

A. Introduction

Deutsche Börse Group (DBG) welcomes the opportunity to comment on BCBS consultative document “TLAC Holding” issued in November 2015.

DBG is operating in the area of financial markets along the complete chain of trading, clearing, settlement and custody for securities, derivatives and other financial instruments and as such mainly active with regulated Financial Market Infrastructure providers.

Among others, Clearstream Banking S.A. (CBL), Luxembourg and Clearstream Banking AG (CBF), Frankfurt/Main, who act as (I)CSD¹ as well as Eurex Clearing AG (ECAG) as the leading European Central Counterparty (CCP), are classified as credit institutions and are therefore within the scope of the European Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR) which transposed i.a. the Basel III rules into European law. Clearstream subgroup is supervised on a consolidated level as a financial holding group.

However, all our group entities in scope of CRD/CRR and therefore Basel III rules are offering limited banking activities ancillary to their function as Financial Market Infrastructure (FMI). In order to operate as a FMI, in line with the dedicated regulatory framework (e.g. CPSS-IOSCO principles for financial market infrastructures as of April 2012²) as well as generally recognised business practices the business models of our group entities are risk averse.

In this context, it needs to be noted that both CSDs and CCPs are regulated primarily under the rules for financial market infrastructures such as in the EU EMIR³ as well as (in the future) the CSD-Regulation⁴ based on the CPSS-IOSCO principles for financial market infrastructures. The banking services both kinds of FMIs are offering (as in the case of our group’s entities) are only ancillary to their functions as intermediaries to stabilise the financial markets. As such, cash positions resulting from its operations dominate the balance sheet and these are mainly driven by short-term

¹ (International) Central Securities Depository

² CPSS-IOSCO No 101 – Principles for financial market infrastructures, published in April 2012;

³ Regulation (EU) 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories (known as EMIR - European Market Infrastructure Regulation), published on 4 July 2012;

⁴ Regulation (EU) No 909/2014 of the European Parliament and of the Council, published on 23 July 2014.

cash liabilities. These are deposited cash collaterals (margins), cash contributions to the default funds, other cash deposits out of the CCP business and cash deposits for settlement or custody purposes respectively.

So far, none of our group entities is classified as G-SIB, D-SIB or O-SIB. Nevertheless, due to the functions (FMI services) DBG group entities provide to the financial community and the financial markets as a whole, those group entities are classified as systemically important FMIs and a classification as SIB in the future may occur.

Based on that and following the FSB framework the TLAC concept is not applicable as such for our regulated entities. Nevertheless, in the European Union regulators enrolled already a TLAC like concept MREL (Minimum requirements on eligible liabilities) via the BRRD (Banking and Recovery Resolution Directive) to all banks. Consequently our institutions are affected by TLAC although they are not classified as G-SIBs. Albeit the current consultation is on TLAC holdings only, it cannot be commented without also commenting certain parts of the TLAC concept itself. Both, the TLAC concept and the possible treatment of TLAC holdings are forming once more an additional piece of the banking framework which is discussed on a stand alone basis and which is further gearing up the capital requirements without analysing the cumulative impacts of the various measures on banks, the financial markets as a whole, the real economy and the possibility to grant loans to the public. We continue to urge the Committee to come up with a consultation on the comprehensive revised Framework (“Basel IV”) and subsequent sufficient quantitative impact analysis on the combined effects in all dimensions (capital, liquidity, concentration risk, etc.).

The document at hand contains a management summary in part B and specific comments in part C.

B. Management Summary

With the introduction of TLAC the funding needed to maintain the systemically important business of internationally active banks in case of a necessary resolution must be maintained in advance. This capital needed might consist of regulatory capital or (to the extent above minimum capital requirements) eligible liabilities that might be bailed-in in resolution. Eligibility of liabilities is limited to such instruments which have a remaining maturity of at least one year.

