10 October 2014 | 13 pages

Diversified Banks
Global

TLAC – A Global View

The next 'shoe to drop' in Too Big to Fail debate

- **Raising The Bar** — TLAC, or total loss absorbing capacity, addresses the issue of sufficient 'gone concern' capital in bank resolution to avoid public support. In Raising The Bar on TLAC, we highlighted the potentially tougher rules by excluding capital allocated to both capital conservation (2.5%) and G-SIB (1-2.5%) buffers to avoid double-counting "other regulatory capital" requirements. This raises the *headline* 16-20% requirement to an *effective* 21-25%. Moreover, liabilities that are "preferred to normal senior unsecured creditors under the relevant insolvency law", or that arise from derivatives will not be eligible, nor will debt with a remaining maturity of less than one year.

- **Global G-SIBs** — At face value, most banks meet requirements with the exception of BBVA, JPM, WFC, STT, ICBC and BoC although we expect a relatively long phase-in period. Interestingly, G-SIBs screen better against leverage exposure (Figure 3) than against RWA (Figure 1/2). As always, the devil is in the detail, which will be released at G20 (15-16 Nov).

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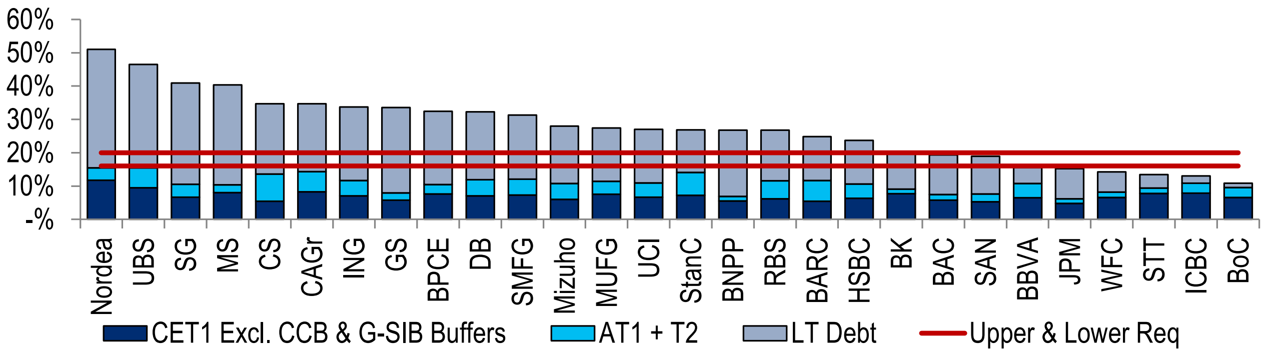
Figure 1. G-SIBs TLAC (Excl. Up To 5% CET1) As Percentage Of RWA vs. 16% And 20% Potential Requirements (1H14)



Source: Company Reports, Citi Research

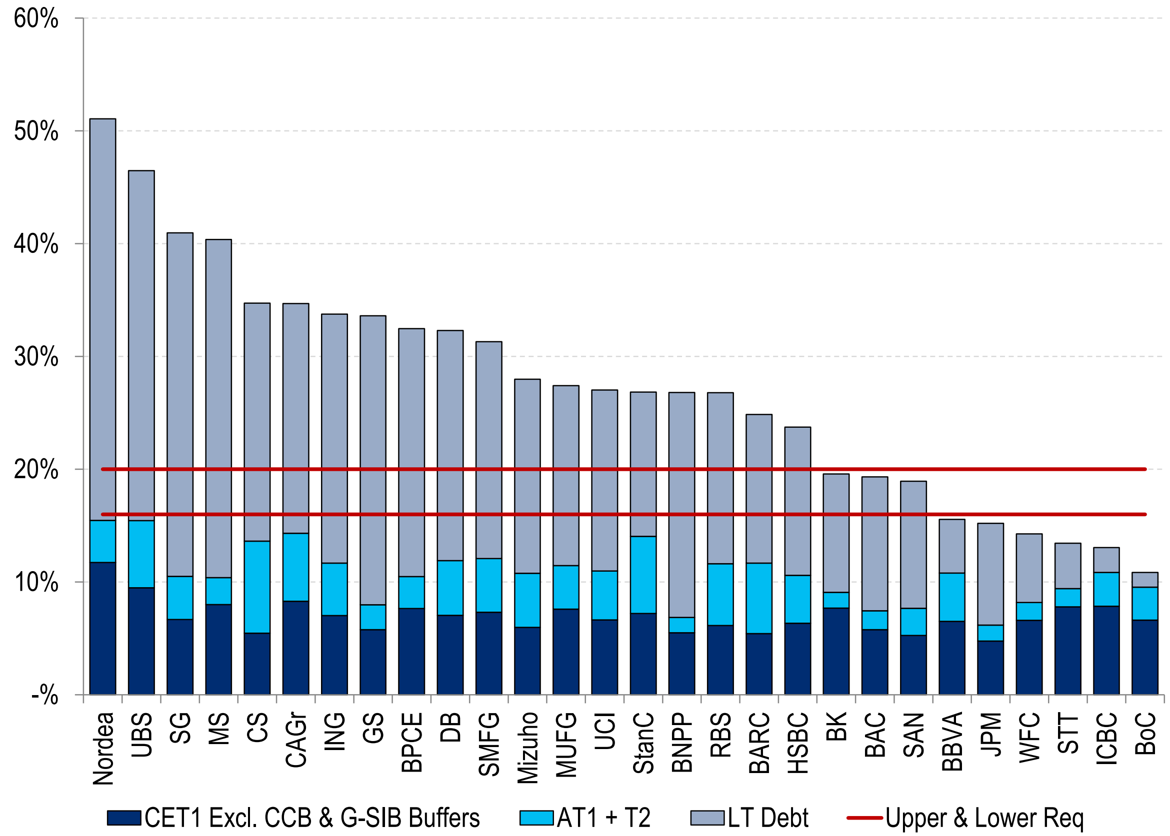
Notes: 1. European banks' senior unsecured and MTN data sourced from Dealogic; 2. CET1 excludes 2.5% Capital Conservation Buffer and 1-2.5% G-SIB Buffer.

