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By email: baselcommittee@bis.org

Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Dear Sirs

BCBS consultation on TLAC Holdings

We refer to the consultative document on TLAC Holdings issued by the Basel Committee on Banking Supervision (BCBS) in November 2015.

On behalf of our members, we set out in the annex our detailed comments on the proposals in the consultative document.

We hope you find our comments useful. For any questions, please do not hesitate to contact Ms Emily Ngan of the Secretariat at (852) 2526 6080.

Yours faithfully

Doris Ma
Secretary

Enc.

c.c. Ms. Karen Kemp, Executive Director (Banking Policy),
Hong Kong Monetary Authority

Comments on the BCBS Consultation on TLAC Holdings

Part A: Responses to Approach Considered

We recognize the current proposal on the new TLAC holdings deduction approach could effectively remove the double counting of capital due to the cross holdings and therefore contain to a large extent the contagious effect in times of financial crisis, we felt that it could also lead to problems such as limiting the market where a G-SIB and its resolution entity(ies) can leverage on for purposes of supporting its / their external TLAC requirements, especially for G-SIBs in emerging markets where the capital markets are not as well developed when compared with their peers in most of the developed countries. As a result, G-SIBs and their resolution entities might have to rely mainly on non-financial investors which are not subject to the new deduction approach.

Some member banks felt that the proposal to make deductions from Tier 2 is unduly restrictive and a corresponding deduction regime (in line with the regime that applies to regulatory capital), allowing TLAC holdings to be deducted from TLAC (or equivalent) resources, is recommended instead. This would seem to be a logical approach and would allow GSIBs to play a more effective role as market-makers for TLAC. We therefore urge the BCBS to consider the overall impact from the perspective of the achieving a balance between contagion risk control, healthy economic development and adequate liquidity supply, etc. when expanding the existing scope of capital deduction approach.

Other adverse impacts of the proposed deduction approach should be considered. For example, it might discourage market making in TLAC issued by 3rd party banks, which will drastically reduce liquidity as the stock of TLAC increases. Furthermore, secondary market making of TLAC will be concentrated principally in the hands of the issuer themselves which will be manifested through wider bid-offer spreads and consequently distort the market relative to other asset classes, especially in times of stress. This may also create the potential for conflict of interest with a G-SIB bank effectively being the only material supplier of liquidity in its own paper.

To ensure a liquid market for newly issued instruments intended to meet TLAC requirements, one member bank propose that underwriting and market making in both own and 3rd party issued TLAC instruments are subject to an exemption. Without permitting a certain level of market making activity, there is a significant risk that the markets for these instruments will lack the liquidity that is essential to attract the broad range of investors necessary to deliver the financial resources that are being sought to meet the new TLAC requirements. An exemption will particularly be pertinent for market making in own issued instruments.

One member bank commented that if capital deduction of TLAC were to be in place, the credit capacity of the general economy could contract even in times without economic stress. G-SIBs who are forced to raise more TLAC might encounter even higher cost of issuing TLAC papers due to a limited investor which may not be a healthy phenomenon in the long run.

Member banks also raise concerns regarding their ability to identify TLAC holdings and the potential impact of this on the liquidity of the market for TLAC instruments. 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.

Finally, "Tier 2 deduction approach" proposes that all TLAC holdings would be treated as if they were investments in Tier 2 capital for the purposes of the deduction rules in regulatory capital. This proposed Tier 2 deduction approach would create significant issue for regulatory capital on a solo basis when an authorized institution being determined as a material sub-group / subsidiary has to issue Internal TLAC (as per item 16 of FSB TLAC Term Sheet) to its associated parent resolution entity, while the said parent resolution entity may be subject to the Internal TLAC requirement to downstream the TLAC to its material sub-groups / subsidiaries. According to the proposed Tier 2 deduction approach, the down streaming of the Internal TLAC would not create any issue for regulatory capital on a consolidated basis as this holding of Internal TLAC would be "eliminated" as both are in the same consolidation group. However, if the parent resolution entity in the example calculates regulatory capital on a solo basis, it would mean that solo capital would have to deduct the total amount due to the Internal TLAC investments into the associated material sub-groups / subsidiaries. We are of a view that this is not the original intent of the proposal. Therefore, we recommend amending the Tier 2 deduction approach proposal to explicitly specify the exclusion of Tier 2 capital deduction requirement on the parent resolution entity on solo basis pertaining to its Internal TLAC holdings in association with the relevant instruments issued by its material sub-groups / subsidiaries.

Part B: Other comments on the consultative document

Sequence number	Parts of the document to which the comments refer (i.e. Main body / Annex)	Paragraphs and / or extracts of the document to which the comments refer (including page number)	Comments
1.	Main body: "Section 1 Introduction" , and Main body: "Section 2 Proposed Tier 2 deduction approach"	Last paragraph of Section 1: "The Basel Committee's proposal changes the calculation of regulatory capital for all internationally active banks (both G-SIBs and non-G-SIBs)." (page 1) Fourth paragraph of Section 2: "The Basel Committee considered extending the Basel III corresponding deduction approach to holdings of TLAC. ….. As a consequence, the Basel Committee proposes that all banks be required to treat their holdings of TLAC as investments in Tier 2 capital for the purposes of the deduction rules." (page 2)	It seems there is an inconsistency between the two Sections when specifying the scope of banks that need to apply the new TLAC holdings deduction approach or the regulatory capital treatment in the consultative document where the text description of "all banks" in Section 2 is much broader than the "all international active banks" in Section 1. To avoid unnecessary confusion in interpretation when applying the new deduction approach, we therefore would like the BCBS to align the scope of application in the final standard.
2.	Main body: "Section 2 Proposed Tier 2 deduction approach"	Fifth paragraph of Section 2: "Therefore, an issue that the Committee will consider as part of the consultation process is whether any adjustment to the existing threshold, set at 10% of a bank's own common equity, is warranted." (page 3)	Understood that this was calibrated for the regulatory capital regime and would need to be increased, or a separate threshold calibrated for TLAC, to avoid significantly constraining the market for TLAC instruments. Some member banks believe that there is a considerable risk that a 10% threshold will significantly constrain the market for TLAC instruments. We recognise, however, that a higher overall limit might have the impact of increasing systemic risk. As such, we encourage the Committee to consider the adoption of an additional standalone threshold for TLAC exposures.

