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Secretariat of the Basel Committee
on Banking Supervision (BCBS)
Bank for International Settlements
CH-4002 Basel, Switzerland

Dear Basel Committee members:

Re: CBA[1] Comments on the BCBS consultative document: *"TLAC Holdings"*

We value the opportunity to review and provide comments on the BCBS's consultative document, *"TLAC Holdings."* Overall, we are supportive of the focus on the Basel principle of removing the double counting of capital, which can act as a significant source of contagion in the banking and financial sectors.

Proposed Tier 2 deduction approach

Although effective in removing incentives for banks' cross-holding of Total Loss-Absorbing Capacity (TLAC) securities, we believe that the proposed Tier 2 deduction approach is inconsistent with the existing deduction approach taken with capital instruments and is overly punitive. We suggest that a "like-for-like" deduction of TLAC should be implemented for Global Systemically Important Banks (G-SIBs) and for those non-G-SIB institutions that are subject to a domestic bail-in framework. Although there are no G-SIBs currently in Canada, the six Canadian Domestic Systemically Important Banks (D-SIBs) will have a requirement to issue bail-in debt to meet a domestic "TLAC" requirement in a timeframe largely consistent with the TLAC implementation.

Under the current Basel III rules, banks are subject to a threshold deduction for their holdings of capital instruments of financial institutions on a "like-for-like" basis, where banks are required to deduct from the next tier of capital only in the case of a shortfall in the corresponding tier of capital. We believe that the same principle should apply to TLAC holdings by recognizing domestic bail-in-able debt as equivalent to TLAC for the threshold deduction purposes. Only in the event that a financial institution did not have enough TLAC or bail-in-able debt would a Tier 2 deduction of G-SIB holdings be required. This treatment would be applicable to both G-SIBs and non-G-SIBs that are subject to a domestic bail-in framework alike. For suggested treatment applicable for internationally active banks that are not subject to a bail-in framework, please see "Non-G-SIB and Non-D-SIB" section of the letter below.

[1] The Canadian Bankers Association works on behalf of 59 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 280,000 employees. The CBA advocates for effective public policies that contribute to a sound, successful banking system that benefits Canadians and Canada's economy. The Association also promotes financial literacy to help Canadians make informed financial decisions and works with banks and law enforcement to help protect customers against financial crime and promote fraud awareness. www.cba.ca.

We also draw to the Basel Committee's attention that deducting TLAC holdings from the holders' Tier 2 capital may have the unintended and negative consequence of incentivizing banks to invest in G-SIBs' Tier 2 capital as opposed to their TLAC. Having the same capital deduction implications for both Tier 2 capital and TLAC investments will have the effect of incentivizing banks to invest in higher yielding and riskier Tier 2 investments over TLAC. Such treatment would go against the general principle that the level of capital requirement should be proportional to the level of associated risk.

We also note that banks are already disincentivised from holding the debt of other banks due to its Liquidity Coverage Ratio (LCR) treatment. We believe this eliminates the need for Basel to take the overly conservative stance on the capital treatment of TLAC holdings as proposed in the consultative paper. Although we appreciate the deduction from Tier 2 was intended to be a disincentive, a like-for-like deduction from TLAC would, in our view, provide a more reasonable form of disincentive.

From a market capacity perspective, Tier 2 capital has traditionally been sourced by the Canadian banks in the Canadian market, which is of limited size. In comparison, the D-SIBs in Canada have global senior debt programs. The proposed approach in the consultation could potentially put unnecessary pressure on the Canadian capital markets, particularly if the same approach is adopted in Canada for the cross-holding of Canadian D-SIB debt once the bail-in rules in Canada are finalized. Even if banks' holdings of G-SIB/D-SIB debt are not close to their respective threshold limits at this point, a perception that they may at some point cross the threshold and trigger a Tier 2 deduction could put additional pressure on the Tier 2 capital market.

Deduction threshold

We appreciate the Basel Committee's recognition of the importance of market making in TLAC instruments, and its potential support for an increased deduction threshold as a result.

