August 20, 2018

By electronic submission to fsb@fsb.org

Secretariat to the Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Re: Monitoring the Technical Implementation of the FSB Total Loss-Absorbing Capacity (TLAC) Standard

Ladies and Gentlemen:

The Bank Policy Institute ("**BPI**"),[1] the Global Financial Markets Association ("**GFMA**")[2] and the Institute of International Finance ("**IIF**" and, together with BPI and GFMA, the "**Associations**")[3] welcome the opportunity to

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1 The Bank Policy Institute is a nonpartisan public policy, research and advocacy group, representing the nation's leading banks and their customers. Our members include universal banks, regional banks and the major foreign banks doing business in the United States. Collectively, they employ almost 2 million Americans, make nearly half of the nation's small business loans, and are an engine for financial innovation and economic growth.

2 The Global Financial Markets Association brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London, Brussels and Frankfurt, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA. For more information, visit http://www.gfma.org.

3 The Institute of International Finance is the global association of the financial industry, with close to 450 members from 70 countries. Its mission is to support the financial industry in the prudent management of risks; to develop sound industry practices; and to advocate for regulatory, financial and economic policies that are in the broad interests of its members and foster global financial stability and sustainable economic growth. IIF members include commercial and investment banks, asset managers, insurance companies, sovereign wealth funds, hedge funds, central banks and development banks.

respond to the request of the Financial Stability Board (the "**FSB**") to submit views on the technical implementation of the FSB's standard on the adequacy of total loss-absorbing and recapitalization capacity for Global Systemically Important Banks ("**G-SIBs**") in resolution (the "**TLAC standard**").

We support the consistent global implementation of a well-constructed TLAC standard, which we believe will, together with other post-crisis resiliency enhancements and actions taken by the firms themselves, secure a durable end to the risk of "too big to fail." From a private sector perspective, the G-SIBs have, as a group, made significant strides in meeting the TLAC standard.

With respect to steps taken by the official sector towards implementation of the TLAC standard, all G-SIB home jurisdictions have implemented, or are in the process of implementing, external standards in line with the FSB's Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution: Total Loss-absorbing Capacity (TLAC) Term Sheet ("**TLAC Term Sheet**").[4] However, as each relevant home and host jurisdiction translates the provisions of the TLAC Term Sheet into local regulation, certain trends in implementation that could have significant consequences have become apparent in the approaches regulators are taking to certain key provisions. In particular, with respect to the calibration of internal TLAC for a material sub-group in a host jurisdiction, the TLAC Term Sheet specifies a bounded range of 75% to 90% of the external TLAC requirement that would apply if the material sub-group were a resolution group.[5] However, while regulators in certain jurisdictions have calibrated or propose calibrating internal TLAC presumptively at the low end of the range—*i.e.*, 75%,[6] at least one jurisdiction has issued a final rule uniformly calibrating internal TLAC near the high end of the range—*i.e.*, 90%.[7]

We believe that the imposition by G-SIB host jurisdictions of internal TLAC requirements that default to the most stringent calibration contemplated by the TLAC Term Sheet increases the risk that, in an actual financial distress scenario, the formulaic distribution of internal TLAC would not match the actual distribution of losses incurred

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4 *See* FSB, Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution: Total Loss-absorbing Capacity (TLAC) Term Sheet (Nov. 9, 2015) at § 21, available at http://www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf. Pursuant to Section 21 of the TLAC Term Sheet, the People's Republic of China, as an Emerging Market Economy ("**EME**"), is currently not required to implement a minimum TLAC standard until 2025—six years after other G-SIB home jurisdictions.

5 TLAC Term Sheet at § 18.

6 Bank of England, Statement of Policy: The Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL) (June 13, 2018) ("**BOE Statement of Policy**") at ¶ 7.7, available at https://www.bankofengland.co.uk/-/media/boe/files/paper/2018/statement-of-policy-boes-approach-to-setting-mrel-2018.pdf?la=en&hash=BC4499AF9CF063A3D8024BE5C050CB1F39E2EBC1; Hong Kong Monetary Authority ("**HKMA**"), Draft Rules: Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements—Banking Sector) Rules (July 25, 2018) ("**HKMA Draft Rules**") at Part 4—Division 3, Rule 26(1), available at https://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/resolution/Consultation_draft_AI_LAC_Rules.pdf.

7 The Federal Reserve has calibrated internal TLAC for the US intermediate holding companies ("**IHCs**") of non-US G-SIBs near the high end of the range—*i.e.*, at 89% of the TLAC level that would be required for a resolution entity on an risk-weighted asset ("**RWA**") basis. In addition, for non-US G-SIBs operating in the United States, the effective extent of US jurisdictional ring-fencing is even greater than would be suggested solely by the calibration of internal TLAC at the high end of the FSB range once the full set of binding capital constraints is taken into account, including the effects of the US stress-testing/Comprehensive Capital Adequacy Review regime. *See* Institute of International Bankers, Comment Letter: Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations; Regulatory Capital Deduction for Investments in Unsecured Debt of Systemically Important U.S. Bank Holding Companies (Feb. 19, 2016) at 6–10, available at https://c.ymcdn.com/sites/iib.site-ym.com/resource/resmgr/IIB_Comment_Letters/20160219IIB_TLACComments_fin.pdf. The original November 2016 European Commission proposal also contained a 90% calibration for non-European Union ("**EU**") G-SIBs. *See* Proposal for Regulation Amending Regulation 575/2013 (CRR) (Nov. 23, 2016) at 69, available at https://ec.europa.eu/transparency/regdoc/rep/1/2016/EN/COM-2016-850-F1-EN-MAIN.PDF.

("**misallocation risk**"). Therefore, a principal recommendation of this letter concerns the need for concerted global cooperation in setting appropriate levels of internal TLAC as jurisdictions move forward with implementation. As a general matter, we request that the FSB consider issuing further guidance to encourage global cooperation and further harmonization of TLAC standards across jurisdictions, as further elaborated below.

Constructing an effective TLAC framework involves both questions of amount and questions related to structure and composition. With respect to amount, we acknowledge the recent positive movements by global authorities. Specifically, Vice Chairman Randal Quarles of the US Board of Governors of the Federal Reserve System ("**Federal Reserve**") recently expressed openness to calibration of internal TLAC for the US IHCs of non-US G-SIBs at a starting point of 75%, down from the current US calibration.[8] The European Parliament Committee on Economic and Monetary Affairs also recently released a legislative draft that would allow internal TLAC calibration in the 75% to 90% range, in contrast to the fixed 90% calibration that was specified for non-EU G-SIBs in the original 2016 European Commission proposal.[9] We urge the FSB to reinforce this positive trend by issuing further guidance strongly endorsing the presumptive calibration of on-balance sheet internal TLAC at 75%. With respect to structure and composition, we believe that a mix of funded prepositioning and contractual agreements (including agreements along the lines of the secured support agreements ("**SSAs**") used by the US G-SIBs) will also be critical.

I. The FSB should encourage consistent regulatory adoption of the external TLAC standard across jurisdictions.

The FSB should take the lead in encouraging consistent implementation of the external TLAC standard across jurisdictions. As a general matter, the regulatory adoption of the standard in G-SIB home jurisdictions has largely satisfied the core specifications of the TLAC Term Sheet, but the flexibility built into the Term Sheet has also led regulators in different jurisdictions to take different approaches to implementing certain aspects of the standard. In some respects, this flexibility has had positive effects. For instance, the TLAC Term Sheet offers multiple pathways for a G-SIB to achieve the required subordination of external TLAC (*e.g.*, structural, legal or contractual subordination), and this flexibility has proven valuable to achieving the aims of the TLAC standard in the context of the differing structures and legal frameworks under which the G-SIBs operate. In other ways, however, the flexibility

8 Randal K. Quarles, Trust Everyone–But Brand Your Cattle: Finding the Right Balance in Cross-Border Resolution (May 16, 2018) (stating that the US "should consider whether the internal TLAC calibration for IHCs could be adjusted to reflect the practice of other regulators"), available at https://www.federalreserve.gov/newsevents/speech/quarles20180516a.htm.

9 Committee on Economic and Monetary Affairs, European Parliament, Report on the proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements and amending Regulation (EU) No 648/2012, at 68 (June 28, 2018) (revising Article 92b), available at http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+REPORT+A8-2018-0242+0+DOC+PDF+V0//EN. This will be subject to a trilogue process between the European Commission, Council of the EU ("**Council**") and European Parliament before finalization. More generally, these signs of movement in the US and EU to reverse the initial calibration of internal TLAC at the highest end of the FSB-specified range are broadly consistent with recent statements by FSB Chairman Mark Carney on the importance of the major G-20 economies taking the "high road" toward effective supervisory cooperation and coordination, rather than the "low road" of ring-fencing. *See* Mark Carney, Speech: The high road to a responsible, open financial system (Apr. 7, 2017), available at https://www.bankofengland.co.uk/-/media/boe/files/speech/2017/the-high-road-to-a-responsible-open-financial-system.pdf?la=en&hash=0264C2348F1C0E8225C7ACCC83ABF85AE827394A; *see also* Mario Draghi, President of the European Central Bank, Speech: Risk-reducing and risk-sharing in our Monetary Union (May 11, 2018), available at https://www.ecb.europa.eu/press/key/date/2018/html/ecb.sp180511.en.html.

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built into the TLAC Term Sheet has resulted in "super-equivalent" requirements for TLAC eligibility in several relevant jurisdictions that are not necessary to the achievement of the aims of the TLAC standard and are likely to prove counterproductive and self-defeating. To advance the principles underlying the Term Sheet, the FSB should issue guidance calling for greater uniformity in the following areas related to external TLAC that have been marked by various forms of jurisdictional super-equivalence:

- minimum long-term debt requirements;
- specific home country governing law requirements;
- calibration principles for multiple point of entry ("**MPOE**") groups; and
- eligibility of retail investors to hold TLAC instruments.

A. The FSB should make clear that the expectation that 33% of external TLAC be in the form of eligible long-term debt need not be implemented as a binding constraint.

