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FRENCH BANKING FEDERATION RESPONSE TO BCBS's CONSULTATION ON TLAC Holdings

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.

The FBF welcomes the opportunity to respond to the Basel Committee's consultation on TLAC Holdings issued in November 2015. The consultative document's topic is the deduction of exposures held by a G-SIB to TLAC instruments issued by other G-SIBs and the prudential treatment for non G-SIBs.

Key messages

- **The FBF shares the FSB concerns about the contagion risk and support the FSB idea for regulators to limit TLAC holdings for internationally active systemic banks. Nevertheless the limit should take into account market making activities that are crucial to support the issuances of high volumes of TLAC.**
- **For banks not subject to TLAC requirements we recommend that, instead of a deduction, TLAC holdings be treated within the BCBS large exposure framework. Were deduction from Tier 2 to be applied to non-GSIBs, there would be a significant reduction in potential subscription of TLAC, making it very difficult for the market to absorb this new requirement.**
- **The deduction should be proportional: like capital instruments that are deducted from regulatory own funds in accordance with their ranking, other TLAC instruments should be deducted from total TLAC, and not from Tier 2.**
- **We suggest that the current 10% of common equity threshold be topped up with another TLAC specific 10% threshold in order to ensure a live and deep market for such TLAC**

instruments and to permit a limited level of activity, such as market making, to occur without banks being subject to a deduction.

- **We strongly recommend not taking into account instruments ranking pari passu with excluded liabilities in the definition of TLAC Holdings.**

In fact, we believe that a full deduction of non-capital TLAC holdings is not justified for these instruments because, according to the bail in waterfall, they rank after CET1, AT1 and T2.While own funds will be used for loss absorption, other TLAC debts will contribute to recapitalisation of the institution, and therefore, their holders will receive a share of a clean, stabilised institution. This share should retain a certain value, with a possible upside given the precautionary valuation that should be made at entry in resolution.

That is why it would not be proportionate to deduct 100% of such instruments and large exposure rules should suffice.

General comments and recommendations

The document provides that all banks should deduct from their Tier 2 net TLAC holdings that do not qualify as capital. We regret that the proposal is not more detailed but we understand that the deduction would be applied when the bank owns more than 10% of the common shares of the issuer, and for the portion over a threshold for other holdings. In other words, Basel III deduction approach would be extended to TLAC Holdings.

1. **Proposed Tier 2 deduction approach**

<u>Scope for deductions of net TLAC Holdings limited to GSIBs</u>

- The FBF supports the FSB view that Authorities should place appropriate prudential restrictions on G-SIBs' and other internationally active banks' holdings of liabilities eligible to meet the Minimum TLAC requirement. Also, we supports the general principle of deduction of net TLAC holdings to reduce the potential for a G-SIB resolution to spread contagion into the global banking system, but this principle should be limited to GSIBs only.

- For banks not subject to TLAC we recommend that, instead of a deduction, TLAC holdings be treated within the large exposure limits. This large exposure framework is specifically aimed at protecting the bank from losses on counterparts. Preventing non G SIBs from investing in TLAC will further narrow the scope of eligible investors, and transfer TLAC holdings from the regulated sector to the shadow banking sector where no monitoring of concentration or systemic risk applies. This is not desirable for financial stability reasons. Furthermore, excluding banks as investors in these instruments will subsequently diminish the depth of this market whereas ample new issues are required in this (new) market over the next couple of years to enable banks to meet the new TLAC requirements[1].

- It makes sense that deductions for TLAC subject banks be higher than the ones for non TLAC eligible banks, as the main objective of the TLAC framework is to deal with G-SIBs resolution, and not smaller banks whose resolution creates less systemic risk.

  Finally, we stress that if non TLAC banks are in the scope of deductions, as opposed to our proposal, there should be a detailed QIS and impact survey. More specifically the QIS and impact survey should focus on investors and analyse which impact the proposed Tier 2 deduction approach would have on their investment strategies. We must make sure that limiting the kind of investments non-GSIBs are allowed would not raise more issues than the ones solved.