We continue to have strong concerns on the concept as such and many of its details. However, this is not the content of the consultation on hand and we therefore are reflecting in this documents only those elements which we see critical in the context of TLAC holdings.⁵ **Having said this, we nevertheless once more want to stress our strong concern against the levels of TLAC as set by the FSB and now taken up by the BCBS. A level of 18% RWA prior to any additional buffer requirement is more than over-prudent!**

Beside our criticism raised so far on several elements of TLAC we in particular do not agree to the exclusion of TLAC liabilities instruments funded by related parties⁶. We urge the BCBS to change the TLAC concept in cooperation with the FSB in this regards. Excluding related party funding via eligible liabilities but allowing such funding via equity instruments does not seem to be an appropriate treatment.

Within prudentially regulated groups similar treatment as equity seems to be more appropriate: Including in TLAC (no equity instrument if criteria are not met) on the single institution level but full deduction on the level of the holding institution and on a consolidated level it is consolidated out anyway.

We cannot agree that TLAC liabilities held by related parties which do not form part of the regulated group (a) should be less reliable than any TLAC holding by third parties, (b) should be treated worse than equity and (c) should push the shareholder to

⁵ We refer in this regards to our consultation comments on TLAC https://deutsche-boerse.com/dbg/dispatch/de/binary/gdb_content_pool/imported_files/public_files/10_downloads/11_about_us/Public_Affairs/Position_paper/DBG_TLAC_FSB_Feb2015.pdf and MREL

https://www.eba.europa.eu/documents/ddm/com.liferay.portlet.dynamicdatalists.model.DDLRecord/993682/view_uploadFiles

⁶ See point 9 <http://www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf>

accept potential (minor) third party investors in case of a resolution while having sufficient financial powers even in such situation to fund itself and also be in the position to prefund with eligible liabilities.

It is the pre-funding that matters, not the pre-funder.

The current treatment as laid down by FSB is heavily interfering into the financing / funding structures of well capitalised institutions / groups of related companies without demonstrating the resulting benefits. **This is neither risk sensitive nor simple nor comparable over time nor providing stability and adequate investor protection.**

Imposing the targeted TLAC levels of the total of own funds plus eligible liabilities might be – despite our general concerns – adequate for regular banks, their business model and balance sheet structure and especially for G-SIBs. Nevertheless at least for dedicated business models like that of FMIs operating under a banking license for their dedicated ancillary business the concept of TLAC is not appropriate.

FMIs operating with a banking licence do not issue TLAC liabilities in the current business models. In the TLAC QIS of the BCBS⁷ it is confirmed that even several G-SIBs reported that they do not have any non-regulatory capital instruments that count as TLAC instruments. In the current framework those banks must achieve their complete TLAC requirements with regulatory capital instruments only.

The introduction of TLAC for G-SIBs and the proposed TLAC holdings are adding further elements to the Basel Banking framework. The BCBS is currently reviewing more or less all elements of the Basel III framework. However, instead of proposing a revised framework currently only bits and pieces are issued for consultation or even put in place without integrating them and without analysing the cumulative and gearing up effects on capital needs of the various elements. In this context we do want to point out:

- The BCBS strengthened the capital framework and the overall ruleset for banks already with the introduction of the Basel III framework. The BCBS is performing or has finalised a variety of reviews with regard to capital regimes, e.g. fundamental review of the trading book, revision to the Standardised Approach for credit risk, capital floors, revisions to the securitisation framework, operational risk requirements, interest rate risk in the banking book, etc. For the foreseeable fu-

⁷ See <http://www.bis.org/bcbs/publ/d341.pdf>

ture many other initiatives, e.g. the treatment of exposures towards sovereigns and central banks, replacement of the current exposure method by the non-internal model method, etc. are already announced to be on the agenda. While we understand that every single initiative might have its justification we urge the BCBS to summarize these initiatives in a “Basel IV” framework. In this process the interaction of these initiatives should be assessed and cumulative capital requirements calibrated. Otherwise capital requirements are geared up heavily as several capital requirements depend on other capital regimes. The variety of initiatives to cover risks via capital requirements might appear appropriate on an isolated basis but their accumulation leads to a situation that banks are heavily restricted on their ability to grant loans to the real economy. We ask to take these aspects into consideration and assess what risks might be covered multiple times by capital requirements and especially capital buffers.