With respect to external TLAC, the TLAC Term Sheet states that there is "an expectation that the sum of a G-SIB's resolution entity or entities (i) tier 1 and tier 2 regulatory capital instruments in the form of debt liabilities plus (ii) other TLAC-eligible instruments that are not also eligible as regulatory capital, is equal to or greater than 33% of their Minimum TLAC requirements" to "help ensure that a failed G-SIB has sufficient outstanding long-term debt."[10] Different jurisdictions have taken different approaches to this non-binding expectation. Notably, the United States went beyond the "expectation" that 33% of external TLAC will be composed of eligible debt securities to specifically require that US G-SIBs meet both an overall external TLAC requirement and a minimum external long-term debt requirement.[11] In contrast, other jurisdictions have come to the conclusion that the TLAC Term Sheet's non-binding debt expectation can be dispensed with without impairing resolvability objectives. For instance, the Bank of England deliberately decided not to require a minimum debt component of external or internal minimum requirement for own funds and eligible liabilities ("**MREL**").[12] Similarly, the EU MREL standards do not impose a quantitative minimum debt requirement[13] and Japan's external TLAC standards do not impose a minimum debt requirement.[14] Perhaps responding to these developments in other jurisdictions, the US Federal Reserve has recently indicated openness to reviewing whether a separate long-term debt requirement should continue to be imposed.[15]

We urge the FSB to issue guidance to confirm and underscore that the TLAC Term Sheet's "expectation" that 33% of external TLAC be in the form of eligible long-term debt is not in any respect a core or essential element

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[10] TLAC Term Sheet at § 6.

[11] 12 CFR §§ 252.62–63.

[12] *See* Bank of England, Responses to Consultation on 'Internal MREL—the Bank of England's approach to setting MREL within groups, and further issues' and Statement of Policy (June 13, 2018) at § 1.5 (stating that "[b]oth internal and external MREL resources can be either in the form of regulatory capital . . . or else debt liabilities that meet certain eligibility criteria"), available at https://www.bankofengland.co.uk/-/media/boe/files/paper/2018/policy-statement-boes-approach-to-setting-mrel-2018.pdf?la=en&hash=5DE6B6F258D5E9835F9CA6261A9050BFC666D8C4.

[13] *See* Regulation (EU) 2016/1540 on criteria for MREL (minimum requirements for liabilities eligible for bail-in) (May 23, 2016), available at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016R1450&from=EN.

[14] *See* Financial Services Agency, The FSA's Approach to Introduce the TLAC Framework (Apr. 13, 2018), available at https://www.fsa.go.jp/en/news/2018/20180413/01.pdf.

[15] Quarles, *supra* note 8 (stating that "it may be possible to streamline the elements of [the US] resolution loss absorbency regime, which include both TLAC and long-term debt requirements"). It is, of course, essential that any increased flexibility in the regulatory requirement not be vitiated by inflexibility with respect to supervisory expectations in this regard.

of the Term Sheet, and need not be implemented as a binding constraint for firms. The FSB guidance should explicitly state that G-SIBs should be able to satisfy their minimum external TLAC requirements by freely substituting equity for long-term debt securities and long-term debt securities for equity, subject to applicable regulatory capital requirements.[16] Given that major home jurisdictions other than the United States have already adopted this flexible approach, such guidance would further the goal of a level international playing field.

B. The FSB should affirm the availability of contractual bail-in recognition clauses as an alternative to requirements that TLAC instruments be governed by the law of a particular jurisdiction.

The TLAC Term Sheet states that eligible external TLAC "must be subject to the law of the jurisdiction in which the relevant resolution entity is incorporated."[17] However, the Term Sheet also states that eligible external TLAC "may be issued under or otherwise subject to the laws of another jurisdiction if, under those laws, the application of resolution tools by the relevant resolution authority is effective and enforceable on the basis of binding statutory provisions or legally enforceable contractual provisions for the recognition of resolution actions."[18] That is to say that the TLAC Term Sheet does not mandate that external TLAC in all cases be governed by a G-SIB's home country law—the use of contractual bail-in recognition clauses to enable valid external TLAC issuance under laws other than that of the G-SIB's home country is explicitly contemplated. However, some official sector comments within the EU have suggested that, following the exit of the United Kingdom ("**UK**") from the EU, debt issued under UK law could conceivably no longer be considered eligible to meet MREL and, further, that contractual recognition of bail-in might not be sufficient to remedy the issue.[19] Furthermore, Switzerland and the United States have introduced super-equivalent requirements that all newly issued external TLAC must be governed by Swiss law and US law, respectively.[20]

Such super-equivalent TLAC eligibility requirements deny G-SIBs the flexibility as to choice of governing law and access to funding that is contemplated under the TLAC Term Sheet and endorsed by other authoritative FSB guidance.[21] We urge the FSB to issue guidance affirming the availability of properly constructed contractual bail-in

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16 If the concern is that a G-SIB would have insufficient long-term debt to absorb losses and/or effect a recapitalization in resolution, we note that it is unlikely that any G-SIB would choose to satisfy its entire TLAC requirement with equity rather than long-term debt securities, because long-term debt securities are generally regarded as a less expensive form of loss-absorbing capacity.

17 TLAC Term Sheet § 13.

18 TLAC Term Sheet § 13.

19 Dominique Laboureix, Single Resolution Board ("**SRB**") Board Member, SRB Perspective: Highlighting Priorities for Improving Resolution in 2018/19 (June 2018) (noting that, in relation to Brexit, "[i]ssuances with contractual clauses would have to be assessed: effectiveness of the clauses and impact on resolvability, in particular when overall issuances under third country law account for a substantive share of the MREL-eligible issuances"); *see also* European Parliament, Committee Meeting: Committee on Economic and Monetary Affairs (July 11, 2018) (stating that, in the context of a hard Brexit, if there is no UK statutory recognition of foreign resolution actions adopted, "then clearly as of the date of this becoming a reality, then [liabilities issued under UK law] would no longer qualify for MREL because [the EU's] bail-in decisions cannot be enforced"), available at http://www.europarl.europa.eu/ep-live/en/committees/video?event=20180711-1430-COMMITTEE-ECON.

20 12 CFR § 252.61 (see definition for "eligible debt security"); Ordinance concerning Capital Adequacy and Risk Diversification for Banks and Securities Dealers, July 1, 2016, art. 126a(1)(c) (Switz.) ("**Capital Adequacy Ordinance**"), translation available at https://assets.kpmg.com/content/dam/kpmg/pdf/2016/08/ch-ordinance-concerning-capital-adequacy-en.pdf. In certain cases, the Swiss Financial Market Supervisory Authority ("**FINMA**") may grant exceptions if "it is substantiated that a FINMA-ordered conversion or debt write-down is enforceable in the jurisdictions concerned." Capital Adequacy Ordinance at art. 126a(1)(c).

21 *See* FSB, Principles for Cross-border Effectiveness of Resolution Actions (Nov. 3, 2015), available at http://www.fsb.org/wp-content/uploads/Principles-for-Cross-border-Effectiveness-of-Resolution-Actions.pdf.

recognition clauses as an alternative to requirements that TLAC be governed by the law of any particular jurisdiction.[22] In particular, we believe that this principle of flexibility should be evaluated in the context of the large amount of TLAC debt that will need to be issued and maintained on a global basis in order to satisfy global TLAC requirements.

Total requirements for G-SIB TLAC issuance are very large and will only become larger as time goes on. Assuming a mean jurisdictional external TLAC requirement of approximately 25% of RWA,[23] we can estimate a total TLAC need for the non-EME (*i.e.*, non-Chinese) G-SIBs of almost \$4 trillion,[24] which would grow to almost \$6 trillion when the Chinese G-SIBs become fully subject to the requirement.[25] The required stock of such loss-absorbing liabilities will grow further when TLAC-like requirements for domestic systemically important banks in many jurisdictions are added.

Given the size of the TLAC debt issuances that will be required in order for G-SIBs to maintain compliance with the TLAC standard, allowing both issuers and TLAC investors to take advantage of issuance formats under non-home country law that nevertheless satisfy FSB standards for recognition of bail-in will be important to enable robust market access. Moreover, a requirement to use exclusively home country law will tend to raise the percentage of investors who own TLAC issued by G-SIBs based in their own country. It would seem far better from a financial stability perspective to enable G-SIB issuers to access a more diversified investor base, so that investor, as well as bank, losses are not concentrated unnecessarily and artificially in the same country.

C. The FSB should encourage application of the TLAC standard to MPOE groups in a manner consistent with the TLAC Term Sheet.

The TLAC Term Sheet contains an agreed-upon framework for calibrating the external TLAC requirement for a banking group that follows a MPOE resolution strategy. Under the Term Sheet, if the sum of minimum TLAC requirements of the resolution entities within an MPOE G-SIB falls above the notional minimum TLAC requirement

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22 Such contractual recognition clauses would of course generally need to satisfy previously articulated FSB standards, including the ability of the G-SIB to demonstrate (*e.g.,* by an independent legal opinion) that the statutory bail-in of the instrument by the home authority will be enforceable under the governing law of the instrument. *See id.* at 15–16.

23 TLAC requirements in the major non-EME markets have ranged in the low to high 20% range when mandatory buffers are included.

24 This and other amounts presented in this paragraph represent estimates of the long-term steady-state amount of TLAC required to be maintained outstanding once the fully phased-in TLAC requirements come into effect in 2022 (for non-EME jurisdictions) and 2028 (for EME jurisdictions), and therefore do not subtract the amount of TLAC that is presently outstanding at G-SIBs. These amounts thus represent gross, rather than incremental, requirements.

25 The total RWA currently maintained by G-SIBs based in non-EME jurisdictions (including the United States, the EU, Canada and Japan) is approximately \$15.5 trillion today, and the total relevant amount of G-SIB RWA is expected to grow to \$23.7 trillion when Chinese G-SIBs begin to comply with the standard. Figures based on data from FDIC, Global Capital Index: Capitalization Ratios for Global Systemically Important Banks (GSIBs) (data as of Dec. 31, 2017), available at https://www.fdic.gov/about/learn/board/hoenig/capitalizationratio4q17.pdf.

It is important to note that, since publication of the TLAC Term Sheet in 2015, the Basel Committee on Banking Supervision ("**BCBS**") has finalized the Basel III framework, which will result in important changes to the calculation of RWA. This will have an impact on the required TLAC volumes, which are calibrated as a fixed percentage of RWA. We would urge the FSB to consider the TLAC-related impact of increases in calculated RWA due to the finalization of the Basel III framework as part of ongoing and future monitoring exercises.

