February 19, 2016

By electronic submission to www.federalreserve.gov

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

Re: Comment Letter on the Notice of Proposed Rulemaking on External TLAC, Long-Term Debt, Clean Holding Company and Other Requirements Applicable to U.S. G-SIBs

Docket No. R-1523; RIN 7100 AE-37

Ladies and Gentlemen:

The Clearing House Association ("**TCH**"), the Securities Industry and Financial Markets Association ("**SIFMA**"), the American Bankers Association ("**ABA**"), the Financial Services Roundtable ("**FSR**") and the Financial Services Forum ("**FSF**") (collectively, the "**Associations**")[1] welcome the opportunity to comment on the proposed rule issued by the Board of Governors of the Federal Reserve System that would impose external total loss-absorbing capacity ("**TLAC**"), long-term debt, clean holding company and other requirements on the top-tier bank holding company parents ("**covered BHCs**") of U.S. global systemically important banking groups ("**U.S. G-SIBs**").[2]

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[1] *See* Annex 8 for a description of each of the Associations.

[2] 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 (Nov. 30, 2015) (the "**NPR**").

This comment letter relates solely to the proposed rule as it would apply to covered BHCs of U.S. G-SIBs and is divided between a high-level summary of our major points in the body of this letter, and a more detailed description and explanation of our comments in Annex 1. The Associations have filed a separate comment letter on the proposed rule as it would apply to the U.S. intermediate holding companies ("**covered IHCs**") of foreign G-SIBs. We have submitted separate comment letters to highlight more effectively the most important concerns and considerations of each group.[3]

The Associations strongly support imposing a properly structured and calibrated TLAC requirement on U.S. G-SIBs, which we believe would be the final piece in the regulatory puzzle needed to ensure that U.S. G-SIBs have enough loss-absorbing resources to result in a durable end to the risk of "too big to fail" ("**TBTF**").[4] Such a requirement will ensure that U.S. G-SIBs will always have enough usable TLAC to be recapitalized without the need for public capital support.

While the proposed rule is intended to achieve this purpose, it contains a number of requirements that are counterproductive or unnecessary to achieving this goal. We believe that the Federal Reserve can and should resolve these issues in the proposed rule while still achieving the important policy objectives by making each of the following changes:

- Eliminating the Separate Long-Term Debt Requirements. The proposed rule's separate long-term debt requirements are unnecessary and should be eliminated.

- Appropriately Calibrating the Required Amounts of TLAC. The required amounts of TLAC (and if the requirement is maintained, long-term debt) under the proposed rule are substantially higher than necessary to ensure that U.S. G-SIBs will be resolvable in an orderly fashion under any reasonably foreseeable severely adverse scenario.

- Eliminating the TLAC Supplementary Leverage Ratio ("**SLR**") or Limiting It to Operation as a Backstop. The TLAC SLR (and if the requirement is retained, the long-term debt SLR) should be eliminated because it is unnecessary, will have an adverse impact on financial market liquidity and is inconsistent with the international TLAC standard established by the Financial Stability Board ("**FSB**"), which is calibrated to operate as a backstop instead of a binding constraint.

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[3] Attached for your convenience as Annex 2 is a glossary showing all the defined terms used in our comment letter.

[4] In contrast, the Associations do not believe that it would be necessary or appropriate to impose any TLAC or long-term debt requirements on the top-tier BHCs of U.S. banking groups that have not been designated as G-SIBs.

- Adopting a More Rational Standard for Loss-Absorbing Long-Term Debt Securities[5] that Qualify as Eligible Debt Securities ("**EDS**"). The definition of EDS should be amended to include all long-term debt securities unless they are unlikely to remain outstanding and be available to absorb losses and recapitalize the covered BHC at the point of failure, including in particular senior long-term debt securities with traditional acceleration events or which are governed by foreign law.

- Eliminating Restrictions on Any Capital Structure Liabilities[6] under the Clean Holding Company Framework. The proposed rule should not treat any liabilities, other than operating liabilities,[7] as "unrelated liabilities" subject to its clean holding company requirements. All capital structure liabilities of a covered BHC can absorb losses and recapitalize the covered BHC at the point of failure without threatening financial stability, so no capital structure liabilities should be protected against losses by forcing covered BHCs to make them structurally or contractually preferred to EDS, even if they are excluded from EDS.

