Adequacy of loss-absorbing capacity of global systemically important banks in resolution

Consultative Document

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The Financial Stability Board (FSB) is seeking comments on policy proposals developed at the request of G20 leaders to enhance the loss-absorbing capacity of global systemically important banks (G-SIBs) in resolution. The policy proposals consist of:

(I) **Principles on loss absorbing and recapitalization capacity of G-SIBs in resolution.** The principles elaborate on the premise set out in the September 2013 report on *Progress and Next Steps Towards "Ending Too Big To Fail" (TBTF)*[1] that G-SIBs must have sufficient loss absorbing and recapitalization capacity available in resolution to implement an orderly resolution that minimizes any impact on financial stability, ensures the continuity of critical functions, and avoids exposing taxpayers to loss.

(II) **Term sheet on Total Loss Absorbency Capacity (TLAC).** The term sheet is a concrete proposal for implementing these principles in the form of an internationally agreed standard for G-SIBs.

The FSB invites comments on its policy proposals and the questions set out below by <u>Monday, 2 February</u>:

Calibration of the amount of TLAC required

1. Is a common Pillar 1 Minimum TLAC requirement that is set within the range of 16 – 20% of risk-weighted assets (RWAs), and at a minimum twice the Basel III leverage requirement, adequate in the light of experiences from past failures to support the recapitalisation and resolution objectives set out in this proposal? What other factors should be taken into account in calibrating the Pillar 1 Minimum TLAC requirement?
2. Does the initial exclusion of G-SIBs headquartered in emerging market economies (EMEs) from meeting the Common Pillar 1 Minimum TLAC requirement appropriately reflect the different market conditions affecting those G-SIBs? Under what circumstances should the exclusion end?
3. What factors or considerations should be taken into account in calibrating any additional Pillar 2 requirements?

Ensuring the availability of TLAC for loss absorption and recapitalization in the resolution of cross-border groups

4. Should TLAC generally be distributed from the resolution entity to material subsidiaries in proportion to the size and risk of their exposures? Is this an appropriate means of supporting resolution under different resolution strategies? Which subsidiaries should be regarded as material for this purpose?

[1] http://www.financialstabilityboard.org/publications/r_130902.htm

5. To what extent would pre-positioning of internal TLAC in material subsidiaries support the confidence of both home and host authorities that a G-SIB can be resolved in an orderly manner and diminish incentives to ring-fence assets? Is a requirement to pre-position internal TLAC in the range of 75 - 90% of the TLAC requirement that would be applicable on a stand-alone basis, as set out in the term sheet (Section 22), appropriate to satisfy the goals of the proposal and ensure that TLAC is readily and reliably available to recapitalize subsidiaries as necessary to support resolution? Can this pre-positioning be achieved through other means such as collateralized guarantees?

Determination of instruments eligible for inclusion in external TLAC

6. Are the eligibility criteria for TLAC as set out in the term sheet (Sections 8-17) appropriate?

7. What considerations bear on the desirability of an expectation that a certain proportion of the common minimum Pillar 1 TLAC requirement consists of (i) tier 1 and tier 2 capital instruments in the form of debt plus (ii) other eligible TLAC that is not regulatory capital?

8. Are the conditions specified in the term sheet (Section 8) under which pre-funded commitments from industry-financed resolution funds to provide resolution funding contribute to TLAC appropriate?

9. Is the manner in which subordination of TLAC-eligible instruments to excluded liabilities is defined in the term sheet (Section 13) sufficient to provide certainty regarding the order in which creditors bear loss in resolution, and to avoid potentially successful legal challenges or compensation claims? Where there is scope for liabilities which are not subordinated to excluded liabilities to qualify for TLAC, are the transparency and disclosure requirements set out in section 13 and 24 sufficient to ensure that holders of these instruments would be aware of the risk that they will absorb losses prior to other equally ranking but excluded liabilities? If not, what additional requirements should be adopted?

Interaction with regulatory capital requirements and consequence of breaches of TLAC

10. Do you agree that the TLAC requirement for G-SIBs should be integrated with Basel III such that the minimum TLAC requirement should be met first, and only after TLAC is met should any surplus common equity tier 1 (CET1) be available to meet the Basel III buffers?

Transparency

11. What disclosures (in particular in terms of the amount, nature and maturity of liabilities within each rank of the insolvency creditor hierarchy) should be required by resolution entities and material subsidiaries to ensure that the order and quantum of loss absorption in insolvency and resolution is clear to investors and other market participants?

Limitation of contagion

12. What restrictions on the holdings of TLAC are appropriate to avoid the risk of contagion should those liabilities be exposed to loss in resolution?

Conformance period

13. Should G-SIBs be required to conform with these requirements from 1 January 2019? Why or why not? What, within the range of 12 to 36 months following the identification as a G-SIB, should be the conformance period for banks identified as G-SIBs at a future date?

Market impact and other aspects

14. How far is the TLAC proposal, if implemented as proposed, likely to achieve the objective of providing sufficient loss-absorbing and recapitalization capacity to promote the orderly resolution of G-SIBs?
15. What will be the impact on G-SIB's overall funding costs of the adoption of a Pillar 1 Minimum TLAC requirement?
16. What will be the impact on the financial system and its ability to provide financing to the real economy?
17. Do you have any comments on any other aspects of the proposals?

Responses should be sent to the following e-mail address: fsb@bis.org. Responses will be published on the FSB's website unless respondents expressly request otherwise.