Furthermore, if we assume that approximately one-third of the overall TLAC requirement will be met by long-term debt, we can estimate the minimum long-term debt need at roughly \$1.3 trillion for the non-EME G-SIBs and nearly \$2 trillion when the Chinese banks are included.

that would apply if the G-SIB in fact had just a single parent-level resolution entity, the home and host authority are encouraged to discuss and agree on an adjustment to minimize that difference.[26]

However, this principle does not seem to have been implemented as a practical matter in various jurisdictions and hence a real danger arises of inconsistent implementation of the TLAC Term Sheet and a lack of comparability across jurisdictions and banking groups. That is, certain jurisdictions do not apply the TLAC Term Sheet calibration principle for MPOE firms and instead require that MPOE groups meet the *higher* of a consolidated requirement and the sum of the individual resolution group requirements, without any explicit procedure for adjustment in accordance with the Term Sheet.[27] Although adherence to a conservative principle of over-calibration along these lines may be understandable as an initial safeguard, it is crucial that the FSB and relevant national authorities take steps now to ensure appropriate adherence to the Term Sheet principles over the longer term.

In principle, the calibration of external TLAC requirements should result in a similar outcome independent of whether a single point of entry ("**SPOE**") or MPOE resolution strategy is adopted. Deviations in practice from the TLAC Term Sheet principles relating to the calibration and adjustment of MPOE group TLAC levels should prompt the FSB to engage in additional monitoring and provide supporting guidance to ensure that such principles are ultimately implemented as intended.

D. The FSB should affirm that any investor protection concerns related to retail purchases of TLAC liabilities are most properly and effectively dealt with by the generally applicable investor protection rules issued by market regulators, rather than specific TLAC eligibility restrictions issued by prudential regulators.

The question of to what extent retail investors should be eligible to hold TLAC instruments, and to what extent retail holdings of TLAC are an impediment to bail-in, has been raised in relation to ownership patterns in several countries.[28] The European Banking Authority ("**EBA**") and European Securities and Markets Authority ("**ESMA**") as well as the SRB recently explored this issue with respect to EU jurisdictions. These authorities concluded that the identity of the holders of TLAC instruments is not, and should not be, a factor in determining whether a liability can or should be bailed in.[29] The EBA and ESMA further observed that (1) firms should properly inform retail investors of the risks presented in holding debt liabilities issued by financial institutions; (2) a strong investor protection framework that is properly implemented by financial institutions and enforced by authorities is essential to ensure that products are distributed to clients with whom they are compatible; and (3) resolution authorities should give attention to this element in their resolution planning and, in particular, assess whether or not bail-in can be credibly and feasibly applied in resolution.[30]

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26 TLAC Term Sheet at § 3.

27 The UK is one example. *See* BOE Statement of Policy at §§ 6.8, 6.9.

28 For instance, as of Q3 2017, retail investors in the euro area held EUR 262.4 billion or 12.7% of the EU bank debt securities issued to euro area investors. Senior unsecured debt constituted 81% (or EUR 212.4 billion) of retail-held debt securities, with the remainder (19% or EUR 50.0 billion) being subordinated debt. EBA, ESMA, Statement of the EBA and ESMA on the treatment of retail holdings of debt financial instruments subject to the Bank Recovery and Resolution Directive (May 30, 2018) ("**EBA-ESMA Statement**") at ¶ 17, available at https://www.eba.europa.eu/documents/10180/2137845/EBA+ESMA+Statement+on+retail+holdings+of+bail-inable+debt+%28EBA-Op-2018-03%29.pdf. Note that there are significant limitations to this data and the data cannot be regarded as complete. *Id.* at ¶ 15.

29 EBA-ESMA Statement at ¶ 5; SRB, Minimum Requirement For Own Funds and Eligible Liabilities (MREL): SRB Policy for 2017 and Next Steps (Dec. 20, 2017) at ¶ 42, available at https://srb.europa.eu/sites/srbsite/files/item_1_-_public_version_mrel_policy_-_annex_i_-_plenary_session.pdf.

30 The EBA and ESMA specifically urged that the new MiFID II framework for the EU should be properly implemented and enforced. EBA-ESMA Statement at ¶ 6. Article 24 of Directive 2014/65/EU (MiFID II) and Articles 44, 46, 47 and

As a general principle of securities and market regulation, TLAC should be distributed only to investors who understand its risks and for whom it is a suitable investment. However, it is important that issues of investor protection be addressed in the appropriate manner by the appropriate type of authority. Investor protection is not naturally addressed by prudential or resolution-related standards. TLAC-related regulation, in particular, is not the right body of law in which to insert rules in the form of distribution restrictions and minimum denominations. Rather, investor protection considerations are most appropriately addressed under the standard principles applied by the authorities that are specifically responsible for investor protection. As noted in the EBA-ESMA Statement, where factors relevant to a specific institution or jurisdiction are present—such as a particularly high concentration of retail investment in TLAC/MREL instruments or a history of mis-selling of such products—it may indeed be appropriate for the resolution authority to take into account any impediment these factors present to an orderly resolution, and adopt appropriate firm-specific *ex ante* measures to address the issue.[31]

In this context, we underscore that it is important to maintain a broad-based and functioning investor base for TLAC instruments. It would be self-contradictory, for example, to bar investors from TLAC instruments when they can freely purchase equities, which often carry greater risk. In addition, purchases of TLAC instruments may be suitable for retail investors where the investor purchases TLAC instruments as part of a balanced portfolio.

In light of the foregoing considerations, we urge the FSB to affirm that investor protection considerations related to retail purchases of TLAC liabilities are most properly and effectively addressed by generally applicable investor protection rules issued by market regulators, rather than TLAC-specific eligibility restrictions issued by prudential banking regulators.

II. The FSB should encourage the consistent adoption of a coordinated global approach to internal TLAC.

A. The FSB should encourage calibration of internal TLAC at the lower end of the range set out in the TLAC Term Sheet to limit misallocation risk.

To support the international coordination necessary to achieve effective cross-border resolution and avoid the harmful effects of jurisdictional ring-fencing, we recommend that the FSB issue further guidance on internal TLAC that strongly endorses the presumptive calibration of internal TLAC for material host country sub-groups of G-SIBs at 75%. The Associations strongly support the recent openness major global authorities have shown to calibrating internal TLAC based on a starting point of 75% of external TLAC—*i.e.*, at the low end of the FSB's 75% to 90% range.[32] We believe that adopting this starting point of 75% strikes an appropriate balance between the value of pre-

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48 of Delegated Regulation (EU) 2017/565 (MiFID II Delegated Regulation) went into effect on January 3, 2018. *Id.* at ¶ 6, n.2. The HKMA has also expressed a view that appropriate investor protection measures must be put in place to ensure that investment in external loss-absorbing capacity ("**LAC**") instruments is restricted to those who understand the risks that such investments involve, and are able to bear those risks. HKMA, Consultation Conclusion: Rules on Loss-Absorbing Capacity Requirements for Authorized Institutions (July 25, 2018) at ¶ 37, available at https://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/resolution/LAC_CP_conclusion_ENG.pdf. The HKMA Draft Rules allow primary issuance of external LAC instruments only to individuals who meet the criteria to qualify as "professional investors" under Hong Kong law. *See id.* at ¶ 36.

31 As described in the EBA-ESMA Statement, measures to be undertaken by the relevant resolution authority could include imposition of a requirement that the firm issue additional MREL to non-retail investors, or rely to a greater extent on MREL liabilities that are subordinated to the class of claims generally held by retail investors. *See* EBA-ESMA Statement at ¶ ¶ 49, 57–65.

32 *See supra* notes 8–9.

positioning internal TLAC and the value of maximizing the amount of available TLAC at the top of the group ("**surplus TLAC**"),[33] which can be used to recapitalize material subsidiaries when, as and where needed.

As FSB member authorities are aware, any assets that are pre-positioned at material subsidiaries are likely to be trapped by host authorities, rendering them unavailable to be readily deployed to recapitalize other material subsidiaries during periods of material financial distress. As a result, excessive pre-positioning of assets is harmful in that it decreases the amount of available TLAC that can be relied upon to recapitalize all material subsidiaries where needed at the time of material financial distress. What the 2008 Financial Crisis and other banking crises have taught us is that both the source, depth and ramifications of financial problems are inherently unpredictable. And if major financial institutions live globally and die nationally, the death is likely to be more violent and the ramifications more widespread. As has been illustrated by recent studies on the increased risk posed by separate and inaccessible pools of capital or liquidity resources, such resources are more likely to be exhausted at a single legal entity than within the combined organization.[34] Accordingly, a meaningful element of flexibility to deal with the unexpected, in going concern and in resolution, is essential. By calibrating internal TLAC starting at 75% and allowing flexibility in how surplus TLAC can be used, host authorities of material sub-groups will collectively take a significant step towards the mitigation of misallocation risk. This progress would be significantly enhanced if the 75% internal TLAC requirement were permitted to be composed of a mix of prepositioned resources and SSAs. By retaining some portion of central resources that can be directed to whatever area is suffering the most acute losses, misallocation risk can be reduced significantly and resilience improved.

In addition to reducing misallocation risk, a presumptive 75% starting point for internal TLAC calibration mitigates another key risk of excessive pre-positioning—the risk that other host authorities will, as a result of a collective action problem, set internal TLAC requirements above the optimal level.[35] If host authority A believes that other host authorities will require an excessive amount of internal TLAC, trapping any corresponding pre-positioned assets in those other host jurisdictions, host authority A will have a strong incentive to also impose internal TLAC requirements at similar excessive levels. If most, or all, host authorities were to act independently to require an excessive amount of internal TLAC for their own jurisdictions, this would deplete the available TLAC and the corresponding assets held at the top of the group, which would otherwise be available to recapitalize those host subsidiaries experiencing the greatest degree of loss or stress in a crisis, thereby creating misallocation risk. If home authorities respond to such *ex ante* ring-fencing behavior by requiring SPOE groups to issue further external TLAC to fund a flexible buffer of contributable assets, the cost of maintaining an SPOE strategy will be substantially and unnecessarily higher than it would have been without such uncoordinated and excessive internal TLAC requirements. In summary, the risk exists that—absent an appropriate coordination framework and incentive structure—the level of internal TLAC will rise by default to the level set by the jurisdiction with the strongest ring-fencing tendencies.