- Providing Appropriate Grandfathering from the Various Restrictions and Requirements in the Proposed Rule. It is vitally important that the Federal Reserve include appropriate grandfathering provisions in the final rule, especially if it decides not to make the modifications to EDS or the clean holding company framework described above.

- Not Imposing any Domestic Internal TLAC. The Federal Reserve should not impose any domestic internal TLAC or long-term debt requirements for domestic subsidiaries of U.S. G-SIBs. But if it were to do so, it should not impose a one-size-fits-all requirement. Instead, the U.S. G-SIBs should have the flexibility to satisfy the requirement with any combination of contributable resources, prepositioned resources and capital contribution agreements.

Part I of this letter describes the wide range of legal, regulatory and practical steps taken by regulators and the U.S. G-SIBs to improve the resiliency and resolvability of U.S. G-SIBs that

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[5] By "**long-term debt securities**" we mean debt with an original maturity of one year or more.

[6] By "**capital structure liabilities**" we mean all equity, hybrid and long-term debt securities that can absorb losses without threatening financial stability. The term does not include short-term debt or other operating liabilities. *See* note 7. By "**short-term debt**" we mean any debt securities with an original maturity of less than one year or with a put option exercisable by the debt holder in less than one year after the original issuance of the debt, including demand deposits and other short-term deposits.

[7] By "**operating liabilities**" we mean an institution's short-term debt, liabilities on most qualified financial contracts, liabilities for rent, utilities and similar other critical services and liabilities arising other than by contract such as those arising from litigation judgments. *See* note 6.

inform the broader framework and context within which the proposed rule and its policy objectives must be evaluated. Parts II through VII of this letter provide high level summaries of our key concerns and recommendations on the most important aspects of the proposed rule. Part VIII provides our views on the question contained in the preamble to the proposed rule as to whether the Federal Reserve should propose, in a separate NPR, domestic internal TLAC or long-term debt requirements for U.S. G-SIBs. Finally, Part IX of this letter provides an overview of the annexes to this letter and appendices to Annex 1, which collectively provide supplemental information and detail about our comments on the proposed rule.

This comment letter (including Annex 1 hereto) includes figures estimating the impact of the proposed rule on covered BHCs. These figures are based on data provided by the eight U.S. G-SIBs to TCH and SIFMA and on the key assumptions described in Annex 3. These key assumptions, including the reissuance assumptions, were designed to avoid overstating the projected shortfalls in eligible TLAC or long-term debt relative to the TLAC and long-term debt requirements or the projected amount of aggregate unrelated liabilities as of January 1, 2019. The TLAC estimates reported or calculated by any of the eight U.S. G-SIBs will vary from the aggregated data provided here, since the key common assumptions were applied to data provided by the eight U.S. G-SIBs in order to aggregate and provide consistency for purposes of this comment letter.

In addition to the assumption that each covered BHC would take significant steps to conform to the requirements,[8] these figures are based on two additional assumptions that are designed to avoid overstating any projected shortfalls or projected amounts of unrelated liabilities: (i) in the next three years, risk-weighted assets ("**RWA**"s) were assumed to remain constant and (ii) covered BHCs were not projected to hold a cushion above the regulatory minimums to avoid a breach, as they normally would. In addition, calling or redeeming ineligible long-term debt, even at par, could come at a significant cost to the U.S. G-SIBs, for example when the market value of the debt is less than par. Any such cost is not included in the analysis. There are also constraints that can impede the ability of the U.S. G-SIBs to exercise call or redemption rights, and non-callable debt cannot be redeemed without the consent of the bondholders.

Based on these data and assumptions, the covered BHCs will face an aggregate shortfall in eligible TLAC and long-term debt relative to the TLAC and long-term debt requirements of $363 billion and will have aggregate unrelated liabilities of $622 billion, or almost ***8 times the projected 5% allowance*** as of January 1, 2019, even assuming they replace all ineligible plain vanilla long-term debt maturing in 2017 or 2018 or callable before 2019 with EDS.

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[8] We assume that the following types of securities, which total $271 billion, are replaced with EDS: (i) eligible long-term debt securities maturing or callable prior to 2019, (ii) ineligible plain vanilla long-term debt securities maturing in 2017 or 2018 and (iii) ineligible plain vanilla long-term debt securities callable at par prior to 2019.

I. Any final rule should acknowledge and take into account the numerous legal, regulatory and practical steps already taken by regulators and the U.S. G-SIBs to improve resiliency and resolvability.

