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**SOCIÉTÉ GÉNÉRALE RESPONSE TO FSB'S CONSULTATIVE
DOCUMENT
ON TOTAL LOSS ABSORBING CAPACITY (TLAC)**

Société Générale is one of the leading financial services groups in Europe, operating in 76 countries and employing 148 000 staff from 121 different nationalities. The Group is organised around three core complementary pillars: Retail Banking in France, International Banking and Financial Services, and Global banking and Investor Solutions.

Société Générale has contributed to the various international banking associations' responses, which draw the attention of the FSB on the various concerns, worries and technical topics that the draft TLAC Term Sheet raises.

On top of that, Société Générale and the other French banks have summarized the most important of these elements in the French Banking Federation's response, which the FSB will also have the opportunity to refer to.

Société Générale would like to stress again the importance of the following issues:

General comments :

The SG Group ('SG') agrees that a common mutually recognised standard for loss absorbency and recapitalisation capacities will increase the overall credibility of G-SIB resolution plans by ensuring that sufficient resources are available to stabilize failing G-SIBs, while preserving critical functions during the execution of the resolution plan, and without any usage of taxpayer funds.

We therefore support the idea of TLAC instruments that complement capital with instruments that would be written-down or converted in non-viability situations. It is therefore of the utmost importance that regulators rationalize the interplay between these instruments and the Basel 3 requirements, which already include some gone concern instruments.

We fully agree that the final calibration of the standard needs to be well informed by the concurrent Quantitative Impact Study (QIS) and various market impact survey. Specifically, the calibration needs to be put in perspective of the entire regulatory framework which has been reinforced in many aspects since 2008, starting with new and enhanced capital and liquidity requirements and, of course, the reinforced supervision and early intervention powers granted to supervisors. It is obviously and tremendously important that an excessive burden on the financial system be avoided and, by way of consequence, that the capacity be preserved for healthy banks to finance the economy and sustain growth in the different parts of the world.

We also encourage any further clarification that the TLAC will allow appropriate tailoring to fit different business models and the various banking structures, analysed in combination with their respective local resolution regimes. SG urges the FSB to take into account all aspects of the special resolution regime put in place in the 28 EU countries (which host 14 of the 30 G-SIBs). This framework, written in accordance with the FSB’s own Key Attributes, incorporates a widely spread implementation of statutory bail-in that gives, in itself, even more safety than the TLAC ratio alone.

The TLAC ratio mixes different concepts of structural, contractual and statutory subordination which are all promising avenues but not all workable at the same level for EU banks. In practice, all those avenues should be accommodated to allow the EU banks concerned to flexibly meet their TLAC requirements while minimising the cost premium disadvantage that they will inevitably have to incur, should the TLAC proposal remain otherwise unchanged.

Detailed comments:

Calibration

Q1: Is a common Pillar 1 Minimum TLAC requirement that is set within the range of 16 – 20% of risk-weighted assets (RWAs), and at a minimum twice the Basel III leverage requirement, adequate in the light of experiences from past failures to support the recapitalisation and resolution objectives set out in this proposal? What other factors should be taken into account in calibrating the Pillar 1 Minimum TLAC requirement?

We see the purpose of a common TLAC standard as to stabilize groups and recapitalize the critical functions only, not to revive the bank as it was before resolution. This raises at least the two following aspects:

- The focus should be on recapitalizing to a level that allows these critical functions to be preserved over time and to carry out an orderly resolution
- At the minimum non-banking assets should be excluded from the RWA or leverage measures that underpin the TLAC requirement.

Furthermore, we strongly support the use of the Quantitative Impact Study (QIS) and various market impact surveys, including the historical losses one. It is of utmost importance that the latter is conducted in light of the recent strengthened regulatory framework in order to appraise the level of capital that could credibly still be present at entry in resolution. We believe that due consideration should also be given to the benefits of diversification (for the vast majority of G-SIBs) which makes them more resilient.

