, to use any relevant values determined under that framework to calculate an RWA (and an LRE);
- for other exposures (on- and off- balance sheet) that are akin to those captured by and therefore amenable to the Basel III framework, to use the Basel III framework to calculate an RWA (and an LRE); and
- in the case of other exposures that are not amenable to industry-specific regulatory frameworks or the Basel III framework, to consider using the entity's accounting values as a basis for determining its RWA (e.g., with the application of a 100% RW) and its LRE.

## II. Size of the internal TLAC requirement

*Guiding Principle 5: The role of the host authority*

**Host authorities retain ultimate responsibility for setting internal TLAC requirements for the material sub-group(s) in their jurisdiction, but should do so in consultation with the home authority. When setting the requirement, host authorities should ensure that there is sufficient internal TLAC to cover the loss-absorption and recapitalisation needs of the material sub-group and support the resolution strategy for the resolution group. Host authorities should also recognise that their requirements will have implications for the resolution group and take this into account when setting internal TLAC requirements.**

The internal TLAC requirement for a material sub-group should be set at a level that is sufficient to support the resolution strategy for the resolution group and enable the entities in the material sub-group to be recapitalised to meet the conditions for authorisation in the relevant host jurisdiction and command market confidence.

When scaling the requirement within the 75% - 90% range of the external Minimum TLAC requirement that would apply to the material sub-group if it were a resolution group, host authorities should consult with the home authorities and consider the implications that the internal TLAC requirement could have for the resolution group, in particular if the sum of internal TLAC requirements exceeds, or is expected to exceed, the resolution group's external Minimum TLAC. A consideration of the extent of exposures of entities within the material sub-group to other entities of the G-SIB outside the material sub-group may be particularly important, as large intra-group exposures may cause the sum of internal TLAC to exceed the resolution group's external Minimum TLAC. However, there is no presumption that host authorities would apply a lower internal TLAC requirement if the sum of internal TLAC requirements exceeds the resolution group's external TLAC.

Additional factors that the host authority could consider when scaling the internal TLAC requirement for the material sub-group(s) in their jurisdiction within the 75% - 90% range include:

- the risk profile of the material sub-group (in the host jurisdiction, and compared to the G-SIB's other material sub-groups) and the expected amount of internal TLAC required to absorb losses and recapitalise the material sub-group[7];
- the overall credibility and feasibility of the home authority's resolution strategy for the resolution group;
- comparability with requirements imposed on other firms or material sub-groups in the same jurisdiction with similar business activities and risk profiles; and
- the availability (or absence) of non-pre-positioned TLAC at the resolution entity that the host authority is satisfied could reliably and flexibly be deployed to absorb losses and recapitalise the entities of the material sub-group as necessary to support the execution of the resolution strategy (see guiding principle 7).

If host authorities choose to apply additional firm-specific internal TLAC requirements or similar requirements, they should discuss with the home authority the rationale for the additional requirement to ensure that the host authority is fully apprised of the home authority's views on the likely impact on the resolution group.

*Guiding Principle 6: The role of the home authority*

**To promote consistency of internal TLAC requirements across material sub-groups of the same resolution group and with a view to ensuring that internal TLAC does not exceed external Minimum TLAC, the home authority should coordinate the host authorities' assessments of internal TLAC requirements and provide information to the host authorities as necessary to support their assessments.**

The home authority should coordinate the host authorities' scaling of internal TLAC requirements and, to this end, discuss with host authorities (e.g., in the CMG) whether:

(i) internal TLAC requirements are coherent across different material sub-groups;

[7] This will to some extent be reflected in the "pre-scaling" calibration of internal TLAC, i.e. the internal TLAC requirement that would have applied to the material sub-group if it were a resolution entity.

(ii) it would be beneficial to maintain some TLAC at the resolution entity (i.e. a portion of TLAC that is not pre-positioned at material sub-groups as internal TLAC or otherwise needed to cover material risks on the resolution entity's own balance sheet) that would be readily available to recapitalise any direct or indirect subsidiary; and

(iii) the sum of internal TLAC requirements (including any additional firm-specific internal TLAC requirements or similar requirements) across all of the material sub-groups as well as any TLAC needed to cover material risks on the resolution entity's solo balance sheet[8] exceeds, or is expected to exceed, the resolution group's external TLAC.

While there is no presumption that hosts would or should subsequently adjust their internal TLAC requirements if they are found to be inconsistent across different material sub-groups or if the aggregate internal TLAC requirements exceed external TLAC, this information should be taken into consideration by the host authority when making its assessment.

While not generally expected to be the case, if the sum of internal TLAC requirements as well as any TLAC needed to cover material risks on the resolution entity's solo balance sheet does exceed external TLAC, then – absent any downward adjustment from host authorities and taking into account consolidation effects – the home authority should take action to ensure the G-SIB has sufficient external TLAC (as per Section 18 of the TLAC term sheet).

In performing its coordination role, the home authority should provide information as necessary to support the host's determination of the internal TLAC requirement for the material sub-group(s) in its jurisdiction. For example, the home authority could be expected to provide information on the importance of the material sub-group to the resolution strategy, the degree of the material sub-group's linkages with the rest of the resolution group, and the comparability of the host authority's internal TLAC requirements with internal TLAC requirements imposed on material sub-groups in other jurisdictions.

*Guiding Principle 7: Surplus TLAC*

**In cases where there is TLAC at the resolution entity that is not distributed to material sub-groups ('surplus TLAC') in excess of that required to cover risks on the resolution entity's solo balance sheet, home authorities should consider the characteristics of the correspondent assets of such surplus TLAC to ensure that it is readily available to recapitalise any direct or indirect subsidiary, as required by Section 18 of the TLAC term sheet.**

Given the scaling of internal TLAC requirements within the 75% - 90% range, there is an expectation that not all external Minimum TLAC would be distributed to material sub-groups in the form of pre-positioned internal TLAC. The remaining external TLAC[9] at the resolution entity ('surplus TLAC') should – in addition to covering risks on the resolution entity's solo balance sheet – be readily available to recapitalise any direct or indirect subsidiary as necessary

[8] Not including exposures to material sub-groups for which internal TLAC has already been allocated.