A revised deduction approach

- **The deduction should be proportional: like capital instruments that are already deducted from regulatory own funds in accordance with their ranking, other TLAC instruments should be deducted from total TLAC, and not from Tier 2.**

  Indeed, we propose as well that deductions of TLAC holdings be applied on the most senior part of TLAC, rather than on Tier 2. Deductions from Tier 2 or other capital should be applied only when non capital TLAC is fully absorbed by deductions. Hence the framework would work on the same basis as deductions of Tier one/Tier 2 holdings which are applied to Tier one/Tier 2 and not higher ranking instruments.

- These amendments should be completed by a modification of the Threshold over which deductions are applied. The issue is raised in the 2nd chapter of the consultation. We suggest that the current 10% of common equity threshold be topped up with another TLAC specific 10% threshold. As the overall required TLAC would be approximately twice as much as required capital, it makes sense to double the threshold applicable as well even if the threshold applicable to capital remains at 10%.

  The availability of a separate threshold to meet market making needs for TLAC is a key provision to ensure that there will be a live market for these instruments, given the volumes of issuances that will be required.

[1] The quantitative impact study of the BCBS estimates that TLAC shortfalls across the G-SIBs could be as high as €1.1 trillion when the fully loaded rules come into force in 2022 creating a significant gap between supply and capacity. Indeed, according to the March 2015 Basel monitoring report, the total mid-2014 CET1 of banks was €3.0 trillion (185 banks in the sample). So applying the 10% threshold would mean that TLAC Holdings of these banks above €300 billion (minus their holdings of instruments that qualify as regulatory capital) should be deducted from their Tier 2 (which was €395 billion at Mid-2014).

2. Proposed TLAC Holdings definition

The document proposes in 4.2 that instruments ranking pari passu with excluded liabilities, in jurisdictions where the 2.5%/3.5% exemption is in force, be deducted when their original maturity is over 1 year.

The last paragraph of 4.2 considers an alternative whereby such instruments would not be deducted. We strongly recommend following this alternative and keeping these instruments out of the deduction for the following reasons:

- As demonstrated in the BCBS paper, it would be extremely challenging from an operational perspective to identify the senior unsecured instruments within the 2.5-3.5% allowance from the rest of the senior unsecured instruments. So the likely consequence is that the investors will have to deduct all of the senior unsecured instruments. It would therefore include instruments which are irrelevant here and would require banks to apply the deduction to a much broader range of instruments than those really counting as TLAC (3.5% of RWAs counting as TLAC to be compared with other and varied senior unsecured liabilities possibly ranging from 10.0% to 20.0% of RWAs).
- It is important to remind that the 2.5%/3.5% come on top of CET1, AT1, T2 and liabilities which are subordinated to excluded liabilities and should thus be reached in very exceptional cases.
- It does not make sense to have such a deduction as there is the 2.5%/3.5% cap for these instruments. As a consequence in these jurisdictions, the basis for bail-in in this insolvency class of debt may be much larger. Hence the losses incurred by holders of these instruments within their class of debt are lower than the ones subordinated TLAC instruments holders will bear in their own class. The risk would therefore be sufficiently covered by risk management and does not require a disproportionate deduction approach to be dealt with.
- Those instruments are already subject to the large exposure limits.

3. Clarification requests

- Internal TLAC: the BCBS document should make it clearer that TLAC Holdings deduction approach only applies to external TLAC instruments and not internal TLAC instruments.
- Holdings of own TLAC and reciprocal cross holdings: the BCBS proposes to extend the Basel III approaches of *“full deduction to holdings of own TLAC and reciprocal cross holdings of TLAC”*. It should be reminded that, according to the final TLAC Term, instruments that are funded directly or indirectly by the resolution entity (or a related party of the resolution entity) cannot be counted as TLAC. It should therefore be made clearer that in the case of intragroup holdings no deduction approach is needed.