Vulcan Insight: EU Banking Proposals – TLAC

Monday 28th November 2016

Key Dates

28th Nov 2016	Basel Committee on Banking Supervision meeting
29th Nov 2016	Basel Committee on Banking Supervision meeting
5th Dec 2016	Eurogroup Finance Ministers Meeting
6th Dec 2016	ECOFIN Finance Ministers Meeting
8th Dec 2016	Governing Council of the ECB: monetary policy meeting followed by press conference
9th Jan 2017	Governors of the Bank for International Settlements to affirm Basel committee decision
10th Jan 2017	Governors of the Bank for International Settlements to affirm Basel committee decision
12th Jan 2017	ECON Parliamentary Committee Meeting
25th Jan 2017	ECON Parliamentary Committee Meeting

Key Analysis

On the 23rd of November 2016, the EU Commission proposed legislation which would amend four separate pieces of existing EU legislation.

- The Capital Requirements Regulation (CRR)
- the Capital Requirements Directive (CRD)
- The Bank Recovery and Resolution Directive (BRRD)
- the Single Resolution Mechanism Regulation (SRMR)

Some of the key proposed changes, which have courted controversy and opposition from Italy and France, concerns how the EU Commission propose to introduce the 'Total Loss-Absorbing Capacity' or TLAC) into EU law.[1]

[1] https://www.ft.com/content/bccb2e6e-b169-11e6-a37c-f4a01f1b0fa1

TLAC shall only apply for European ‘Global Systemically Important Institutions’ (G-SIIs) which as of November 2016 are[2]:

Austria	ERSTE GROUP
Belgium	KBC
Denmark	DANSKE BANK
	NYKREDIT
France	BANQUE POSTALE
	BNP PARIBAS*
	CREDIT AGRICOLE*
	BPCE*
	CREDIT MUTUEL
	SOCIETE GENERALE*
Germany	BAYERN LB
	COMMERZBANK
	DEUTSCHE BANK*
	DZ BANK
	LBBW
	NORDLB
Italy	INTESA SANPAOLO
	UNICREDIT*
Netherlands	ABN AMRO
	ING*
	RABOBANK
Norway	DNB
Spain	SANTANDER*
	BBVA
	LA CAIXA
	BFA
Sweden	NORDEA*
	SEB
	HANDELSBANKEN
	SWEDBANK
UK	BARCLAYS*
	HSBC*
	LLOYDS
	NATIONWIDE
	RBS*
	STANDARD CHARTERED*

[2] http://www.fsb.org/wp-content/uploads/2016-list-of-global-systemically-important-banks-G-SIBs.pdf

The proposals are a follow on from the 9th November 2015 Financial Stability Board meeting which issued "the final Total Loss-Absorbing Capacity (TLAC) standard for global systemically important banks (G-SIBs)". [3]

> "The TLAC standard has been designed so that failing G-SIBs will have sufficient loss-absorbing and recapitalisation capacity available in resolution for authorities to implement an orderly resolution that minimises impacts on financial stability, maintains the continuity of critical functions, and avoids exposing public funds to loss.[4]

On the 17th of June 2016, the Council of the Economic and Financial Affairs of the EU (EU Finance Ministers Meeting), published their conclusion:

> "UNDERLINES the importance of the work being carried out by several institutions at Banking Union, EU28 and international level, in particular work by the Commission to:
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> a) propose amendments to the legislative framework in view of implementing the Total Loss Absorbing Capacity (TLAC) standard and reviewing the minimum requirement for own funds and eligible liabilities (MREL). The Council will seek to ensure consistent rules and adequate amounts for the bail-inable buffers that contribute to an efficient and orderly resolution process in line with BRRD for all credit institutions for which bail-in would be the validated resolution strategy."[5]

Under the EU Commission proposals, resolution authorities (Central Banks and National Regulators) could be able to require that the G-SIIs, different to the smaller banks within Europe, hold additional capital if it can be established that it is "duly justified, necessary and proportionate".[6] Italy and France favoured a regime that did not impose greater potential capital requirements that would differentiate between large and small as well as global standards on TLAC.

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[3] http://www.fsb.org/wp-content/uploads/20151106-TLAC-Press-Release.pdf
[4] http://www.fsb.org/wp-content/uploads/20151106-TLAC-Press-Release.pdf
[5] http://www.consilium.europa.eu/press-releases-pdf/2016/6/47244642837_en.pdf
[6] http://europa.eu/rapid/press-release_MEMO-16-3840_en.htm

The proposal also includes the requirement "for establishing an intermediate EU parent undertaking where two or more institutions established in the EU have the same ultimate parent undertaking in a third country."