[9] Where 'external TLAC' refers to the minimum external TLAC requirement in Section 4 of the TLAC term sheet.

to support the execution of the resolution strategy, as required by Section 18 of the TLAC term sheet.

Home authorities should consider the characteristics of surplus TLAC at the resolution entity to ensure that it meets the TLAC term sheet requirement of being readily available to recapitalise any direct or indirect subsidiary, while avoiding inconsistency with any liquidity requirements applicable to the resolution entity and, where appropriate, taking into account the business model needs of the resolution entity. For example, home authorities may consider it appropriate for surplus TLAC to be held in the form of assets that can be promptly and easily valued, and which are likely to retain sufficient value in times of market-wide stress. Those assets could be held by the resolution entity, to support flexible allocation to subsidiaries that require recapitalisation and to avoid any operational or legal limitations on the ability of the G-SIB to reallocate assets from individual subsidiaries.

Surplus TLAC in this form may increase the confidence of host authorities (both of material sub-groups and of other subsidiaries) that surplus TLAC would be made available for loss-absorption and recapitalisation of subsidiaries in their jurisdictions.

## III. Composition and issuance of internal TLAC

*Guiding Principle 8: Internal TLAC composition*

**Host authorities should determine the composition of internal TLAC in consultation with the home authority. In particular, host authorities should consult with the home authority on the impact that the composition of internal TLAC relative to external TLAC could have on the credibility and sustainability of the resolution strategy and the ability of the material sub-group to effectively pass losses and recapitalisation needs to the resolution entity.**

**Host authorities in consultation with the home authority may consider the inclusion within the internal TLAC requirement of an expectation that internal TLAC consist of debt liabilities accounting for an amount equal to, or greater than, 33% of the material sub-group's internal TLAC requirement. In applying such an expectation, host authorities should take into account the composition of the material sub-group's existing internal TLAC instruments and the practicality of making changes to it, with a view to ensuring that the material sub-group is not required to issue additional internal TLAC beyond the requirement set by the host authority.**

Host authorities should determine the composition of internal TLAC for the material sub-group(s) in their jurisdiction in consultation with the home authority. This will allow the home authority to monitor and where necessary take action to prevent changes in the composition of internal TLAC relative to external TLAC that could threaten the credibility of the resolution strategy or the viability of the resolution entity. For example, external TLAC in the form of debt pre-positioned at the material sub-group as internal TLAC in the form of equity could result in a scenario where the resolution entity is unable to finance its interest payments on its external TLAC debt because it has not earned sufficient dividend payments on internal TLAC instruments in the form of equity. In some scenarios, however, changes in the composition of internal TLAC relative to external TLAC may be necessary to implement the resolution strategy. For example, external TLAC in the form of senior debt might be provided as internal TLAC to material sub-groups in the form of subordinated debt so that internal TLAC is subordinated to the material sub-group's excluded liabilities.

To help ensure the availability of sufficient loss-absorbing capacity at the point of resolution, host authorities in consultation with the home authority may consider including within the internal TLAC requirement an expectation that the sum of a material sub-group's tier 1 and tier 2 regulatory capital instruments in the form of debt liabilities plus other non-regulatory capital internal TLAC-eligible instruments, is equal to or greater than 33% of its internal TLAC requirement. This is consistent with the TLAC term sheet, which states that the core features of internal TLAC are the same as those for external TLAC, and sets out an expectation that the sum of tier 1 and tier 2 regulatory capital instruments in the form of debt liabilities plus other non-regulatory capital TLAC-eligible instruments, is equal to or greater than 33% of a G-SIB's resolution entity or entities' minimum external TLAC requirements. In applying such an expectation, host authorities should take into account the composition of the material sub-group's existing internal TLAC instruments and the practicality of making changes to it, with a view to ensuring that the material sub-group is not required to issue additional internal TLAC beyond the requirement set by the host authority.

*Guiding Principle 9: Collateralised guarantees*

**Home and relevant host authorities in CMGs may jointly agree to substitute on-balance sheet internal TLAC with internal TLAC in the form of collateralised guarantees, subject to the conditions in Section 19 of the TLAC term sheet. The host authority should satisfy itself that the collateralised guarantee will credibly and feasibly pass losses and recapitalisation needs to the resolution entity at the Point of Non-Viability (PONV).**

Consistent with Section 18 of the TLAC term sheet, internal TLAC must be pre-positioned on-balance sheet at material sub-groups. However, home and host authorities may also jointly agree to substitute on-balance sheet internal TLAC with internal TLAC in the form of collateralised guarantees. When determining if the conditions for the use of collateralised guarantees in Section 19 of the TLAC term sheet have been met, home and host authorities should consider the following:

a. *The guarantee is provided for at least the equivalent amount as the internal TLAC for which it substitutes*. The amount guaranteed under the guarantee should not be capable of variation by agreement between the resolution entity and the material sub-group entity without the prior consent of the host authority. Where adjustments to the guarantee are required to reflect changes in the amount of internal TLAC required under the internal TLAC requirement, the host should not unreasonably withhold consent.

b. *The collateral backing the guarantee is, following appropriately conservative haircuts, sufficient to cover fully the amount guaranteed*. In this regard, central bank eligibility criteria and haircuts may constitute a relevant reference for home and host authorities to determine the types of collateral backing the guarantee and appropriate conservative haircuts. The collateral backing the guarantee could be based on (i) a specific pool of identified collateral (in which case the right to dispose of, or substitute, such collateral would require the prior consent of the host authority); or (ii) a list of eligible collateral from which the resolution entity may initially select and thereafter substitute collateral (in which case the use of collateral not on the eligible list would require the prior consent of the host authority). In all cases, the quality of collateral should be sufficient to provide comfort to host authorities.