Adequacy of loss-absorbing capacity of global systemically important banks in resolution

Overview

At the St. Petersburg Summit in 2013, the G20 Leaders called on the Financial Stability Board (FSB), "in consultation with standard setting bodies, to assess and develop proposals by end-2014 on the adequacy of global systemically important financial institutions' loss absorbing capacity when they fail."[2]

The FSB's agenda for addressing the risks arising from global systemically-important financial institutions (G-SIFIs) was set out in 2010, with the goal of reducing both the probability and impact of failure of such firms. It consisted of requirements for assessing the systemic importance of institutions, for additional going-concern loss absorbency, for increased supervisory intensity, for more effective resolution and for stronger financial market infrastructure. Substantial progress has been made in the implementation of these requirements. However, for home and host authorities and markets to have confidence that systemically important banks are truly no longer "too big to fail" and are resolvable without the use of public funds, they must have confidence that these firms have sufficient capacity to absorb losses, both before and during resolution.

The FSB has developed, in consultation with the Basel Committee on Banking Supervision (BCBS), policy proposals to enhance the loss-absorbing capacity of G-SIBs in resolution. The proposals consist of:

(I) a set of principles that elaborate on the premise set out in the September 2013 report on *Progress and Next Steps Towards "Ending Too Big To Fail" (TBTF)*[3] that there must be sufficient loss absorbing and recapitalization capacity available in resolution to implement an orderly resolution that minimizes impact on financial stability, ensures the continuity of critical functions, and avoids exposing taxpayers to loss; and

(II) a term sheet that is a proposal for implementing these principles in the form of an internationally agreed standard on the adequacy of total loss-absorbing capacity for G-SIBs.

Background

The *Key Attributes of Effective Resolution Regimes for Financial Institutions* ("Key Attributes")[4] which were endorsed as an international standard by G20 leaders in November 2011 set out the essential features that should be part of effective resolution regimes of all jurisdictions. Authorities globally have been working to implement the *Key Attributes* through

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2 See G20 Leaders' Declaration 2013 https://www.g20.org/sites/default/files/g20_resources/library/Saint_Petersburg_Declaration_ENG_0.pdf

3 http://www.financialstabilityboard.org/publications/r_130902.htm

4 http://www.financialstabilityboard.org/publications/r_111104cc.pdf

legislative changes and the preparation of firm-specific resolution strategies and plans, cooperation agreements and resolvability assessments. Resolution strategies and the resolution plans which operationalize them should set out how firms may be resolved without severe systemic disruption, without exposing public funds to loss, and while ensuring continuity of systemically important (or "critical") functions. Losses should be absorbed in the first place by shareholders and then by unsecured and uninsured creditors consistent with the statutory hierarchy of creditor claims.

The *Key Attributes* describe the powers and tools that authorities should have to achieve this objective. These include the bail-in power, i.e., the power to write down *and* convert into equity all or parts of the firm's unsecured and uninsured liabilities of the firm under resolution or any successor in a manner that respects the creditor hierarchy and to the extent necessary to absorb the losses. Hence, the resolution strategies that are being developed for G-SIBs[5] provide for a recapitalisation[6] by a way of a bail-in (with or without use of a bridge institution[7]) to support the orderly resolution or wind-down of a G-SIB in a manner that maintains at a minimum continuity of critical functions. As set out in the July 2013 FSB Guidance on the Development of Effective Resolution Strategies, one crucial consideration in the development of effective resolution strategies is the availability in resolution of loss-absorbing capacity in sufficient amounts and at the right location(s) within a group.

The FSB's September 2013 TBTF report[8] identified the need to develop a proposal on the adequacy of loss-absorbing capacity in resolution as one of the important outstanding issues to be addressed in the FSB's overall agenda to end TBTF. The report recognizes that adequate loss-absorbing capacity is not by itself a sufficient condition for ensuring effective resolution,[9] but underscores that adequate loss absorbing capacity is a necessary condition to implement resolution strategies that are aimed at maintaining the continuity of critical functions and promoting market confidence without exposing taxpayers to the risk of loss.

In addition to the work of the FSB, several jurisdictions have adopted reforms or announced initiatives relevant to the loss-absorbing capacity of G-SIBs. The EU Bank Recovery and Resolution Directive (BRRD), which was adopted in April 2014, includes a requirement for EU Member States to set minimum requirements for loss-absorbency for all banks (Minimum Requirement for own funds and Eligible Liabilities, MREL). Also, in the United States, the Federal Deposit Insurance Corporation published in December 2013 a notice on its approach to single-point-of-entry resolution (SPE), seeking comment on, among other things, the amount and characteristics of loss-absorbing capacity that would be needed at the holding company level to facilitate this strategy.

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5 See FSB Guidance on Developing Effective Resolution Strategies of July 2013.

6 Depending on the resolution strategy, recapitalisation of the holding company and/or operating entities or of a new entity, such as a bridge institution, to which critical functions are transferred.

7 The bridge bank tool is also a mechanism to allocate losses by transferring all or substantially all assets of the parent holding company of the group, and only parts of the liabilities to a newly established bridge bank.

8 See footnote 3 above.

9 Other outstanding issues include the completion of legislative reforms to implement the Key Attributes, the removal of obstacles to cross-border resolution, structural changes as appropriate to ensure resolvability, enhanced cross-border information sharing, and the prevention of large-scale early termination of financial contracts in resolution. See Progress report#

A new requirement for "total loss-absorbing capacity (TLAC)"

The FSB proposes to achieve the availability of adequate loss-absorbing capacity for G-SIBs in resolution by setting a new minimum requirement for "total loss-absorbing capacity (TLAC)". The minimum Pillar 1 TLAC requirement is a requirement for loss absorbing capacity on both a going concern and gone concern basis, incorporating existing Basel 3 minimum capital requirements and excluding Basel 3 capital buffers. The TLAC requirement should ensure adequate availability of loss-absorbing capacity in resolution. The aim is to establish a framework that is consistent with the Basel capital framework and continues to set appropriate incentives for firms to be well capitalised. The kinds of instruments that count towards satisfying existing minimum regulatory capital requirements would therefore also count towards satisfying the common minimum Pillar 1 TLAC requirement.

A common Pillar 1 minimum TLAC requirement for G-SIBs will improve global financial stability as it will ensure that each G-SIB has a minimum amount of loss absorbing capacity available, so will help authorities, if required, to resolve financial institutions in an orderly manner without taxpayer support.