One way to account for the inclusion of TLAC investments as part of the deduction threshold is to simply increase the existing threshold to a higher level. However, a higher overall threshold may have the unintended consequence of allowing banks to invest in a greater amount of riskier capital instruments (such as common equity) of other financial institutions without incurring capital deduction, potentially resulting in increased systemic risk in the banking system. Therefore, we suggest a standalone threshold specific to investments in TLAC instruments. Such an approach to TLAC deductions would allow banks to hold limited amounts of TLAC for market-making and other balance sheet management purposes without inadvertently creating higher capacity for banks to invest in capital instruments of financial institutions.

We recommend that a separate threshold limit for TLAC holdings should be set in the range of 8-10% based on net common equity (CET1 before non-significant investment deductions). The underlying assumption in this calibration method is that holdings of these instruments would be proportional to the amount available in the market, which in turn is at least partly driven by the regulatory minimum. Under this assumption, we would scale up the current 10% threshold, which applies today based on 11.5% minimum Total Capital (including 2.5% conservation buffer and 1% G-SIB buffer), by the new requirement including TLAC, which would be 21.5% (2022 level) for 1% G-SIB banks. This would result in a separate TLAC-specific threshold level of 8.7% (i.e. 18.7% - 10% current threshold). Please see the appendix for additional comments on the calibration of the TLAC threshold.

The global TLAC market will be sizable, and we believe that our suggested approach of establishing a separate threshold for TLAC should allow banks to provide trading support for a liquid debt market that is essential for financial stability, while meeting the objective of reducing the risk of contagion through excessive holdings of TLAC.

Capital market liquidity in recent years has shown higher sensitivity to market shocks as dealers have significantly reduced their holdings for market making purposes due to the capital rule changes. Due to the lack of liquidity in secondary trading, investors turned to the primary market to look for higher new issuance premiums. This results in increased funding cost for banks, and eventually it will be passed on to the end user of funds, which would potentially negatively impact the real economy. The proposed new deduction threshold should be set at a level that will not further exacerbate the trading liquidity issue.

Non-G-SIB and Non-D-SIB

We appreciate the Basel Committee's concern that non-G-SIBs (i.e. specifically non-G-SIBs/non-D-SIBs that are not subject to a domestic bail-in regime) are disadvantaged if the deduction takes place on a like-for-like basis as they would have to deduct TLAC holdings above the threshold directly from their Tier 2 capital, whereas G-SIBs and D-SIBs would first deduct from their TLAC resources (under our proposal). We believe that this competitive disadvantage should be addressed through the separate TLAC deduction threshold as per our proposal. We expect that given the nature of these institutions' businesses, that any amount of G-SIB TLAC held above the separate threshold amount would be de minimis, or to the extent it is not, a deduction from Tier 2 would be an acceptable disincentive.

Impact of change of status of G-SIB Banks

We recommend that the guidance should contemplate a change in a bank's G-SIB status. Just as a newly designated G-SIB is given a transition period to achieve its new capital requirements, we also believe that holders of the new G-SIB's TLAC should be given a transition period to adjust to their TLAC holdings requirement.

We offer additional comments on the consultative document in the attached appendix, and thank you for taking our comments into consideration. We look forward to future discussions on these issues.

Sincerely,

Enclosure

cc: Ms. Liane Orsi, Capital Specialists, OSFI Regulation Sector
Mr. Silvano Tittonel, Director, Capital Definition and Precedents, OSFI Regulation Sector

CBA comments on Basel Committee consultative document: *Total Loss Absorbing Capacity (TLAC) Holdings*

CBA Members' Comments and Requests for Clarification

2. PROPOSED TIER 2 DEDUCTION APPROACH *(pages 2 - 3)*

Please refer to our cover letter for our main recommendations and observations on the consultative document. Even though TLAC requirements apply only to G-SIBs, many domestic regulators have either adopted or in the process of adopting similar requirements. Furthermore, the requirements of domestic bail-in-able debt in terms of instrument features and quantum are largely in line with TLAC eligible instruments. Hence any deduction on a corresponding basis should be applied to domestic bail-in-able debt requirements by the local regulators rather than Tier 2.