c. *The guarantee does not limit or otherwise affect the loss-absorbency of the subsidiaries' other capital instruments, such as minority interests, as required by Basel III*. The guarantee should not be drafted such that claims against it are made before the write-down and/or conversion into equity of internal TLAC in the form of regulatory capital instruments.

d. *The collateral backing the guarantee is unencumbered and in particular is not used as collateral to back any other guarantee or security arrangement*. The collateral backing the guarantee should be owned by the guarantor and be readily accessible. In this regard, host authorities may consider requiring the collateral backing the guarantee to be held with a third party custodian. Comfort to the host authority on the value of collateral backing the guarantee should be provided through a periodic independent audit. A list of the collateral backing the guarantee could also be maintained in a register, and regularly updated to reflect any change in the collateral pool.

e. *The collateral has an effective maturity that fulfils the same maturity condition as that for external TLAC*. Host authorities may consider the use of periodic independent audits or custody arrangements for the purposes of verifying the maturity of the collateral backing the guarantee.

f. *There are no legal, regulatory or operational barriers to the transfer of the collateral (or the proceeds of a sale of collateral) from the resolution entity to the relevant material sub-group*. Before substituting on-balance sheet internal TLAC with internal TLAC in the form of collateralised guarantees, host authorities should assess the implications of a transfer of collateral (or the proceeds of a sale of collateral) to ensure that there are no operational barriers and that relevant regulatory requirements in home and host jurisdictions (e.g., concerning capital, liquidity and large exposures) do not create an impediment to a prompt transfer. Authorities may also require the resolution entity to provide a legal opinion or otherwise satisfactorily demonstrate that there are no legal impediments to the transfer of the collateral to the relevant entity in the material sub-group.

*Guiding Principle 10: Internal TLAC issuance*

**The issuance of internal TLAC by a material sub-group – whether issued directly from the relevant entity within the material sub-group to the resolution entity or indirectly through each legal entity in the chain of corporate ownership – should credibly support the resolution strategy and the passing of losses and recapitalisation needs to the resolution entity. If this cannot be achieved, authorities should consider requiring the G-SIB to make changes to their internal TLAC issuance strategies in order to improve its resolvability.**

Internal TLAC is issued from an entity or entities within the material sub-group to the resolution entity. Authorities in consultation with G-SIBs should decide whether the issuance of non-common equity internal TLAC instruments should occur directly between the relevant entity within the material sub-group and the resolution entity or whether the distribution of internal TLAC should follow the existing chain of legal entity ownership ("daisy chain"). Direct issuance may provide greater transparency and legal certainty to home and host authorities, but the conversion of internal TLAC into equity could create changes in the resolution group's structure. Daisy chain issuance, on the other hand, may help avoid changes in the resolution group's structure, but this has to be balanced against the complexity of issuing internal TLAC through different legal entities (including where such entities may be incorporated in a third jurisdiction other than that of the home or host authority).

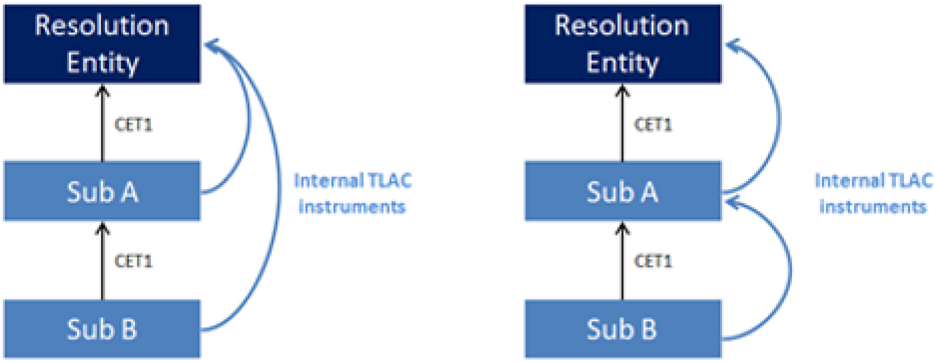



*Figure one: issuance of internal TLAC – direct (left) and daisy chain (right)*

Regardless of the approach taken, the issuance of internal TLAC instruments should in all cases support the resolution strategy and the passing of losses and recapitalisation needs to the resolution entity. If the issuance of internal TLAC instruments is unlikely to achieve this (for example, because issuance introduces additional cross-border, taxation or legal risk), then home or host authorities as appropriate should consider requiring the G-SIB to make changes to its internal TLAC issuance strategies in order to improve resolvability.

Where the issuance of internal TLAC relies on the daisy chain approach, each subsidiary in the daisy chain should issue sufficient internal TLAC to cover any internal TLAC in which it has invested (as well as any internal TLAC for the subsidiary's own balance sheet, if it forms part of a material sub-group) to avoid double counting of internal TLAC.[10] One possible way to avoid double counting from a regulatory perspective would be a requirement for each subsidiary in the daisy chain to deduct any internal TLAC in which it has invested from its own internal TLAC resources. Under such an approach, investments in internal TLAC that are subject to deduction would receive a zero risk-weight, which may also prevent the daisy chain approach from having an impact on solo or sub-consolidated capital buffer requirements. To the extent that internal TLAC consists of regulatory capital instruments, then existing deduction mechanisms for regulatory capital instruments may apply, but for internal TLAC in the form of non-regulatory capital instruments, such deduction mechanisms may need to be established.

[10] If internal TLAC is issued directly to the resolution entity, the requirement in section 18 of the TLAC term sheet applies ("The resolution entity should issue and maintain at least as much external TLAC as the sum of internal TLAC, which it has provided or committed to provide, and any TLAC needed to cover material risks on the resolution entity's own balance sheet").