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Global G-SIBs: TLAC Vs. RWA

- **Need For Further Unsecured Debt Issuance?** — Banks with relatively lower levels of senior debt look more challenged. The RWA-based TLAC approach also appears to be a greater constraint than the leverage exposure-based approach, for such banks, according to our estimates. Ultimately, the issue seems to be one of P&L impact from higher funding cost of additional 'gone concern' capital.

Figure 2. Global G-SIBs TLAC (Excl. Up To 5% CET1) As Percentage Of RWA vs. 16% And 20% Potential Requirements (1H14) (larger version of Fig. 1)



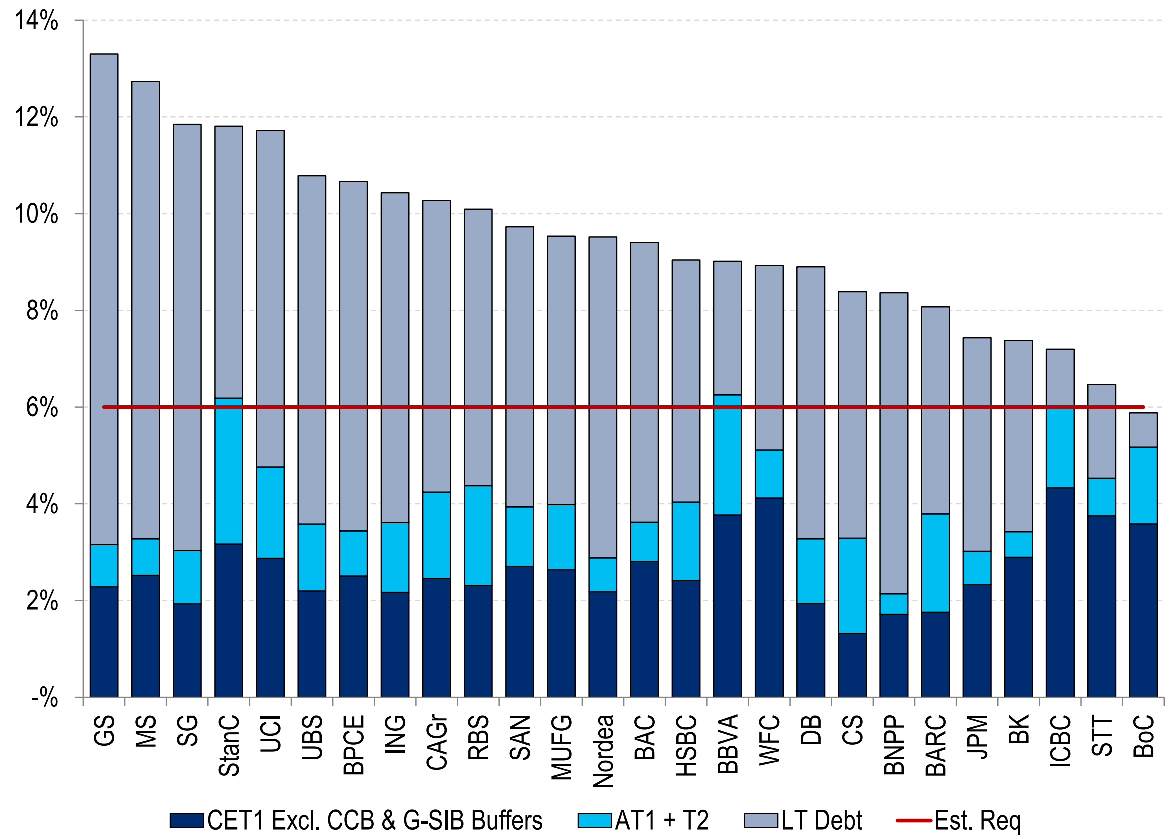
Source: Company Reports, Citi Research

Notes: 1. European banks' senior unsecured and MTN data sourced from Dealogic; 2. CET1 excludes 2.5% Capital Conservation Buffer and 1-2.5% G-SIB Buffer.

Global G-SIBs: TLAC Vs. Leverage Exposure

- **Passing 6% Hurdle** — We set our threshold at 6% following Bloomberg reporting that G-SIBs would have to hold not only minimum TLAC of 16-20% of RWA but also at least twice the minimum Basel 3 Tier 1 leverage requirement. Again, we exclude capital relating to both capital conservation (2.5%) and G-SIB (1-2.5%) buffers, to avoid double-counting “other regulatory capital” buffers. On a leverage basis, almost all G-SIBs that disclose leverage ratios appear to pass the potential TLAC requirement. Lower risk-weight banks naturally fare relatively worse on a leverage exposure-based metric than one a RWA-based metric.

Figure 3. Global G-SIBs TLAC (Excl. Up To 5% CET1) As Percentage Of Leverage Exposure vs. Estimated 6% Potential Requirement (1H14)



Source: Company Reports, Citi Research Estimates

Notes: 1. European banks’ senior unsecured and MTN data sourced from Dealogic; 2. CET1 excludes 2.5% Capital Conservation Buffer and 1-2.5% G-SIB Buffer; 3. BNPP, BBVA, BCPE, CAGr, ING, Nordea, SAN, UCI leverage exposures estimated based on 2Q14 leverage ratio disclosures; 4. MUFG leverage exposure estimated based on end-FY13/14 leverage ratio disclosure; 5. WFC, Bank of China, and ICBC based on Citi estimate leverage exposure. Bank of China and ICBC estimates based on reported assets + off balance-sheet guarantees and acceptances/letters of credit; 6. We exclude Mizuho and SFMG due to lack of disclosure on leverage exposure or leverage ratio.

Region Commentary

US G-SIBs

