

Mr William Coen
Secretary General
Basel Committee on Banking Supervision
Bank for international Settlements
CH-4002 Basel
Switzerland

12th February 2016

Dear Mr Coen,

TLAC Holdings

This is the British Bankers' Association's ('BBA') response to the above consultation; we welcome the opportunity to provide our views. The BBA is the leading trade association for the UK banking sector with 200 member banks headquartered in over 50 countries with operations in 180 jurisdictions worldwide.

The BBA has firmly supported the work lead by the Financial Stability Board ('FSB') to promote the development of effective resolution regimes. We consider that the agreement of the minimum standards for Total Loss Absorbing Capacity ('TLAC') to be an important milestone in the development of cross-border resolution and believe that loss absorbency requirements will contribute successfully to ensuring that the failure of banks can be managed in an orderly manner, which mitigates any risks to financial stability. We recognise that appropriate constraints on cross-holdings of TLAC instruments are a complement to this. This objective must be achieved, however, in a manner which recognises the importance of a deep and liquid market for TLAC instruments, so as to ensure there is sufficient market capacity and demand to accommodate the substantial issuance levels expected to be necessary to meet the new requirements.

Tier 2 deduction

The BBA strongly encourages the Basel Committee to reconsider the proposal that banks be required to treat their holdings of TLAC as investments in Tier 2 for the purposes of deductions treatment. It is vital that a coherent and consistent approach is taken vis-a-vis the treatment of capital holdings under the Basel III regime, namely to adopt a corresponding deduction approach whereby deductions of TLAC holdings are made from TLAC resources. In our view, any divergences from this should be proportionate to the risks posed by cross-holdings of TLAC, and should be justified through a focused impact analysis or monitoring period, which sets out the likely impact on the liquidity of TLAC instruments.

The starting point for our analysis of the proposed deduction approach is the expected credit risk associated with TLAC instruments, which is lower than that for regulatory capital. On this basis, an approach which departs from the existing corresponding deduction regime and requires TLAC investments to be deducted from Tier 2 does not appear logical or justified. We do not consider the conceptual simplicity of a single regime for both G-SIBs and non-G-SIBs offsets this issue. Indeed, whilst we support the Committee's focus on maintaining a 'level-playing field', designing the regime to reflect the fact that the non-G-SIBs may not have TLAC resources of their own from which to deduct their investments does not mean that they would be disadvantaged by a regime which permitted this for G-SIBs. In any case, it is unclear why the existing large exposures and risk

weighted regime is insufficient to mitigate contagion risks for banks which are not subject to TLAC requirements. Furthermore, whilst TLAC has been designed explicitly for G-SIBs, it appears likely that some jurisdictions will implement similar requirements applicable to a wider range of institutions: the minimum requirement for own funds and eligible liabilities (MREL) regime in Europe being a prime example. Where this is the case it would be appropriate for a corresponding deduction regime to apply.

Need for Market Making

It is also necessary for the Committee to consider the importance of market making and the contribution of this to the liquidity of TLAC instruments. Specifically, we believe it is necessary to allow a certain level of market making activity, so as to ensure that the market for these instruments has sufficient liquidity to accommodate the expected issuance and ensure broader investor appetite. As part of this, we propose that a market making exemption is provided, consistent with the Basel Committee's views set out in the Fundamental Review of the Trading Book. This should apply to both TLAC issued by third parties and own issued TLAC. This would ensure that market making is not concentrated amongst only G-SIBs, which could distort the market. This approach would also help to create the correct incentives to attract smaller sized banks/financial institutions as potential investors, so as to ensure the market has sufficient depth and diversity needed to withstand the stock of TLAC issuance expected.

Proposed alternative approach

As such, we recommend that the Basel Committee applies an approach consistent with the existing deduction regime for regulatory capital, namely to require holdings in TLAC eligible instruments to be deducted from TLAC resources rather than Tier 2, via the use of two thresholds, as explained further below. Should the bank not have sufficient TLAC resources to permit the deduction then, consistent with the principle of the existing regime, this should be made from Tier 2. Such an approach will ensure that G-SIBs can play their roles as market-makers for TLAC instruments without the significant constraint which would be imposed by a Tier 2 deduction.

For the non-G-SIBs, we recommend that the Committee extends the Large Exposure regime to TLAC, as discussed in section 3.4 of the consultation document. For the reasons outlined above, we do not consider that the concerns regarding the complexity of a dual approach or complexity to be significant.

10% threshold

We note that the Committee seeks comments on the proposal to apply the Basel III 10% threshold to the proposed deduction regime and whether any adjustment to this may be necessary. Our clear view is that there is considerable risk that a 10% threshold will significantly constrain the market for TLAC instruments. Not least as the existing 10% threshold was introduced for the purposes of solely regulatory capital instruments. We would therefore expect this to be adjusted and/or another threshold created to specifically accommodate TLAC instruments.

We recognise that a higher overall limit may inadvertently create incentives for banks to utilise the additional capacity for increasing regulatory capital investments in financial sector entities rather than for TLAC holdings. This risk should, however, be balanced against the need to accommodate a corresponding deductions approach which may warrant deductions against regulatory capital in the event of excess TLAC deductions. As such, we encourage the Committee to consider the adoption of a standalone threshold for TLAC exposures as well as an adjustment to the existing 10% capital threshold. This approach would:

- not result in an increase in overall systemic risk, which might be a consequence of an increase in just the existing threshold;

- would recognise that TLAC instruments are less risky than regulatory capital instruments given their position in the creditor hierarchy; and
- would facilitate the corresponding deductions approach thereby allowing for deductions from regulatory capital if there were insufficient TLAC resources available to make the necessary deduction.