The FSB proposes to further consider the need for a deduction mechanism for internal TLAC, including how such a mechanism would interact with existing deduction mechanisms for regulatory capital.

*Guiding Principle 11: Internal TLAC governing law*

**Internal TLAC should generally be subject to the governing law of the jurisdiction in which the material sub-group entity issuing the internal TLAC is incorporated. It may be issued under or be otherwise subject to the laws of another jurisdiction if, under those laws, the application of resolution tools by the relevant resolution authority, or the write-down or conversion into equity of instruments at PONV by the relevant authority, is effective and enforceable on the basis of binding statutory provisions or legally enforceable contractual provisions for the recognition of resolution actions and statutory PONV write-down powers.**

Internal TLAC should generally be issued under and governed by the law of the host jurisdiction. The TLAC term sheet reserves the option for the host authority to subject internal TLAC to its own resolution bail-in or other resolution powers if the consent of the home authority to trigger internal TLAC is not forthcoming. The application of such powers may not be credible if the internal TLAC were issued under and governed by the law of a jurisdiction other than the host jurisdiction.

However, internal TLAC could be issued under or be otherwise subject to the laws of another jurisdiction if, under those laws, the application of resolution tools by the relevant resolution authority would be effective and enforceable on the basis of binding statutory provisions or legally enforceable contractual provisions for the recognition of resolution actions and statutory PONV write-down powers. This is consistent with the provision in the TLAC term sheet for external TLAC.

*Guiding Principle 12: Internal TLAC obstacles*

**Authorities and G-SIBs should identify and address any legal, regulatory or operational obstacles that may arise from the implementation of internal TLAC mechanisms.**

The implementation of internal TLAC mechanisms may encounter certain legal, regulatory or operational obstacles. The exact nature of any obstacles is likely to differ across jurisdictions. Authorities will need to consider the obstacles that may arise in their jurisdiction and, where appropriate, take action to address them.

Particular issues that may need to be considered include:

- Subordination of internal TLAC. The feasibility of contractual subordination of internal TLAC to the subsidiary's excluded liabilities (as per Section 10 of the TLAC term sheet) may depend on, among other considerations, the extent to which existing instruments do not preclude new tranches of subordination. In such cases, G-SIBs should consider measures to revise the contractual terms of these existing instruments, or issuing internal TLAC in the form of instruments that do not create a new tranche of subordination (e.g., regulatory capital).[11]

- Regulatory frameworks for large exposures. In some jurisdictions, large exposure frameworks that seek to limit exposures to single counterparties apply on an intra-group basis. The issuance of internal TLAC could increase intra-group exposures beyond the regulatory limits. This could be addressed through an amendment of the regulatory framework, e.g. to exclude internal TLAC instruments from these limits (comparable to the treatment of exposures that are deducted from capital under the Basel Committee's large exposures framework).[12]
- Tax treatment of internal TLAC. In some cases, there may be asymmetrical tax treatment of internal TLAC instruments between home and host authority jurisdictions under the respective tax codes (e.g., whether non-regulatory capital internal TLAC instruments are treated as equity or debt). In this respect, authorities may consider how non-common Tier 1 and Tier 2 regulatory capital instruments are treated, as these are also subject to write-down and/or conversion into equity outside of resolution.
- Mechanism to upstream losses. Differences in legal frameworks between home and host jurisdictions, including with regard to the ranking of internal TLAC instruments in the applicable creditor hierarchy and limited liability law, could affect the passing of losses and recapitalisation needs to the resolution entity.

## IV. Features of trigger mechanisms for internal TLAC

*Guiding Principle 13: Contractual trigger clauses*

**Contractual triggers for internal TLAC should specify the conditions under which a write-down and/or conversion into equity is expected to take place.**

Contractual triggers for internal TLAC instruments should at a minimum specify the conditions under which a write-down and/or conversion into equity is expected to take place. In accordance with the TLAC term sheet, this should be the point at which the material sub-group reaches PONV, as determined by the host authority. Since this judgement is made with reference to the relevant legal framework in the host jurisdiction, the contractual terms should be consistent with the relevant PONV conditions in the host jurisdiction.

Home and host authorities should consider if the extent of the write-down and/or conversion into equity of internal TLAC and the period for home authority consent should be incorporated into the contractual terms, or whether such principles should be agreed separately. Providing greater specificity in the contractual terms may be necessary in daisy chain structures to mitigate the risk that losses and recapitalisation needs do not pass through each step in the chain

[11] If internal TLAC is issued by a material sub-group entity which does not have any excluded liabilities (for example, an intermediate holding company) on its balance sheet that rank pari passu or junior to internal TLAC eligible instruments on its balance sheet (or where the amount of such excluded liabilities does not exceed 5% of the material sub-group entity's eligible internal TLAC), then internal TLAC may be structurally subordinated.

[12] See paragraph 31 of "Supervisory framework for measuring and controlling large exposures" (http://www.bis.org/publ/bcbs283.pdf), April 2014.

to the resolution entity due to a failure to trigger at a given level in the chain. However, the benefits of greater specificity should be weighed against the potential risks of constraining the flexibility of home and host authorities.

See Annex 2 for an indicative example of the aspects to be covered by contractual trigger language that home and host authorities could use as a starting point.

*Guiding Principle 14: Point of non-viability powers*[13]

**Where statutory PONV powers are relied on to write-down and/or convert into equity internal TLAC in the form of regulatory capital instruments outside of resolution, authorities should consider if those powers should be complemented with appropriate contractual PONV triggers.**

If the exercise of statutory PONV powers is subject to certain limitations, authorities should consider whether there is a case for including contractual triggers for internal TLAC that is in the form of regulatory capital instruments (absent the requirement for home authority consent, which does not apply to these instruments), even where statutory PONV triggers already exist.