The consequences of the collective action problem with respect to internal TLAC are illustrated in the series of figures in **Annex 1**. As illustrated by **Annex 1**, if only one host jurisdiction sets internal TLAC calibration at an excessive rate, it could emerge as the net winner from this ring-fencing strategy. But, if other jurisdictions do the same in response, which is the more likely result, there is a substantial risk that *all* home and host authorities will individually and collectively be harmed as a consequence. This collective action problem among international

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33 The FSB defines surplus TLAC as "TLAC that is not distributed to material sub-groups in excess of that required to cover risks on the resolution entity's solo balance sheet." Guiding Principles on Internal Total Loss-absorbing Capacity of G-SIBs ('Internal TLAC') (July 6, 2017) ("**Internal TLAC Guiding Principles**") at Guiding Principle 7, available at http://www.fsb.org/wp-content/uploads/P060717-1.pdf.

34 *See, e.g.*, Wilson Ervin, Understanding 'ring-fencing' and how it can make banking riskier (Feb. 7, 2018), available at https://www.brookings.edu/research/understanding-ring-fencing-and-how-it-could-make-banking-riskier/.

35 *See* Randall D. Guynn, Gabriel D. Rosenberg & Nuveen Dhingra, FSB Finalizes Guiding Principles on Internal TLAC (July 10, 2017), available at https://www.finregreform.com/single-post/2017/07/10/fsb-finalizes-guiding-principles-on-internal-tlac/ [finregreform.com].

authorities is precisely the coordination challenge that FSB guidance should attempt to address. In addition to strongly emphasizing the global resolvability and resiliency benefits of a 75% calibration, any new FSB guidance in this area should take note of recent efforts by leading global authorities to build into their local internal TLAC frameworks an incentive mechanism that, if widely adopted, could help reinforce a collaborative equilibrium among host authorities rather than the competitive (and ultimately destructive) equilibrium just illustrated.

For instance, the Bank of England has recently issued a final Statement of Policy in which it underscores that when deciding, as host regulator, whether to calibrate a material subsidiary's internal MREL requirement above 75%, it will consider the availability of other uncommitted resources within the group that could be used to support the material UK subsidiary, as well as other jurisdictions' calibration of internal MREL requirements.[36] Similarly, the HKMA has proposed to consider the likely availability of additional financial resources within the wider resolution group in determining whether to maintain a 75% calibration.[37] If the same basic approach followed by the UK and Hong Kong were to be generally adopted, a host jurisdiction that raises its internal TLAC calibration above 75% will face a pair of foreseeable risks: (i) the risk that other host jurisdictions to the G-SIB in question will likewise raise their internal TLAC calibrations and (ii) the risk that any G-SIBs with respect to which it is the home regulator will be subjected to correspondingly higher internal TLAC requirements in turn. The FSB should consider endorsing a positive reinforcement mechanism along these lines as an appropriate accompaniment to a 75% calibration to help incentivize host jurisdictions to maintain such calibration as a group.

The discussion of avoiding misallocation risk with respect to internal TLAC has raised an important issue about the best balance of "flexibility" and "certainty" in home-host relations. The discussion above shows that a focus on absolute certainty—*i.e.*, high preplacement of internal resources to benefit a host jurisdiction—is ultimately counterproductive and raises risks. Likewise, a pure focus on flexibility, to improve results for the home without considering host requirements, appears to be infeasible as a practical matter. A wise balance of these two objectives, as discussed above, can lead to a good result for both the home jurisdiction and the full array of hosts. Of course, in order for this balance between flexibility in the form of surplus TLAC and certainty in the form of prepositioning to work most effectively, there must be robust cooperation among home and host authorities. We urge the FSB to take the lead in encouraging such cooperation in the form of regular communication and information-sharing.

We also note that the absolute quantitative amount of a given internal TLAC requirement will in practice depend on the external TLAC requirement to which the 75% (or higher) scaling is applied. For instance, in the UK, the Bank of England's fully phased-in RWA-based external MREL requirement for UK-headquartered resolution entities is 2x(Pillar 1 + Pillar 2A). Because Pillar 2A is firm-specific, the internal MREL requirement for each material UK subsidiary will vary based on its Pillar 2A requirement. Assuming, for instance, that Pillar 2A is set at 2.8%, the internal MREL requirement would be 75% of 2x(8% + 2.8%), which is 16.2% of RWAs. By contrast, the FSB-specified internal TLAC requirement would be lower—equal to 13.5% of RWAs—if calibrated at 75% of the FSB's external TLAC requirement of 18% and would rise to 16.2% only if the calibration were set at 90% of the FSB's external TLAC requirement. Because this absolute amount of required internal TLAC is what matters for either incurring or avoiding the costs of excessive ring-fencing, the FSB should consider recommending that the presumptive 75% internal TLAC calibration be calculated vis-à-vis the RWA-based external TLAC requirements specified in the TLAC Term Sheet itself—*i.e.*, 18% of RWA on a fully phased-in basis—rather than the specific external TLAC formula that may be applied on a jurisdictional basis. At a minimum, the FSB should address in its guidance on internal TLAC calibration the deleterious ring-fencing consequences that can arise from excessive calibration of internal regulatory capital buffers, whether cast as a component of the minimum required level of internal TLAC or as a prudential add-on to the specified minimum requirement.

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36 BOE Statement of Policy at § 7.7.

37 HKMA Draft Rules at Part 4—Division 3, Rule 26(2)–(3).

The necessity of preserving central resources by imposing sensible limits on pre-positioned internal TLAC requirements is additionally underscored by the fact that internal TLAC requirements for material sub-groups are calibrated on the basis of the RWAs and other balance sheet characteristics of the material sub-group itself, which in practice will include a substantial degree of exposure to other elements of the sub-group's broader G-SIB resolution group. Considered at the resolution group level (which, for SPOE G-SIBs, is the same as the consolidated group level), these intra-group exposures net out to zero and are eliminated in consolidated accounting. These intra-group exposures are therefore not relevant to the calculation of the overall external TLAC requirement that is set for the resolution group as a whole, but they *do* increase the size of the required internal TLAC resources that must be pre-positioned at the material sub-group level. Recognition of the impact of these stand-alone balance sheet effects at the sub-group level lends further justification for the FSB to target a 75% calibration for material sub-groups worldwide, as well to promote strict adherence to the TLAC Term Sheet standards for identification of a material sub-group.

B. The FSB should issue guidance encouraging jurisdictions to adhere to the standards specified in the TLAC Term Sheet for designating material host country subsidiaries and sub-groups.

The TLAC Term Sheet articulates a set of "5 percent tests"[38] that are meant to be the principal objective gauge of whether a G-SIB's subsidiary operations in a host jurisdiction rise to a level that justifies the imposition of a local internal TLAC requirement on the hosted subsidiary or sub-group. The principle underlying this element of the TLAC Term Sheet is that the misallocation risks inherent in the required prepositioning of TLAC resources are so significant that they should only be judged as acceptable by home and host regulators when the subsidiary operations of a G-SIB in a particular host jurisdiction are so substantial that they are critical to the successful resolution of the G-SIB resolution group as a whole.

To implement this principle, the TLAC Term Sheet supplements the "5 percent tests" with a further provision which states that, even where these quantitative tests are not met, a material sub-group requiring application of a minimum internal TLAC requirement may be found to exist where the entities that make up such a sub-group have been identified by the firm's Crisis Management Group ("**CMG**") as material to the exercise of the firm's critical functions.[39] However, certain jurisdictions have incorporated into their internal TLAC proposals a degree of discretion and latitude to unilaterally designate entities as material subsidiaries that is contrary to the guidelines established by the TLAC Term Sheet.[40]

We urge the FSB to issue guidance encouraging host jurisdictions to specify that—in the case of G-SIBs—the standard for designating a local material subsidiary will correspond, in both process and substance, to the standard specified by the TLAC Term Sheet. Here, as elsewhere, it will be difficult for any host jurisdiction to abide by the FSB-recommended approach if one or other jurisdictions implement a broader concept of materiality, so FSB monitoring in this area may be of particular value. Relatedly, we recommend that the FSB consider whether further guidance is needed to ensure that internal TLAC requirements imposed by non-material host jurisdictions do not exacerbate the problem of misallocation risk or unduly interfere with the resiliency of G-SIB groups. Attention to this

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38 The TLAC Term Sheet defines a material sub-group to include any sub-group that (1) has more than 5% of the consolidated RWAs of the G-SIB group; (2) generates more than 5% of the total operating income of the G-SIB group; or (3) has a total leverage exposure measure larger than 5% of the G-SIB group's consolidated leverage exposure measure. *See* § 17.

39 TLAC Term Sheet at § 17.

40 For instance, the Hong Kong LAC proposal provides that, where the HKMA, in its sole discretion, concludes that a given Hong Kong subsidiary is "material to the provision of critical financial functions" in Hong Kong, it may designate that subsidiary as material and subject it to a minimum internal LAC requirement. HKMA Draft Rules at Part 2, Rule 6(1)(b)(iv).

issue could be coupled with increased FSB focus on coordinated implementation of the information sharing protocols included in previously published FSB guidance on CMG coordination with non-CMG host authorities.[41]

C. The FSB should issue guidance setting out further considerations to be taken into account in setting intra-group requirements, particularly for non-G-SIBs subject to TLAC-like requirements.

To further support cross-border cooperation, increase financial resilience and ensure that on-balance sheet internal TLAC or equivalent requirements are only set where necessary for the effective delivery of the preferred resolution strategy, we recommend that the FSB consider issuing additional guidance to clarify the key elements that must be considered in setting intra-group requirements in the context of resolution-focused loss-absorbing capacity frameworks that apply to non-G-SIBs in certain major jurisdictions.

The Associations note that, within the EU, the TLAC standard is in the process of being transposed into the existing MREL framework. This includes requirements for internal MREL for all institutions in scope for the Bank Recovery and Resolution Directive ("**BRRD**"), as well as for material subsidiaries of third country G-SIBs operating within the EU. The proposed requirements for internal MREL under the BRRD are thus applicable to a broader scope of institutions than the TLAC Term Sheet covers by its terms. Importantly, the scope of the proposed EU requirements for internal MREL gives no consideration to the materiality of a subsidiary and requires pre-positioning of MREL at every EU entity without specifying any scaling range (such as the 75% to 90% range in the TLAC Term Sheet) for the calibration of the requirement. Furthermore, there is a proposal by the Council to permit host resolution authorities within the EU to increase the internal MREL requirement by 2% of RWA without the need to consult or seek consent from the home resolution authority.[42]

We suggest that the FSB devote attention to the risks that heightened internal loss-absorbency requirements can introduce in these contexts, and the impact this can have both for G-SIBs and non-G-SIBs. Furthermore, where internal loss-absorbing capacity requirements are applied *within* a home jurisdiction, we believe the FSB should encourage home authorities to take particular care that such requirements are not excessively calibrated and do not carry unnecessary conditions, such as required contractual conversion triggers that are more suited to the material host country context.

