FÉDÉRATION BANCAIRE FRANÇAISE

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FRENCH BANKING FEDERATION RESPONSE TO THE FSB'S CONSULTATIVE DOCUMENT ON INTERNAL TLAC

The French Banking Federation (FBF) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorized as banks and doing business in France, i.e. more than 390 commercial, cooperative and mutual banks. FBF member banks have more than 38,000 permanent branches in France. They employ 370,000 people in France and around the world, and service 48 million customers.

General comments

The FBF supports the extensive work of the FSB in defining the responsibilities of the various stakeholders (in particular Home and Host Authorities) notably in terms of identification of material sub-groups and when determining quantitative and qualitative internal TLAC requirements.

We therefore expect that these guiding principles, once they are finalized after taking into account the industry's observations, which in their great majority merely reflect the practical reality of the application of the TLAC in the various jurisdictions, will be endorsed by the European Commission in the context of its work towards convergence between TLAC and MREL.

In a nutshell, it seems to us to be of the upmost importance that the FSB amend elements of the preamble:

- A better balance should be found between home and host regulators. The current proposals give great power to the host authorities in many respects (TLAC requirements, resolution powers, etc.). The FBF believes that the proposed framework may create further fragmentation in supervision and may encourage ring-fencing rather than co-operation. The final guidelines should put more emphasis on the group resolution strategy validated in resolution colleges/CMGs, which is the keystone to allocate financial means within the group.
- TLAC requirements were primarily designed under a top-down approach. The overall (external requirements) are set at group level. The current proposals now favor a bottom-up approach where ultimately the overall requirements may be superseded by the sum of the local TLAC requirements – which is a radical change of paradigm. On the contrary we believe that the top-down approach is more consistent with an enhanced supervisory co-operation.
- Local requirements for GSIB entities should be comparable with resolution requirements applicable to entities that are not part of GSIBs.

- In addition, we believe that the guideline should clarify that internal TLAC only applies in jurisdictions which have transposed TLAC and which also have put in place a legal resolution framework.
- Finally, we advocate some flexibility with respect to the design of internal TLAC instruments and the use of proceeds of the external TLAC issuances. A number of issues have been rightly addressed (e.g. the balance of the P/L account at the holding company and the related tax issues). However, those analyses are biased by implicit assumptions regarding the group structure and the applicable resolution strategy (namely a pyramidal group, with a clean non-operating holding company subject to an SPE strategy). In practice, banking group structures may be very different from that theoretical structure (mutual groups, operating holding companies…). Capital and liquidity needs of the various entities should be carefully taken into account before calibrating and designing the TLAC allocation. In particular, we believe that guarantees may be the most adequate tool in many instances (e.g. when the beneficiary entity has a liquidity surplus).

Our response to the FSB consultation is organized in two parts:

- Our comments on the different proposed guiding principles, with some suggested amendments where appropriate ;
- Our specific answers to the questions raised in the consultative document.

PART 1 : Comments and suggested amendments on the guiding principles

Guiding Principle 1: Material sub-group identification

- The FBF is very much in favor of setting objective criteria in order to identify material sub groups. While we note positively the role of "control tower" of the home authority, it seems important to us to clarify and reinforce in this first principle, **the central role of this authority**. Thus, it should be mentioned within this first principle, the fundamental and predominant role of the home authority in the global governance of the decisions inherent in internal TLAC.

- Secondly, provision should be made in this principle for the modalities of communication by the home authority to the GSIB of the list of its material sub-groups, envisaged internal TLAC levels and possibly the modalities of conflict resolution where appropriate.

- In addition to dealing with cross-border internal TLAC, the TLAC Term sheet introduces also a possibility for the home authority to identify material sub-groups within the jurisdiction of the resolution entity. To prevent gold plating of capital protection, entities that are already within the scope of a cooperative mutual solidarity system that protects the solvency and liquidity of the affiliated cooperative banks and institutions would not be targeted by internal TLAC and hence not be identified as material sub-group for internal TLAC purposes.

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

- In the same vein as our general remark concerning the legal resolution framework of the host jurisdiction, the first paragraph should be amended as follows:

"In jurisdictions where the FSB key attributes of resolution regimes have been fully transposed, *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."*

- Within this principle, it should be clarified that if the composition of a material subgroup can result from the characteristics stated, in no way should the host authority be able to impose a structural change in the ownership structure in order to create or modify a material sub-group.

