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July 1, 2004

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551
Attention: Ms. Jennifer J. Johnson, Secretary

Re: Risk-Based Capital Standards: Trust Preferred Securities
and the Definition of Capital – Docket No. R-1193

Ladies and Gentlemen:

We appreciate the opportunity to comment on the Board of Governors of the Federal Reserve System's notice of proposed rulemaking regarding Risk-Based Capital Standards: Trust Preferred Securities and the Definition of Capital (69 *Federal Register* 28851 (May 19, 2004); the "proposed rule").

In general we support the proposed rule, particularly the decision of the Board to continue to permit the inclusion of trust preferred securities in Tier 1 capital notwithstanding the change in accounting for such securities which resulted from Interpretation No. 46, *Consolidation of Variable Interest Entities* (FIN 46), as revised, of the Financial Accounting Standards Board. We agree that the accounting changes effected by FIN 46 should not result in a change in the regulatory capital treatment of trust preferred securities, and commend the Board for its decision.

We have the following comments with respect to the proposed rule:

I. Trust Preferred Securities

(i) **Subordination.** The proposed rule provides that the subordinated note underlying an issue of trust preferred securities (a "junior subordinated note") must be "subordinated to all senior and all other subordinated debt of the banking organization." This formulation is somewhat imprecise. For example, it does not expressly anticipate multiple issuances of trust preferred securities by the same banking organization and could otherwise be clearer as to the type of "other subordinated debt" contemplated. Accordingly, we recommend

that the Board clarify that a junior subordinated note that is subordinated in right of payment upon bankruptcy or liquidation of a banking organization to all of the banking organization's borrowed and purchased money (other than similar junior subordinated notes), similar obligations arising ~~from~~ off-balance sheet guarantees and direct credit substitutes, and obligations associated with derivative products will be deemed to meet this requirement. Such a definition would parallel (other than as to level of subordination) the definition of subordinated debt which the Board is proposing for Tier 2 subordinated debt in Section II.A.2.d.ii.(4).¹ We further request the Board to clarify that a junior subordinated note need not be subordinated to obligations to the trade creditors.

(ii) **Events of Default/ Acceleration.**

We understand that, in addition to events of bankruptcy of the issuer, the Board staff intends to permit the following to constitute events of default which give rise to the right of the trustee or the holders to accelerate the maturity of a junior subordinated note:

(A) the issuer defaults in the payment of interest upon the junior subordinated note when it becomes due and payable, and fails to cure the default prior to the next succeeding interest payment date (provided that the valid extension of an interest payment period by the issuer does not constitute a default for this purpose); or

(B) the issuer fails to pay all or any part of the principal of (or premium, if any, on) the junior subordinated note as and when it becomes due and payable, either at maturity, upon redemption at the option of the issuer or holder, by declaration of acceleration, or otherwise.

We request the Board to **make** clear that, in addition to events of bankruptcy of the issuer, the above-described events may constitute events of default which give rise to the right of the trustee or the holders to accelerate the maturity of a junior subordinated note.

We also request that the Board make clear that the following events may constitute events of default with respect to a junior subordinated note so long as such events, by themselves, do not give rise to a right of the trustee or the holders to accelerate the maturity of such note:

(1) the issuer defaults in the performance of, or breaches, any of the covenants in the indenture for the junior subordinated note; or

(2) the issuer of the trust preferred securities voluntarily or involuntarily liquidates, dissolves, winds-up its business or terminates its existence (except in connection with (i) the distribution of the junior subordinated note to holders of the trust preferred securities in liquidation of their interests in the trust or (ii) certain mergers, consolidations or amalgamations, as permitted by the declaration of trust relating to the trust).

¹ As further discussed in Section III(i) below, we request that the Board clarify the meaning of the terms "purchased money" and "off-balance sheet guarantees and direct credit substitutes" for purposes of such definition.

(iii) **Deferral.** The proposed rule requires that the notification for any deferral period must be reasonably short, “generally no more than one business week.” In accordance with current practice in the trust preferred securities market, a banking organization is normally required to give notice to begin or extend a deferral period prior to the record date for an interest payment date. The record date is usually 15 calendar days prior to the interest payment date. So as not to upset current market practice, we request the Board to provide that it is acceptable if the notification period for a deferral period terminates 5 business days prior to such record date (rather than a week prior to the interest payment date).