> "The requirement will apply only to third-country groups that are identified as non-EU G-SIIs or that have entities on the EU territory with total assets of at least EUR 30 billion (the assets of both subsidiaries and branches of those third-country groups will be taken into account in the calculation)."[7]

It has been reported that this change would "force US investment banks such as Goldman Sachs and JPMorgan to have additional capital and liquidity in the EU".[8] EU Ministers of Finance and the European Parliament will ultimately have to agree with the final version of the proposals which could see significant lobbying from Member States and industry alike. The deadline for the international rules on TLAC to become law is the end of 2018 to be applied in 2019.[9]

Today and tomorrows' meetings of the Basel Committee on Banking Supervision will provide the first indication of potential fissures developing between the EU and the US on this all important decision making body concerning revisions to BASEL III. It will not have gone unnoticed that the EU decided to propose the changes for US investment banks operating in Europe just a few days in advance of this meeting to settle the proposed revisions to BASEL III.

The key division between the EU and the US is whether Banks can use their internal risk models to determine how much capital they should set aside for certain type of lending or securities (EU favour this position), or whether a standardised model set by regulators should be adopted (US favour this position).[10]

In advance of the meeting, on Friday the 25th of November 2016, the European Banking Federation (represents all the major Banks in Europe) released a lengthy joint statement in effect asking the EU not to accept the proposed revisions.

[7] http://europa.eu/rapid/press-release_MEMO-16-3840_en.htm
[8] https://www.ft.com/content/26078750-b003-11e6-a37c-f4a01f1b0fa1
[9] http://europa.eu/rapid/press-release_MEMO-16-3840_en.htm
[10] https://www.ft.com/content/15e6e51a-a279-11e6-82c3-4351ce86813f

> "Addressing the upcoming talks in the Basel Committee on Banking Supervision (BCBS), the Board called on the committee to respect the G20 mandate for additional capital requirements, which should not have a significant impact in any region, including Europe. EBF members also invited the committee to respect the global playing field in banking by considering the variety of banking models in Europe."[11]

At the same time, in an unusual step for EU regulation of banking, it expressed its support for the EU Commission proposed changes published on the 23rd of November 2016.

> "The Board took note of the EU Banking Reform package presented earlier this week by the European Commission and underlined that this shows that EU now is close to completing its implementation of the G20 global reform agenda. The package appears to comfort banks with a regulatory framework conducive to growth in the EU." [12]

The European Banking Authority, who will have ultimate responsibility for drawing up the rules that are agreed in revising Basel III, in a previously published report on the 4th of November 2016 have already suggested some recommendations which will undoubtedly have been advocated by the ECB at the Basel meetings. The EBA is recommending:

I. increasing the threshold value for small trading book business below which firms would be able to use the non-trading book approach to calculate capital requirements (proposed as EUR50 million);
II. introducing a proposed EUR20 million threshold for small derivative businesses below which firms would be allowed to use simple approaches currently used to calculate CCR capital requirements, subject to recalibration;
III. proportionality approaches for smaller banks;
IV. implementing technical requirements through delegated acts or Technical Standards so that the EBA can assess key changes in the regulation timeously; and

[11] http://www.ebf-fbe.eu/wp-content/uploads/2016/11/EBF_024369-Board-Communique-Brussels-November-2016.pdf
[12] http://www.ebf-fbe.eu/wp-content/uploads/2016/11/EBF_024369-Board-Communique-Brussels-November-2016.pdf

V. requiring more granular reporting so that regulators can obtain a better overview of firms' CCR (exposure value of derivatives) exposures and monitor the appropriateness of the different proportionality thresholds."[13]

These proposals have not been sufficient to stave off concerns from European Banks that increased capital requirements shall be caused by the outcome of the meetings being held today and tomorrow. Germany have already indicated their approval of the EU Banking proposed changes[14], which included the introduction of proportionality seen as a measure to assist its Landesbanken, but they remain resolute in their opposition to the changes being discussed at today and tomorrow's meeting on Basel III.

Ultimately, should major divisions emerge at today and tomorrows meetings where a compromise cannot be arrived at, it will increase uncertainty about the international regulatory rules on Banking that have been in place for over 40 years. It will also contribute to capital market expectation of a deeper fragmentation between the European and US banking industry, and signs of a slowdown in regulatory convergence.

[13] http://www.eba.europa.eu/documents/10180/1648752/Report+on+SA+CCR+and+FRTB+implementation+%28EBA-Op-2016-19%29.pdf

[14] http://www.reuters.com/article/eu-banks-regulations-germany-idUSB4N1CG004