The Federal Reserve, the Federal Deposit Insurance Corporation (the "**FDIC**"), their counterparts around the world and the U.S. G-SIBs themselves have made significant progress in ending the risk that some institutions might be treated as TBTF. Indeed, FDIC Chairman Martin J. Gruenberg has described that progress as "impressive" and "transformational."[9] They have done so in two ways. First, the regulators have imposed enhanced prudential standards on the U.S. G-SIBs, including dramatically enhanced capital and liquidity requirements, which have made the U.S. G-SIBs substantially more resilient against failure and thus have substantially reduced the probability of their failure.[10] Second, if one or more of these organizations fail despite their increased resiliency, the regulators and the U.S. G-SIBs have developed strategies for resolving U.S. G-SIBs that are designed to eliminate the potential harm that might be caused to the financial system or the wider economy and thereby eliminate the historical motive for considering such firms as TBTF.[11]

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[9] *See, e.g.,* Martin J. Gruenberg, Chairman of the FDIC, *A Progress Report on the Resolution of Systemically Important Financial Institutions*, Speech at the Peterson Institute for International Economics (May 12, 2015), *available at* https://www.fdic.gov/news/news/speeches/spmay1215.html. *See also* Paul Tucker, Chairman of the Systemic Risk Council, Oral Remarks, *Ending Too Big to Fail: Reform and Implementation*, a conference co-sponsored by the Hoover Institution and the Bipartisan Policy Center (Jan. 22, 2016), *available at* http://www.hoover.org/events/ending-too-big-fail-reform-and-implementation (video webcast at 56:38-59:24); Paul Tucker, Deputy Governor for Financial Stability at the Bank of England, *Solving too big to fail—where do things stand on resolution?*, Remarks at the Institute of International Finance 2013 Annual Membership Conference (Oct. 12, 2013), *available at* http://www.bankofengland.co.uk/publications/Documents/speeches/2013/speech685.pdf ("US authorities could resolve most US SIFIs right now."). Many changes have also been made to improve the resiliency and resolvability of the regional bank holding companies. *See* Oliver Wyman, *Post-Crisis Changes in the Stability of the US Banking System: Evidence from US Bank Holding Companies from 2004 to 2014* (Mar. 26, 2015), *available at* http://www.oliverwyman.com/content/dam/oliver-wyman/global/en/2015/mar/Post_Crisis_Changes_in_the_Stability_of_the_US_Banking_System_Final_1.pdf; *see also* U.S. Dep't of Treasury, *Dodd-Frank at Five Years: Reforming Wall Street and Protecting Main Street* (Jul. 2015) *available at* https://www.treasury.gov/press-center/Documents/DFA%205%20Year%20Deck.pdf.

[10] 80 Fed. Reg. at 74927; Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking Organizations (Regulation YY), 12 C.F.R. § 252. For information about how these enhanced prudential standards have improved the resiliency of the U.S. G-SIBs, *see* Annex 4.

[11] *See, e.g.*, FDIC and the Bank of England, *Resolving Globally Active, Systemically Important, Financial Institutions* (Dec. 10, 2012); FDIC, Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy, 78 Fed. Reg. 76614 (Dec. 18, 2013); Bank of England, *The Bank of England's approach to resolution* (Oct. 2014); Financial Stability Board, *Key Attributes for Effective Resolution Regimes for Financial Institutions* (Oct. 2011; Updated version Oct. 2014). *See also* Bipartisan Policy Center, *Too Big to Fail: The Path to a Solution* (May 9, 2013). For information about how these strategies and related structural changes have made the U.S. G-SIBs resolvable, *see* Annex 4.

Among these resolution strategies are single-point-of-entry ("**SPOE**") strategies designed to impose all of the losses of a failed G-SIB on its private sector investors in a manner that avoids any threat to financial stability or harm to the broader economy.[12] The FDIC has identified the SPOE strategy as the strategy most likely to be used to resolve a U.S. G-SIB under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**").[13] Six of the eight U.S. G-SIBs recently identified one or more SPOE strategies as the most effective strategies for resolving them without government support under the U.S. Bankruptcy Code.[14]

The U.S. G-SIBs have taken actions to make SPOE and other resolution strategies more feasible at the request of the FDIC and the Federal Reserve. For example, all eight of the U.S. G-SIBs have adhered to the ISDA 2015 Universal Resolution Stay Protocol,[15] which was designed to override cross-defaults in certain financial contracts that the FDIC and the Federal Reserve had identified as an important obstacle to successful resolution under SPOE.[16] The U.S. G-SIBs have also taken steps to ensure the continuity of shared services during resolution,[17] to demonstrate their operational readiness for resolution, and to simplify and improve the