## V. The process for triggering internal TLAC

Stage 1 – Home and host communication prior to triggering internal TLAC

*Guiding Principle 15: Home and host communication*

**Host authorities should make home authorities aware as far as possible in advance that they are considering making a determination that the material sub-group has reached PONV. This applies regardless of whether internal TLAC is triggered through statutory powers (in the case of regulatory capital instruments) or contractual triggers.**

Early communication will allow home and host authorities to consider options to restore the material sub-group's viability and will allow the home authority to begin its own analysis and, if necessary, prepare for the potential resolution of the resolution group. Although it may not always be possible for the host authority to alert the home authority significantly far in advance of a PONV determination (e.g., in the case of a fast-burn failure such as a large fraud or trading loss), early communication between home and host authorities will help ensure that the home authority is prepared for any eventual determination by the host authority that the material sub-group has reached PONV and its implications for the rest of the resolution group.

*Guiding Principle 16: Options to restore material sub-group viability*

**Home and host authorities should consider alternative options to restore the material sub-group's viability. Internal TLAC should only be triggered as a 'last resort' option when PONV is reached and no credible alternative options to restore the material sub-group's viability are available.**

[13] PONV powers as used in this document refers to the ability and/or obligation of an authority to write down and/or convert to equity regulatory capital and/or other TLAC instruments when the authority determines (with the home authority's consent where this is required for non-regulatory capital TLAC instruments) that without such a write-down and/or conversion the relevant entity would become non-viable.

Given the impact that the triggering of internal TLAC may have on the rest of the group, it should be seen as a 'last resort' option that is executed when PONV is reached and no credible alternative options to restore the material sub-group's viability are available that can be executed in an appropriate timeframe. The host authority should consult with the home authority on potential alternative options to restore the material sub-group's viability prior to making a determination that the material sub-group has reached PONV. Alternative options may include recovery actions such as the sale of assets or capital injections from the parent.

Stage 2 – Determination to trigger internal TLAC

*Guiding Principle 17: Triggering internal TLAC*

**The host authority's decision to trigger internal TLAC should be based on the determination that the material sub-group has reached the point of non-viability, and not be driven solely by resolution actions or the triggering of TLAC elsewhere in the group.**

Consistent with Section 19 of the TLAC term sheet, internal TLAC should only be triggered where the material sub-group reaches PONV (in line with the relevant legal framework).[14] Accordingly, there should be no trigger clauses that allow internal TLAC to be triggered by host authorities solely upon entry into resolution of the resolution entity[15] or the write-down and/or conversion into equity of TLAC elsewhere in the group (e.g., triggering of internal TLAC in another material sub-group, or entry into resolution of another resolution group). Such action could jeopardise the effective implementation by the home authority of the resolution strategy for the resolution group.

When seeking to trigger internal TLAC, the host authority should be expected to provide information to the home authority to support its determination that the material sub-group has reached PONV and to allow the home authority to prepare its own actions. The host authority should seek to provide, on a best efforts basis and subject to legal and time constraints, the following information:

- the basis for the host authority's PONV determination, including an explanation of why alternative options to restore the material sub-group's viability are not feasible or credible;
- the most recent key financial and regulatory information for the material sub-group (e.g., balance sheet, income statement, host authority capital and other regulatory requirements);
- the amount of internal TLAC to be written-down and/or converted into equity;

[14] Recognising that the concept of non-viability should permit the exercise of resolution powers before a bank is insolvent.

[15] This may not apply in the case of non-common Tier 1 and Tier 2 instruments issued externally by an entity within the material sub-group that are counted towards the sub-group's internal TLAC requirement, where the instrument may be triggered on the basis of the group's financial condition if the instrument is being included in the consolidated group's capital in addition to the issuing entity's solo capital. In any case, such instruments may only be used to meet internal TLAC requirements until 31 December 2021.

- any potential obstacles to the write-down and/or conversion into equity of internal TLAC and any additional actions to be taken by the host authority that may need to be taken into account;
- the proposed communication strategy and plan to ensure consistent external communication; and
- any additional information that the home authority may request for its analysis.

The home authority should inform CMG members of the action being taken and the communication plan.

*Guiding Principle 18: Home authority consent*

**Where the consent of the home authority of the resolution entity is required to trigger internal TLAC [16] the host authority should – once it has reached a determination that the material sub-group has reached PONV – provide the home authority with sufficient time, for example 48 hours, to decide whether to consent to the write-down and/or conversion into equity of internal TLAC. Consistent with guiding principle 15, communication and coordination between home and host authorities should commence as early as possible and well in advance of making a determination that the material sub-group has reached PONV.**

Host and home authorities should agree ex ante a timeframe in which the home authority would be expected to decide whether to consent to the write-down and/or conversion of internal TLAC following a determination by the host authority that the material sub-group has reached PONV. This timeframe should be reasonable and not prevent the host authority from taking timely action to recapitalise the material sub-group. As such, it may not be possible for the window for home authority consent to extend beyond, for example, 48 hours, and the home authority should in any event take into account the urgency of the matter. The agreed timeframe should also take into account differences in time zones between home and host jurisdictions.

Consistent with guiding principle 15, the period for the home authority to give consent to the write-down and/or conversion of internal TLAC should not be the starting point of home and host authority discussions. Host authorities should make home authorities aware as far as possible in advance that they are considering making a determination that the material sub-group has reached PONV, to allow the home authority to begin its own analysis and, if necessary, prepare for the potential resolution of the resolution group.

In cases where the home authority objects to the write-down and/or conversion into equity of internal TLAC, or does not provide consent within the ex ante agreed timeframe, the host authority may choose to apply its own resolution bail-in or other resolution powers to the material sub-group. This should be avoided to the greatest extent possible, as such actions may lead to a disorderly resolution with severe consequences for the financial system. The home authority should generally be expected to respect and consent to the triggering of internal

[16] Consistent with Section 19 of the TLAC term sheet, consent from the home authority of the resolution entity is required for the triggering of non-regulatory capital instruments that are used to meet internal TLAC requirements. Trigger conditions for certain regulatory capital instruments are set out in the Basel Committee's point of non-viability (PON) press release of 13 January 2011. See http://www.bis.org/press/p110113.htm.