- In line with the general BCBS guiding principles as formulated in the discussion paper “The regulatory framework: balancing risk sensitivity, simplicity and comparability”⁸ we want to point out that **stability over time** is also needed⁹. As such we urge the BCBS once more to consider carefully whether amendments in the framework are necessary for the currently discussed topic but also more in general. In line with our former statements on other BCBS consultations we urge the BCBS not to overpower banks with regard to capital requirements and their management.
- While in this consultation the treatment of TLAC holdings is discussed in parallel the proposal of the revised framework for credit risk¹⁰ is out for a second consultation (BCBS d347). That consultation includes a proposal for the future treatment of subordinated debt and certain equity holdings which is contradicting the BCBS proposal on TLAC holdings. This is a very good example to stress the need for a comprehensive and holistic consultation on all proposed changes as a revised “Basel IV” framework. BCBS d347 proposes a 150% risk weighting for all kind of non-equity (Tier 2) subordinated debt regardless of the issuer, see paragraph 44 of the revised proposal. Equity holdings fulfilling the criteria laid down in BCBS d347 receive a 250% risk weight. As such it may be appropriate to treat TLAC

⁸ See <http://www.bis.org/publ/bcbs258.htm>

⁹ See our response to the consultation under: <http://www.bis.org/publ/bcbs258/deutschebrsegro.pdf>

¹⁰ See <http://www.bis.org/bcbs/publ/d347.pdf>

holdings within the range of 150% and 250%. Any other treatment would be in sharp contrast of the proposal in BCBS d347.

The undertaking efforts of the BCBS have been made in order to increase resilience of the banking industry and to make banks less risky as well as to avoid the risk of spending tax payers' money to safe critical functions of the financial industry. Agreeing to this, risk weights for exposures to banks should be reduced in line with the principle of risk sensitivity. Contrary to that, the BCBS is making various proposals **to do exactly the opposite**. This is true for the proposed revision of Standardised Approach for Credit Risk (BCBS d347) and the proposal on the treatment of TLAC holdings based on section 15 of the TLAC concept as issued by the FSB.

The TLAC concept as well as generally discussed or already implemented rules on recovery and resolution regimes focus on bail-in-able instruments with a remaining maturity of one year or more while nevertheless asking to make also other instruments with a shorter remaining maturity bail-in-able. We cannot agree to have a non-mirroring handling of eligible liabilities on the one hand side with the treatment of TLAC holdings on the other side. In other words: We do not see the need to change the treatment for non TLAC-eligible subordinated or otherwise bail-in-able debt compared to status quo or in line with the general treatment as proposed in BCBS d347. Subordination is already reflected in both: **The individual credit assessment and the regulatory treatment.**

Having regarded both the general framework on TLAC with regards to TLAC holding capital requirements as well as the current BCBS consultative proposal we:

- **Disagree** to the cornerstones of the TLAC holding requirements as set out in the TLAC concept of FSB;
- **Disagree** to the proposed solution on TLAC holdings as presented by the BCBS;
- **Disagree** to a dedicated treatment under the large exposure limits as proposed in section 3.3 of the consultative document;
- Consequently also **disagree** to the proposed alternatives of a Common Equity Tier 1 deduction (section 3.1 of the consultative proposal) as well as a combination of deduction on large exposure regime depending on the classification of the holder of the TLAC instruments (section 3.4 of the consultative proposal);
- **Support** a treatment for TLAC holdings via increased risk weights. However, different to the proposal made in section 3.2 of the consultative document which in

practise asked for a risk weight of 1,250%, we have the opinion that the level of risk weight should only have an adequate but limited mark-up towards other ordinary exposures towards the institution including the general treatment of subordinated debt. This takes into account the efforts of BCBS to make banks more resilient and less risky and therefore taking the principle of risk sensitivity and the lower likelihood of default for the eligible liability compared to equity components into account as well as the proposal on the treatment of subordinated debt in BCBS d347. We consider a risk weight in the range as laid down in paragraphs 42 to 44 in BCBS d347 (i.e. 150% to 250%) as appropriate. As such a risk weight of 200% should be considered. This is subject to the final outcome of the treatment of subordinated debt in BCBS d347.