Against this background, we consider that the low end of the [16-20] percent of Risk Weighted Assets should already be considered very comfortable to meet FSB objectives, given that Common Equity Tier One buffers will sit on top.

Focus on TLAC versus leverage ratio

If we understand the rationale of having a leverage ratio reference as a backstop, SG is concerned by the proposed level expressed as twice the leverage ratio. Indeed, currently under review, the leverage ratio may be increased by the BCBS above the envisaged level of 3 percent. This raises several concerns:

- If the leverage ratio was to be increased above 3%, it would, then, quickly become the most binding TLAC requirement for many banks. This would become very detrimental, more especially for low RWA-intensive activities such as mortgage lending.

- Moreover, a moving target generates uncertainty about the final level, endangering the ability of banks to implement a progressive build-up of their TLAC issuance at a time where banks and markets will require a good level of predictability.

Alternative solution would be that the principle of doubling the leverage numerator would be modified and that **the requirement be established at a fixed level** in the term sheet, 6% being considered as a maximum.

It should also be clarified that capital buffers will not sit on top of the TLAC calibration based on the leverage ratio. If the leverage ratio is to play its role as a backstop, it should be construed in the same way as in Basel requirements, where Common Equity Tier one held toward buffers counts toward Tier one for the leverage ratio.

Q2: Does the initial exclusion of G-SIBs headquartered in emerging market economies (EMEs) from meeting the Common Pillar 1 Minimum TLAC requirement appropriately reflect the different market conditions affecting those G-SIBs? Under what circumstances should the exclusion end?

The general exemption of G-SIBs headquartered in emerging markets seems excessively broad in scope and in time, and apparently contradictory to general FSB objectives. To preserve a level playing field, it should be clarified **that the exemption will apply only as long as the relevant bank's cross-border footprint and liabilities structures remain limited**, such that it can be qualified as an emerging market bank, and does not become an international bank that simply happens to be headquartered in an emerging market.

In order to ensure a level playing field in emerging markets, this exemption should also apply to foreign banks by waiving any requirement for material subsidiaries competing in the exempted countries and adjusting accordingly their total external TLAC requirements at the resolution entity level.

Conversely, material subsidiaries in foreign jurisdictions of G-SIBs headquartered in emerging markets should be subject to TLAC in the same way as their competitors in these foreign markets.

Q3: What factors or considerations should be taken into account in calibrating any additional Pillar 2 requirements?

Given the Pillar 1 level being considered (even at the lower range ie 16%), we believe that the Pillar 2 rule should clarify that **its goal is to answer major and objectively recognised impediments to resolution** that banks have not yet addressed appropriately.

This is why we believe the Section 6 of the Term Sheet should clarify that any Pillar 2 requirement should be exclusively set at the level of resolution entity(ies) and not at the level of any subsidiary that is not a resolution entity.

FSB should clarify that it can only be a small percentage of the Pillar one to avoid goldplating.

Prepositioning

Q4: Should TLAC generally be distributed from the resolution entity to material subsidiaries in proportion to the size and risk of their exposures? Is this an appropriate means of supporting resolution under different resolution strategies? Which subsidiaries should be regarded as material for this purpose?

In principle, credible resolution strategies and plans will ensure that an appropriate level of LAC and liquidity is reserved at any resolution entity level to recapitalize its subsidiaries where need be. Keeping the “recap reserve” at the resolution entity not only preserves the bank business model from fragmentation of resources in day-to-day business, it maximizes the ability of the institution to allocate the resources in times of crisis.

Thus, **there should be no need for prepositioning as a response to uncertainties in the coordination between authorities** of preferred strategies as defined in plans. Prepositioning of on-balance sheet loss absorbency should only be kept as an alternative for resolution plan actions where the up-streaming of losses could not be guaranteed or organised quickly in other possible ways.