Clarification Requested

- What is the definition of an internationally active bank; is there a threshold (e.g. total assets exceeding a certain dollar amount)?
- Currently there are no processes within the bank to monitor investments (long / short) in TLAC. Investments in technology and process improvements will need to be made to monitor and report TLAC holdings, so a sufficient implementation timeline will be required.

Calibration of Proposed Threshold

The scenarios below illustrate the effect and implication of various threshold deduction designs to a bank's capital/TLAC deductions and resulting ratios (see table below).

- **Scenario (A)** shows the baseline example, based on the current Basel III capital rules, where the bank is subject to capital deductions for non-significant investments to the extent they are above the 10% threshold.
- **Scenarios (B1) and (B2)** show that extending the Basel III capital rules to TLAC holdings, while maintaining the current 10% threshold would cause significantly higher capital deductions from each tier of capital, simply by including TLAC holdings as part of the non-significant investment basket. Scenarios B1 and B2 further show the effect of having the TLAC deductions taking place from the bank's own Tier 2 or TLAC resources.
- **Scenario (C)** demonstrates that adjusting the existing deduction threshold higher to account for the TLAC holdings may have an unintended consequence of reducing the capital deduction amount in other tiers of capital.
- **Scenario (D)** demonstrates that creating a separate TLAC-specific threshold per CBA's proposal will avoid the unintended consequence discussed in Scenario C. Comparing Scenario D to A, all capital ratios remained virtually the same while the "TLAC ratio" is significantly lower in Scenario D due to the deductions (a very slight increase in CET1 ratio in Scenario D is due to the fact that the portion of TLAC holdings that are deducted no longer attracts RWA).

CBA Members' Comments and Requests for Clarification

	A	**B1**	**B2**	**C**	**D**
	Current Basel III (capital only)	**Aggregate 10% Threshold - deduct from T2**	**Aggregate 10% Threshold - deduct from TLAC**	**Aggregate 20% Threshold - deduct from TLAC**	**TLAC-specific Threshold at 10% (CBA proposal)**
Non-significant investment in CET1	300	300	300	300	300
Non-significant investment in AT1	100	100	100	100	100
Non-significant investment in T2	100	100	100	100	100
Non-significant investment in TLAC	350	350	350	350	350
Total non-significant inv. for Threshold	500	850	850	850	500
Total non-significant inv. for proposed TLAC Threshold	n/a	n/a	n/a	n/a	350
Gross CET1	5,000	5,000	5,000	5,000	5,000
Deduction before non-significant investments	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)
Adjusted CET1 capital	3,000	3,000	3,000	3,000	3,000
Threshold (for A & D capital only; for B1, B2 & C incl. TLAC)	300	300	300	600	300
TLAC-specific Threshold (for D only)	n/a	n/a	n/a	n/a	300
Total non-significant investment over Threshold	200	550	550	250	200
Non-significant investment in TLAC over TLAC Threshold	n/a	n/a	n/a	n/a	50
CET1 deduction	**120**	**194**	**194**	**88**	**120**
AT1 deduction	**40**	**65**	**65**	**29**	**40**
T2 deduction	**40**	**291**	**65**	**29**	**40**
TLAC deduction	**-**	**-**	**226**	**103**	**50**
Total deduction from all capital/TLAC resource	200	550	550	250	250

CBA Members' Comments and Requests for Clarification

	A **Current Basel III (capital only)**	**B1** **Aggregate 10% Threshold - deduct from T2**	**B2** **Aggregate 10% Threshold - deduct from TLAC**	**C** **Aggregate 20% Threshold - deduct from TLAC**	**D** **TLAC-specific Threshold at 10% (CBA proposal)**
Net CET1 capital	2,880	2,806	2,806	2,912	2,880
Net AT1 capital	560	535	535	571	560
Net T2 capital	760	509	735	771	760
Net TLAC	3,500	3,500	3,274	3,397	3,450
RWA before non-significant investments	30,000	30,000	30,000	30,000	30,000
RWA after non-significant investments (@100% RW)	30,650	30,300	30,300	30,600	30,600
CET1 ratio	**9.40%**	**9.26%**	**9.26%**	**9.52%**	**9.41%**
AT1 ratio	**1.83%**	**1.77%**	**1.77%**	**1.86%**	**1.83%**
T2 ratio	**2.48%**	**1.68%**	**2.43%**	**2.52%**	**2.48%**
TLAC ratio	**11.42%**	**11.55%**	**10.80%**	**11.10%**	**11.27%**