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[12] *See, e.g.,* FDIC, Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy, 78 Fed. Reg. 76614 (Dec. 18, 2013); FDIC and the Bank of England, *Resolving Globally Active, Systemically Important, Financial Institutions* (Dec. 10, 2012). For a step-by-step graphical illustration of the two most common versions of an SPOE resolution strategy, *see* Annex 5. *See also* Thomas H. Jackson, *Building on Bankruptcy: A Revised Chapter 14 Proposal for the Recapitalization, Reorganization, or Liquidation of Large Financial Institutions*, in MAKING FAILURE FEASIBLE: HOW BANKRUPTCY REFORM CAN END "TOO BIG TO FAIL" (Hoover Institution 2015) (Kenneth E. Scott, Thomas H. Jackson & John B. Taylor, eds.).

[13] *See, e.g.,* Martin J. Gruenberg, Chairman of the FDIC, *A Progress Report on the Resolution of Systemically Important Financial Institutions*, Speech at the Peterson Institute for International Economics (May 12, 2015); FDIC, Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy, 78 Fed. Reg. 76614 (Dec. 18, 2013).

[14] They did so in the public summaries of their 2015 resolution plans under Section 165(d) of the Dodd-Frank Act, which are available at https://www.fdic.gov/regulations/reform/resplans/.

[15] International Swaps and Derivatives Association ("**ISDA**"), Adhering Parties: ISDA 2015 Universal Resolution Stay Protocol (last updated Nov. 17, 2015), *available at* http://www2.isda.org/functional-areas/protocol-management/protocol-adhereance/22.

[16] *See, e.g.,* FDIC and Federal Reserve, Press Release, *Agencies Provide Feedback on Second Round Resolution Plans of "First Wave" Filers* (Aug. 5, 2014) (requiring first-wave filers to take actions to address certain identified shortcomings in their 2013 Title I resolution plans, including "amending, on an industry-wide and firm-specific basis, financial contracts to provide for a stay of certain early termination rights of external counterparties triggered by insolvency proceedings"). *See also* Annex 4 for a summary of some of the steps they have taken to ensure compliance with these requirements.

[17] "**Shared services**" refers to services, such as legal, compliance, intellectual property or data processing services, provided by one or more legal entities within an affiliated group to one or more other legal entities within the group.

alignment of their legal structures to improve their resolvability, as required by the FDIC and the Federal Reserve.[18]

Perhaps most importantly, the U.S. G-SIBs have anticipated the proposed rule by ensuring that they carry a substantial amount of long-term debt and other capital structure liabilities at their top-tier BHCs and by eliminating most short-term debt at that level.[19] As a result, each group's short-term debt and most of its other operating liabilities are or will be maintained at the subsidiary level. This makes the covered BHC's long-term debt securities structurally subordinated to the group's short-term debt and most of its other operating liabilities.

By making a covered BHC's capital structure liabilities structurally subordinated to the group's short-term debt and most of its other operating liabilities, the covered BHC's capital structure liabilities become "usable" to absorb losses—i.e., they can absorb losses without threatening financial stability because the group's losses can be imposed entirely on the holders of the covered BHC's capital structure liabilities before any losses are imposed on the holders of the group's short-term debt and other operating liabilities. And by holding enough capital structure liabilities to absorb all reasonably conceivable losses,[20] no losses would be imposed on the holders of short-term debt and other operating liabilities at the operating subsidiary level.[21] This is the key to ensuring a durable end to the risk of TBTF. It allows a U.S. G-SIB's losses to be imposed entirely on the private sector without inducing the holders of the group's short-term debt or financial contracts to run[22] or the holders of its other operating

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[18] *See, e.g.,* FDIC and Federal Reserve, Press Release, *Agencies Provide Feedback on Second Round Resolution Plans of "First Wave" Filers* (Aug. 5, 2014) (requiring first-wave filers to take various actions, including "ensuring the continuity of shared services that support critical operations and core business lines throughout the resolution process," "demonstrating operational capabilities for resolution preparedness, such as the ability to produce reliable information in a timely manner," and "establishing a rational and less complex legal structure that would take into account the best alignment of legal entities and business lines to improve the firm's resolvability"). *See also* Annex 4 for a summary of some of the steps they have taken to ensure compliance with these requirements.