Should the prepositioning requirement be retained, the concept of preserving only critical functions should be respected, thus reducing the capital and liquidity fragmentation to the extent really necessary. The definition of a material subsidiary should be adapted (Term sheet section 21) :

- The 5% threshold should not be applied to the NBI as this metric does not reflect a relevant criteria to select critical functions,
- The selected subsidiaries, apart from the 5% quantitative threshold, should also meet the conditions that **they are classified as D-SIBs in their respective countries, as defined by the BCBS criteria, and that all D-SIBs in the country are subject to similar requirements”**.

Q5: To what extent would pre-positioning of internal TLAC in material subsidiaries support the confidence of both home and host authorities that a G-SIB can be resolved in an orderly manner and diminish incentives to ring-fence assets? Is a requirement to pre-position internal TLAC in the range of 75 - 90% of the TLAC requirement that would be applicable on a stand-alone basis, as set out in the term sheet (Section 22), appropriate to satisfy the goals of the proposal and ensure that TLAC is readily and reliably available to recapitalize subsidiaries as necessary to support resolution? Can this pre-positioning be achieved through other means such as collateralized guarantees?

In the limited circumstances expressed above, an internal LAC requirement should be set to a range of maximum 60-75% of the external Pillar 1 Minimum TLAC requirement that would apply if it were a resolution entity. The final calibration should be set on an individual basis by the CMG.

The proposed level of 75-90% is too high to ensure the right balance between the resolution entity and its subsidiaries and could well result in a total requirement exceeding the total external ratio. Furthermore, the requirements in the TLAC rules should be sufficiently flexible on the features of eligible Internal LAC instruments, taking into consideration operational difficulties to issue debt within certain jurisdictions. In particular, the expectation that TLAC be partially met (33%) by debt instruments should be waived in the case of internal TLAC, and FSB should encourage host authorities not to impose any more restrictive definitions on internal TLAC than those that are contained in the Term Sheet for external TLAC

In addition, **both collateralised and uncollateralized guarantees should be permitted** as qualifying for internal TLAC requirements if the legal framework gives enough comfort to the CMG.

Eligibility

Q6: Are the eligibility criteria for TLAC as set out in the term sheet (Sections 8-17) appropriate?

Need to accommodate existing special resolution regimes

As already stressed in our General Comments, we believe that the proposed eligibility criteria should better reflect the different ways in which the FSB key attributes have been implemented across jurisdictions (insolvency proceedings versus special resolution regimes).

In our opinion, the proposal should pay a more balanced consideration to the various resolution schemes which will depend on the banks' business models, and their corporate structures, analysed in combination with their applicable resolution legal regimes. Special resolution regimes as the EU BRRD provide different, and often additional as compared to other regimes, tools to the resolution authorities (legal powers to bail-in with proper mandatory and discretionary exclusions, resolution funds possibly completing/facilitating the provision of liquidity).

Level playing field between various legal structures

The FSB proposal strongly favours the model of non-operating holding companies. This is in particular the case of those which have already been issuing senior debt for some time. Indeed, their current senior debt outstanding will become immediately eligible for the TLAC ratio (assuming that the proposed conditions for exclusions will be amended to some degree in the final rule - derivatives for instance).

Conversely, banks with operating holding companies will have to issue a new type of TLAC instruments if the restrictions on senior debt eligibility are confirmed. It may even be that many of these banks would have no other choice than to issue capital instruments, due to covenants¹ present in current Tier 2 documentation that prevents them to issue subordinated debts with a higher ranking than Tier 2. This raises several key concerns:

- proportionally greater additional costs (higher spreads on 100% of the TLAC debt issuances) and
- increase of the volume of TLAC to be globally issued by banks during the ramp-up period.

Although this is not the case of any French bank, it is worth noting that a similar difficulty exists for banks with existing non-operating holding companies which have until now raised senior debt from their operating subsidiaries.

All-in-all, **this creates a significantly un-level playing field for EU banks generally**, including the French banks.