The requirement should improve market confidence that each G-SIB can be resolved in an orderly manner, thereby improving the provision of credit globally, including in emerging market economies and those countries that are implementing the Key Attributes that are not home to G-SIBs.

By strengthening the credibility of authorities' commitments to resolve G-SIBs without exposing taxpayers to loss, TLAC in conjunction with other measures should act to remove the implicit public subsidy from which G-SIBs currently benefit when they issue debt and incentivize creditors to better monitor G-SIBs' risk taking. It should also help achieve a level playing field internationally, reducing G-SIBs' funding cost advantage and ensuring they compete on a more equal footing within their home and foreign markets.

TLAC adequacy will need to take account of individual G-SIBs' recovery and resolution plans, their systemic footprints, business models, risk profiles and organisational structures. The principles and term sheet therefore provide guidance for home and host authorities on how to determine an additional Pillar 2 TLAC requirement for individual firms which may apply over and above the Pillar 1 TLAC minimum. The calibration and composition of firm-specific TLAC requirements should be determined in consultation with Crisis Management Groups and subject to review in the Resolvability Assessment Process (RAP).

The FSB proposes that a single specific minimum Pillar 1 TLAC requirement be set within the range of 16 – 20% of RWAs and at least twice the Basel 3 Tier 1 leverage ratio requirement. The final calibration of the common Pillar 1 Minimum TLAC requirement will take account of the results of this consultation and the Quantitative Impact Study and market survey which will be carried out in early 2015.

To help ensure that there are sufficient resources available in resolution, there is an expectation that TLAC in the form of debt capital instruments and other TLAC-eligible liabilities that are not regulatory capital will constitute an amount equal to or greater than 33% of the Minimum Pillar 1 TLAC requirement.

Eligibility of liabilities as TLAC

TLAC should consist only of liabilities that can be effectively written down or converted into equity during resolution of a G-SIB without disrupting the provision of critical functions or giving rise to material risk of successful legal challenge or compensation claims. To this end, the FSB term sheet proposes a set of specific criteria that liabilities must meet to be eligible as TLAC (see sections 8 to17 of the term sheet). However, recognizing that losses in resolution may exceed a G-SIB's TLAC, liabilities that are not eligible as TLAC or that are not included in a G-SIB's TLAC remain subject to potential exposure to loss in resolution, in accordance with the applicable resolution law.

Location of TLAC within group structures

A crucial consideration of a resolution strategy's effectiveness is the availability of sufficient amounts of loss-absorbing capacity at the right location(s) within a G-SIB's group structure. In determining the individual requirements for specific firms, authorities have to take into account their preferred resolution strategies and identify the entity or entities within a group to which resolution tools would be applied (resolution entity or resolution entities). Depending on the preferred resolution strategy, resolution entities may be the top-tier parent or holding company, intermediate holding companies or subsidiary operating companies. The resolution entity and any direct or indirect subsidiaries of the resolution entity which are not themselves resolution entities form the resolution group. A G-SIB may consist of one or more resolution groups. It may form a single resolution group with the parent company, which may be a holding company or an operating entity, as the sole resolution entity or, alternatively, consist of two or more resolution groups with a corresponding number of resolution entities. Under this proposal, a Minimum TLAC requirement will apply to each resolution entity within each G-SIB and will be set in relation to the consolidated balance sheet of each resolution group.

When a resolution entity enters resolution, TLAC issued by the resolution entity and held by external creditors would be written down and/or converted into the equity of the (re-capitalised) resolution entity (or a newly established bridge entity). Losses would be absorbed in the first instance by the shareholders and thereafter by the external creditors of the resolution entity according to the applicable creditor hierarchy.

Internal TLAC

A key objective of the new TLAC standard is to provide home and host authorities with confidence that G-SIBs can be resolved in an orderly manner and thereby diminish any incentives to ring-fence assets domestically. A resolution entity should generally act as a source of loss absorbing capacity for its subsidiaries where those subsidiaries are not themselves resolution entities. The FSB proposes that subsidiaries located outside of their resolution entity's home jurisdiction that are identified as material and that are not themselves resolution entities are subject to an internal TLAC requirement in proportion to the size and risk of the material subsidiaries' exposures (sections 20 to 23 in the term sheet). The presence of an adequate amount of prepositioned internal TLAC should provide host authorities of G-SIB subsidiaries with comfort that resources will be available through the write-down or conversion of the pre-positioned internal TLAC to recapitalise subsidiaries without applying resolution measures to them, as necessary to implement the resolution strategy and support the continued provision of essential financial services and maintenance of financial stability in their jurisdictions. The FSB proposes a quantum of internal TLAC for review in the QIS that must be pre-positioned at material subsidiaries be equivalent to 75-90% of the TLAC requirement that would apply to a material subsidiary on a stand-alone basis, but that the specific internal TLAC requirement is defined by the relevant host authority in consultation with the home authority and validated through the RAP. This quantum of pre-positioned internal TLAC is intended to provide sufficient comfort for host authorities that sufficient resources are available to absorb losses in local material subsidiaries but provide some flexibility to deploy non-pre-positioned internal TLAC as necessary across the group in resolution. The internal TLAC requirement should be set within a given range that is defined by FSB on the basis of the QIS.

Public Disclosures

To enhance the credibility and feasibility of resolution and strengthen market discipline the FSB principles and term sheet set out disclosure requirements for G-SIBs in regard to the amount, maturity and composition of TLAC as well as the position of TLAC-eligible liabilities in the creditor hierarchy so that creditors and other counterparties of G-SIBs have clarity about the order in which they will absorb losses in resolution. The FSB will work with the BCBS to specify the disclosure requirements.

Regulation of investors

To reduce the risk of contagion, the FSB term sheet (section 18) proposes rules on deductions from G-SIBs' own TLAC or regulatory capital equal to their exposures to TLAC liabilities issued by other G-SIBs.