It is to be noted that TLAC eligible liabilities are at risk only after the equity is exhausted and that the levels and quality of needed equity for banks have increased massively due to the recent regulatory changes (Basel III) and are supposed to increase even further with the ongoing regulatory initiatives (“Basel IV”). Finally, the likelihood of being used in a default is low and in any case below 100%. We acknowledge the fact that risk is higher than that of ordinary exposures but by far less than that of equity which is supported by the respective proposal of BCBS d347. As such, we clearly disagree to the FSB requirements as stated in section 15 of the TLAC concept and ask the BCBS to implement the TLAC holding rules by taking our concerns into account.

Our position on the TLAC holdings concept is expressed in more detail in the following part C.

C. Specific comments on the consultative document

I. General treatment of TLAC holdings:

- A dedicated treatment of TLAC holdings in the capital regimes for banks will make it even less attractive for other banks to hold such instruments. This is true with regards to willingness to hold such instruments but also to the demand on higher yield. Although we accept that a reduction of TLAC holdings by other G-SIBs is in line with the attempt to reduce interconnectedness of G-SIBs we nevertheless want to point out that financing of banks in general is getting more and more difficult and expensive and pushing banks as investors out may rather destabilise the banking sector than stabilise.
- The proposal to deduct all TLAC holdings from regulatory capital seems to be over-prudent from our perspective. This approach puts the TLAC holdings at all times at the same risk as equity (minimum Tier 2) holdings. However, in the ordinary course of business TLAC holdings may receive a preferential treatment compared to Tier 2 capital, e.g. related to income payments. In addition, it does not count for solvency purposes of the issuing institution. Due to the massively increased capital requirements the risk of a default is reduced. Furthermore, the likelihood of TLAC liabilities being forced to be bailed-in in a resolution situation is by far less than 100%. **Treating TLAC liabilities like Tier 2 equity instruments would assume full bail-in at all times.**
- We therefore disagree to the proposed Tier 2 deduction approach of the BCBS. We also disagree to the alternative considered Common Equity Tier 1 deduction approach. Both approaches significantly lack on risk sensitivity.
- Since the beginning of the financial crisis the BCBS has introduced a bulk of initiatives to strengthen the resilience of banks, e.g. by significantly increasing the capital requirements (quantitatively and qualitatively), introducing a more prudent liquidity regime, harmonisation of the large exposures regime, increasing the requirements for a thorough corporate governance, revisions to the remuneration practice with the goal of less short term gain incentives, etc. All of those initiatives have the consequence that the probability of a bank failure has significantly diminished compared to 2008. As such the reduced risks for banks to go bankrupt should lead to reduced risk weights for exposures to banks, especially to banks' equity. Following the principle of risk sensitivity a full deduction of equity holdings

of financial entities in principle is questionable. Having said this, in any case we strongly oppose to a deduction from equity or a risk weight of 1,250% for TLAC holdings.

- While we oppose the same treatment for TLAC holdings and equity investments we agree that TLAC holdings are more risky than other assets. The higher risk may be taken into account via higher risk weights in the solvency regime. However, the fact that a financial instrument qualifies as TLAC will have direct implications on the respective ratings and the respective risk weights even without a dedicated treatment. The BCBS considers a dedicated treatment of any kind of subordinated debt not forming part of banks' equity. The BCBS d347 proposes a 150% flat risk weight for such exposures. TLAC holdings are content wise nothing else than a special form of subordinated debt. Taking into account a higher likelihood of being used (bail-in) in a resolution, a higher risk weight may be considered which nevertheless should be lower as the risk weight for equity positions.
- In the current framework four generic types of exposures towards banks can be distinguished in:
 1. plain equity,
 2. subordinated debt qualifying as Tier 2 equity,
 3. other subordinated debt and
 4. other plain exposures (e.g. receivables).