The three possibilities to obtain a certain level of subordination (structural, contractual, statutory) should be kept (see Q9). However, it should be clarified that other forms of structural subordination, and in particular **the possibility of issuance via SPVs** as a potential avenue to replication of similar advantages as Non-Operating Holding Company issuance, should be permitted (this is actually already our understanding of the term sheet, but should be confirmed).

Finally, we would draw the attention of the FSB to the fact that the holding company model cannot necessarily be considered as a best-in-class model as far as resolution purposes are concerned. We, however, understand that it may be essential to resolve banks in jurisdictions where no statutory bail-in powers have been enacted or where the special resolution regimes rely extensively on insolvency

¹ The existing Tier 2 contractual documentation provides that these subordinated debts are immediately ranked after the senior debt

legislation or on discretionary powers of resolution authorities. This is not the case in France and in Europe.

Exclusions:

a) Structured notes

Section 12 of the term sheet mixes exclusions for financial stability reasons (exclusion of operating liabilities for instance) or coming from doubts on the operational feasibility of the bail-in powers. This is the case of the structured notes and, to a lesser extent, the derivatives exclusions. We are opposed to the latter exclusions, at least the one of structured notes.

Structured notes are conceptually not different from vanilla issuances hedged by derivatives. The fact that derivatives are embedded in the notes does not modify in any way the fact that they are fully eligible to bail-in.

The fact is that the term ‘structured notes’ is quite broad in content, and encompasses different sorts of instruments which most often have relatively simple market risk features. A large range of the structured notes are quite industrial instruments, with a large degree of standardization, including back-office, listing and valuation processes.

Thus, we see **no reason for an a priori 100 % exclusion of these validly bail-inable liabilities.**

Alternatively, a principle based approach would probably allow the FSB to guide the possible exclusions that would be in the hands of the resolution authorities when assessing the feasibility and credibility of the plans. The French banks would be ready to participate to any FSB work aiming at defining such a grid of principles related to structured notes.

b) “callable on demand without supervisory approval”

Regarding the TS12, some clarifications are also required about the rationale underlying the exclusion of “any liability that is callable on demand without supervisory approval”. In any case, **any liability that is callable only at the issuers’s discretion should be eligible**, considering that issuers would only call those instruments as long as they comply with TLAC minimum requirement.

Redemption restrictions

The redemption restrictions listed in Section 15 of the Term Sheet raise concerns. They would (i) create an extraordinary regulatory burden as dated debt redemption may be also subject to such approval process and (ii) go against the principle of “sustainable for the income capacity of the bank” as a bank will refinance only if it has to or wishes to take advantage of a favorable market opportunity. The timing of such decisions is simply not compatible with a supervisory approval process.

As such, **compliance with the TLAC ratio should be a sufficient motivation for banks to approach redemption in a coherent manner.** Resolution authorities would be entitled to put in place a closer monitoring in case a likely breach of TLAC is plausible (in case of markets disruption for instance), and in such cases, a remediation plan should be required from the concerned entity.

Q7: What considerations bear on the desirability of an expectation that a certain proportion of the common minimum Pillar 1 TLAC requirement consists of (i) tier 1 and tier 2 capital instruments in the form of debt plus (ii) other eligible TLAC that is not regulatory capital?
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We believe that the **current expectation should be applied with proportionality in relation to the CET1 expectations** of the relevant supervisor and the affordability of the hybrid debt market. This means that it should be clarified that internal LAC is not subject to such expectations given i/ the option to provide guarantees instead of subordinated debts, ii/ that subordinated debt practices are not favoured in some countries by authorities.

Q8: Are the conditions specified in the term sheet (Section 8) under which pre-funded commitments from industry-financed resolution funds to provide resolution funding contribute to TLAC appropriate?

We take the opportunity provided by this question to recall that **the prefunded resolution funds put in place in all EU countries should be taken into account** when assessing the TLAC calibration because they will secure a smooth resolution, in particular by completing the bank's own resources in providing liquidity or guarantees for new money.