Impact of the proposal on the financial system and real economy

In early 2015, the FSB will, with the participation of the BCBS and the BIS, undertake comprehensive impact assessment studies, comprising a Quantitative Impact Study (QIS), and a micro- and macroeconomic impact assessments, to inform the calibration of the Pillar 1 element of the common Minimum TLAC requirement for all G-SIBs. In addition, it will carry out a market survey to gauge the depth of markets for eligible TLAC instruments and how these markets and holders might be affected. A survey of historical losses and recapitalisation needs will be another important input to ensure the calibration is sufficient to achieve the objectives of TLAC. The impact analyses will also consider the consequences of a TLAC requirement on banks in emerging markets, G-SIBs headquartered in EMEs, and state-owned banks. Together, these assessments should provide more information on the impact of the proposal on the broader financial system, financial stability and the real economy.

All G-SIBs currently issue TLAC-eligible instruments and their current and prospective cost will be an important starting point for the QIS and the impact assessment. Most G-SIBs would need to expand their issuance of TLAC-eligible instruments and to do so out of resolution entities that may not be the current issuer of eligible instruments. And some senior debt of G-SIBs currently in issuance would need to be restructured in order to be eligible as TLAC (e.g. to subordinate it to excluded liabilities).

In terms of broader economic implications, the added funding costs associated with a TLAC requirement will lead to a reduction of the implicit public subsidy for G-SIBs. To the extent that a TLAC requirement reduces the contingent sovereign liabilities associated with bail-outs, sovereign funding costs should decline as well. G-SIBs may pass on a share of their higher funding costs to their clients, prompting a shift of banking activities to other banks without necessarily reducing the amount of activity. Alternatively, G-SIB dividends and other distributions, such as employee remuneration, might fall. The economic impact of higher G-SIB funding costs needs to be set against the benefits that accrue from more economically efficient pricing of G-SIB services and risk taking and less mis-allocation of capital and resources. To the extent that TLAC holders will have greater incentives to screen and discipline G-SIBs in order to lower the risk of losses, or to diminish their losses associated with resolution, the probability of G-SIB failure and the economic costs of their resolution should decline as well. The impact assessment will also consider the benefits to the global economy of the greater intermediation and risk sharing capacity that maintenance of an open and integrated financial system provides.

Next steps

The FSB will revise the principles and term sheet in light of the public consultation and findings from a quantitative impact study and market survey and submit a final version to the G-20 by the 2015 Summit.

The conformance period for the TLAC requirement will be informed by the QIS, but will not be before 1 January 2019.

I. Proposed principles on loss absorbing and recapitalization capacity of G-SIBs in resolution

1. **There must be sufficient loss absorbing and recapitalization capacity available in resolution to implement an orderly resolution that minimizes any impact on financial stability, ensures the continuity of critical functions, and avoids exposing taxpayers (that is, public funds) to loss with a high degree of confidence.**

   This is the main guiding principle from which the other principles flow. Liabilities that are not eligible as TLAC will still be subject to potential exposure to loss in resolution, in accordance with the applicable resolution law.

Calibration of the amount of TLAC required

2. **Authorities should determine a firm-specific Minimum Total Loss Absorbency Capacity (TLAC) requirement for each G-SIB which respects principles (3), (4), and 5)**

   In calibrating the individual requirement for specific firms, authorities will take into account the recovery and resolution plans of individual G-SIBs, their systemic footprint, business model, risk profile and organisational structure.

3. **Each G-SIB should be required to maintain Minimum TLAC that is at least equal to a common Pillar 1 floor agreed by the FSB.**

   A common Pillar 1 floor is necessary to help achieve a level playing field internationally and to ensure that there is market confidence that each G-SIB has a minimum amount of loss absorbing capacity that would be available to absorb losses and recapitalise in resolution.

4. **In setting Minimum TLAC, authorities should make appropriately prudent assumptions about losses incurred prior to resolution, as well as losses realized in the prudent valuation necessary to inform resolution actions.**

   The *Key Attributes* require that resolution action is taken at a sufficiently early point, if there is no reasonable prospect of recovery outside of resolution, with the aim of preserving value. Furthermore, the early intervention of supervisory authorities should moderate those losses. There could therefore be some positive net asset value at entry into resolution. But, balanced against this, experience shows that the valuation in resolution reveals losses that had not previously been realized, that the resolution may be followed by additional losses, and that overly-optimistic risk weightings may need to be revised upward.

5. **After the resolution transaction and to ensure continuity of critical functions, the entity or group of entities emerging from resolution must meet the conditions for authorization, including any consolidated capital requirements, and be sufficiently well capitalized to command market confidence.**

   Resolution is not resurrection. But nor is it insolvency: the institution or successor institution (e.g., bridge institution) has to meet at least the minimum conditions for authorization in order that supervisors may allow it to continue performing authorized activities, in particular critical functions. Moreover, the reorganization or solvent wind-down that will be necessary following resolution may require a level of capitalization above that required by supervisors so that counterparties continue to trade with the resolved firm and provide funding to it. Consideration of potential losses arising from post-resolution reorganization should also be made.

Ensuring the availability of TLAC for loss absorption and recapitalization in the resolution of cross-border groups

6. **Host authorities must have confidence that there is sufficient loss absorbing and recapitalization capacity available to subsidiaries in their jurisdictions with legal certainty at the point of entry into resolution.**

   Without such confidence, host authorities could demand extra resources to be ring-fenced in their own jurisdictions either ex ante or ex post in a resolution. The adverse consequences of such actions, including global fragmentation of the financial system, and disorderly resolutions of failed cross-border firms, should be avoided. To implement an orderly resolution, there must be sufficient flexibility to use loss absorbing capacity within a G-SIB where needed. This means that there will need to be a credible mechanism by which losses and recapitalization needs may be passed with legal certainty to the resolution entity or entities.