The risk treatment of such exposures leads to a decreasing capital requirements. TLAC holdings that do not form part of equity or Tier 2 eligible instruments are very close to the other subordinated debt as described above. It is therefore doubtful that there is a need to have a dedicated treatment at all as already now clear rules are in place to deal with exposures being invested in subordinated debt. Nevertheless we recognize that the funding of banks will change via the introduction of TLAC as this is done for the purpose to avoid the utilization of tax payers' monies in case of a bank's resolution. The future TLAC liability instruments may be of a higher risk than current subordinated debt instruments. They nevertheless are senior to equity instruments including Tier 2 subordinated debt. As such the risk weighted exposure amount needs to be substantially lower than those of any equity investment or Tier 2 subordinated instruments. The risk weights for TLAC holdings may be higher than the risk weight for ordinary expo-

asures or other subordinated debt (which should be continued to be treated like that, i.e. no TLAC holding):

Current framework		Potential framework	
Instrument	Current risk weight	Instruments (including TLAC liabilities)	Proposed risk weight ¹¹
Plain equity	Deduction (equal 1,250%)	Plain equity	Deduction (equal 1,250%)
Subordinated debt (Tier 2)	Deduction (equal 1,250%)	Subordinated debt (Tier 2)	Deduction (equal 1,250%)
---	---	TLAC liabilities	To be defined (see our proposal below)
Subordinated debt	20% to 150%	Subordinated debt	20% to 150%
Other exposures (Receivables)	20% to 150%	Other exposures (Receivables)	20% to 150%

Currently we support none of the four BCBS proposals named in the consultative document in particular. Nevertheless, we propose to use a risk weighted approach as outlined below. Our proposal distinguishes between a) TLAC holdings within a consolidated group and b) investments in non-related TLAC holdings issuers. We clearly see a strong proximity to equity instruments for intragroup TLAC holdings which we do not see related to 3rd party institutions.

¹¹ Simplified as distinction between exposures below and above threshold is not performed.

Our proposal takes into account our disagreement toward section 9 of the TLAC term sheet:

TLAC issuer		Capital treatment
Bank <u>within</u> the same prudential consolidation as the holder of the TLAC liability		Deduction from regulatory capital as proposed by the BCBS, starting at Tier 2 instruments and in absence of Tier 2 higher quality instruments are deducted.
Bank <u>outside</u> the same prudential consolidation as the holder of the TLAC liability		Midpoint between the proposed values for subordinated debt and dedicated equity positions as proposed in section 7 of Annex I of BCBS d347, i.e. currently 200%.

- The probability of TLAC holdings bailed-in and converting them into equity is for sure lower than the risk to lose funds on equity holdings which are the first line of defence if losses occur. Not every loss situation leads to a resolution and bail-in. Just for this reasoning the equal treatment of equity holdings and TLAC holdings doesn't seem adequate and should be withdrawn. We clearly see the higher risk of TLAC liabilities compared to non-TLAC liabilities and even other subordinated debt. This may be appropriately incorporated in the capital regime via adequately increased risk weights. In the current Basel III regime there is no differentiated treatment between subordinated debt (which does not qualify as Tier 2 capital) and not subordinated debt. The BCBS is currently proposing to change this, see BCBS d347 and we strongly urge the BCBS to have a harmonised approach in line with the proposal of BCBS d347. Boosting the capital requirements from the current levels to 1,250% is by far not appropriate.

- Any approach via the **large exposure regime** (general or specific G-SIB limit) is rejected as not adequate to handle TLAC holdings. Large exposures will be limited by the large exposure rules anyway.¹² An exposure towards a single counterparty / group of connected counterparties to avoid concentration risks is limited for good reasons. Going beyond these limitations for a single counterparty in our view is not appropriate. Contrary, we see the need to enlarge exemptions and special treatments for short-term interbank exposures in order to foster appropriately money markets (see also the argumentation given by the BCBS itself for credit risk purposes in BCBS d347, page 6. The reason for a preferential treatment named in the BCBS d347 is even more valid for the large exposure regime). A cumulative limit on all TLAC holdings is not taking into account the other risk position the bank may have towards G-SIBs, e.g. via equity positions. As such, imposing a cumulative limit for TLAC holdings in aggregate is deemed not appropriate by us.

II. Dedicated treatment of TLAC holdings at related parties:

In November 2015 the FSB released the “Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution – Total Loss-Absorbing Capacity (TLAC) Term Sheet”. In this final document the eligibility criteria of TLAC instruments are defined. In point 9 lit. f it is stated that TLAC-eligible instruments must not be funded directly or indirectly by the resolution entity or a related party of the resolution entity, except where the relevant home and host authorities in the CMG (crisis management group) agree that it is consistent with the resolution strategy to allow TLAC-eligible instruments or liabilities issued to a parent of a resolution entity to count towards external TLAC of the resolution entity.