D. The FSB should affirm that prescriptive requirements or guidance pertaining to the form and amount in which surplus TLAC is maintained is not necessary or desirable.

Although the Associations support measures aimed at ensuring the availability of surplus TLAC that can be flexibly deployed in the event of stress, we would not consider it appropriate or desirable for the FSB or national authorities to propose strict requirements in relation to the form and amount of such surplus TLAC. Such restrictions can have unintended consequences. For instance, imposing requirements related to how surplus TLAC must be held—*e.g.*, requiring such recapitalization resources to be held as HQLA—may have adverse implications for a firm's ability to finance its external TLAC issuances. If a G-SIB is required to issue external TLAC and invest the proceeds as surplus TLAC at the holding company in the form of HQLA, it would face significant unnecessary costs from structural negative carry as a result of raising long-term funds via subordinated issuance and investing the proceeds

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41 *See* FSB, Guidance on Cooperation and Information Sharing with Host Authorities of Jurisdictions where a G-SIFI has a Systemic Presence that are Not Represented on its CMG (Nov. 3, 2015), available at http://www.fsb.org/wp-content/uploads/Guidance-on-cooperation-with-non-CMG-hosts.pdf.

42 Council, Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directive 2014/59/EU on loss-absorbing and recapitalisation capacity of credit institutions and investment firms and amending Directive 98/26/EC, Directive 2002/47/EC, Directive 2012/30/EU, Directive 2011/35/EU, Directive 2005/56/EC, Directive 2004/25/EC and Directive 2007/36/EC (May 22, 2018) at art. 45h.5, available at http://data.consilium.europa.eu/doc/document/ST-9057-2018-INIT/en/pdf.

in short-term instruments or deposits. As recognized by the Internal TLAC Guiding Principles, flexibility should be maintained with respect to which entities within the group hold surplus TLAC.[43]

E. The FSB should monitor jurisdictional implementation of arrangements for triggering the conversion or write-down of internal TLAC debt for consistency with the TLAC Term Sheet and Internal TLAC Guiding Principles, including to ensure an appropriate home country role in activating the trigger.

Section 19 of the TLAC Term Sheet specifies that consent from the home authority of the resolution entity is required for the triggering of non-regulatory capital instruments that are used to meet internal TLAC requirements. The Internal TLAC Guiding Principles further underscore the important role that a home country consent requirement plays in ensuring that the activation of the internal TLAC trigger occurs in a manner that is consistent with the home country's coordination role in executing the resolution plan for the resolution group.[44] In light of the importance of these principles, we recommend that the FSB monitor jurisdictional implementation of arrangements for triggering the conversion or write-down of internal TLAC debt to ensure consistency with applicable FSB guidance, with particular focus on confirming the incorporation of an appropriate home country role in activating the trigger.

F. The FSB should issue guidance affirming qualified SSAs as a valid substitute for on-balance sheet internal TLAC.

The TLAC Term Sheet explicitly states that home and relevant host authorities in CMGs "may agree to substitute on-balance sheet internal TLAC with internal TLAC in the form of collateralised guarantees."[45] We believe that qualifying SSAs quintessentially perform a function equivalent to the "collateralised guarantee" contemplated by the Term Sheet and, if jointly agreed by home and host jurisdictions as specified in the FSB TLAC Term Sheet, could be accepted as an alternative or supplement to on-balance sheet internal TLAC. Each US G-SIB has put in place or is in the process of putting in place a legally binding SSA. Each of these agreements imposes secured obligations on the top-tier parent and certain other affiliates (the "**Support Entities**") to use the group's contributable assets to recapitalize its material subsidiaries, including its material overseas subsidiaries, as part of the US G-SIB's SPOE strategy in order to keep such subsidiaries out of their own insolvency or special resolution proceedings.[46]

An SSA should constitute a qualified SSA if it grants a material overseas subsidiary a legally enforceable, secured right to require a Support Entity to contribute sufficient assets to (including in the form of the forgiveness, or a conversion to equity, of a sufficient portion of any debt issued by) the overseas subsidiary. The host authority could rely on its supervisory powers to require the relevant subsidiary to exercise that right when it is otherwise failing or likely to fail.

As a key safeguard against the dangers posed by misallocation risk, we recommend that the FSB explicitly recognize that such qualifying SSAs may constitute valid collateralized guarantees (and thus internal TLAC) under the TLAC Term Sheet. In keeping with their design and function, SSAs should be usable on a pooled resource basis, to reduce misallocation risk, rather than pre-allocated for the benefit of a specific jurisdiction or subsidiary. The

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43 Guiding Principle 7 of the Internal TLAC Guiding Principles explains that readily available assets which match the surplus TLAC of a G-SIB can be held in an entity other than the resolution entity "provided that there are no legal or operational impediments to transferring them back to the resolution entity or using them to recapitalize any direct or indirect subsidiary of the resolution entity as necessary to support the execution of the resolution strategy."

44 Internal TLAC Guiding Principles at Guiding Principle 17.

45 TLAC Term Sheet at § 19.

46 The resolution strategies of each of the US G-SIBs are set forth in the public summaries of their 2017 Resolution Plans submitted under Title I of the Dodd-Frank Act. *See* Resolution Plans, available at https://www.federalreserve.gov/supervisionreg/resolution-plans-search.htm.

recognition in this fashion of assets held by Support Entities and subject to qualified SSAs as a contributable resource would represent a step in accord with evolving developments in resolution planning.

Relatedly, we urge the FSB to issue guidance endorsing the principle that debt may qualify as internal TLAC if the issuer of the debt is the secured beneficiary of a qualified SSA, even if the debt instrument itself does not contain a contractual write-down/conversion provision. Such guidance should also encourage home authorities to share information about qualified SSAs and other aspects of resolution planning so as to facilitate global coordination.

G. The FSB should issue guidance encouraging home and host jurisdictions to take any necessary steps to enable internal TLAC debt instruments to be treated as debt instruments for tax purposes.

We urge the FSB to issue guidance encouraging regulatory authorities to work with relevant tax authorities to enable internal TLAC debt instruments to receive ordinary debt-like tax treatment. Capital instruments that are hybrid in nature, with debt-like legal forms and equity-like loss-absorbing features, could potentially be treated as equity under the tax regimes of various jurisdictions. Some jurisdictions, such as Hong Kong, have taken steps to affirm that TLAC debt instruments will generally be given debt-like tax treatment.[47] Such measures provide beneficial certainty on tax treatment under host jurisdiction law and avoid unnecessary and unjustified adverse tax consequences that will carry no financial stability benefit and in some cases may impair the optimal functioning of the TLAC framework.

The treatment of internal TLAC instruments as equity due to contractual trigger elements in such instruments could result in potentially adverse tax consequences. Notably, under US law, the following consequences could result from such recharacterization of internal TLAC instruments issued by a non-US host subsidiary to its US parent:

- Treatment of payments as dividends. Payments of interest made by an overseas subsidiary to its US parent would be non-deductible dividends for US tax purposes, resulting in greater income and earnings by the overseas subsidiary for purposes of determining the amount ultimately included in income by its US parent under relevant US tax regimes—*e.g.*, for purposes of global intangible low-taxed income ("**GILTI**") and Subpart F. Notwithstanding the above, the US parent would be fully taxable on the dividends it was deemed to receive, under relevant US hybrid rules. Moreover, repayment of the recharacterized debt might be treated as a taxable dividend to the US entity holding the internal TLAC debt, rather than as a tax-free return of principal, to the extent of the overseas subsidiary's accumulated earnings and profit.

- Tax credits. Depending on the circumstances (including whether the US entity holding the internal TLAC is a direct parent of the overseas subsidiary), recharacterization of the internal TLAC debt as nonvoting equity could have an adverse effect on the US group's ability to claim US tax credits for overseas taxes that it otherwise would be entitled to take with respect to equity interests in the overseas subsidiary. This could have the effect that economic income earned by the overseas subsidiary is subject to tax by both overseas tax authorities and the United States without offset.

We therefore believe that concerns arising from the potential recharacterization of internal TLAC debt as equity for US federal income tax purposes should be considered by host jurisdiction authorities in formulating their requirements for internal TLAC debt.

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47 *See* HKMA, Draft Bill: Inland Revenue (Amendment (No.) Bill 2018 (July 25, 2018), available at https://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/resolution/Consultation_draft_IRO_LAC_Amendment_Bill.pdf); Rev. Proc. 2017-12, 2017-3 IRB 424.

We also urge the FSB to evaluate certain unintended tax consequences related to TLAC, in particular with regard to the recent tax reforms implemented within the United States—*i.e.,* the Base Erosion and Anti-Abuse Tax (BEAT), that could adversely affect foreign firms operating in the United States that are subject to internal TLAC requirements. Tax consequences related to TLAC should be evaluated across different jurisdictions to ensure that the impact of any disparate tax treatment of TLAC is not unduly burdensome for certain jurisdictions relative to others, and to prevent the emergence of other unintended tax interactions with respect to the implementation of TLAC across various jurisdictions.

H. The FSB should make clear that there is no expectation that internal TLAC requirements include a mandatory debt component.