- **WFC had previously noted that US regulators were looking for 18-24% loss absorbing capital**— The changes global regulators are making to the TLAC calculation may be addressing concerns from US regulators that the banks weren't being required to hold enough loss absorbing capital. At its 2014 Investor Day, WFC noted they believed US regulators were looking for an 18-24% target ratio vs. the 15-16.5% target proposed originally by the banks (per WSJ).

- **STT, WFC, and JPM weakest positioned among the US banks**— While the question still remains as to how US regulators will choose to implement the global rule once it is finalized, STT, WFC, and JPM appear to be the weakest positioned among the US G-SIBs. However, a minimum global requirement of 16%-20% has a wide range of potential EPS impacts. We estimate the EPS impacts could be anywhere from 1-5%, relative to 2015 consensus estimates, if the banks issue LT debt to meet the requirement at current spreads.

European G-SIBs – MREL Binding Constraint

- **MREL Tougher** — As it stands, the EU's Minimum Requirement for Own Funds and Eligible Liabilities (MREL) under the Bank Recovery & Resolution Directive (BRRD) appears more to be onerous than TLAC. MREL requires 8% of total liabilities to be absorbed by capital/eligible liabilities before use of Resolution Fund is permitted. We understand the current requirement also excludes a higher level of 5.125% CET1, or the point of non-viability (PONV), although this could potentially change.

- **Spanish Banks Lag** — Spanish banks fare relatively worse on TLAC, likely a function of the higher level of secured funding on the balance sheet. On a potential MREL requirement of 8% (leverage exposure-based), wholesale banks like Barclays, BNP Paribas and Deutsche Bank screen at the tighter end of the spectrum.

Japanese G-SIBs

- **Different legal regime for resolution** — One of the biggest issues for Japanese banks is the different feature of the resolution regime. Japan's DIC has not given any US OLA type of discretion for the bail-in. However under DIC law, DIC may request court involvement for legally effective resolution, which virtually enables the authority to behave in just the same way as the OLA. We believe the treatment of senior debt could be the same as in other regions.

- **No big difference among three banks** — Japanese mega banks are sitting in the very middle of global peers on a RWA-based TLAC approach; we found no meaningful difference among the three banks. MUFG is the only bank in Japan that has disclosed a B3 leverage ratio and on a leverage-based approach MUFG is also broadly within the global average. We therefore do not view Japanese G-SIBs negatively relative to their global peers.