Given that minimum TLAC expectations are effectively double regulatory capital requirements, a standalone TLAC threshold could be expected to be in the region of 10% of CET1, however the final calibration of this should be informed through impact analysis via a monitoring period. The existing regulatory threshold would also need to be adjusted, however, given the creation of a separate TLAC threshold. We would not expect the increase in the 10% existing threshold to be as much as would be needed if there was only one threshold which was used for all TLAC and regulatory capital instruments. The precise calibration of the TLAC threshold and increase in existing immaterial holdings threshold needs to be carefully examined and should be determined by an impact analysis of market capacity to be conducted over a specified monitoring period. The monitoring period will help to assess the required capacity in the market to accommodate significant levels of issuance in the period up to 2019.

Should the Committee decide not to amend the Tier 2 deduction proposal, then we highlight that very careful analysis will be required to understand the impact of the 10% threshold on the ability of GSIBs and non-GSIBs to invest and participate in activities such as underwriting.

Definition of TLAC holdings

As an overarching comment, members have significant concerns regarding their ability to identify TLAC holdings and the potential impact of this on the liquidity of the market for TLAC instruments. In order to ensure a coherent regime, the overarching principle should be that the pool of investments to be deducted should directly correspond with the pool of eligible instruments that banks are required to issue in order to meet TLAC requirements. The eligibility of instruments is dependent both on the instrument and, in some cases, the issuing entity. On the former, it is unclear why instruments which are ineligible for TLAC requirements should be deducted, given there is no risk of double counting. With respect to the issuing entity, TLAC eligible instruments will need to be issued by a resolution entity. This is dependent on the finalisation of resolution plans for individual banks, and rests on disclosure of these plans, so that the market can clearly identify the issuing entities. For this reason, it will be important for there to be as much clarity as is possible in the final drafting of the rules and for there to be recognition that investing banks should be permitted to rely on disclosures made by the issuing entity. The disclosure regime will therefore be critical in this regard.

In terms of the introductory comments to section 4, we agree that the definition of a TLAC holding should not apply to any instrument within the excluded liabilities section of the TLAC term sheet. The proposal to include instruments issued by G-SIBs headquartered in emerging jurisdictions is logical but the concerns as to the ease of identifying what constitutes a TLAC eligible instrument are considerable. A consistent approach for indirect or synthetic holdings has equal merit in principle, and would be consistent with the regulatory capital framework, but members believe it may be significantly more complex to identify such holdings than it is for regulatory capital. It is therefore vital that final requirements set out additional detail and specific definitions as to what is intended to constitute indirect and synthetic holdings, including the extent to which look through is needed. The scope of TLAC instruments which need to be deducted will clearly be correlated with the extent to which indirect and synthetic holdings are identified, e.g. indices referencing senior debt.

Instruments subordinated to Excluded Liabilities but rank pari passu with TLAC

The underlying rationale for a deductions regime, namely to mitigate contagion risk and avoid double counting of TLAC resources, is much weaker in respect of instruments which rank pari passu with but are ineligible to meet the TLAC requirement. Whilst certain types of liabilities may rank pari passu with TLAC, and therefore be subject to losses alongside TLAC instruments, the risk weighted

regime should adequately deal with losses imposed on the investor. Furthermore, given issuing banks are no longer issuing such liabilities to meet their TLAC requirements, the risk of double counting is reduced.

Moreover, from the perspective of a bank which is required to issue TLAC resources, consideration should be given to whether its TLAC resources which no longer qualify, i.e. where remaining maturity has fallen to less than a year, should be used for offsetting and netting purposes and against which deductions can be made. It should be recognised that even though these resources may no longer meet the minimum TLAC eligibility requirement, they will continue to be loss absorbing, and can be bailed-in *pari passu* with the TLAC class. Should the Basel Committee decide to require holdings of instruments which rank *pari passu* with TLAC to be deducted, it should follow that these deductions should be allowed against TLAC resources which no longer qualify but rank *pari passu* with TLAC.

Instruments which rank pari passu to Excluded Liabilities

We note that the proposal to include instruments which rank *pari passu* to excluded liabilities will only apply for institutions headquartered in jurisdictions making use of the allowance. Where this is the case, we anticipate that it will be extremely challenging to identify which liabilities would rank *pari passu* with excluded liabilities, and also which issuers are making use of the allowance. As recognised by the Basel Committee any type of 'adjusted' deduction contemplated in the consultation would have significant operational challenges. A possible consequence of this might be that investing banks determine they need to deduct any and all investment in such instruments. As such we propose that, irrespective of remaining maturity, deductions should not be made for holdings in instruments ranking *pari passu* with excluded liabilities. Furthermore, it is unclear how such a proposal addresses contagion risk or double counting of TLAC, given such instruments are not eligible for TLAC. If however, such instruments were bailed-in, they would attract losses after regulatory capital and TLAC eligible liabilities, therefore contagion risk is considerably weaker. If deductions are to include senior instruments, it is necessary to consider the extent to which such exposures can be netted and deducted from the stock of liabilities which is *pari passu* with excluded liabilities, rather than being required to apportion the entire deduction against TLAC eligible liabilities, or even Tier 2 capital.

Implementation date

It should be clear from our response above that we consider there will be considerable operational challenges in identifying TLAC holdings, not least as the disclosure regime is still nascent. As such, we believe there is a strong case to phase in the rules after the disclosure rules come into effect, so that the deduction regime applies fully from 2022. We believe that the lack of grandfathering provisions within the TLAC Term Sheet and the potentially significant deductions supports this point. Furthermore, an orderly transition will facilitate investor appetite and demand for newly issued TLAC instruments. Such an approach would also be consistent with our proposal for a monitoring period.

Please do not hesitate to contact us should you wish to discuss any of the issues addressed by our comment letter further.

Yours sincerely,



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