As noted in Section I.A of this letter, the TLAC Term Sheet states, with respect to external TLAC, that there is an "expectation" that 33% of minimum TLAC requirements be met with long-term debt.[48] Certain jurisdictions, such as the United States and Hong Kong, have imposed, or propose to impose, a requirement that 33% or more of internal TLAC be met with TLAC debt instruments.[49]

Although we strongly support the goal of establishing appropriate and reasonable TLAC requirements, we believe that the separate debt requirement is unnecessary to ensure that material overseas subsidiaries have enough TLAC at the point of non-viability to be recapitalized. Since internal TLAC does not serve a market discipline purpose, a minimum debt requirement is even less necessary in the case of internal TLAC than it is for external TLAC. Instead, we believe that material overseas subsidiaries should be permitted to satisfy their minimum internal TLAC requirements by freely substituting equity for debt and vice-versa, subject to applicable regulatory capital requirements. Fundamentally, it would be counterintuitive to prohibit the substitution of equity for debt since equity can function as both going-concern and gone-concern capital. In contrast, debt generally functions only as gone-concern capital. For these reasons, we recommend that the FSB issue guidance encouraging host jurisdictions to adopt an approach similar to that proposed by the Bank of England, which has independently arrived at the decision not to impose a separate minimum internal debt requirement.[50]

At a minimum, we urge the FSB to consider guidance encouraging host jurisdictions to take a consultative approach to internal TLAC composition, tailored to each material sub-group. For instance, the Internal TLAC Guiding Principles state that host authorities may "in consultation with the home authority" consider the inclusion of a minimum internal debt requirement.[51] The Internal TLAC Guiding Principles further explain that, in applying such an expectation, host authorities should "take into account the composition of the material sub-group's existing internal TLAC instruments and the practicality of making changes to it, with a view to ensuring that the material sub-group is not required to issue additional internal TLAC beyond the requirement set by the host authority."[52] Action by the FSB to promote the practical introduction of these elements into the determination of internal TLAC composition would further reinforce the approach of consultation and cooperation between global resolution authorities.

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48 TLAC Term Sheet at § 6.

49 *See* HKMA Draft Rules at Part 4—Division 6, Rules 33–35; 12 CFR § 242.162.

50 *See* BOE Statement of Policy.

51 Internal TLAC Guiding Principles at Guiding Principle 8.

52 Internal TLAC Guiding Principles at Guiding Principle 8.

III. The FSB should issue guidance encouraging regulators to administer the regulatory capital buffers that complement TLAC minimums in a manner consistent with the TLAC Term Sheet in order to promote harmonized implementation across jurisdictions.

The FSB could consider issuing guidance on best practices in relation to the interaction between minimum TLAC requirements and prudential capital buffers (this relationship is also known as the "**stacking order**"). Such guidance would be directed at ensuring that the stacking order is comparable across jurisdictions and proportionate to the stated objectives. The lack of technical detail in the TLAC Term Sheet on this subject has led to different approaches, which may affect the interaction between TLAC and capital requirements across jurisdictions.[53] In particular, it would be both beneficial and consistent with the Term Sheet framework for the FSB to make clear that prudential RWA buffers should only be calculated "on top" of those minimum TLAC requirements that are specified on the basis of RWA, while leverage ratio buffers should only be calculated "on top" of minimum TLAC requirements that are specified on the basis of total leverage exposure.

IV. The FSB should cooperate with BCBS to revise standards on TLAC holdings and Pillar 3 disclosures.

A. The FSB should encourage the BCBS to revise the TLAC holdings standard to adopt the like-for-like principle of the Basel III capital framework's corresponding deduction approach.

The final BCBS standard on TLAC holdings requires that a banking organization's holdings of TLAC instruments that do not otherwise qualify as regulatory capital be deducted from the Tier 2 capital of the banking organization that holds the TLAC instrument (or other similar instrument subject to deduction).[54] This is in stark

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53 In the EU, the original BRRD did not contain provisions on the relationship between MREL and RWA buffers, whereas the Commission delegated regulation 2016/1450 suggested putting RWA buffers on top of RWA-based MREL only. In introducing TLAC in the EU, the European Commission proposal for amendments to the BRRD and Capital Requirements Directive ("**CRD**") provided for a stacking order that would always place prudential RWA buffers "on top" of MREL, regardless of the basis of the MREL calculation. European Commission proposal CRD Articles 128-141a; BRRD 45, 45c and 45d. For banks whose MREL was higher when calculated on the basis of the leverage ratio denominator, this resulted in placing RWA buffers "on top" of leverage-ratio MREL, thus resulting in excessive and unintended total capital requirements. The subsequent negotiation of these amendments in the Council and the European Parliament suggests that a more logical stacking order is being contemplated, which will only place the prudential RWA buffers "on top" of MREL only in RWA terms, although the references are still incomplete and indirect, referring to the Minimum Distributable Amounts. Council proposal CRD 141; BRRD 16a; European Parliament proposal CRD Article 141.

In the UK, the Prudential Regulatory Authority has clarified that prudential RWA buffers should only be calculated "on top" of MREL calculated on the basis of RWA, while leverage ratio buffers should only be calculated "on top" of MREL on the basis of the leverage ratio denominator. SS16/16 updated on 11 December 2017 following CP 15/17. A similar approach has been taken under the US TLAC rule. 12 CFR § 252.63

In the United States, the Federal Reserve's Final Rule establishes a new but distinct "TLAC buffer" requirement, calculated on the basis of RWA, that must be held in the form of Common Equity Tier 1 ("**CET1**"). *See* 12 CFR § 252.161 (definition of Covered IHC TLAC Buffer). A breach of the minimum "TLAC buffer" of 2.5% results in restrictions on capital distributions and executive compensation. *Id.* at § 252.165(d)(4). The TLAC buffer is calculated as the CET1 capital ratio (expressed as a percentage) minus the greater of zero or the amount of "additional Tier 1 capital" and "eligible long-term debt" (also expressed as a percentage) available to cover the 16% RWA internal TLAC requirement. *Id.* at § 252.165. The calculation would effectively prevent CET1 capital used to meet the minimum required internal TLAC on the basis of RWA from being included in the TLAC buffer. In fact, this rule puts the RWA buffer requirements on top of the RWA based TLAC requirement only. Note that the Federal Reserve has also put a leveraged buffer requirement on top of leverage based TLAC. *Id.* at § 252.165.

54 BCBS, Standard: TLAC holdings (Oct. 12, 2016) ("**TLAC Holdings Standard**"), available at https://www.bis.org/bcbs/publ/d387.pdf.

contrast to the symmetric "like-for-like" principle of the Basel III capital framework's corresponding deduction approach.[55]

The BCBS explained that the asymmetric approach allows for the same treatment to be applied to both G-SIBs and non-G-SIBs (which are not subject to TLAC requirements) and reduces potential contagion by providing appropriate disincentives for banks to invest in TLAC.[56] However, this explanation seems incongruous given the fact that G-SIBs are treated differently from non-G-SIBs in so many other respects, notably being subject to differing capital, leverage and loss-absorbing capacity requirements.[57] Importantly, the BCBS regime of large exposure limits is explicitly directed at limiting the potential for banks to experience contagion from the failure of a single counterparty.[58] Therefore a more straightforward and appropriate alternative would be to extend the large exposure regime to TLAC for non-G-SIBs, rather than applying a deduction.

The Associations also note that very few jurisdictions have implemented the BCBS standard so far, likely reflecting the fact that it is overly complex and ultimately sub-optimal. The fact that the final BCBS standard on treatment of TLAC holdings remains to be finalized (or even consulted upon) in most major jurisdictions, including the United States and the UK, raises fundamental concerns around the ability of most jurisdictions (and their banks) to meet the envisaged conformance timetable with respect to this topic.[59] More fundamentally, it also raises concerns around consistent implementation of the TLAC Term Sheet in this area.

In light these considerations, we would urge the FSB to reconsider the arguments put forward by IIF and GFMA in their response to the BCBS consultative document on TLAC holdings.[60] At a minimum, the Associations urge the FSB, in coordination with the BCBS, to monitor both the rule-making process and the subsequent implementation of the TLAC holdings standard on a jurisdictional level, with a view to assessing the market impact and effect on the issuance and market liquidity of TLAC instruments. We would also stress, as a technical matter, that the extent of any particular individual firm's aggregate holdings of TLAC instruments is difficult to capture and monitor in the absence of consistent implementation of the TLAC Term Sheet with respect to fundamental TLAC eligibility criteria. We would like to stress that there is a clear need for appropriate phase-in of the final requirements, given the operational complexity of identifying and applying regulatory deductions to all categories of applicable TLAC.

B. The FSB should encourage the BCBS to replace the TLAC holdings standard's 5% threshold for market making with a market making exemption.

Recognizing the need to permit market making activity in order to support the liquidity needed to raise the substantial financial resources being sought to meet new TLAC requirements, the BCBS introduced into the final

55 *See* BCBS, Basel III: A global regulatory framework for more resilient banks and banking systems (June 1, 2011) at ¶ 79, available at https://www.bis.org/publ/bcbs189.pdf.

56 TLAC Holdings Standard at 2.

57 Furthermore, for G-SIBs, contagion risk is already addressed under the G-SIB assessment methodology. That is, banks are already disincentivized from holding TLAC issued by G-SIBs due to the higher G-SIB scores associated with such portfolios.

58 BCBS, Standards: Supervisory framework for measuring and controlling large exposures (Apr. 2014) at 1–2, available at https://www.bis.org/publ/bcbs283.pdf.

59 The requirements of the TLAC Holdings Standard take effect at the same time as the minimum TLAC requirements for each G-SIB, as described in Section 21 of the TLAC Term Sheet. TLAC Holdings Standard at ¶ 66d.

60 IIF, GFMA, Industry Comments on BCBS Consultative Document: TLAC Holdings (Feb. 12, 2016), available at https://www.bis.org/bcbs/publ/comments/d342/iifgfma.pdf.

TLAC holdings standard the concept of a 5% threshold.[61] This threshold allows a banking organization to risk-weight—rather than deduct from its Tier 2 capital—non-significant investments in TLAC liabilities of unconsolidated financial institutions, up to 5% of the investing banking organization's common equity (after applying all other adjustments), with holdings measured on a gross long basis.[62]

While the Associations agree that the TLAC holdings standard should make adequate allowance for market making activities, the operation of the BCBS 5% threshold provision is overly complex and, as a result, may not be effective in fostering the intended level of liquidity. Specifically, for G-SIBs, the 5% threshold is subject to additional conditions: it may be used only for TLAC liabilities in the G-SIB's trading book that are sold within 30 business days.[63] Once a G-SIB has designated a holding as falling within this 5% threshold category, the holding may not subsequently be included in the general 10% threshold under which non-significant investments in unconsolidated financial institutions may be risk-weighted.[64]

As an alternative to the 5% threshold, we would suggest a market making exemption from deductions that would permit banks to engage in market making activities both with respect to their own outstanding TLAC and other banks' TLAC.[65] Relatedly, we urge the FSB to closely monitor the impact of the 5% threshold on market liquidity and to allow for appropriately phased implementation of the requirements, taking into account the ongoing finalization of the necessary disclosure regime and substantive TLAC rules in various jurisdictions.

C. The FSB should encourage the BCBS to revise Pillar 3 TLAC-related disclosures to provide for more proportionate, less duplicative disclosure.