TLAC, provided that the agreed-upon process has been followed and that the host authority has provided convincing evidence that the triggering of internal TLAC is necessary, and that alternative options to restore the material sub-group's viability (consistent with guiding principle 16) are not credible. Similarly, host authorities should avoid the premature application of statutory resolution powers to material sub-groups in their jurisdiction. Nevertheless, if host authorities choose to apply their own resolution bail-in or other resolution powers to the material sub-group, they should inform the home authority, providing sufficient notice of their intentions to allow the home authority to prepare for the implications of the resolution action on the resolution entity and the resolution group. In addition, the home and host authorities should aim to coordinate their external communication strategies regarding the resolution action.

Stage 3 – Write-down and/or conversion of internal TLAC

*Guiding Principle 19: Material sub-group recapitalisation*

**The host authority should determine the capital shortfall and recapitalisation level of a material sub-group that has reached PONV. The host authority should assist the home authority with its assessment of the condition of the resolution entity and the resolution group, including any subsidiaries in the host jurisdiction.**

A material sub-group must meet the capital standards set by the host jurisdiction. As such, the host authority should be best placed to determine the size of the capital shortfall for the material sub-group and therefore the amount of internal TLAC that should be written down and/or converted to equity. At the same time, there should be an expectation that the host authority will co-operate with the home authority by sharing relevant information for its assessment of the material sub-group, including any capital shortfalls. This will assist the home authority in carrying out its own analysis on the resolution entity and the resolution group.[17]

The host authority will, at a minimum, need to propose to write-down and/or convert into equity a sufficient amount of internal TLAC so that the material sub-group will meet the jurisdiction's regulatory capital requirements (e.g., the minimum Basel III capital requirements and firm-specific additional requirements). To the extent possible, and as judged necessary, the recapitalisation should also replenish any applicable regulatory capital buffers such as the capital conservation buffer. If there is additional internal TLAC available, then the host authority should consider whether converting some or all of the remaining internal TLAC into equity is necessary to address loss uncertainty and provide added assurance and strengthen market confidence in the material sub-group. However, the host authority should also take into account any expected restructuring (e.g., divestment or wind-down of assets) of the material sub-group.

If the triggering of internal TLAC results in the material sub-group no longer meeting its internal TLAC requirement, the host authority should provide a grace period, and may choose to allow the material sub-group up to 24 months to come back into compliance with the internal TLAC requirement.

[17] This principle does not address the valuations that may be necessary in resolution. The FSB will consider this aspect separately.

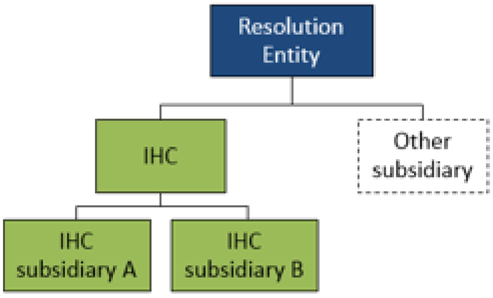
*Guiding Principle 20: Choice of write-down or conversion into equity*

**Home and host authorities should ensure that the write-down and/or conversion into equity of internal TLAC in the form of regulatory capital instruments that are held by third parties does not (i) result in a potential change of control of the material sub-group that would be inconsistent with the resolution strategy for the resolution group or prohibited by the legal framework; or (ii) give rise to material risk of successful legal challenge.**

If all of a material sub-group's internal TLAC is held – or ultimately held – by the resolution entity, then there may be no economic distinction between the choice of a write-down or a conversion into equity of internal TLAC. However, home and host authorities will need to consider the implications of writing-down or converting into equity internal TLAC in the form of regulatory capital instruments that are held by third parties. For example, if the common equity of a material sub-group entity is not fully written-off, holders of externally issued common equity may be diluted in case of a conversion into equity of other internal TLAC instruments but, on the other hand, could stand to benefit from a write-down of such instruments.

In addition, the conversion into equity of non-common Tier 1 and Tier 2 regulatory capital instruments held by third parties could result in a change of control of the material sub-group. These instruments will not count towards a material sub-group's internal TLAC requirement after 31 December 2021, but home and host authorities will need to ensure that their conversion into equity does not result in a change of control of the material sub-group that would be inconsistent with the agreed resolution strategy. Where these instruments remain on the balance sheet of the material sub-group after 31 December 2021 and rank pari passu or junior to internal TLAC instruments, home and host authorities will also need to ensure that the write-down and/or conversion into equity of internal TLAC does not give rise to material risk of successful legal challenge. To ensure that the composition of the material sub-group's liabilities does not present either of these risks, resolution authorities may need to require G-SIBs to make changes to improve their resolvability.

## Annex 1 – Examples of material sub-group composition

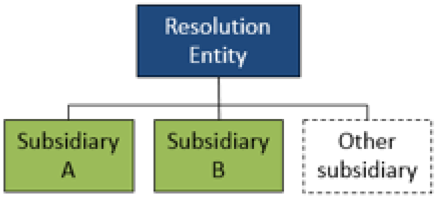


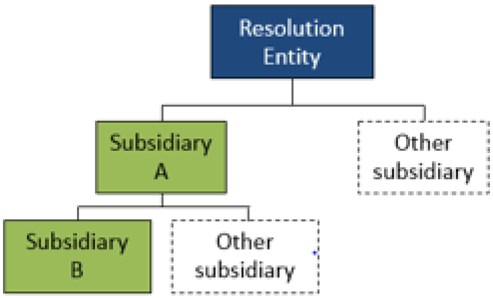

Case one: an **intermediate holding company** (IHC) that consolidates the G-SIB's subsidiaries in the host jurisdiction