[19] These structural changes were made in part in response to the feedback the U.S. G-SIBs received from the FDIC and the Federal Reserve on their 2013 Title I resolution plans. *See* id. (requiring first-wave filers to develop "a holding company structure that supports resolvability"). *See also* Annex 4.

[20] *See* note 31.

[21] For additional information about how much loss-absorbing capacity has been created at covered BHCs and how it has been restructured to make it usable, *see* Annex 4.

[22] By "**run**" we mean a cascade of withdrawal requests on demand deposit accounts, a general refusal by short-term creditors and counterparties on repurchase agreements and other qualified financial contracts ("**QFCs**") to roll over or renew the short-term debt, repos or other QFCs at maturity, a demand for additional cash collateral that is enforceable in the short-term and even actions to seek repayment of short-term debt before maturity.

liabilities to cut off critical services,[23] which could result in contagion, destabilize the financial system and harm the broader economy.

In its proposed rule, the Federal Reserve notes the importance of eliminating not merely TBTF, but also the "perception" of TBTF and the competitive and other problems that can result from such a perception. The market, however, now values long-term debt issued by U.S. G-SIBs on the assumption that they will not receive government support and thus that TBTF has been eliminated.[24] According to a 2014 Government Accountability Office report, a majority of methods for determining whether a TBTF subsidy exists for the largest banks found no current funding advantage and perhaps even a funding disadvantage relative to smaller banks.[25] Consistent with this view, the major rating agencies have eliminated the "uplift" previously given to the ratings of U.S. G-SIBs based on the expectation of government support to prevent failure,[26] with one of them specifically citing the Federal Reserve's proposed rule as a basis for doing so.[27] Finally, these market expectations are consistent with the considered judgments of the vast majority of financial regulatory experts around the world,[28] and no evidence since the

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[23] By "**critical services**" we mean services provided by critical vendors to a covered BHC's operating subsidiaries that are required for them to be able to continue to operate, maintain their franchise values and provide their critical functions to the market under an SPOE or other resolution strategy.

[24] *See, e.g.*, Ben Eisen, *A New Worry for Bank Investors: Bail-In Risk*, Wall Street Journal (Feb. 17, 2016) ("Holders of the bonds of the biggest banks used to benefit from the assumption that such firms were 'too big to fail,' meaning taxpayers would ride to the rescue if they ran into trouble [and the] financial crisis proved them largely correct. Now they are on the hook. To avoid publicly financed rescues for big banks that flirt with failure, regulators globally have drawn up rules that would dictate when and how bank investors would absorb losses. Some bondholders would be 'bailed in,' meaning banks would be helped by, for example, writing off those bonds. In some cases, regulators can require banks to convert the debt to equity, diluting shareholders. Regulators hope this will induce shareholders to better monitor bank risk.").

[25] United States Government Accountability Office, Report to Congressional Requesters, *Large Bank Holding Companies: Expectations of Government Support* at 40 (July 2014) ("Our analysis and the results of studies we reviewed provide evidence that the largest bank holding companies had lower funding costs than smaller bank holding companies during the 2007-2009 financial crisis but that differences may have declined or reversed in more recent years.").

[26] Standard & Poor's Rating Services, *U.S. Global Systemically Important Bank Holding Companies Downgraded Based on Uncertain Likelihood of Government Support* (Dec. 2, 2015); Moody's Investor Services, *US TLAC Proposal Falls Within Expectations; Banks Able to Comply* (Nov. 9, 2015); Fitch Ratings, Sovereign *Support for Banks: Rating Path Expectations* (Mar. 27, 2014); Moody's Investor Service, *Rating Action: Moody's concludes review of eight large US banks* (Nov. 14, 2013)

[27] Standard & Poor's Rating Services, *U.S. Global Systemically Important Bank Holding Companies Downgraded Based on Uncertain Likelihood of Government Support*, at 1 (Dec. 2, 2015).

[28] *See*, *e.g.*, Mark Carney, Governor of the Bank of England and Chairman of the Financial Stability Board, *Introduction to the Open Forum* (Nov. 11, 2015) ("Once implemented, [the FSB's international TLAC standard] will ensure that large financial institutions can fail without disrupting the financial system or calling on taxpayers to bail them out."); Financial Stability Board, Press Release, *FSB issues final Total Loss-Absorbing Capacity standard for global systemically important banks* (Nov. 8, 2015); Martin J. Gruenberg, Chairman of the FDIC, *A Progress Report on the Resolution of Systemically Important Financial Institutions* (May 12, 2015);

2008 financial crisis has emerged to the contrary. In other words, market *perception* is fully consistent with legal and regulatory *reality*.