Q9: Is the manner in which subordination of TLAC-eligible instruments to excluded liabilities is defined in the term sheet (Section 13) sufficient to provide certainty regarding the order in which creditors bear loss in resolution, and to avoid potentially successful legal challenges or compensation claims? Where there is scope for liabilities which are not subordinated to excluded liabilities to qualify for TLAC, are the transparency and disclosure requirements set out in section 13 and 24 sufficient to ensure that holders of these instruments would be aware of the risk that they will absorb losses prior to other equally ranking but excluded liabilities? If not, what additional requirements should be adopted?

We support the intent to limit TLAC to debts that are unquestionably subject to bail-in to absorb losses and recreate own funds. Nevertheless, we believe that **the condition on subordination should not be too prescriptive and rather be tailored by resolution authorities taking into consideration the applicable resolution law.**

Exclusions from TLAC should be addressed according to the applicable resolution regime. In EU, TLAC should take into account the statutory bail-in regime which enables the bail-in of a broad scope of senior debts and leave the resolution authority flexibility to exclude some debts in resolution (for practical or systemic reasons, on a case by case basis). While we understand that the authorities may wish to ensure that the inclusion of senior debt will not give rise to successful legal challenge or compensations claims (last paragraph of section 13 of the Term Sheet), the current FSB drafting tends to take into account such senior debts only up to 2,5% of RWA. SG considers that as far as the condition is fulfilled, the senior unsecured debt should be eligible to TLAC in full. At the very least, should the final calibration be above 16% of RWA any additional percentage should be allowed to be fulfilled with senior debt.

Interaction with regulatory capital requirements

Q10: Do you agree that the TLAC requirement for G-SIBs should be integrated with Basel III such that the minimum TLAC requirement should be met first, and only after TLAC is met should any surplus common equity tier 1 (CET1) be available to meet the Basel III buffers?

The general concept that the TLAC requirement would appropriately be articulated with the Basel III capital requirements is important : see also the general comment on articulation between going concern and gone concern and question 1 on the accounting of capital buffers in the leverage requirement..

Nevertheless, an integration of the TLAC rules within the Basel III framework does not seem to be a pre-condition for this.

Transparency

Q11: What disclosures (in particular in terms of the amount, nature and maturity of liabilities within each rank of the insolvency creditor hierarchy) should be required by resolution entities and material subsidiaries to ensure that the order and quantum of loss absorption in insolvency and resolution is clear to investors and other market participants?

We support the general concept of appropriate transparency on the nature, amount and maturity of debts being retained in the TLAC.

Information to clarify the treatment of debt-holders in resolution should be disclosed as it will increase the capacity of the markets to understand their respective risks. However, this information should pay more attention to the legal regime that would apply as the ranking in resolution may deviate from the ranking under liquidation, as the case is in the EU framework already.

In terms of granularity of the information disclosed, we encourage the FSB to base its requirement on what already exists under the current prudential framework, in order to avoid multiplying disclosures unnecessarily. Moreover, we believe that the disclosure should be required only at the resolution entity level.

Limitation of contagion

Q12: What restrictions on the holdings of TLAC are appropriate to avoid the risk of contagion should those liabilities be exposed to loss in resolution?

The proposal is considered too conservative as, even in systemic crisis time, G-SIBs should be able to afford a certain level of counterparty risk arising from a G-SIB entry into resolution. It is worth reminding that the TLAC debt eligible instruments at the most senior range would most likely not absorb losses but would be converted into equity, thus significantly reducing the final risk.

On top of this, the proposal more particularly entails three negative consequences:

- It would impact the market-making businesses,
- It would not allow to hold the necessary assets to hedge some market position as included in issued notes (for instance structured notes sold to investors) although the detention of these assets does not generate a counterparty risk for the bank,
- It further reduces the investor base to an extent that may well be not affordable.