Chinese G-SIBs

- **Deposit rich —** Chinese banks fare poorly on TLAC because their business model is based on traditional deposit funding. Loan/deposit ratios for the major banks are mostly between 70-75% and so there has been little need to raise long-term debt funding. Whatever debt funding they have mostly consists of sub-debt / Tier 2 capital instruments and a minor amount of convertible bonds. This potential TLAC shortfall means that BOC and ICBC may need to raise long-term debt over the next few years.

- **Timing and breadth —** Aside from the details on the requirements, timing will be key. Recent news reports suggest that G-SIBs in EM countries like China will be given more time to meet the requirements. It is also possible that local regulators eventually apply TLAC requirements to all the major banks in China, creating a more level playing field among the big banks.

Comparison Of Bail-In Requirements

- **Devil Always In The Detail** — There remain a number of unanswered questions including: where loss absorbing capital needs to be held, how SPE (single point of entry) vs. MPE (multiple point of entry) will be treated and, to what extent, non-insured deposits will count towards loss absorbing capital requirements. Note US regulators have not released a proposal as of yet, pending the outcome of the TLAC discussions.

Figure 4. Comparison of PLAC / MREL / TLAC

	Measure: Jurisdiction:		PLAC UK	MREL EU	TLAC Global (G-SIBs)
Qualifying Items	CET1 Capital Requirement		✓	✓ Excl. 5.125% PONV	✓ Excl. 2.5% CCB and 1-2.5% G-SIB
Qualifying Items	AT1	High Trigger Low Trigger	✓ ✓	✓ ✓	[✓] ✓
Qualifying Items	T2		✓	✓	✓
Qualifying Items	Senior Unsecured (>1yr)		✓	✓	✓ May be subject to contractual bail-in feature (or structural (holdco) subordination?)
Qualifying Items	Other		[✓] Clearly identified as subject to bail-in	[✓] Corporate deposits >1 year	**[?]**
Calculation Basis			% RWA	% Total Liabilities (including counterparty netted derivatives)	TBD (% RWA and/or % Total Liabilities)
Amount			Up to 17% (scaled down for smaller banks, may be higher for specified larger banks)	TBD Set individually for each bank [Speculation on 8% remaining from PONV; equivalent to 10+% initial level for most banks]	TBD [16-20% RWA and/or ≥6% Leverage Ratio]
Applicable Entity			■ UK headquartered G-SIBs – 1) Including UK/EEA operations; 2) Excluding non-EEA where regional resolution strategy applies ■ Ringfenced banks / other D-SIBs	Solo & Consolidated	TBD Should reflect resolution strategy for each bank
Timing			On hold, pending GLAC discussions	From Jan 2016 (although requirement could be built-up over time)	Consultation to follow G-20 in Nov 2014

Source: Citi Research, UK Draft Legislation, BRRD, FSB

Appendix

Figure 5. Companies Mentioned

Bank	RIC	Price	Target	Rating
Bank of America	BAC.N	16.6	19.0	1
Bank of China	3988.HK	3.5	4.2	1
Barclays	BARC.L	2.3	3.0	1
BBVA	BBVA.MC	9.1	9.5	2
BNP Paribas	BNPP.PA	48.9	62.0	1
BNY Mellon	BK.N	37.3	42.0	2
Credit Suisse	CSGN.VX	26.2	33.0	1
Deutsche Bank	DBKGn.DE	25.9	36.0	1
Goldman Sachs	GS.N	181.3	195.0	2
Group BPCE	-	-	-	-
Group Credit Agricole	CAGR.PA	11.0	15.0	1
HSBC	HSBA.L	6.3	6.9	2
ICBC	1398.HK	4.9	6.6	1
ING Bank	ING.AS	11.1	12.4	1
JP Morgan Chase	JPM.N	59.1	68.0	1
Mizuho	8411.T	189.3	320.0	1
Morgan Stanley	MS.N	33.3	35.0	2
MUFG	8306.T	589.4	800.0	1
Nordea	NDA.ST	87.8	101.0	1
Royal Bank of Scotland	RBS.L	3.6	3.5	3H
Santander	SAN.MC	7.2	7.6	2
SMFG	8316.T	4,120.0	6,500.0	1
Societe Generale	SOGN.PA	37.7	56.0	1
Standard Chartered	STAN.L	11.0	14.0	1
State Street	STT.N	69.1	90.0	1
UBS	UBSN.VX	15.6	22.0	1
Unicredit Group	CRDI.MI	5.8	7.3	1
Wells Fargo	WFC.N	51.1	56.0	2

Source: Citi Research. Oct 9th close.

Appendix A-1

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