That said, there unquestionably remain some political or media *misconceptions* that TBTF is alive and well, which can only be based on a failure to understand that the reforms described above have occurred or have had such impact. We strongly urge the Federal Reserve to explain clearly the importance of any final TLAC rule and its impact in ending TBTF.[29] Certainly, we would urge the Federal Reserve not to increase the stringency of the final TLAC (or other) rule in order to address a misconception that is at odds with legal and market reality.

II. The proposed rule's separate long-term debt requirements are unnecessary and should be eliminated.

While the Associations strongly support the goal of establishing appropriate and reasonable TLAC requirements for covered BHCs, the Associations believe that the separate long-term debt requirements are completely unnecessary to ensure that the covered BHCs have enough TLAC at the point of failure to be recapitalized at Basel III levels. At the same time, we would oppose any proposal to exclude long-term debt securities from eligible TLAC, effectively limiting eligible TLAC to equity securities. Instead, we believe that covered BHCs should be able to satisfy their minimum TLAC requirements by freely substituting equity for long-term debt securities and long-term debt securities for equity, subject to applicable regulatory capital requirements.

It is unlikely that any covered BHC would choose to satisfy its entire TLAC requirement with equity rather than long-term debt securities, since long-term debt securities are a less expensive form of loss-absorbing capacity. Based on the initial level of minimum required TLAC in the proposed rule, a covered BHC is virtually certain to have sufficient TLAC at the point of failure to recapitalize the group at Basel III levels without a separate minimum long-term debt requirement. It would be counterintuitive to prohibit a covered BHC from substituting equity for long-term debt securities since equity can absorb losses both inside and outside of a bankruptcy or Title II proceeding, and therefore function as both going-concern and gone-concern capital. In contrast, absent a consensual debt restructuring outside of a bankruptcy or Title II proceeding, long-term debt securities can only absorb losses in a bankruptcy or Title II

Paul Tucker, Deputy Governor for Financial Stability at the Bank of England, *Solving too big to fail: where do things stand on resolution?* (Oct. 12, 2013); Daniel K. Tarullo, Member of the Board of Governors of the Federal Reserve System, *Toward Building a More Effective Resolution Regime: Progress and Challenges* (Oct. 18, 2013).

[29] See, e.g., Paul Tucker, Chairman of the Systemic Risk Council, Oral Remarks, *Ending Too Big to Fail: Reform and Implementation*, a conference co-sponsored by the Hoover Institution and the Bipartisan Policy Center (Jan. 22, 2016), *available at* http://www.hoover.org/events/ending-too-big-fail-reform-and-implementation (video webcast at 1:05:30-1:06:30) (U.S. officials should more actively "explain what has been done" to end TBTF.)

proceeding, and therefore generally function only as gone-concern capital. Thus, we believe that long-term debt securities should be permitted but not required to satisfy any minimum TLAC requirements in excess of regulatory capital requirements.

We do not believe that a separate minimum long-term debt requirement is necessary in order for the FDIC to be appointed receiver under Title II while a covered BHC still has enough TLAC to be recapitalized at Basel III levels (i.e., satisfy the capital refill goal). It is true that Title II of the Dodd-Frank Act cannot be invoked until a covered BHC is "in default or in danger of default."[30] But that standard does not require the Treasury Secretary to wait until a covered BHC is balance-sheet insolvent, or even unable to pay its debts, before invoking Title II. It allows the Treasury Secretary to invoke Title II before balance-sheet insolvency based on a determination that the covered BHC is *unlikely* to be able to pay its debts as they come due. Covered BHCs and their supervisors would have a strong incentive to commence a resolution proceeding in advance of balance-sheet insolvency in order to ensure that the covered BHC has enough TLAC to be recapitalized at Basel III levels.

Moreover, the Federal Reserve can respond to a depletion in a covered BHC's TLAC outside of a bankruptcy or Title II through its other regulatory and supervisory tools. In addition, a covered BHC can achieve capital restoration similar to a recapitalization under an SPOE resolution strategy outside of a bankruptcy or Title II proceeding, including pursuant to a capital contingency plan or by activating its recovery plan. Finally, because a covered BHC is permitted to file a voluntary petition under Chapter 11 of the Bankruptcy Code before it becomes balance-sheet insolvent or even before it becomes unlikely to be able to pay its debts as they come due, the covered BHC can achieve the same recapitalization goal by filing a voluntary petition under Chapter 11 and implementing an SPOE recapitalization strategy, without the need for a separate minimum long-term debt requirement.