Determination of instruments eligible for inclusion in TLAC

7. **Exposing instruments eligible for Minimum TLAC to loss should be legally enforceable, and should not give rise to systemic risk or disruption to the provision of critical functions.**

   Given that TLAC-eligible liabilities will need to absorb losses and contribute to recapitalization needs in order for an orderly resolution to take place, there is a particular need to ensure that authorities possess the necessary legal powers to expose the TLAC-eligible liabilities to loss without significant risk of successful legal challenge or giving rise to compensation costs. Similarly, authorities must be confident that the holders of these instruments are able to absorb losses in a time of stress in the financial markets without spreading contagion and without necessitating the allocation of loss to liabilities where that would cause disruption to critical functions or significant financial instability. TLAC should not therefore include operational liabilities on which the performance of critical functions depends, and TLAC should be subordinated in some way to those operational liabilities.

8. **Liabilities that qualify as Minimum TLAC should be stable, long term claims that cannot be called at short or no notice.**

   Maturity restrictions on TLAC eligible liabilities are necessary to ensure that, if a firm's financial situation deteriorates, the loss absorbing capacity available in any subsequent resolution is not diminished through a withdrawal of funds. The risk of a sudden and unexpected breach of TLAC is therefore much reduced.

Interaction with regulatory capital requirements and consequence of breaches of TLAC

9. **Regulatory capital buffers must be usable without entry into resolution.**

   Firms must be allowed to utilize the buffers without entering resolution. The setting of a minimum TLAC requirement should not interfere with that.

10. **A breach or likely breach of Minimum TLAC should be treated as severely as a breach or likely breach of minimum capital requirements and addressed swiftly, to ensure that sufficient LAC is available in resolution.**

    If a firm exhausts its regulatory capital buffers and has breached or is likely to breach its minimum TLAC requirement, authorities should require the firm to take prompt action to address the breach or likely breach. Authorities must ensure that they intervene and place a firm into resolution sufficiently early if it is deemed to be failing or likely to fail and there is no reasonable prospect of recovery.

Transparency

11. **Investors, creditors, counterparties, customers and depositors should have clarity about the order in which they will absorb losses in resolution.**

    This requires disclosure of information on the hierarchy of liabilities on a legal entity basis for, at a minimum, all material legal entities, so that there is as much clarity as possible ex-ante about how losses are absorbed and by whom and in which order. The subordination of eligible TLAC to operational liabilities (Principle 7) helps to ensure that there is increased certainty over the order in which liabilities absorb losses in resolution.

Limitation of contagion

12. **Authorities should place appropriate prudential restrictions on G-SIBs' and other internationally active banks' holdings of liabilities eligible to meet the Minimum TLAC requirement.**

    To reduce the potential for a G-SIB resolution to spread contagion into the global banking system, it will be important to strongly disincentivise internationally active banks from holding TLAC issued by G-SIBs.

Review

13. **The calibration and composition of firm-specific TLAC requirements should be subject to review in the FSB Resolvability Assessment Process.**

    The objective of the RAP is to promote adequate and consistent reporting on the resolvability of each G-SIFI, and help determine what should be done to address material recurring issues with respect to resolvability. As TLAC is a key element of ensuring resolvability for G-SIBs, it should be captured in the RAP. In particular, the RAP should assess extent to which the calibration and composition of firm-specific TLAC requirements, including internal TLAC arrangements, and transparency in the order of loss absorption in insolvency and resolution, promote confidence amongst home and host authorities, creditors and other stakeholders that effective resolution arrangements are in place for all G-SIBs.

II. Proposed Total Loss Absorbency Capacity (TLAC) term sheet

1. SCOPE OF COVERED FIRMS	Global systemically important banks (G-SIBs).
2. MINIMUM EXTERNAL TLAC REQUIREMENT	G-SIBs will be required to meet a new requirement for Minimum External Total Loss Absorbency Capacity ("Minimum TLAC") alongside minimum regulatory capital requirements. This firm-specific minimum requirement will comprise a Pillar 1 and Pillar 2 element, and be set in accordance with this term sheet. The Minimum TLAC requirement will be applied to each resolution entity within each G-SIB. A resolution entity is the entity or entities to which resolution tools will be applied in accordance with the resolution strategy for the G-SIB. Depending on the resolution strategy, resolution entities may be parent or subsidiary operating companies, or ultimate or intermediate holding companies. The Minimum TLAC requirement will be set in relation to the consolidated balance sheet of each resolution group. The resolution group is the group of entities that includes a single resolution entity and any direct or indirect subsidiaries of the resolution entity which are not themselves resolution entities or subsidiaries of other resolution entities. All subsidiaries form part of a resolution group. A G-SIB's aggregate Minimum TLAC requirement should be invariant to whether it has one or more than one resolution entities.
3. OBJECTIVE	The objective of the Minimum TLAC requirement is to ensure that G-SIBs have the loss absorbing and recapitalization capacity necessary to help ensure that, in and immediately following a resolution, critical functions can be continued without taxpayers' funds (public funds) or financial stability being put at risk.
4. COMMON PILLAR 1 FLOOR FOR MINIMUM EXTERNAL TLAC REQUIREMENTS	A comprehensive Quantitative Impact Study and cost benefit analysis will be used to inform the determination of the Pillar 1 element of the common Minimum TLAC requirement for all G-SIBs. The Pillar 1 common Minimum TLAC requirement will be 16% - 20% of the resolution group's RWAs. This does not include any applicable regulatory capital buffers. Authorities may set additional Pillar 2 requirements above the common minimum. A resolution entity in a G-SIB with a 1% G-SIB surcharge would therefore need to maintain overall TLAC, including combined capital buffers, of at least 19.5% - 23.5% of the RWAs of the resolution group and a resolution entity in a G-SIB with a 2.5% G-SIB surcharge would need to maintain TLAC, including combined capital buffers, of at least 21% - 25% of RWAs, assuming that all applicable countercyclical buffers were set to zero and that no other buffers applied.

