BANK FOR INTERNATIONAL SETTLEMENTS

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# Internal TLAC – Executive Summary

The G20 adopted several policy measures in the wake of the 2007–09 Great Financial Crisis to address the problem of financial institutions that are "too big to fail". These include an international standard on resolution regimes: the Key Attributes of Effective Resolution Regimes for Financial Institutions issued by the Financial Stability Board (FSB).[1] Effective application of the resolution powers specified in the Key Attributes depends on financial institutions having adequate loss-absorbing capacity.

## Total loss-absorbing capacity (TLAC)

The 2015 FSB TLAC Standard set the standard on the adequacy of TLAC for global systemically important banks (G-SIBs).[2] The key aims are to provide home and host authorities with confidence that G-SIBs can be resolved in an orderly manner and to foster mutual trust and confidence between home and host authorities in a group resolution strategy. To achieve this, the TLAC Standard introduces two key requirements: external and internal TLAC.

### External and internal TLAC

**External TLAC** is issued to third parties by the entities to which resolution tools will be applied under the group resolution strategy. These entities are known as **resolution entities**, and a resolution entity and its subsidiaries constitute a **resolution group**. The amount of external TLAC issued must be sufficient to provide loss-absorbing resources to the resolution group as a whole.

**Internal TLAC** comprises capital instruments or other liabilities issued, directly or indirectly, to a resolution entity by subsidiaries that are deemed material within the resolution group. It is the mechanism by which losses and the recapitalisation needs of a G-SIB's material subsidiaries may be passed to the resolution entity of the resolution group. This is achieved by writing down the internal TLAC or converting it to equity without the subsidiaries entering into resolution.

## Features of internal TLAC

The TLAC Term Sheet sets out the core features of internal TLAC.[3] These are summarised below.

### Where is internal TLAC required?

Internal TLAC is "pre-positioned" in **material subgroups (MSGs)** outside the resolution entity's home jurisdiction. An MSG consists of one or more direct or indirect subsidiaries of a resolution entity that meet at least one of the following criteria on a solo or subconsolidated basis:[4]

1 See the FSB Key Attributes – Executive Summary for more detail.

2 The TLAC Standard comprises Principles on the Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution and a TLAC Term Sheet that implements the Principles in the form of an international standard (see the TLAC – Executive Summary).

3 The requirements for internal TLAC are elaborated in Sections 16 to 19 of the Term Sheet. This is supplemented by the FSB's Guiding Principles on the Internal Loss-absorbing Capacity of G-SIBs ('Internal TLAC').

4 Subsidiaries that make up an MSG are not themselves resolution entities and are incorporated in a jurisdiction other than the home jurisdiction of the resolution entity. Those subsidiaries are usually established in the same jurisdiction. Exceptionally, an MSG may include subsidiaries incorporated in more than one jurisdiction where the crisis management group agrees that it is necessary to support the group resolution strategy and ensure that internal TLAC is distributed appropriately within the MSG.

- have more than 5% of the consolidated risk-weighted assets of the G-SIB group
- generate more than 5% of the total operating income of the G-SIB group
- have a total leverage exposure measure larger than 5% of the G-SIB group's consolidated leverage exposure measure
- have been identified by the G-SIB's crisis management group as material to the exercise of the G-SIB's critical functions

An MSG might be, for example, an intermediate holding company that consolidates operating subsidiaries in a host jurisdiction under a single holding; a subgroup composed of an operating subsidiary and one or more subsidiaries under its control; or a single operating subsidiary. Host authorities identify MSGs in their jurisdictions in consultation with the G-SIB home authority and crisis management group.

## How much internal TLAC is required?

The amount of pre-positioned internal TLAC is intended to provide comfort to host authorities that adequate resources are available to absorb losses and meet recapitalisation needs in the local MSG.

The FSB TLAC Term Sheet stipulates that an MSG should maintain internal TLAC scaled within a range of 75–90% of the minimum external TLAC requirement that would apply to the MSG if it were a resolution group. That calculation is based on the subconsolidated balance sheet of the MSG. Calibration of the requirement within the range of 75–90% is determined by the host authority of the MSG in consultation with the home authority of the resolution group. When scaling internal TLAC requirements, host authorities should consider, among other things, the implications for the availability of loss-absorbing capacity across the resolution group.

## What qualifies as internal TLAC?

The necessary features of internal TLAC are broadly the same as those of external TLAC, except with regard to the issuing entity and permitted holders. In particular, the instruments must be unsecured, be perpetual or have a minimum maturity of at least one year, and be subordinated to liabilities of the issuer that are excluded from eligibility as internal TLAC.

The same liabilities are excluded from both external and internal TLAC. These include insured, short-term and sight deposits, liabilities arising from derivatives and debt instruments with derivative-linked features.

Home and host authorities may agree to substitute collateralised guarantees for on-balance sheet internal TLAC, provided that specific conditions are met to ensure the collateral is adequate and will be available if needed.

## How is internal TLAC triggered?

The relevant host authority must be able to write down internal TLAC or convert it to equity when it determines that the issuer is at the point of non-viability, without putting it into resolution under the statutory framework. The use of internal TLAC is intended to be a last resort, where the parent is unable to recapitalise a distressed subsidiary or subgroup. It results in the writedown and conversion of the parent's claims on the subsidiary into new equity.

The writedown or conversion of internal TLAC requires the consent of the home authority of the MSG's resolution entity, unless the internal TLAC consists of regulatory capital instruments and writedown is not subject to consent under Basel III. The FSB Guiding Principles on Internal Total Loss-absorbing Capacity of G-SIBs ('Internal TLAC') specify the procedure for obtaining that consent and triggering internal TLAC.

This Executive Summary and related tutorials are also available in FSI Connect, the online learning tool of the Bank for International Settlements.