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3.	Main body: "Section 3.2 Penal Risk Weight"	"An appropriately conservative risk weight may be able to address the credit risk associated with holdings of TLAC. However, unless set at a level that is equivalent to a deduction, such an approach will not remove the double counting of TLAC."	One member bank shows support to differentiate senior, Tier 2 and AT1 for the reason that it can address the credit risk associated with holdings of TLAC. Given that capital instruments must absorb losses prior to TLAC instruments; risk weight of net TLAC holdings should be accordingly lower than risk weight of equity holdings in an investing bank. However if a deduction approach is taken, an additional investment cap can be introduced on top of current 10% capital base since this allowance originally was set for capital instrument investment rather than the TLAC instrument investment. The determination of increasing the threshold should take into account the size of the potential TLAC instrument issuance and the acceptable scale of TLAC holdings that would be retained in the banking industry.
4.	Main body: "Section 4 What constitutes a TLAC holding?"	Third paragraph: "In addition to the issues discussed in the sections below, the Committee proposes that the definition of a TLAC holding: • exclude all holdings of instruments or other claims listed in the "Excluded Liabilities" section of the TLAC term sheet (eg deposits, derivatives, tax liabilities etc); • include both instruments issued by G-SIBs headquartered in emerging	(1) The first bullet listed some of the examples in the FSB's term sheet (i.e. Section 10 "Liabilities Excluded From TLAC") for purposes of defining the TLAC holdings. One of the elements is <u>deposits</u> that need to be excluded from the TLAC holdings. Despite it being obvious to exclude insured deposits from the TLAC holdings, we would like to take the opportunity to clarify some specific nature of the deposits elements that could be differentiated between "excluded liabilities" and "TLAC eligible" for the sake of a granular understanding of the overall regime.

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		market jurisdictions and G-SIBs headquartered in other jurisdictions (ie TLAC holdings should include TLAC instruments issued by Chinese G-SIBs, even though they are not initially subject to the minimum external TLAC requirement); …..” (page 5)	For instance, if a retail customer has a fixed term deposit with contractual maturity of 2 years amounting to USD1 million with a resolution bank entity in which USD0.3 million is subject to the deposit insurance scheme. The remaining maturity at the moment is 18 months. We would like to clarify if we should treat the USD0.3 million insured deposit amount as “excluded liability” despite its original contractual maturity is NOT less than one year (one of the criteria to be qualified as “excluded liability”) while the rest of the USD0.7 million be regarded as TLAC eligible which can be subject to bail-in to absorb losses in resolution assuming the categorization would not give rise to material risk of successful legal challenge or valid compensation claims. (2) The BCBS proposed in the second bullet that TLAC holdings also include the qualified instruments issued by G-SIBs headquartered in emerging market economies (EME) even before they are subject to the minimum external TLAC requirements per the timetable of the FSB’s final term sheet, under which the schedule for EME starts from the year of 2025 (unless triggered by the acceleration criteria) which would be 6 years after the implementation of TLAC for designated G-SIBs in developed countries (non-EME). Our understanding for the above FSB’s final

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			arrangement, as compared with the first consultative paper in November 2014 (under which G-SIBs in EME were proposed to be exempted from the TLAC requirements), is to achieve a balance between resolving the arguable leveled playing field issue and setting a reasonable timing for the readiness of EME's G-SIBs implementing the TLAC regime taking into account the various differences between the two kinds of markets. Having said that, it seems the proposed timing of inclusion of TLAC instruments issued by G-SIBs headquartered in EME as TLAC holdings, and the implementation of the new deduction approach in parallel with non-EME G-SIBs' timetable not only deviates from the underlying intentions of the FSB's TLAC arrangement as mentioned above, but also might hinder the development of the capital market of EME due to the new capital deduction rule applying to all potential investing banks both onshore and offshore of the EME, let alone the resulting substantial surge of the credit costs that need to attract other institutional investors in a much narrower market (such as insurance companies or brokers / dealers). The BCBS should also note that the early inclusion (i.e. before the year of 2025) of EME's G-SIBs issued TLAC instruments as TLAC holdings of investing banks subject to capital deduction might accelerate the direct competition between the G-SIBs of EME and

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			non-EME for a much narrower scope of potential investors in advance of the TLAC implementation schedule from the year of 2025 for EME. The expected result is obviously in favor of G-SIBs in non-EME where most of the capital markets are much more mature and in-depth than their EME's counterparts, and hence can enjoy a better credit spread notwithstanding at a higher cost. We therefore urge the BCBS to reconsider the proposal of early inclusion of TLAC instruments issued by G-SIBs in EME as TLAC holdings of investing banks subject to the deduction rule to avoid any unexpected consequences that may impede the readiness of those G-SIBs in complying with the timeline already set out by the FSB for EME on the implementation of the TLAC regime.