

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

Overview of Responses to the Public Consultation

Introduction

On 16 December 2016, the FSB published a consultative document – [*Guiding Principles on the Internal Total Loss-absorbing Capacity of G-SIBs \('Internal TLAC'\)*](#) – that proposed a set of high-level guiding principles to assist the home and host authorities of crisis management groups (CMGs) for global systemically important banks (G-SIBs) in the implementation of internal TLAC mechanisms. Internal TLAC, as set out in the FSB's TLAC standard¹, is the loss-absorbing capacity that resolution entities have committed to material sub-groups. It provides a mechanism for the passing of loss absorption and recapitalisation needs of material sub-groups to the resolution entity of a G-SIB resolution group, without entry into resolution of the subsidiaries within the material sub-group.

The FSB received 19 responses to the public consultation from G-SIBs, industry associations, official sector bodies and advisory firms.² Respondents generally welcomed the clarification provided by the consultative document on issues relating to the implementation of internal TLAC, but a number of respondents expressed the view that the consultative document contained some shortcomings and did not address certain issues.

This note summarises the comments raised in the public consultation and sets out the main changes that have been made to the guidance to address them.

Summary of Main Issues

The role of home and host authorities

Many respondents objected to the description of the roles and responsibilities of home and host authorities in relation to internal TLAC. These respondents expressed the view that the consultative document was excessively biased towards the role of host authorities. They instead advocated greater balance of home and host authority responsibilities to underscore the cooperative, group approach to resolution agreed in CMGs and led by home authorities. Other respondents suggested that limits on the ability of host authorities to impose excessive internal

¹ See “Total Loss-Absorbing Capacity (TLAC) Principles and Term Sheet” (<http://www.fsb.org/wp-content/uploads/TLACPrinciples-and-Term-Sheet-for-publication-final.pdf>), 9 November 2015.

² The comment letters are published on the FSB's website (with the exception of those that requested otherwise): <http://www.fsb.org/2017/03/public-responses-to-the-december-2016-consultative-document-guiding-principles-on-the-internal-total-loss-absorbing-capacity-of-g-sibs-internal-tlac/>

TLAC requirements were necessary to avoid a collective action problem that could act as an impediment to the feasibility of resolution strategies. In particular, these respondents noted that excessive internal TLAC requirements could reduce the amount of surplus TLAC available at the resolution entity to recapitalise other subsidiaries or to manage a scenario where losses are distributed asymmetrically. The FSB notes that the roles and responsibilities of home and host authorities in relation to internal TLAC are already established in the TLAC term sheet, and that the consultative document and final guidance seek to provide guidance consistent with the TLAC standard.

Nevertheless, the final guidance includes some changes to balance the roles of home and host authorities in relation to internal TLAC. In particular, guiding principle one in the final guidance seeks to better emphasise the role of the home authority in initiating and coordinating the process of identifying material sub-groups. In addition, references in guiding principles five and six to there being 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 have been removed from the final guidance. However, the final guidance does not include an opposite presumption that host authorities would lower their requirements or seek to eliminate the difference in such cases – as some respondents had advocated – as this may conflict with the responsibility of the host authority to set internal TLAC requirements as established in the TLAC term sheet. The final guidance also reiterates the commitment of CMG authorities to cooperate in the resolution planning process for a G-SIB as established in the FSB's Key Attributes.³

Pre-positioning of internal TLAC

Some respondents felt that the guidance should reflect regulatory developments and structural changes made by G-SIBs since the finalisation of the TLAC standard in November 2015. In particular, certain G-SIBs have entered into secured support agreements that impose a legally binding obligation on the resolution entity to provide support to its subsidiaries. These respondents felt that the existence of secured support agreements obviated the need for pre-positioned internal TLAC, and suggested that the guidance should permit internal TLAC requirements to be met with such agreements.

As noted above, the consultative document and final guidance seek to provide guidance consistent with the TLAC standard. Section 18 of the TLAC term sheet requires internal TLAC to be pre-positioned on balance sheet at the material sub-group. However, it should be noted that 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 set out in Section 19 of the TLAC term sheet.

Material sub-group composition

A few respondents argued that the concept of a material sub-group consisting of “sister subsidiaries” as proposed in guiding principle two was vague and could lead to an ad-hoc creation of material sub-groups that would be inconsistent with existing sub-consolidations. The final guidance clarifies that a material sub-group of sister subsidiaries should only apply where those subsidiaries have significant financial or operational interdependencies. In

³ See “Key Attributes of Effective Resolution Regimes for Financial Institutions” (http://www.fsb.org/wp-content/uploads/r_141015.pdf), 4 November 2011, updated 15 October 2014.

addition, guiding principle two establishes that material sub-groups 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.