3. OTHER APPROACHES CONSIDERED *(pages 3 – 4)*

3.1 Common Equity Tier 1 deduction *(page 3)*

Although we agree that consistency in approach across all forms of Basel III capital (rather than a deduction against common equity) should be maintained to maximize consistency/simplicity of treatment across international regulatory jurisdictions, deduction of TLAC at the Tier 2 capital level is inconsistent with existing threshold deductions, which increases complexity.

CBA Members' Comments and Requests for Clarification	
We agree with BCBS that this approach should not be considered because it would result in more onerous treatment of TLAC holdings than for Additional Tier 1 and Tier 2 capital.	
3.4 Large Exposure limits *(page 4)*	
If this approach was considered, there would be a need to assess all implications related to large exposure framework. This approach might not meet the intended objective; however, the large exposure limit could be amended in order to address risks that relate to TLAC holdings. The current approach does not consider diversification of exposures to various G-SIBs. One approach may be to increase the threshold and introduce a much lower limit for each specific issuer.	
3.5 Deduction for G-SIBs and large exposures limit for non-G-SIBs *(page 4)*	
Applying the same threshold deduction requirement to G-SIBs and Non-G-SIBs appears most appropriate to eliminate double counting of TLAC. The preferred approach for D-SIBs would be the dual approach as per section 3.4, where D-SIBs would be required to deduct their TLAC holdings from their own issued TLAC and non D-SIBs would deduct TLAC holdings from Tier 2 or other (for example large exposure limit).	
4. PROPOSED REVISIONS TO THE DECEMBER 2014 FRAMEWORK TO INCORPORATE THE STC CRITERIA *(pages 6 - 9)*	
4.1 Instruments subordinated to Excluded Liabilities *(page 5)*	
Footnote 11 states, *"The assessment relates to the original maturity of the instrument, not the residual maturity. Therefore, instruments that have an original maturity of over 1 year will be treated as a TLAC holding by the investing bank even if the residual maturity is 1 year or less."* We suggest that the proposed TLAC paragraph 77a in Annex 1 makes clear this requirement that the TLAC instrument would be included based on its original maturity and not based on whether it is being recognized by the G-SIB as TLAC. We would recommend that in order to facilitate G-SIB holding tracking, BCBS may consider adding website link on the G-SIB web page to ensure that TLAC issuance from the G-SIB is centrally disclosed. With the pillar 3 disclosure on TLAC template, this central reporting enables consistent capturing of G-SIB TLAC holdings.	

CBA Members' Comments and Requests for Clarification
4.2 Instruments ranking pari passu to Excluded Liabilities *(page 6)*
The BCBS has stated that *"… all liabilities ranking pari passu with Excluded Liabilities that could receive recognition as TLAC by the issuing G-SIB are included as a TLAC holding for the investing bank*". Operationally, this is very difficult to capture in any source system. As such, identification of these items may be missed by non-G-SIBs. We recommend that G-SIBs provide more disclosure on these liabilities. This will also assist in the goal of avoiding mistaken market expectations related to these liabilities. Clarification is needed on how any non-qualifying TLAC of a G-SIB will be treated.
7. IMPLEMENTATION DATE *(page 8)*
We believe that the Basel Committee should consider possible implications for banks holding TLAC of banks that are added or deleted from the list of G-SIB banks. We believe that investing banks should be subject to a similar transition period for holding of bank debt where the issuing bank's status has changed.
ANNEX 1 – CHANGES TO BASEL III TEXT *(page 9)*
BCBS placement of paragraph 77a suggests that the text is part of the *"Defined benefit pension fund assets and liabilities*" regulatory deduction paragraphs. Some form of sub-heading is needed when inserting the suggested paragraph 77a to avoid this important reference from being missed similar to that for the other regulatory deductions.