We suggest that the holding of G-SIBs TLAC instruments by other G-SIBs reflect the different risks rankings, the lowest range being included in the large exposures limitations while recognizing the higher loss given default compared to other transactions. Holding of TLAC instruments not generating risks for banks (hedging purposes) should be exempted of such limitation.

Conformance period

Q13: Should G-SIBs be required to conform with these requirements from 1 January 2019? Why or why not? What, within the range of 12 to 36 months following the identification as a G-SIB, should be the conformance period for banks identified as G-SIBs at a future date?

The volumes of eligible TLAC instruments to be issued will be so high that the final date should, of course, take into consideration the final market survey results. The resulting amounts could even be higher as the rule may quickly extend to D SIBs in some jurisdictions (see Q16). In order to reduce market disruptive impacts and allow banks to smoothen the extra funding costs (see Q15), **a phase in period starting in 2019 appears to be necessary** to ensure that banks have enough time to transform their balance sheet.

Several French banks particularly would have no other choice than drastically increasing their Tier 2 issuances unless the various subordination avenues and the senior debt eligibility criteria are accommodated to reach a more practicable requirement.

When it comes to the topic of newly identified G-SIBs, we believe that a 24-36 months conformance period would be more appropriate as markets should come back to more normal pace once the ramp-up period is finalized.

Market impact and other aspects

Q14: How far is the TLAC proposal, if implemented as proposed, likely to achieve the objective of providing sufficient loss-absorbing and recapitalization capacity to promote the orderly resolution of G-SIBs?

As suggested already, our opinion is that the contemplated calibration is very probably excessive as the regulatory landscape has already been reshaped ambitiously since 2008 and that most of the G-SIBs run diversified business models which have proven their resilience during the recent years.

We agree however that the TLAC should provide an appropriate level of confidence to markets which, in our mind, should not only come from the level of TLAC but the quality of supervision, the consistency in the regulatory landscape of the different major regions where G-SIBs are implemented. **The role of the FSB in i/ the consistent implementation of the Key Attributes across jurisdictions and ii/ the support to mutual recognition of resolution regimes and plans is of utmost importance** to avoid conflicting rules and practices that would jeopardize the run of international activities.

Q15: What will be the impact on G-SIB's overall funding costs of the adoption of a Pillar 1 Minimum TLAC requirement?

The development of the FSB standard has already triggered markets reactions and adaptations. More particularly, the credit rating agencies have already been proposing modifications to their methodologies although the TLAC rules are not finalized. Investors are now well aware that they will have to pay attention to the possible eligibility of debts instruments to TLAC. Spreads should quickly take this into account where it is not the case yet, although the markets will take some time to find the right balance in terms of spreads.

On a global basis, there is no doubt that the contemplated calibration will result in huge volumes to be issued. **This will have a very significant impact on the overall banks profitability which in turn will weaken their capital generation capacity to the detriment of banking activities development.** Nevertheless, it is important noting that the current design of the term sheet will result in very different impacts between banks depending on whether they already issue debts, including senior debts, from non-operating holding companies (see Q6). Other banks, i/ either with holding companies but historically issuing debts from their operating companies or ii/ with no holding companies and with little other choice to issue junior debts, will support full cost of issuing TLAC eligible instruments from almost scratch. These banks will support the inevitable tension on spreads during the ramp-up period during which the pricing power may well be in the hands of the investors.

Q16: What will be the impact on the financial system and its ability to provide financing to the real economy?

One of the primary goals of EU legislation in the field of banking is to create a level playing field within the single market. This means that requirements such as the Basel III capital requirements, or the upcoming TLAC requirement, are in general always applied equally to all systemically important banks in the European Union, regardless if they qualify for the FSB G-SIB criteria or if they are only deemed systemically important at the EU or domestic national level.

This will lead to a need for many European banks, which are not G-SIBs but are still deemed systemically important to also issue vast amounts of the new type TLAC debt instruments. It would obviously have a severe negative impact on economic growth in a situation where the economic recovery in Europe is already quite fragile.