Currently, most trust preferred securities provide that an election of a deferral period by the junior subordinated note issuer cannot be made if an event of default exists and is continuing under the junior subordinated note. We understand that Board staff has recently questioned the continued inclusion of such a provision in junior subordinated notes. We request the Board to clarify that the terms of a junior subordinated note may provide that an issuing banking organization cannot elect a deferral period if at the time it would make such election either an event of default specified in clause (A) under “Events of Default/Acceleration” above or an insolvency event with respect to the issuing banking organization has occurred.

II. Preferred Stock

(i) **Step-ups.** The proposed rule would exclude preferred stock with dividend rate step-ups from Tier 1 capital. Such exclusion is inconsistent with the October 27, 1998 release of the Basel Committee on Banking Supervision entitled “Instruments eligible for inclusion in Tier 1 capital.” That Basel release permits a moderate rate step-up, in conjunction with a call option, if the step up occurs a minimum of 10 years after the date of issuance and if it results in an increase over the initial rate that is no greater than either (A) 100 basis points, less the swap spread between the initial index basis and the stepped-up index basis or (B) 50% of the initial credit spread, less the swap spread between the initial index basis and the stepped-up index basis. So that U.S. banking organizations are not put at a competitive disadvantage, they should have the same ability as non-U.S. banks to issue Tier 1 instruments with moderate step-ups. Accordingly, we request that the Board modify its proposal to permit such moderate step-ups in Tier 1 preferred stock and other Tier 1 capital instruments.

(ii) **Provisions Restricting a Banking Organization’s Ability to Defer or Eliminate Dividends.** The proposed rule would provide that perpetual preferred stock included in Tier 1 capital may not have any provisions restricting the banking organization’s ability to defer or eliminate dividends. We request that the Board clarify that providing voting rights to holders of preferred stock after a missed dividend will not be viewed as a provision restricting the banking organization’s ability to defer or eliminate dividends. Such voting rights are customarily provided to holders of preferred stock and are also required for listing such stock on certain stock exchanges.

III. Subordinated Debt

(i) **Subordination.** The proposed rule requires that bank holding company subordinated debt be subordinated, among other things, to “purchased money” and similar obligations arising from “off-balance sheet guarantees and direct credit substitutes;” however,

no definition of these terms is provided. We request that the Board provide a definition of these terms.

We also request that the Board insert (i) the phrase "in the event of a conservatorship or receivership of such subsidiary depository institution" after the phrase "general creditors and depositors" in the first sentence of Section II.A.2.d.ii.(4), (ii) the phrase "in right of payment" after each occurrence of the phrase "must be subordinated" in the second sentence of that section, and (iii) the phrase "in the event of a bankruptcy or liquidation of such bank holding company or non-depository institution subsidiary" after the phrase "similar arrangements" in such second sentence.

Finally, we request the Board to clarify that the phrase "all borrowed and purchased money," as used in Section II.A.2.d.ii.(4), does not include (i) other subordinated debt or (ii) junior subordinated debt which supports a trust preferred security or other instrument which at some point over its life is eligible to count as Tier 1 capital.

(ii) **Five Year Minimum Maturity.** We request that the Board insert the phrase "(other than by acceleration of maturity in the event of a bankruptcy)" after the phrase "prior to the original stated maturity" and after the phrase "back to the issuing banking organization" in Section II.A.2.d.i.

(iii) **Fixed/Floating Rate and Step-Up Subordinated Debt.** With the consent of Board staff, a number of banking organizations have issued fixed/floating rate subordinated debt instruments which qualify as Tier 2 capital. Such instruments initially bear interest at a fixed rate, which converts to a floating rate on a date certain ("conversion date"). Under the terms of such instrument, the issuing banking organization may redeem such instrument on or after the conversion date. We request the Board to clarify in its final rule that such fixed/floating rate subordinated debt instruments may qualify as Tier 2 capital. In addition, because the fixed/floating rate feature in such subordinated debt instruments effectively functions as a moderate step-up, we request the Board to clarify that such step-ups are permitted in subordinated debt instruments which qualify as **Tier 2** capital.

Thank you for the opportunity to comment on the proposed rule. Please address any questions relating to this comment letter to the undersigned at **212-839-5533**.

Very truly yours,



Daniel M. Rossner