If the Federal Reserve nevertheless decides to retain separate long-term debt requirements, the Associations believe that the final rule should include a one-year cure period for any breaches of those long-term debt requirements, provided that all minimum TLAC requirements are complied with during the cure period. Such a cure period seems appropriate and reasonable, in our view, in light of the fact that separate long-term debt requirements are unnecessary to ensure that the covered BHCs have enough TLAC at the point of failure to be recapitalized at Basel III levels for the reasons stated above. Moreover, any supervisory action taken after the permitted cure period should be reasonable and proportional in light of the circumstances giving rise to the breach.

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[30] Dodd-Frank Act, § 203(b)(1). The term "in default or in danger of default" is broadly defined to include balance-sheet insolvency or likely insolvency, the failure or likely failure to be able to pay one's debts as they come due or the commencement or likely commencement of a voluntary or involuntary proceeding under the Bankruptcy Code. Id. § 203(c)(4).

III. The required amounts of TLAC (and if the requirement is maintained, long-term debt) under the proposed rule are substantially higher than necessary to ensure that U.S. G-SIBs will be resolvable under any reasonably foreseeable severely adverse scenario.

For the reasons more fully described in Annex 1 to this comment letter, including in light of all of the regulatory enhancements that have reduced the probability and potential impact of failure, the Associations believe that the Federal Reserve has calibrated its proposed minimum TLAC requirements at levels that are substantially higher than necessary to ensure that covered BHCs would have enough TLAC at the point of failure to be recapitalized under any reasonably conceivable severely adverse scenario.[31] These excessive requirements will increase the cost of borrowing by U.S. G-SIBS, which in turn may increase the cost of credit to the market and run a risk of reducing the amount of credit available to the economy.[32]

Moreover, the market does not have an unlimited capacity to absorb new issuances of long-term debt securities during a given time period. If the TLAC and long-term debt requirements are finalized as proposed, the covered BHCs would be required to issue $634 billion in new EDS between the effective date of the final rule and January 1, 2019 in order to comply with these requirements. This would likely cause the cost of long-term debt to both the covered BHCs and commercial companies to rise substantially compared to the cost that would otherwise prevail. If commercial companies are unable to obtain long-term financing for their projects on acceptable terms or the cost of raising long-term debt rises significantly because of

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[31] The FSB released the results of a quantitative impact study that showed that the worst-case historical cumulative losses suffered by any G-SIB (or likely G-SIB) peaked at 12.8% of RWAs and that the losses at most G-SIBs were far less severe. *See* Financial Stability Board, *Historical Losses and Recapitalisation Needs Findings Report*, Table A1 (Nov. 9, 2015). In fact, the study overestimates the losses in terms of RWAs defined by Basel III since the denominator used for the FSB's estimate was defined more narrowly than the Basel III denominator. Thus, the minimum TLAC ratios proposed by the Associations below would be more than sufficient to cover worst-case historical losses.

[32] Indeed, the Federal Reserve has recognized that that the proposed new TLAC and long-term debt requirements will increase the cost of credit. *See* 80 Fed. Reg. at 74939 (estimating that "covered BHCs would employ an increased lending rate of 1.3 to 3.1 basis points as a result of the proposed external TLAC and LTD requirements"). In fact, we believe that the Federal Reserve's estimate substantially understates the likely increase in costs because it only considers the potential impact on the cost of loans extended by U.S. G-SIBs. This approach completely ignores the critical role that U.S. and foreign G-SIBs play in facilitating market-based finance. As the Federal Reserve itself has recognized, in the United States lending by banks is responsible for less than half of total lending. Stanley Fischer, Vice Chairman, Board of Governors of the Federal Reserve System, *The Importance of the Nonbank Financial Sector* at 1 (Mar. 27, 2015). The bulk of lending is done by market purchases of debt securities, and the debt markets cannot function efficiently without a range of services that are supplied nearly exclusively by G-SIBs and predominantly by U.S. G-SIBs. Regulations like minimum TLAC and long-term debt requirements increase the costs to U.S. G-SIBs of providing these services and at least some of those costs are passed on to debt issuers and that surely will have some negative effect on U.S. GDP growth. The Federal Reserve should recognize this channel of credit in estimating the costs of the proposed rule.

excessive TLAC requirements, those excessive requirements could have an adverse impact on the economy as a whole.