	The Pillar 1 Minimum TLAC requirement must also be at least twice the quantum of capital required to meet the relevant Tier 1 leverage ratio requirement – that is, if the Basel 3 leverage ratio were set at 3% for G-SIBs, at least 6% of the Basel 3 leverage ratio denominator.
5. G-SIBS THAT ARE HEADQUARTERED IN EMERGING MARKETS	G-SIBs that are headquartered in emerging markets will not, initially, be subject to the Common Pillar 1 Minimum TLAC requirement.
6. PRINCIPLES FOR DETERMINING ADDITIONAL PILLAR 2 FIRM-SPECIFIC MINIMUM EXTERNAL TLAC REQUIREMENTS	Authorities which are home to resolution entities, in discussion with Crisis Management Groups and validated through the Resolvability Assessment Process, should determine the size of a Pillar 2 component of the specific Minimum TLAC requirement for each G-SIB resolution entity in accordance with the principle that there must be sufficient LAC available in resolution to implement an orderly resolution, minimize the impact on financial stability, ensure the continuity of critical functions, and avoid exposing taxpayers' funds to loss with a high degree of confidence. The amount and distribution of LAC within a G-SIB should also be sufficient to facilitate an orderly resolution and incentivize home-host co-operation (see below).
7. RELATIONSHIP WITH CAPITAL REQUIREMENTS	Minimum TLAC is an additional requirement to minimum regulatory capital requirements set out in the Basel 3 framework. Items that count towards satisfying minimum regulatory capital requirements may also count towards satisfying the minimum TLAC requirement. Only CET1 in excess of that required to satisfy minimum regulatory capital requirements and Minimum TLAC requirements may count towards regulatory capital buffers. If debt that matures or no longer qualifies as TLAC is not replaced, a G-SIB may breach its buffer requirements in the same way that it may breach its buffer requirements if maturing Tier 2 instruments that count towards the Basel III Total Capital requirement are not replaced. For the duration of the breach of the buffer requirement, the automatic restrictions specified in Basel III would apply. The G-SIB may choose to issue additional regulatory capital instruments or other TLAC-eligible debt to address this breach. This exactly mirrors the treatment of a breach of buffer requirements due to Tier 2 instruments maturing and not being replaced. In addition, to help ensure that a failed G-SIB has sufficient outstanding long-term debt for absorbing losses and/or effecting a recapitalization in resolution, there is an expectation that the sum of a G-SIB's resolution entity or entities' (i) tier 1 and tier 2 capital instruments in the form of debt plus (ii) other eligible TLAC that is not regulatory capital, is equal to or greater than 33% of their Minimum TLAC requirements.

	A breach, or likely breach, of the Minimum TLAC requirement should ordinarily be treated by supervisory and resolution authorities as seriously as a breach, or likely breach, of minimum regulatory capital requirements.
8. INSTRUMENTS ELIGIBLE FOR INCLUSION IN EXTERNAL TLAC	The core features set out below apply at least to the liabilities that count towards satisfying the common Pillar 1 minimum requirement for Minimum TLAC. They do not necessarily apply to liabilities that count towards the Pillar 2 element of the requirement. Liabilities not included in TLAC remain subject to potential exposure to loss in resolution, in accordance with the applicable resolution law. Credible ex-ante commitments to recapitalise a G-SIB in resolution as necessary to facilitate an orderly resolution and, in particular, to provide continuity of the firm's critical functions, from those authorities which may be required to contribute both to resolution funding costs (to cover losses and meet recapitalisation needs) and temporary resolution funding may count towards a firm's Pillar 1 Minimum TLAC, subject to the agreement of the relevant authorities, and so long as there are no legal impediments to so doing, including that there is no requirement that senior creditors are exposed to loss when such a contribution is made, and that there is no particular limit specified in law in respect of the amount which may be contributed. Such commitments must be pre-funded by industry contributions and may account for an amount equivalent to 2.5% RWA or more if the final calibration of the common Pillar 1 Minimum TLAC requirement exceeds 16% RWA] of the resolution group's Pillar 1 Minimum TLAC requirement.
9. Issuer	External TLAC should be issued and maintained[10] by resolution entities. All regulatory capital instruments issued by the resolution entity or resolution entities of a firm and held by third parties are eligible to satisfy Minimum TLAC requirements. Regulatory capital instruments issued by entities other than the resolution entity within a resolution group and held by persons outside of the G-SIB's group may count toward the resolution entity's Minimum TLAC requirement only to the extent that they are recognized as Tier 1 or Tier 2 capital instruments for the purpose of consolidated capital requirements applicable to the resolution entity, under the rules set out in paragraphs 62 to 64 of the Basel III framework[11], and with the agreement of the relevant home and host authorities that such instruments can be exposed to loss at the point of non-viability of the subsidiary, without applying resolution tools to the subsidiary.

[10] This would include, for example, retained earnings attributable to holders of CET1 issued by the resolution entity.

[11] Basel III: A global regulatory framework for more resilient banks and banking systems (www.bis.org/publ/bcbs189.pdf) and point of non-viability (PON) press release of 13 January 2011 (www.bis.org/press/p110113.htm).