The Pillar 3 disclosure requirements published by BCBS in March 2017 include disclosure requirements that pertain to both external and internal TLAC.[66] These requirements consist of a number of templates and tables that banks are expected to fill out, including Table CCA. Table CCA details the main features of a bank's regulatory capital instruments and other TLAC-eligible instruments.[67] Furthermore, the instructions for Table CCA state that banks are required to make available on their websites the full terms and conditions of all instruments included in regulatory capital and TLAC.[68] While we support the implementation of appropriate disclosure requirements, we recommend that Table CCA be produced at a more summarized aggregation level. Furthermore, we believe that the requirement to produce instrument-level reporting of TLAC instruments would be unnecessarily granular and duplicative and furnish little or no incremental benefit in terms of market discipline, given that the information would typically already be disclosed in the offering documents for the TLAC instruments.

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61 TLAC Holdings Standard at ¶ 80a–c.

62 TLAC Holdings Standard at ¶ 80a, 83.

63 TLAC Holdings Standard at ¶ 80a.

64 TLAC Holdings Standard at ¶ 80b, 81.

65 For further discussion of this issue, see HSBC, Comment Letter: Total loss Absorbing Capacity ('TLAC') Holdings - consultative document (Feb. 10, 2016), available at https://www.bis.org/bcbs/publ/comments/d342/hsbc.pdf; TCH, SIFMA et al., Commenter Letter: Consultative Document – TLAC Holdings (Feb. 17, 2016), available at https://www.bis.org/bcbs/publ/comments/d342/tsfi.pdf.

66 BCBS, Standards: Pillar 3 disclosure requirements – consolidated and enhanced framework (Mar. 29, 2017) ("**Pillar 3 Disclosure**"), available at https://www.bis.org/bcbs/publ/d400.pdf.

67 Pillar 3 Disclosure at 4, 38–40.

68 Pillar 3 Disclosure at 38.

In the most recent consultation by the BCBS on Pillar 3 standards, further changes were proposed,[69] which the industry commented upon. We refer the FSB to that response and wish to underscore the concerns expressed in relation to the proposed changes to some of the disclosure templates. Fundamentally, we think it is critical to ensure that the TLAC disclosure templates are finalized in a proportionate manner—in particular, the proposed expanded application of Template CC1 to resolution groups should be abandoned as it would pose an undue disclosure burden for G-SIBs with an MPOE resolution strategy.

Generally, and in keeping with the pace of jurisdictional implementation related to BCBS's guidance on the treatment and deduction of TLAC holdings, there has also been very little guidance put forth by local jurisdictions related to the public disclosure and regulatory reporting of TLAC to date. In view of this, we would also urge the FSB to encourage local jurisdictions to apply clear and coherent standards of disclosure to ensure that firms are generally subject to equal and consistent levels of disclosure requirements.

* * * * *

We thank the FSB Secretariat for its consideration of our comments. If you have any questions, please do not hesitate to contact John Court at +1-202-589-2409, Allison Parent at +1-202-962-7393 or Andrés Portilla at +1-202-857-3645.

Sincerely,

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69 *See* BCBS, Consultative Document; Pillar 3 disclosure requirements – updated framework (Feb. 27, 2018), available at https://www.bis.org/bcbs/publ/d432.pdf; BCBS, Technical Amendment: Pillar 3 disclosure requirements – regulatory treatment of accounting provisions (Mar. 22, 2018), available at https://www.bis.org/bcbs/publ/d435.pdf.

Annex 1

The consequences of the collective action problem with respect to internal TLAC are illustrated in the series of figures in this Annex.[1] The figures present a simplified depiction of an SPOE firm that operates, for illustrative purposes, through just four entities: the Top-Tier BHC and three foreign subsidiaries (A, B and C), each in a different host jurisdiction. The Top-Tier BHC is subject to an external TLAC ("**eTLAC**") requirement, while the foreign subsidiaries are each subject to internal TLAC ("**iTLAC**") requirements.

The eTLAC requirement in this example is calculated by doubling the minimum going-concern capital requirement applicable to the firm and then adding any applicable capital buffer. At the subsidiary level, the applicable iTLAC requirement is established by first determining what the eTLAC requirement of the subsidiary would be if it were a resolution entity (applying the same formula for calibrating eTLAC described above) and then applying an iTLAC scalar in the range of 75% to 90% in accordance with the TLAC Term Sheet.

<u>Figure 1: All host jurisdictions start at 75% internal TLAC calibration</u>

Illustration: Adverse impact of excessive internal TLAC or host-country capital buffers

Top-Tier BHC (Unconsolidated)			
Assets		Liabilities and Capital	
Cash	50	GLAC	
HQLAs	50	eTLAC Debt	200
Rec'bles		Other	0
iTLAC Debt-A	50	Going-Concern	
iTLAC Debt-B	25	Minimum	200
iTLAC Debt-C	25	Buffers	0
Eq in subs	200		
Total	400	Total	400

Definitions:
TLAC = GLAC + Going Concern Capital
eTLAC = 2X Minimum Capital + Buffers
iTLAC = 75%-90% of eTLAC

Starting Assumptions:
Internal TLAC = 75% of external TLAC
No host-country capital buffers

Surplus assets from perspective of:	
Host A	150
Host B	125
Host C	125

Potential adverse impact:
Reduce pool of surplus assets
Impediment to X-border SPOE
Increase pD of top-tier BHC

Foreign Subsidiary A			
Assets		Liabilities and Capital	
Cash	10	GLAC	
HQLAs	15	iTLAC Debt (@75%-90%)	50
Other	125	Other	0
		Going-Concern Capital	
		Minimum	100
		Buffers	0
Total	150	Total	150

eTLAC = 2*100 = 200
iTLAC (75%) = 150
iTLAC (90%) = 180
iBuffer = 0-20

Foreign Subsidiary B			
Assets		Liabilities and Capital	
Cash	5	GLAC	
HQLAs	7.5	iTLAC Debt (@75%-90%)	25
Other	62.5	Other	0
		Going-Concern Capital	
		Minimum	50
		Buffers	0
Total	75	Total	75

eTLAC = 2*50 = 100
iTLAC (75%) = 75
iTLAC (90%) = 90
iBuffer = 0-10

Foreign Subsidiary C			
Assets		Liabilities and Capital	
Cash	5	GLAC	
HQLAs	7.5	iTLAC Debt (@75%-90%)	25
Other	62.5	Other	0
		Going-Concern Capital	
		Minimum	50
		Buffers	0
Total	75	Total	75

eTLAC = 2*50 = 100
iTLAC (75%) = 75
iTLAC (90%) = 90
iBuffer = 0-10

In Figure 1 of this stylized example, each host jurisdiction has adopted a "low-end" 75% calibration of iTLAC, which leaves contributable resources of 100 in the form of cash and HQLA available at the Top-Tier BHC to be contributed to any subsidiary that experiences a concentrated loss. Because these contributable resources are available at the Top-Tier BHC, each foreign subsidiary has access to an amount of "surplus assets" available to cover losses above and beyond the required minimum level of going-concern capital that is equal to: 100 (the full amount of contributable Top-Tier BHC resources) *plus* the amount of "gone-concern" iTLAC debt ("**iTLAC Debt**") that is present at each such subsidiary.

Thus, for Foreign Subsidiary B, for instance, the amount of "surplus assets" available to cover concentrated loss is 100 (the full amount of contributable resources at the Top-Tier BHC) plus 25 (the amount of iTLAC Debt that is pre-positioned at Foreign Subsidiary B in accordance with the 75% iTLAC calibration) for a total of 125.

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1 These figures are based on an interactive Excel spreadsheet prepared by Randall Guynn of Davis Polk & Wardwell LLP to illustrate the adverse consequences of excessive internal TLAC at the IIF/TCH Symposium on Cross-Border Resolution in London, England, on June 15, 2018. A copy of the interactive spreadsheet can be downloaded at https://www.davispolk.com/files/internal_ringfencing_interactive_illustration_-_locked.xlsx [davispolk.com].

Figure 2: Host Jurisdiction A raises the calibration of internal TLAC to 90%.

Illustration: Adverse impact of excessive internal TLAC or host-country capital buffers

Top-Tier BHC (Unconsolidated)

Assets		Liabilities and Capital	
Cash	20	GLAC	
HQLAs	50	eTLAC Debt	200
Rec'bles		Other	0
iTLAC Debt-A	80	Going-Concern	
iTLAC Debt-B	25	Minimum	200
iTLAC Debt-C	25	Buffers	0
Eq in subs	200		
Total	400	Total	400

Definitions:
TLAC = GLAC + Going Concern Capital
eTLAC = 2X Minimum Capital + Buffers
iTLAC = 75%-90% of eTLAC

Starting Assumptions:
Internal TLAC = 75% of external TLAC
No host-country capital buffers

Surplus assets from perspective of:

Host A	150
Host B	95
Host C	95

Potential adverse impact:
Reduce pool of surplus assets
Impediment to X-border SPOE
Increase pD of top-tier BHC

Foreign Subsidiary A

Assets		Liabilities and Capital	
Cash	40	GLAC	
HQLAs	15	iTLAC Debt (@75%-90%)	80
Other	125	Other	0
		Going-Concern Capital	
		Minimum	100
		Buffers	0
Total	180	Total	180

eTLAC = 2*100 = 200
iTLAC (75%) = 150
iTLAC (90%) = 180
iBuffer = 0-20

Foreign Subsidiary B

Assets		Liabilities and Capital	
Cash	5	GLAC	
HQLAs	7.5	iTLAC Debt (@75%-90%)	25
Other	62.5	Other	0
		Going-Concern Capital	
		Minimum	50
		Buffers	0
Total	75	Total	75

eTLAC = 2*50 = 100
iTLAC (75%) = 75
iTLAC (90%) = 90
iBuffer = 0-10

Foreign Subsidiary C

Assets		Liabilities and Capital	
Cash	5	GLAC	
HQLAs	7.5	iTLAC Debt (@75%-90%)	25
Other	62.5	Other	0
		Going-Concern Capital	
		Minimum	50
		Buffers	0
Total	75	Total	75

eTLAC = 2*50 = 100
iTLAC (75%) = 75
iTLAC (90%) = 90
iBuffer = 0-10

Figure 2 above illustrates the effects of a decision by Host Jurisdiction A to increase its local calibration of iTLAC to 90%. To satisfy the increased iTLAC requirement at Foreign Subsidiary A, the Top-Tier BHC contributes an additional 30 in cash to Foreign Subsidiary A and receives, as an asset, a corresponding increase in the iTLAC Debt it holds in Foreign Subsidiary A.

