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Flash: FSB Issues Tough TLAC Proposal

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On Nov 10, the Financial Stability Board (FSB) proposed a set of principles as well as a term sheet for a new international minimum "total loss absorbency requirement" for a systemic banks. We believe it is even stronger than previously believed, and if finalized without changes could have a significant impact on capital redistribution over the next several years.

From our quick review, here are some of the key provisions:

- **Required TLAC Minimums**: All systemic banks must hold at least 16 to 20% of their risk-weighted assets as well as two times the 3% leverage ratio.
- **Qualifying Capital**: Tier 1 common equity is eligible, but not if it is used to meet the capital buffer requirements under the Basel III minimums. Unsecured debt also generally is eligible, but it must have at least a one-year of maturity remaining and can not be easily subject to recall.
- **Material Subsidiary**: All material subsidiaries must have pre-positioned debt equivalent to 75-90% of the TLAC requirement that would apply if it were a SIFI in its own right.
- **Capital Restructuring**: The proposal assumes that a significant amount of capital issuance will be required to meet the new standards and that "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)."
- **Limitations on Cross Ownership**: To avoid contagion risk, the proposal would not let otherwise eligible debt count toward their TLAC requirement if the holder is another SIFI bank.

The proposal states that TLAC minimums should be set on a firm-specific basis, and lists a number of conditions under which national regulators should impose even higher requirements on a "Pillar 2" basis.

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After a quantitative impact study, the FSB will adjust the calibration of the total and subsidiary (internal) minimum TLAC requirements by the end of 2015. Regulators will also test the level of expected investor appetite for such debt and perform a cost-benefit analysis.

Banks will have at least until 2019 to comply, but the exact effective date will be set after the results of the quantitative impact study are reviewed.

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