Guiding Principle 3: Multi-jurisdictional material sub-groups

- In order to reflect the economic reality of the organization of banking institutions and to respect the spirit and text of the TLAC Term Sheet as to the principle of materiality, Principle 3 should be amended as follows:

*"Material sub-groups ~~should~~ **would** only consist of **material** 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."*

Guiding Principle 4: Regulated or unregulated non-bank entities

- As regards inclusion of non-bank entities, we advocate for a distinction between regulated and unregulated non-banks. Indeed regulated non-banks which have their own resolution regime should not be part of a material sub-group, and therefore should be excluded from the scope of these guiding principles. This is notably the case for insurance companies, which may be part of a banking group, and are subject to their proper resolution regime.
- In the case of non-regulated non-banks, it may be that other protections (eg for the provision of critical services) may be far more effective than internal TLAC. Internal TLAC should only be used for such entities as a last resort if no better protection is available.

- As regards the internal TLAC requirement for such entities, the consultative document presents a preliminary methodology to assess the RWAs of non-bank entities that would be included in material sub-groups eligible to internal TLAC.
  However this methodology does not cover the case where an answer is already provided by the prudential consolidation of the group.

We therefore suggest adding at the end of the principle 4 : ***« However, when the holding in the entity is already taken into account in the prudential consolidation of the group, the RWA assigned to the holding in the entity within the group's RWAs is used without any need to check the accounts of the entity. »***

Guiding Principle 5: The role of the host authority

- In line with our general comments, FSB TLAC Term sheet and in order to ensure a proper level playing field between banks within a given jurisdiction, Principle 5 should be amended as follows:

"In jurisdictions where FSB resolution key attributes have been fully transposed**, 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 **within the CMG framework and after endorsement by ~~with the~~** home authority **that would ensure that the sum of internal TLAC requirement does not exceed the external TLAC**. 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. **Lastly, when setting the requirement, Host

authorities should demonstrate that the requirement is proportionate to the one set for domestic banks within their jurisdictions."

[…]

"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 ***not being supported by a Resolution entity under a Single Point of Entry resolution framework*** *within the material sub-group to other* ***material*** *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."*

Justification: no risk should be accounted toward entities which are supported by the resolution entity and will not be put into resolution.

Guiding Principle 6: The role of the home authority

- The responsibility of the home authority could be reinforced in ensuring that the sum of internal TLACs does not exceed external TLAC.

Guiding Principle 7: Surplus TLAC

- Surplus TLAC should be managed within the broader framework of the liquidity and capital management of the group and the already existing prudential constraints (notably solvency, large exposures and liquidity). No further specific requirements are necessary.

- From our perspective, the bank should be allowed the possibility to allocate TLAC wherever it is appropriate and be in a position to ensure fluidity of its distribution where necessary.

Guiding Principle 8: Internal TLAC composition

- The current proposals seem unduly restrictive and economically negative. It is essential to leave banks a certain flexibility in the composition of their internal TLAC, and not to create additional constraints alongside current prudential requirements such as LCR, NSFR, Large exposures.

- Besides, as stated in the preamble, the composition of the internal TLAC allocated to a given entity should take into account various considerations including:

- The liquidity needs of the beneficiary entity. If the entity has already a liquidity surplus (e.g. deposits are in excess of loans), the supplementary liquidity is likely to be reused at economically unfavourable conditions. If TLAC is provided in the form of debt format this would also deteriorate the leverage ratio. In that particular instance guarantees would make more sense;
- Tax considerations: the supplementary debt required may be penalized by the tax regimes (difference of corporate tax rates between the providing entity and the receiving entity, non-deductibility of excess leverage…) and will tend to reduce fiscal income for host countries as the taxable base would be lower.

As a consequence, the 33% debt guidance carried over from external TLAC seems unnecessary for internal TLAC.

Guiding Principle 9: Collateralised guarantees

- We regard guarantees as a particularly efficient way to provide internal TLAC with minimal economic drawbacks since they do not materially alter the beneficiary's balance-sheet. Hence, we think that the proposed requirements are unduly penalising:
    - Collateral should be primarily construed as a pool of instruments – including cash –, that are to a large extent substitutable and renewable, and can be managed in a rather dynamic way, provided the amount and quality is sufficient. In particular, the effective maturity must be construed taking into the dynamic life-cycle of a pool of collateralized instruments including the conversion into cash and the renewal of instruments whose nominal maturity is less than 1 year;
    - The minimum 100% requirement can be relaxed where there is a strong co-operation between the home and the host authority. When the entities are subject to the same supranational resolution authority, this requirement could be dropped.

- The FSB rightly notices that support arrangements between the providing entity and the beneficiary may alter the loss-absorbency of minority interests. We believe this is not specific to guarantees but valid for any support granted by the parent entity (whether cash or non-cash, implicit or explicit); in addition we think the overall TLAC and resolution frameworks actually encourage minority-stake holders to believe so.