Significantly, if the sequence of events were to end here, Host Jurisdiction A would have advantaged itself by raising its iTLAC calibration to 90%, having increased the amount of surplus assets exclusively available to it while leaving Foreign Subsidiaries B and C with diminished amounts of surplus assets. Foreign Subsidiaries B and C each see the surplus assets available to *them* decrease by 30—the full amount of the increased iTLAC requirement at Foreign Subsidiary A. As we will see in further figures below, however, this temporary advantage does not last as other hosts adopt similar behavior.

Figure 3: Host Jurisdictions B and C also raise the calibration of internal TLAC to 90%.

Illustration: Adverse impact of excessive internal TLAC or host-country capital buffers

Top-Tier BHC (Unconsolidated)

Assets		Liabilities and Capital	
Cash	5	GLAC	
HQLAs	35	eTLAC Debt	200
Rec'bles		Other	0
iTLAC Debt-A	80	Going-Concern	
iTLAC Debt-B	40	Minimum	200
iTLAC Debt-C	40	Buffers	0
Eq in subs	200		
Total	400	Total	400

Definitions:
TLAC = GLAC + Going Concern Capital
eTLAC = 2X Minimum Capital + Buffers
iTLAC = 75%-90% of eTLAC

Starting Assumptions:
Internal TLAC = 75% of external TLAC
No host-country capital buffers

Surplus assets from perspective of:

Host A	120
Host B	80
Host C	80

Potential adverse impact:
Reduce pool of surplus assets
Impediment to X-border SPOE
Increase pD of top-tier BHC

Foreign Subsidiary A

Assets		Liabilities and Capital	
Cash	40	GLAC	
HQLAs	15	iTLAC Debt (@75%-90%)	80
Other	125	Other	0
		Going-Concern Capital	
		Minimum	100
		Buffers	0
Total	180	Total	180

eTLAC = 2*100 = 200
iTLAC (75%) = 150
iTLAC (90%) = 180
iBuffer = 0-20

Foreign Subsidiary B

Assets		Liabilities and Capital	
Cash	20	GLAC	
HQLAs	7.5	iTLAC Debt (@75%-90%)	40
Other	62.5	Other	0
		Going-Concern Capital	
		Minimum	50
		Buffers	0
Total	90	Total	90

eTLAC = 2*50 = 100
iTLAC (75%) = 75
iTLAC (90%) = 90
iBuffer = 0-10

Foreign Subsidiary C

Assets		Liabilities and Capital	
Cash	5	GLAC	
HQLAs	22.5	iTLAC Debt (@75%-90%)	40
Other	62.5	Other	0
		Going-Concern Capital	
		Minimum	50
		Buffers	0
Total	90	Total	90

eTLAC = 2*50 = 100
iTLAC (75%) = 75
iTLAC (90%) = 90
iBuffer = 0-10

In Figure 3 above, we see the outcome that results when Host Jurisdictions B and C follow Host Jurisdiction A's lead and increase their iTLAC calibration level from 75% to 90%. Because the Top-Tier BHC has been required to contribute an additional 15 in contributable resources from available reserves of cash and HQLA to each of Foreign Subsidiary B and C, the pool of contributable resources available at the Top-Tier BHC has decreased by 30.

Importantly, this reactive behavior by Host Jurisdictions B and C has *worsened* the position of Foreign Subsidiary A relative to its initial starting position when all foreign subsidiaries were subject to a 75% calibration. With Host Jurisdictions B and C having adopted the same ring-fencing behavior as Host Jurisdiction A, Foreign Subsidiary A has in fact witnessed the surplus assets available to it drop from 150 (see Figure 1) to 120.

For their part, Foreign Subsidiaries B and C—although their respective host jurisdictions have "defended" themselves by adopting the high-end 90% calibration—are also worse off than when they started, having each seen the level of surplus assets available to them drop from 125 (see Figure 1) to 80.

Figure 4: Host Jurisdiction A adds a buffer requirement of 20

Illustration: Adverse impact of excessive internal TLAC or host-country capital buffers

Top-Tier BHC (Unconsolidated)

Assets		Liabilities and Capital	
Cash	5	GLAC	
HQLAs	15	eTLAC Debt	200
Rec'bles		Other	0
iTLAC Debt-A	80	Going-Concern	
iTLAC Debt-B	40	Minimum	200
iTLAC Debt-C	40	Buffers	0
Eq in subs	220		
Total	400	Total	400

Definitions:
TLAC = GLAC + Going Concern Capital
eTLAC = 2X Minimum Capital + Buffers
iTLAC = 75%-90% of eTLAC

Starting Assumptions:
Internal TLAC = 75% of external TLAC
No host-country capital buffers

Surplus assets from perspective of:

Host A	100
Host B	60
Host C	60

Potential adverse impact:
Reduce pool of surplus assets
Impediment to X-border SPOE
Increase pD of top-tier BHC

Foreign Subsidiary A

Assets		Liabilities and Capital	
Cash	40	GLAC	
HQLAs	35	iTLAC Debt (@75%-90%)	80
Other	125	Other	0
		Going-Concern Capital	
		Minimum	100
		Buffers	20
Total	200	Total	200

eTLAC = 2*100 = 200
iTLAC (75%) = 150
iTLAC (90%) = 180
iBuffer = 0-20

Foreign Subsidiary B

Assets		Liabilities and Capital	
Cash	20	GLAC	
HQLAs	7.5	iTLAC Debt (@75%-90%)	40
Other	62.5	Other	0
		Going-Concern Capital	
		Minimum	50
		Buffers	0
Total	90	Total	90

eTLAC = 2*50 = 100
iTLAC (75%) = 75
iTLAC (90%) = 90
iBuffer = 0-10

Foreign Subsidiary C

Assets		Liabilities and Capital	
Cash	5	GLAC	
HQLAs	22.5	iTLAC Debt (@75%-90%)	40
Other	62.5	Other	0
		Going-Concern Capital	
		Minimum	50
		Buffers	0
Total	90	Total	90

eTLAC = 2*50 = 100
iTLAC (75%) = 75
iTLAC (90%) = 90
iBuffer = 0-10

In Figure 4, we see a reaction from Host Jurisdiction A to the weakened position Foreign Subsidiary A has been placed in due to the cycle of ring-fencing that has transpired so far. Recognizing that it has reached the upper limit of the FSB range by calibrating internal TLAC at 90%, Host Jurisdiction A—acting on concern about the depletion it has witnessed in Top-Tier BHC contributable resources—might seek to further protect itself by requiring Foreign Subsidiary A to add a going-concern capital buffer on top of the existing minimum going-concern capital requirement.

Figure 4 above shows the consequences of this step, which has a substantially equivalent effect to the previous increase by Host Jurisdiction A in its overall iTLAC calibration—Foreign Subsidiaries A, B and C each find the surplus assets available to them reduced by 20, while the Top-Tier BHC reserve of contributable assets has been further reduced to just 20.

This highlights the important insight that excessively calibrated buffer requirements can, in both principle and practice, produce the same deleterious ring-fencing consequences as the more obvious step of adopting a high iTLAC scalar such as 90%. It also illustrates the potential for excessively calibrated host jurisdiction buffer requirements to deplete the flexible pool of contributable resources, ultimately to the detriment of host jurisdictions both individually and collectively.

Figure 5: Host Jurisdictions B and C each respond by adding a buffer requirement of 10

Illustration: Adverse impact of excessive internal TLAC or host-country capital buffers

Top-Tier BHC (Unconsolidated)			
Assets		Liabilities and Capital	
Cash	0	GLAC	
HQLAs	0	eTLAC Debt	200
Rec'bles		Other	0
iTLAC Debt-A	80	Going-Concern	
iTLAC Debt-B	40	Minimum	200
iTLAC Debt-C	40	Buffers	0
Eq in subs	240		
Total	400	Total	400

Definitions:
TLAC = GLAC + Going Concern Capital
eTLAC = 2X Minimum Capital + Buffers
iTLAC = 75%-90% of eTLAC

Starting Assumptions:
Internal TLAC = 75% of external TLAC
No host-country capital buffers

Surplus assets from perspective of:	
Host A	80
Host B	40
Host C	40

Potential adverse impact:
Reduce pool of surplus assets
Impediment to X-border SPOE
Increase pD of top-tier BHC

Foreign Subsidiary A			
Assets		Liabilities and Capital	
Cash	40	GLAC	
HQLAs	35	iTLAC Debt (@75%-90%)	80
Other	125	Other	0
		Going-Concern Capital	
		Minimum	100
		Buffers	20
Total	200	Total	200

eTLAC = 2*100 = 200
iTLAC (75%) = 150
iTLAC (90%) = 180
iBuffer = 0-20

Foreign Subsidiary B			
Assets		Liabilities and Capital	
Cash	20	GLAC	
HQLAs	17.5	iTLAC Debt (@75%-90%)	40
Other	62.5	Other	0
		Going-Concern Capital	
		Minimum	50
		Buffers	10
Total	100	Total	100

eTLAC = 2*50 = 100
iTLAC (75%) = 75
iTLAC (90%) = 90
iBuffer = 0-10

Foreign Subsidiary C			
Assets		Liabilities and Capital	
Cash	10	GLAC	
HQLAs	27.5	iTLAC Debt (@75%-90%)	40
Other	62.5	Other	0
		Going-Concern Capital	
		Minimum	50
		Buffers	10
Total	100	Total	100

eTLAC = 2*50 = 100
iTLAC (75%) = 75
iTLAC (90%) = 90
iBuffer = 0-10

As occurred previously in response to Host Jurisdiction A raising its iTLAC calibration to 90%, here in Figure 5 Host Jurisdictions B and C respond in kind to Host Jurisdiction A implementing a buffer requirement, each adding a going-concern capital buffer of 10.

Importantly, the net result of this step is to fully deplete the central reserve of contributable resources at the Top-Tier BHC, which now stands at zero. Within this stylized example, any further need for downstreaming of iTLAC resources or replenishment of contributable TLAC resources will need to come from further eTLAC issuances.

This illustrates the potential for unconstrained host authority add-ons with respect to required iTLAC levels and buffer requirements to drive the ultimate eTLAC requirement higher than the calibration that policymakers have otherwise chosen.