February 5, 2016

Robert deV. Frierson, Esq.
Secretary
Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Notice of Proposed Rulemaking; Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations; Regulatory Capital Deduction for Investments in Certain Unsecured Debt of Systemically Important U.S. Bank Holding Companies (80 Fed. Reg. 74926, November 30, 2015) (the "NPR")

Mr. Frierson:

The Structured Products Association (the "Association") appreciates this opportunity to comment on the NPR and to propose alternatives to the exclusion of structured products from eligible debt securities in the NPR.[1] The following comments address only those matters that are specifically related to structured products.

Rate-Linked Notes and the Definition of Structured Note

The proposed definition of "eligible debt security" excludes "structured notes." The proposed definition of "structured note" in Section 252.61 of the NPR raises a number of questions, including whether and what types of so-called rate-linked notes would constitute "structured notes."

[1] The comments presented in this letter represent the views of the Structured Products Association, which is the trade group for the U.S. structured products industry. The Association is committed to promoting the development and growth of the structured products market in the United States, and to ensuring that investors in structured products understand the risks and rewards of their investments. The Association was the first trade organization for structured products in the United States and now has more than 7,600 members, including members from securities exchanges, self-regulatory organizations, law firms, compliance professionals, family offices, investment advisers, issuers, and underwriters ("manufacturers") and distributors of structured products. The Association is committed to providing a unified voice for members, engaging with regulators, and educating the investment community.

The preamble of the NPR (the "Supplementary Information") indicates that "[t]he proposed definition of a structured note is not intended to include non-dollar-denominated instruments or instruments whose interest payments are linked to an interest rate index (for example, a floating-rate note linked to the federal funds rate or to LIBOR) that satisfy the proposed requirements in all other respects."

We believe that further clarification would facilitate the implementation of the exclusion of certain structured notes as TLAC-eligible debt securities. First, the substance of the language quoted above should be specifically included in the rule text in any final rule, as opposed to being relegated to the Supplementary Information.

Second, if the intent is that the reference to "non-dollar-denominated instruments" is to refer only to otherwise eligible debt securities that are denominated in a currency other than U.S. dollars, the language should more clearly convey this intent. The current wording has generated uncertainty among some market participants as to whether certain types of structured notes denominated in non-U.S. currencies would be permissible.

Reference Rates

We understand that the references made to the "federal funds rate or LIBOR" in the discussion of eligible securities likely are intended to be exemplary and should be understood to reference readily ascertainable reference rates. However, instead of including references to specific rates, it would be helpful for the final rule to clarify that a structured note will not include an instrument the interest rate of which references a readily ascertainable rate that is not under the sole control of the issuer and that is widely available to the public. Examples would include existing commonly used benchmark rates, such as the ISDA interest reference rates, as well as short-term reference rates.

Structured Notes with an Readily Ascertainable Valuation

Regulators have indicated that one of their objectives is to make it easy to value eligible debt securities upon an event of default and, based on that value, to convert the debt securities to equity in a bridge institution. The comments in this section are premised on this understanding.

Structured notes with an original maturity of over one year should be included in eligible long-term debt if they have an agreed-upon, or stipulated, value upon resolution. An agreed-upon or stipulated value upon resolution would address any valuation issue and would make structured notes as easy to value as plain vanilla notes, removing any concerns that such notes may pose an impediment to an orderly resolution.

Structured notes of several frequent issuers already provide that they can be valued at their principal amount upon a payment acceleration due to an event of default caused by the voluntary or involuntary bankruptcy of the issuer. In these cases, upon the occurrence of such an event, the holder of the note may be entitled to receive the principal amount of the note, with no upward or downward adjustment due to changes in the reference asset. This market practice has developed for reasons similar to the valuation concerns that we understand are driving the exclusion from eligible debt instruments for structured notes. Because the amount of principal to be paid at maturity for many structured notes may be uncertain, and, consequently, the principal amount to be paid at acceleration would also be uncertain, some structured note issuers have defined a "default amount" due upon acceleration, which amount also provides a certain valuation in the event of a disagreement between the note holders and an outside evaluator of the notes.