Guiding Principle 10: Internal TLAC issuance

- Both proposed approaches may be valuable, however banks should be given the possibility to have other approaches, according to their own group structure, provided that any triggering of internal TLAC does not lead to a change of overall control of the group.

Guiding Principle 11: Internal TLAC governing law

- G-SIBs should be given the option to provide internal TLAC under the law of their home jurisdictions, according to the circumstances. This is especially the case where the local legislation could result in impediments to effectiveness.

Guiding Principle 12: Internal TLAC obstacles

- We support internal TLAC being excluded from large exposure limits.

Guiding Principle 13: Contractual trigger clauses

- We understand the introduction of contractual trigger clauses, however internal TLAC must remain a last resort measure after all other avenues have been explored. As such any contractual trigger clauses in internal TLAC should never allow for internal TLAC to be triggered before the triggering of any other liability that ranks junior to or *pari passu* with internal TLAC.

Guiding Principle 14: Point of non-viability powers

No comments.

Guiding Principle 15: Home and host communication

No comments.

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

No comments.

Guiding Principle 17: Triggering internal TLAC

No comments.

Guiding Principle 18: Home authority consent

No comments.

Guiding Principle 19: Material sub-group recapitalisation

- The primary goal of the write-down/conversion is to restore the viability of the failing subsidiary. We believe therefore:
  - The reference level of recapitalization should be the minimal capital requirement.
  - Any excess recapitalization should be calibrated bearing in mind the primary goal (restoring the viability). Regulatory capital buffers may only be used as a guidance.

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

- The choice between write-down and conversion into equity is closely related with the fate of minority stakeholders mentioned in Principle 9.

PART II : Answers to questions raised in the consultative document

1. What factors should the relevant authorities take into account when determining the composition of material sub-groups and the distribution of internal TLAC between the entities that form the material sub-group (guiding principle 2)?

Firstly we consider that a better balance should be found between home and host regulators. The current proposals give too much leeway to host authorities in many respects (TLAC requirements, resolution powers, etc.). The FBF believes that the proposed framework may create further fragmentation in supervision and may encourage ring-fencing rather than co-operation. We believe that the internal TLAC should apply only in jurisdictions where TLAC has been transposed and which also enjoys a legal resolution framework. Moreover it is important to keep TLAC requirements such as they were primarily designed: a top-down approach, which is more consistent with an enhanced supervisory co-operation at group level.

Secondly we consider that the CMG is the appropriate forum for the decision on identification of material sub-groups, with the home authority unambiguously leading the process in consultation with the host authority based on clear objective criteria designed by the FSB. The FBF strongly believes that host authorities should not seek to impose internal TLAC on subsidiaries if they have not been identified as being material by the CMG by idiosyncratic interpretation of the criteria articulated in Principle 2.

Finally we note that Principle 3 introduces a degree of conditionality into the composition of the subgroup. It should be firmed as follows:

> "*Material sub-groups ~~should~~ would only consist of **material** entities in more than one jurisdiction where…*"

In addition to dealing with cross-border internal TLAC, the TLAC Term sheet states as well a possibility for the home authority to identify Material sub-groups within the jurisdiction of the resolution entity. To prevent gold plating of capital protection, entities that are already within the scope of a cooperative mutual solidarity system that protects the solvency and liquidity of the affiliated cooperative banks and institutions would not be targeted by internal TLAC and hence not be identified as material sub-group for internal TLAC purposes.

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?

   - As regards inclusion of non-bank entities we advocate for a distinction between regulated and unregulated non-banks. Indeed regulated non-banks which have their own resolution regime should not be part of a material subgroup, and therefore should be excluded from the scope of these guiding principles. This is notably the case for insurance companies, which may be part of a banking group, and are subject to their proper resolution regime.

- In the case of non-regulated non-banks, it may be that other protections (eg for the provision of critical services) may be far more effective than internal TLAC. Internal TLAC should only be used for such entities as a last resort if no better protection is available.

Where non-bank entities are included, the calculation on internal TLAC should be based on the binding constraint of the higher of either RWAs or Leverage based on Basel III. We oppose a bespoke framework that would introduce regulatory discretion into the internal TLAC process.

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?

The guidelines should state that home authorities ensure that the sum of internal TLAC requirements does not exceed the resolution group's external TLAC requirement. This could be ensured by discussions within the CMG/college led by the home authority.