	Home and host authorities must ensure that the conversion of capital issued from material subsidiaries would not result in a change of control of the material subsidiary that would be inconsistent with the agreed resolution strategy.
10. Security	Eligible external TLAC must be unsecured.
11. Minimum Maturity	Eligible external TLAC must have a minimum remaining maturity of at least one year. In addition, the appropriate authority should ensure that the maturity profile of a G-SIB's TLAC liabilities is adequate to ensure that its TLAC position can be maintained should the G-SIB's access to capital markets be temporarily impaired.
12. Excluded liabilities	Eligible external TLAC must not include: a. insured deposits; b. any liability that is callable on demand without supervisory approval; c. liabilities that are funded directly by the issuer or a related party of the issuer, except where the relevant home and host authorities in the CMG agree that it is consistent with the resolution strategy to count eligible liabilities issued to a parent of a resolution entity towards external TLAC; d. liabilities arising from derivatives or debt instruments with derivative-linked features, such as structured notes; e. liabilities arising other than through a contract, such as tax liabilities; f. liabilities which are preferred to normal senior unsecured creditors under the relevant insolvency law; or g. any other liabilities that, under the laws governing the issuing entity, cannot be effectively written down or converted into equity by the relevant resolution authority.
13. Priority	Eligible external TLAC must absorb losses prior to excluded liabilities in insolvency or in resolution without giving rise to material risk of successful legal challenge or compensation claims; and authorities must ensure that this is transparent to creditors (see Section 24 for requirements for disclosure). In all cases, the risk of successful legal challenge or valid compensation claims, and the transparency of the order in which creditors can expect to bear losses in insolvency or in resolution, is subject to review in the FSB Resolvability Assessment Process.

	To ensure that eligible external TLAC absorbs losses as described in the preceding paragraph, it must be: a. contractually subordinated to all excluded liabilities on the balance sheet of the resolution entity. They may, however, rank senior to capital instruments, including Tier 2 subordinated debt, in the insolvency creditor hierarchy; or b. junior in the statutory creditor hierarchy to all excluded liabilities on the balance sheet of the resolution entity; or c. issued by a resolution entity which does not have excluded liabilities on its balance sheet (for example, a holding company) so that TLAC eligible liabilities are not pari passu or senior to any excluded liabilities. Therefore, there is no need for the TLAC issued from such a resolution entity itself to be contractually or statutorily subordinated. The requirement specified in the preceding paragraph of this Section 13 may not apply in those jurisdictions in which all liabilities excluded from TLAC specified in Section 12 are statutorily excluded from the scope of the bail-in tool and therefore cannot legally be written down or converted to equity in a bail-in resolution. In this case, liabilities that rank alongside them and are included in scope of the bail-in tool and meet the eligibility criteria for TLAC would in fact be able to absorb losses in resolution and qualify for TLAC. If this option is used, authorities must ensure that this would not give rise to material risk of successful legal challenge or valid compensation claims, and that the terms of the TLAC eligible liabilities specify that they are subject to bail-in. In those jurisdictions where the resolution authority may, under exceptional circumstances specified in the applicable resolution law, exclude or partially exclude from bail-in all of the liabilities excluded from TLAC specified in Section 12, the relevant authorities may permit liabilities that would otherwise be eligible to count as external TLAC but which rank alongside those excluded liabilities in the insolvency creditor hierarchy to contribute a quantum equivalent of up to 2.5% RWA or more if the final calibration of the common Pillar 1 Minimum TLAC requirement exceeds 16% RWA of the resolution entity's Pillar 1 Minimum TLAC requirement. If this option is used, authorities must ensure that the capacity to exclude or partially exclude liabilities from bail-in would not give rise to material risk of successful legal challenge or valid compensation claims.
14. Set-off / netting	To the extent that instruments count towards eligible external TLAC, they must not be subject to set off or netting rights that would undermine their loss-absorbing capacity in resolution.
15. Redemption Restrictions	G-SIBs are prohibited from redeeming eligible external TLAC without supervisory approval, except when replacing eligible TLAC with liabilities of

	the same or better quality and the replacement of liabilities is done at conditions which are sustainable for the income capacity of the bank.
16. Governing Law	Eligible external TLAC must be subject to the law of the jurisdiction in which the relevant resolution entity is incorporated, or if subject to the law of another jurisdiction, must include legally enforceable contractual provisions recognizing the application of resolution tools by the relevant resolution authority if the resolution entity enters resolution, unless there is equivalent binding statutory provision for cross-border recognition of resolution actions.
17. Triggers (for externally issued TLAC)	Eligible TLAC should contain a contractual trigger or be subject to a statutory mechanism which permits the relevant resolution authority to expose TLAC to loss or convert to equity in resolution.
18. REGULATION OF INVESTORS	In order to reduce the risk of contagion, G-SIBs must deduct from their own TLAC or regulatory capital exposures to eligible external TLAC liabilities issued by other G-SIBs in a manner generally parallel to the existing provisions in Basel 3 that require a bank to deduct from its own regulatory capital certain investments in the regulatory capital of other banks. The Basel Committee should further specify this provision, including a prudential treatment for non-G-SIBs.
19. CONFORMANCE PERIOD	Firms that are G-SIBs at the time of issuance of a final TLAC standard by the FSB would be required to comply by [TBD following a QIS, but in any event no earlier than 1 January 2019]. Firms' TLAC positions will be disclosed and monitored at an earlier date. Firms that subsequently become G-SIBs would have [12 - - 36] months] to comply with the FSB TLAC standard following the date on which they become G-SIBs. A G-SIB that fails and enters resolution, or its successor bridge entity, would have [12 months or 24 months] to come back into compliance with the FSB TLAC standard following the date on which it exits resolution, if it is still determined by the FSB to be a G-SIB. Authorities should, as a last resort alternative to resolution, allow a firm to come to a voluntary agreement with its creditors to convert liabilities to equity and so recapitalise the firm outside of resolution. In such circumstances, firms would also be allowed [12 months or 24 months] to comply again with the FSB TLAC standard.
20. INTERNAL TLAC	The following provisions on internal TLAC are designed to ensure the appropriate distribution of TLAC to material subsidiaries by G-SIB resolution entities, in order to facilitate co-operation between home and host authorities and implementation of cross-border resolution strategies that are feasible and