The host authority may choose to keep some or all internal TLAC at the level of the IHC. In this case the host authority should ensure that there are no operational or legal barriers to the ready availability of internal TLAC to recapitalise the subsidiaries in the material sub-group, consistent with the requirement for non-pre-positioned TLAC in Section 18 of the TLAC term sheet

Case two: The grouping of **sister subsidiaries**. For example, this could extend to the case where there are separate subsidiaries (e.g., a banking entity and a broker dealer entity) that have significant financial or operational interdependencies, such that the host authority considers it appropriate to group them together in a single material sub-group

In this case the distribution of internal TLAC could be based on the contribution of each subsidiary in the material sub-group to the quantitative criteria in Section 17 of the TLAC term sheet



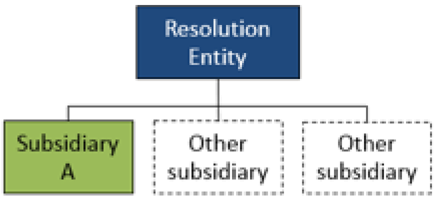




Case three: A **single material subsidiary and one or more of the subsidiaries under its control**. In this case, some subsidiaries in the regulatory or accounting scope of consolidation may be excluded from the material sub-group (e.g., for those subsidiaries that will not be preserved under the resolution strategy)

The distribution of internal TLAC could be based on the contribution of each subsidiary in the material sub-group to the quantitative criteria in Section 17 of the TLAC term sheet. Alternatively, some or all internal TLAC could be held at the top-level subsidiary. As above for case one, the host authority should ensure that there are no operational or legal barriers to the ready availability of internal TLAC to recapitalise the other subsidiaries in the material sub-group

Case four: A **single material subsidiary**

In this case internal TLAC should be distributed to the material subsidiary



## Annex 2 – Example contractual trigger for internal TLAC

**Write-down Trigger Clause:** "**Contractual Write-Down or Conversion Outside of Resolution:** *Notwithstanding any other agreements, arrangements, or understandings between [the issuer] and [the holder of the TLAC eligible instrument], by acquiring the [TLAC eligible instrument], the [holder of the TLAC eligible instrument] acknowledges, accepts, agrees to be bound by, and consents to the [Contractual Write-Down or Conversion] of [this instrument] in any of the following circumstances:*

*(a) upon the determination by the [relevant host resolution/competent authority] that:*

*(i) [issuer] has reached the point of non-viability (Condition 1); and*

*(ii) it is not reasonably likely that (ignoring the Contractual Write-Down or Conversion, any exercise of resolution powers [and any injection of capital from the public sector or resolution funds] ) action will be taken by or in respect of the [issuer] that will result in Condition 1 ceasing to be met.*

***Or***

*(b) upon the [exercise of a statutory PONV power] in respect of regulatory capital instruments of [the issuer].*

*[The [relevant host resolution authority] shall make this determination in its sole discretion but the [Contractual Write-Down or Conversion] may only take place once the written consent of the [relevant home resolution authority] has been obtained, in accordance with the [principles] agreed between the [relevant home resolution authority] and [relevant host resolution authority]]*

*[**Acknowledgment of Independent Bail-In Power:** The [holder of the TLAC eligible instrument] separately acknowledges, accepts, agrees to be bound by, and consents to the [Write-Down and/or Conversion] of [this instrument], upon the exercise of a [Bail-In Power] in respect of the [issuer]]**

***Definitions:***

*"Bail-in Power" means [insert reference to host authority resolution regime]*

*"statutory PONV power" means [Insert reference to host authority PONV power]*

*"Write- Down or Conversion" means, as determined necessary by the [relevant host resolution authority] [to restore [issuer] to complying with its minimum capital requirements and such additional amount to restore market confidence] †*

- *(i) the reduction or cancellation of all, or a portion, of the principal amount of, or interest on, the [TLAC eligible instrument];*
- *(ii) the conversion of all, or a portion, of the principal amount of, or interest on, the [TLAC eligible instrument] into shares or other securities or other obligations of the Issuer; (and the issue to, or conferral on, the holder of the [TLAC eligible instrument] of such shares, securities or obligations); and/or*
- *(iii) the amendment or alteration of the maturity of the [TLAC eligible instrument], or amendment of the amount of interest due on the [TLAC eligible instrument], or the dates on which interest becomes payable, including by suspending payment for a temporary period"*

---

* Only strictly required where the instrument is governed by a law other than that of the host jurisdiction as where the instrument is governed by the law of the host jurisdiction or mutual recognition regimes are in place the bail-in should occur automatically as a result of the operation of law.

† To insert if conditions on the extent of write-down are to be included in the contractual terms.