Besides consistently with the TLAC Term Sheet and in order to ensure a proper level playing field between banks within a given jurisdiction, Principle 5 should be amended as follows:

"In jurisdictions where FSB key attributes of resolution régimes have been fully transposed*, 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* ***within the CMG framework and after endorsement by*** *~~with the~~ home authority* ***that would ensure that the sum of internal TLAC requirement does not exceed external TLAC****. 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.* ***Lastly, when setting the requirement, Host authorities should demonstrate that the requirement is proportionate to the one set for domestic banks within their jurisdictions."***

[…]

"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 ***not being supported by a Resolution entity under a Single Point of Entry resolution framework*** *within the material sub-group to other* ***material*** *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."*

Justification: no risk should be accounted toward entities which are supported by the resolution entity and will not be put into resolution.

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)?

Banks should be allowed sufficient flexibility for the surplus to be held anywhere in the group as long as it is readily available to absorb any losses, recognising the fungibility of instruments likely to be used to meet TLAC. Whilst the pre-positioning of TLAC can support cooperation, it is important to avoid an excessive requirement that would reduce the flexibility of a group to itself respond to a stress situation by allocating resources as and when necessary to absorb the shock.

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?

Current proposals seem unduly restrictive and economically negative. It is essential to leave banks a certain flexibility in the composition of their internal TLAC, and not to create additional constraints alongside current prudential requirements such as LCR, NSFR, Large exposures.

As stated in the preamble, the composition of the internal TLAC allocated to a given entity should take into account various considerations including:

- The liquidity needs of the beneficiary entity. If the entity has already a liquidity surplus (e.g. deposits are in excess of loans), the supplementary liquidity is likely to be reused at economically unfavourable condition. If the TLAC is provided in the debt format this would also deteriorate the leverage ratio. In that particular instance guarantees would make more sense;
- Tax considerations. The supplementary debt may be penalized by the tax regimes (difference of corporate tax rates between the providing entity and the receiving entity, non-deductibility of excess leverage…) and will tend to reduce fiscal income for host countries as the taxable base would be lower.

As a consequence, the 33% debt guidance carried over from external TLAC seems unnecessary for 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?

We support the two internal issuance approaches outlined in the consultation, either directly from a material sub-group to the resolution entity or indirectly to the resolution entity through the ownership chain, should be permitted where they support the resolution strategy. However, we believe that limiting internal issuance to these two approaches is overly restrictive and does not recognise that other internal issuance strategies can credibly support a G-SIB's resolution strategy and the passing of losses to the resolution entity.

The FSB should amend Principle 10 to recognise other approaches to issuing internal TLAC, for example issuance by a material sub-group indirectly to the resolution entity through wholly owned affiliates that are outside of the direct ownership chain. This would recognise the complexity of large international banks that need the flexibility to fund their material sub-groups efficiently across global structures. Where a bank can demonstrate that an approach to issuing internal TLAC supports the passing of losses to the resolution entity, the FSB should recognise these approaches as eligible to issuing internal TLAC.

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

We support the FSB conducting further work on deduction mechanisms, recognising there may be potential jurisdictional differences in how internal TLAC deductions to regulatory capital may work in practice.

8. Do you agree with the obstacles to the implementation of internal TLAC mechanisms set out in guiding principle 12? How should G-SIBs and authorities address those obstacles and what additional obstacles, if any, might arise?

We support internal TLAC being excluded from large exposure limits.

9. Do you agree with the key features of contractual trigger language for internal TLAC, as set out in guiding principle 13 and in Annex 2? Should authorities consider the use of contractual triggers for internal TLAC in the form of regulatory capital instruments, including in cases where statutory point of non-viability powers exist in relation to such instruments?

We understand the introduction of contractual trigger clauses, however internal TLAC must remain a last resort measure after all other avenues have been explored. As such, any contractual trigger clauses in internal TLAC should never allow for internal TLAC to be triggered before the triggering of any other liability that ranks junior to or *pari passu* with internal TLAC.

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?

We support the assertion that triggering of internal TLAC should be a ‘last resort’ and that there should be no automatic triggering of internal TLAC. The guidelines should also be amended to ensure that banks are included in the consultation of alternative actions before triggering internal TLAC in order to enable these actions to be implemented effectively.

We further support the host authority being required to provide information to the home authority on PONV determination to assist in group resolution strategies. However, we are concerned that a timeframe of 48 hours may be too long for a decision to be reached and not leave banks enough time to enact the strategy decided upon. We believe that a much shorter window is provided in the guidelines to ensure authorities are suitably set up in advance to communicate in a timely manner and that there should be a strong expectation that they would communicate actively.

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?

No comments.