Although some outstanding structured notes that provide for a default amount often include a valuation process based on bidding that would not be practicable in the case of an orderly resolution that is intended to take place quickly over the course of a weekend, the inclusion of the default amount concept in a substantial number of outstanding structured notes suggests there may be a market demand for structured notes that at the time of issuance provide for a stipulated value upon a default.

Structured Notes Subject to Clean Holding Company Limitations

As part of its "clean holding company" requirements, the NPR proposes a 5% cap of the value of a covered bank holding company's eligible external TLAC for certain non-contingent liabilities to third parties that are not otherwise eligible debt securities. Liabilities subject to the 5% cap include structured notes that are not considered eligible long-term debt, vendor liabilities and obligations to employees. The rationale for the 5% limit is to allow for current levels of operational liabilities while limiting other liabilities that may interfere with orderly resolution of the covered BHC.

It is unclear why those structured notes that are not considered eligible long-term debt present an obstacle to orderly resolution, and should therefore be subject to the 5% cap, regardless of whether they are considered to be eligible long-term debt that count towards TLAC figures.

As described above, a significant portion of BHCs' outstanding structured notes have a readily ascertainable value that would not present valuation issues that would inhibit a rapid and orderly resolution. However, even for other portions of the covered BHC's structured notes, it would be unnecessary to perform valuations on such structured notes, or determine the amount of associated claims or the structured note holders on the Monday following resolution weekend or immediately thereafter. Such structured notes would simply represent additional residual value in the bankruptcy estate or receivership that would ultimately be distributed to the holders of all eligible debt securities and other liabilities that were subject to recapitalization.

Limiting the pool of structured notes available for recapitalization would, in fact, hinder the stated goals of the NPR, including ending concerns that certain firms are "too big to fail" by limiting the pool of liabilities that are available for recapitalization. Thus, regardless of whether they are permitted to be counted as eligible debt securities, structured notes issued by the covered BHC would also create additional potential loss absorbing capacity at the covered BHC. The additional loss absorbing capacity at the covered BHC would increase market confidence that liabilities of the subsidiaries would not be subject to losses. From a market stability standpoint, increasing the amount of structured notes at the BHC level that would absorb losses would be little different than increasing the amount of eligible debt that would absorb losses. Concerns as to investor expectations in a single point of entry resolution would necessarily be addressed in the risk factors in the offering materials for the structured notes. In addition, excluding structured notes from eligible long-term debt would itself be a significant deterrent against excessive growth of these liabilities at the covered BHC, since a covered BHC will be quite focused on ensuring that it complies with its eligible long-term debt and TLAC requirement. To the extent that regulators determine a cap to be necessary for structured notes, it may be less disruptive to the market to set a higher percentage cap and observe the effect of the cap on the activities of the covered BHCs before imposing more restrictive requirements.

Finally, to the extent that regulators decline to alter their approach to structured notes in the manner outlined above, we believe that they should at a minimum grandfather all structured notes that do not constitute eligible debt securities issued or incurred by a covered BHC before the final rule's effective date, so that such structured notes would not be required to be subject to the 5% cap, as to do otherwise would prove disruptive to the public debt markets and impose unnecessary compliance costs on covered BHCs.

Conclusion

According to industry estimates, U.S. financial institutions raised an aggregate of approximately $60 billion in structured notes in 2015. These financings represent a significant portion of their funding of senior indebtedness. Relatively simple revisions to the definition of eligible debt securities would enable them to continue to be used to support the liquidity needs of bank holding companies, and as set forth above, they can have terms that would render them simple to value in the event of a resolution.

These instruments also represent a different pool of investors for banks, providing a significant funding diversification benefit. Conventional senior fixed and floating rate debt instruments are purchased for the most part by institutional investors. In contrast, most structured notes are most frequently purchased by individual investors. Maintaining the eligibility of these instruments under the new rules will help keep this distribution and funding channel available to bank holding companies.

The Association appreciates the opportunity to submit these responses. We are available to meet and discuss these matters and to respond to questions.

Very truly yours,

/s/ Keith Styrcula

Keith Styrcula
Chairman and Founder
Structured Products Association