## Annex 3 – TLAC Term Sheet Sections 16-19

| | |
|---|---|
| **16. INTERNAL TLAC** | The primary objective of internal TLAC is to facilitate co-operation between home and host authorities and the implementation of effective cross-border resolution strategies by ensuring the appropriate distribution of loss-absorbing and recapitalisation capacity within resolution groups outside of their resolution entity's home jurisdiction.<br><br>Internal TLAC refers to loss-absorbing capacity that resolution entities have committed to material sub-groups. A material sub-group consists of one or more direct or indirect subsidiaries of a resolution entity that:<br><br>a. are not themselves resolution entities;<br><br>b. do not form part of another material sub-group of the G-SIB;<br><br>c. are incorporated in the same jurisdiction outside of their resolution entity's home jurisdiction unless the CMG agrees that including subsidiaries incorporated in multiple jurisdictions is necessary to support the agreed resolution strategy and ensure that internal TLAC is distributed appropriately within the material sub-group; and that<br><br>d. either on a solo or a sub-consolidated basis meet at least one of the criteria set out in Section 17.<br><br>A G-SIB may have more than one material sub-group within a single jurisdiction.<br><br>The host authority of subsidiaries that meet one or more criteria set out in Section 17 will determine the composition of the material sub-group and distribution of internal TLAC in its jurisdiction in a manner that supports the effective implementation of the agreed resolution strategy and achieves the objectives of internal TLAC. It should do so in consultation with the home authority of the resolution entity of the resolution group to which the material sub-group belongs and the CMG.<br><br>Material sub-groups will be required to meet a requirement of a minimum amount of liabilities and instruments that qualify as internal TLAC ("Minimum Internal TLAC") consistent with Sections 18 and 19. This principle does not limit a host authority's legal power to impose, consistent with Section 5, any additional firm-specific external or internal TLAC requirements or similar requirements on any local subsidiary of a G-SIB. In so doing, host authorities should take due account of TLAC requirements applied to similar firms within their jurisdictions. In particular, authorities in the resolution entity's jurisdiction may decide to apply internal TLAC requirements (or similar requirements) to subsidiaries or sub-groups within their jurisdictions.<br><br>Branches are not subject to internal TLAC requirements separate from any external or internal TLAC requirement applied to the legal entity of which they are a part. |
| **17. MATERIAL SUB-GROUPS** | A sub-group of a resolution entity is considered "material" for purposes of applying the Internal TLAC requirement if the subsidiary alone or the subsidiaries forming the sub-group on a sub-consolidated basis at the level of the sub-group meet at least one of the following criteria:<br><br>a. have more than 5% of the consolidated risk-weighted assets of the G-SIB group; or |

| | |
|---|---|
| | b. generate more than 5% of the total operating income of the G-SIB group; or<br><br>c. have a total leverage exposure measure larger than 5% of the G-SIB group's consolidated leverage exposure measure; or<br><br>d. have been identified by the firm's CMG as material to the exercise of the firm's critical functions (irrespective of whether any other criteria of this Section are met).<br><br>The list of material sub-groups and their composition should be reviewed by the home and host authorities within the CMG on an annual basis and, if necessary, revised by the relevant host authorities. |
| **18. SIZE OF THE INTERNAL TLAC REQUIREMENT** | TLAC generally should be distributed as necessary within resolution groups in proportion to the size and risk of exposures of its material sub-groups.<br><br>Each material sub-group must maintain internal TLAC of 75% to 90% of the external Minimum TLAC requirement that would apply to the material sub-group if it were a resolution group, as calculated by the host authority. The actual Minimum Internal TLAC requirement within that range should be determined by the host authority of the material sub-group in consultation with the home authority of the resolution group.<br><br>The host authority should calculate the sub-consolidated balance sheet of the material sub-group which will be the denominator of the internal TLAC calculation. Exposures between entities within the same material sub-group should not be included in the balance sheet of the sub-consolidation but exposures of entities within the material sub-group to other entities of the G-SIB outside of the material sub-group should be included in the balance sheet of the sub-consolidation.<br><br>Unless otherwise agreed between home and relevant host authorities, internal TLAC must be pre-positioned on-balance sheet at the material sub-groups and should be sufficient at this level to facilitate effective cross-border resolution strategies for G-SIB resolution groups. TLAC that is not pre-positioned should be readily available to recapitalise any direct or indirect subsidiary as necessary to support the execution of the resolution strategy. Authorities should ensure that there are no legal or operational barriers to this.<br><br>The resolution entity should issue and maintain at least as much external TLAC as the sum of internal TLAC, which it has provided or committed to provide, and any TLAC needed to cover material risks on the resolution entity's own balance sheet. However, external TLAC may be lower if and to the extent this is due to consolidation effects only. |
| **19. CORE FEATURES OF ELIGIBLE INTERNAL TLAC** | The core features of eligible internal TLAC are the same as those for eligible external TLAC (except with regard to the issuing entity and permitted holders). Liabilities that are excluded from eligible external TLAC in Section 10 are also excluded from eligible internal TLAC.<br><br>Internal TLAC instruments of a subsidiary must be statutorily or contractually subordinated to liabilities of that subsidiary that would fall into the category of excluded liabilities as set out in Section 10.<br><br>Internal TLAC that comprises regulatory capital instruments must comply with the relevant provisions of Basel III, including those in relation to write down and conversion at the point of non-viability. Regulatory capital instruments other than CET1 |

| | |
|---|---|
| | that are issued externally out of a subsidiary belonging to a material sub-group and held by third parties may count toward that material sub-group's internal TLAC requirement only until 31 December 2021 and only to the extent that home and host authorities agree that their conversion into equity would not result in a change of control of those entities that would be inconsistent with the agreed resolution strategy.<br><br>Internal TLAC must be subject to write-down and/or conversion to equity by the relevant host authority at the point of non-viability, as determined by the host authority in line with the relevant legal framework, without entry of the subsidiary into statutory resolution proceedings. Any write-down or conversion to equity of internal TLAC is subject to consent from the relevant authority in the jurisdiction of the relevant resolution entity, except where consistent with the circumstances in which Basel III provides that such consent is not required.<br><br>This would not preclude the host authority from subjecting internal TLAC to its own resolution bail-in or other resolution powers should the consent of the home authority not be forthcoming.<br><br>Home and relevant host authorities in CMGs may jointly agree to substitute on-balance sheet internal TLAC with internal TLAC in the form of collateralised guarantees, subject to the following conditions:<br><br>a. the guarantee is provided for at least the equivalent amount as the internal TLAC for which it substitutes;<br><br>b. the collateral backing the guarantee is, following appropriately conservative haircuts, sufficient fully to cover the amount guaranteed;<br><br>c. the guarantee is drafted in such a way that it does not affect the subsidiaries' other capital instruments, such as minority interests, from absorbing losses as required by Basel III;<br><br>d. the collateral backing the guarantee is unencumbered and in particular is not used as collateral to back any other guarantee;<br><br>e. the collateral has an effective maturity that fulfils the same maturity condition as that for external TLAC; and<br><br>f. there should be no legal, regulatory or operational barriers to the transfer of the collateral from the resolution entity to the relevant material sub-group. |