	credible. The proceeds of external TLAC committed to material subsidiaries is referred to as Internal TLAC. Each of a G-SIB's resolution entities must maintain sufficient externally issued TLAC-eligible instruments to cover its Minimum TLAC requirement, which is to be set in relation to the consolidated balance sheet of the relevant resolution group, as set out in Section 2. Each material subsidiary of a G-SIB that is not a resolution entity should meet an internal TLAC requirement by maintaining a minimum amount of eligible internal TLAC (see below). This ensures that losses and recapitalization needs from material subsidiaries that are not themselves resolution entities can be passed to a resolution entity without the need for statutory resolution tools to be applied directly to such subsidiaries. Tier 1 and Tier 2 regulatory capital instruments issued <u>externally</u> by a material subsidiary may count toward that material subsidiary's internal TLAC requirement, but only to the extent that: a. the relevant host authority can expose them to loss, or convert them to equity at the point of non-viability, without applying resolution tools to the subsidiary; and b. they are recognized as Tier 1 or Tier 2 capital instruments for the purpose of consolidated capital requirements applicable at the level of the resolution entity, under the rules set out in paragraphs 62 to 64 of the Basel III framework. c. Home and host authorities agree that the quantum of externally issued regulatory capital does not pose a "change of control" risk in resolution that would be inconsistent with the agreed resolution strategy. These principles do not limit a host authority's legal power to impose external or internal TLAC requirements on a material or non-material subsidiary. In so doing, host authorities should take due account of TLAC requirements applied to similar firms within their jurisdictions. Branches are not subject to internal TLAC requirements separate from any external or internal TLAC requirement applied to the legal entity of which they are a part.
21. Material Subsidiaries	A regulated operating entity within a G-SIB that is not a resolution entity should normally be defined as a material subsidiary, and therefore be subject to an internal TLAC requirement, if the subsidiary is an entity incorporated in a national jurisdiction other than that in which the resolution entity is incorporated, and it meets at least one of the below criteria: a. has more than 5% of the consolidated risk-weighted assets of the G-SIB group; or generates more than 5% of the consolidated revenues of the G-SIB group; or

	c. has a total leverage exposure measure larger than 5% of the G-SIB group's total leverage exposure measure; or d. has been identified by the firm's CMG as material to the exercise of the firm's critical functions. The list of material subsidiaries should be reviewed and, if necessary, revised by the CMG on an annual basis. The criteria above relate only to material subsidiaries which are not resolution entities. The resolution strategy may determine that subsidiaries are resolution entities irrespective of whether they meet the above criteria. The internal TLAC requirements do not apply to resolution entities, including those which would meet the above criteria.
22. Size of the Internal TLAC Requirement	TLAC generally should be distributed as necessary within resolution groups in proportion to the size and risk of material subsidiaries' exposures. Each material subsidiary must maintain internal TLAC of 75% to 90% - the range will be reviewed in the QIS and the actual figure within that range would be determined by the relevant host authority in consultation with the home authority] of the external Pillar 1 Minimum TLAC requirement that would apply to the material subsidiary if it were a resolution entity, as calculated by the host authority. Unless otherwise agreed between home and relevant host authorities, this amount of internal TLAC must be pre-positioned on-balance sheet and should be sufficient at this level to facilitate effective cross-border resolution strategies for G-SIB resolution groups. The resolution entity should ensure that TLAC that is not pre-positioned would be readily available to recapitalise subsidiaries as necessary to support the execution of the resolution strategy. Authorities should ensure that there are no legal or operational barriers to this. To avoid "double gearing", the resolution entity should issue and maintain at least as much external TLAC as the sum of internal TLAC, which it has provided or committed to provide, and any TLAC held against risks on the resolution entity's own balance sheet. However, external TLAC may be lower if and to the extent this is due to consolidation effects only.
23. Core Features of Eligible Internal TLAC	The core features of eligible internal TLAC are the same as the core features set out above for eligible external TLAC (except with regard to the issuing entity and permitted holders), including that internal TLAC instruments are subordinated to liabilities excluded from eligible external TLAC. Internal TLAC that comprises regulatory capital instruments must comply with the relevant provisions of Basel 3, including those in relation to write down and conversion at the point of non-viability. Internal TLAC must be subject to write down and / or conversion to equity by the relevant host authority at the point of non-viability, as determined by the host authority in line with the relevant legal framework, without applying resolution tools to the subsidiary.

	Any write-down or conversion to equity of internal TLAC is subject to consent from the relevant authority in the jurisdiction of the relevant resolution entity, except where Basel 3 provides that such consent is not required. This would not preclude the host authority from subjecting internal TLAC to its own resolution bail-in or other resolution powers should the consent of the home authority not be forthcoming. Home and relevant host authorities in CMGs may jointly agree to substitute on-balance sheet internal TLAC with internal TLAC in the form of collateralized guarantees, subject to the following conditions: • the guarantee is provided for at least the equivalent amount as the internal TLAC for which it substitutes; • the collateral backing the guarantee is, following appropriately conservative haircuts, sufficient fully to cover the amount guaranteed; • the guarantee is drafted in such a way that it does not affect the subsidiaries' other capital instruments, such as minority interests, from absorbing losses as required by Basel 3; • the collateral backing the guarantee is unencumbered and in particular is not used as collateral to back any other guarantee; • the collateral has an effective maturity that fulfils the same maturity condition as that for external TLAC; and • there should be no legal, regulatory or operational barriers to the transfer of the collateral from the resolution entity to the relevant material subsidiary.
24. PUBLIC DISCLOSURE BY G-SIBS OF THEIR ELIGIBLE TLAC	G-SIBs must disclose the amount, maturity, and composition of TLAC maintained by each resolution entity and at each material subsidiary. G-SIBs must also disclose, at a minimum, the amount, nature, and maturity of any liabilities of each resolution entity which in the relevant insolvency creditor hierarchy rank pari-passu or junior to liabilities which qualify for inclusion in Minimum TLAC. Material subsidiaries that are not themselves resolution entities need to disclose any liabilities which rank pari-passu with or junior to internal TLAC. The FSB will work with the BCBS to carry out further work to specify the disclosure requirements.