Internal TLAC composition

Several industry respondents argued that a 33% debt expectation for internal TLAC, as proposed in guiding principle eight of the consultative document, is not necessary on the basis that it would, variously, increase leverage, penalise well capitalised subsidiaries, limit flexibility and potentially require a restructuring of existing capital and funding flows. The FSB notes that, as set out in guiding principle eight, the application of such an expectation 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.

Surplus TLAC

Many respondents objected to guiding principle seven of the consultative document on surplus TLAC, in particular the suggested characteristics of surplus TLAC and the proposal that the surplus be held at the resolution entity. These respondents argued that it is operationally and legally feasible to use a range of assets to recapitalise material sub-groups, and that holding surplus TLAC at the resolution entity – particularly if the resolution entity is a non-operating holding company – would be financially inefficient and may conflict with the G-SIB's funding structure. These respondents advocated greater flexibility for G-SIBs to manage surplus TLAC within a broader framework taking into account the group structure and liquidity and funding needs of the group.

The final guidance recognises the possibility, subject to review by the home and host authorities within the CMG, of surplus TLAC being held in an entity other than the resolution entity provided there are no legal or operational impediments to the transfer of surplus TLAC back to the resolution entity or to its ready availability to recapitalise any direct or indirect subsidiary of the resolution entity as necessary to support the execution of the resolution strategy, consistent with Section 18 of the TLAC term sheet.

Internal TLAC issuance and deductions

Guiding principle ten of the consultative document proposed that the issuance of internal TLAC should credibly support the resolution strategy and the passing of losses and recapitalisation needs to the resolution entity. In this context, two possible means of internal TLAC issuance were described: direct issuance from the relevant entity in the material sub-group to the resolution entity, and indirect issuance through each legal entity in the chain of corporate ownership. Industry respondents to the consultation expressed concern that limiting issuance of internal TLAC to these two approaches would be overly restrictive given that other forms of internal TLAC issuance could be adopted. Accordingly, the final guidance clarifies that direct and indirect issuance represent examples of internal TLAC issuance. In addition, the final guidance defines indirect issuance as issuance through multiple legal entities within the group (i.e., not necessarily following the chain of corporate ownership). Regardless of which approach is taken, issuance of internal TLAC is expected to credibly support the resolution strategy and the passing of losses and recapitalisation needs to the resolution entity.

Guiding principle ten also proposed that the FSB further consider the need for a deduction mechanism for internal TLAC to avoid possible double counting. Respondents broadly supported this proposal, with several highlighting the need for additional clarity before G-SIBs begin designing and structuring internal TLAC instruments. The final guidance includes an annex that sets out an example of a possible approach to internal TLAC deductions. To avoid possible double counting of internal TLAC, authorities should consider applying such a deduction approach, or an equivalently robust supervisory approach.

Point of non-viability powers

Several respondents commented on guiding principle 14, which proposed that the use of statutory powers to trigger internal TLAC be complemented with contractual triggers to address potential limitations relating to the exercise of statutory powers. These respondents felt that contractual triggers would not be necessary if a statutory trigger was in place. As such, the proposed guiding principle has been removed from the final guidance.

Internal TLAC conformance period and implementation of the guidance

A few respondents called on the FSB to provide clarity on the timeframe for the implementation of internal TLAC requirements, in particular in the case where a new material sub-group is identified after the implementation of the TLAC standard. To this end, the final guidance includes an additional guiding principle on the conformance period for internal TLAC. Internal TLAC requirements apply as from 1 January 2019, consistent with the conformance period for the TLAC standard established in Section 21 of the TLAC term sheet. If a new material sub-group is identified at a later date, the material sub-group in question should meet the internal TLAC requirement within 36 months from the date of its identification at the latest, or within an appropriate shorter period as determined by the host authority in consultation with the home authority.

Relatedly, some respondents expressed the view that once internal TLAC has been triggered and a G-SIB has entered into resolution, requirements for internal TLAC beyond the material sub-group's regulatory capital requirements should be suspended during the resolution period on the basis that imposing a requirement during this time would be counterproductive. Guiding principle 19 of the consultative document and guiding principle 18 of the final guidance establish that the host authority should in such cases allow the material sub-group up to 24 months to come back into compliance with the internal TLAC requirement following the date on which the G-SIB exits resolution. This is consistent with the period for a G-SIB in resolution to come back into compliance with the TLAC standard as set out in Section 21 of the TLAC term sheet.