Such approach is clearly rejected as it is preventing related parties to hold the TLAC liabilities of e.g. a subsidiary, an approach for which we see no good reason as this approach is not applied on equity which is another source of Total Loss Absorbing Capacity. Such situation may be tackled via a differentiated regime on TLAC holdings, as proposed by us see above, rather than imposing a no-show on the subsidiary level. This diverging treatment of TLAC liabilities and equity is not justified and should

¹² Note: large exposure rules are implemented in a variety of countries even before the publication of the international rules for large exposures by the BCBS. Although they are different in detail, they nevertheless have the core principles in common. In case need be, the BCBS could recommend to introduce the LE rules for exposures between G-SIBs sooner than targeted for so far.

be reversed. We urge the BCBS to change the TLAC concept in cooperation with the FSB in this regards. Excluding related party funding via eligible liabilities but allowing such funding via equity instruments does not seem to be an appropriate treatment.

Within prudentially regulated groups similar treatment as equity seems to be more appropriate: Including in TLAC (no equity instrument if criteria are not met) on the single institution level but full deduction on the level of the holding institution, consequently on a consolidated level it is consolidated out anyway.

We acknowledge the aim to prevent a situation that the amount of Total Loss Absorbing Capacity within a group is not reliable as they might be double-counted. However:

1. On a consolidated level these holdings are consolidated out again;
2. Due to the treatment of full equity deduction at the level of the TLAC holder, double counting is avoided.

TLAC holdings held by related parties within the group of supervised entities are as good as any other TLAC holding as it is paid-in. We cannot agree that TLAC liabilities held by related parties which do not form part of the regulated group (a) should be less reliable than any TLAC holding by third parties, (b) should be treated worse than equity and (c) should push the shareholder to accept potential (minor) third party investors in case of a resolution while having sufficient financial powers even in such situation to fund itself and also be in the position to prefund with eligible liabilities. **It is the pre-funding that matters, not the pre-funder.**

III. Equal treatment of investments in non-TLAC instruments with TLAC holdings:

The BCBS proposal on TLAC holdings targets to include investments in instruments ranking pari passu to TLAC liabilities in the same manner than “real” TLAC holdings and as such propose to deduct them from regulatory capital (or have the same treatment under any of the discussed alternative approaches). This dedicatedly includes bail-in-able instruments which are not included as TLAC holdings because their remaining maturity is less than 1 year. We clearly reject this approach. With BCBS d347 a dedicated approach is proposed for subordinated debt and this route should be followed. In line with the BCBS considerations to mirror treatment on both sides of the coin either short term bail-in-able liabilities should count as TLAC liabilities or holdings of such instruments not eligible for TLAC are to be treated like any

other exposure of the same kind. In case this logic is not followed, there will remain - with a few exceptions - only two kinds of non-equity exposures to banks: Short term exposures and exposures classified as TLAC Holdings. As such, a lot of the current discussion on the treatment of bank exposures towards other banks in the credit exposure framework is useless (we refer to our comments above). To that extend already the differentiation into sub-ordinated loans and TLAC holdings (at least towards G-SIBs) becomes very theoretical.

We also urge the BCBS to discuss this issue with the FSB in order to remove such treatment from the FSB TLAC Term Sheet, Section 15. A simple deduction of those holdings does not seem to be appropriate as it significantly lacks on risk sensitivity.

Eventually, this again shows that the different aspects currently discussed at the BCBS are neither linked nor harmonised and that a comprehensive “Basel IV” framework is urgently needed.

IV. Technical issues on TLAC holding regime:

Despite our general objection to the proposed approach by the BCBS a dedicated treatment for banks holding only a minor share (less than 10%) or even no share in the equity of a G-SIB may be necessary. In this regards, we wonder why the BCBS on page 3 of its consultative document distinguishes two cases as with the classification of a related party according to the FSB TLAC concept TLAC holdings are not allowed. In this context, the mentioned threshold still needs to be defined in case deemed necessary.

We hope that our comments given are useful in the further process and are taken up going forward. We are happy to discuss any question related to the comments made.

Eschborn, 12 February 2016

Jürgen Hillen

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