The Associations believe that the TLAC requirements set forth in the table below would be sufficient to ensure that covered BHCs would have enough TLAC to be recapitalized at the point of failure. As described in more detail in Annex 1, this is because, among other reasons, the current proposed calibration needlessly double counts the G-SIB surcharges and over-estimates the appropriate supplementary leverage ratio ("**SLR**") requirement. We therefore urge the Federal Reserve to reduce its minimum TLAC requirements to those proposed in the table below.

Minimum Ratio or Buffer	Proposed Risk-based Ratio Requirements (% of covered BHC's RWA)	Proposed SLR Requirements (% of covered BHC's Total Basel III Exposure)
Minimum External TLAC Ratio	14% + Applicable Method 1 G-SIB surcharge	8%
External TLAC Buffer	None[33]	N/A
Minimum External Long-Term Debt Ratio	None	None

The Associations' proposed TLAC SLR-based ratio is more consistent with the concept of leverage-based standards acting as a *backstop* to risk-based standards rather than as a *binding constraint*. This concept has been endorsed by both the Basel Committee and the Federal Reserve.[34]

The Associations continue to be very concerned with regulatory initiatives that increase the likelihood that a leverage standard will act as more than a backstop and will become the

[33] There is no need for a separate external TLAC buffer (and such a buffer would amount to double counting) because the G-SIB surcharge is already reflected in the proposed risk-based TLAC ratio and the G-SIB enhancement is already reflected in the TLAC SLR. Moreover, covered BHCs are likely to maintain additional TLAC above the minimum requirements in order to reduce the risk of breaching the minimum requirements.

[34] Basel Committee, *Revised Basel III Leverage Framework and Disclosure Requirements (June 2013) at par. 2* (indicating that the purpose of the Basel III leverage ratio is to provide a "simple non-risk based 'backstop'"); Governor Daniel Tarullo, *Dodd-Frank Implementation* (Sept. 9, 2014) (the U.S. enhanced supplementary leverage ratio applicable to U.S. GSIBs "is appropriate to help ensure that the leverage ratio remains a relevant *backstop* for these firms"). Governor Lael Brainard, *Dodd-Frank at Five: Assessing Progress on Too Big to Fail* (July 9, 2015) ("The higher leverage standard for the systemic banking institutions is designed as a *backstop* to the surcharge-enhanced risk-based capital standard"); and Board of Governors of the Federal Reserve System, *Notice of Final Rule: Amendments to the Capital Plan and Stress Test Rules* (Dec. 2, 2015) ("The leverage ratio requirement continues to serve as an important *backstop* as it guards against possible weaknesses in the risk-based capital requirements") (emphasis added).

binding constraint. The TLAC SLR-based ratio in the Proposed Rule is one of those standards. The defects in leverage-based capital ratios—principally their lack of risk-sensitivity—are, we realize, well understood by regulators and banks alike. Unlike defects in risk-based standards which can be analyzed and fixed (by adjusting risk-weights and refining models), the risk insensitivity of leverage standards is a fundamental defect that cannot be fixed. It is inherent in the standards, and that is why leverage should only be used as a backstop. The practical impacts of risk-insensitive leverage standards are exacerbated by the high proportion of their assets that the liquidity coverage ratio forces large banks to hold as high-quality liquid assets. Reliance on leverage standards as more than a backstop, in our view, should be eliminated or at least dialed-back, not increased.

In addition, while we do not believe that the proposed rule should contain any minimum long-term debt requirements, if the Federal Reserve nevertheless decides to include minimum long-term debt requirements, the proposed risk-based long-term debt requirement should be 6% and the long-term debt SLR should be 2.5%.

IV. The definition of EDS should be amended to include all long-term debt securities unless they are unlikely to remain outstanding and be available to absorb losses and recapitalize the covered BHC at the point of failure, including in particular senior long-term debt securities with traditional acceleration events or which are governed by foreign law.

The proposed rule would exclude from EDS a range of commonly issued long-term debt securities without any persuasive reason for doing so. Simply put, all long-term debt securities that would reliably absorb losses in a resolution context, consistent with the policy objective of the proposed rule, should qualify as EDS. Excluding any such long-term debt securities from EDS, together with making them structurally or contractually preferred to EDS pursuant to the clean holding company requirement, would be counterproductive because this would simply reduce the amount of consolidated capital created by bailing in EDS (i.e., converting these debt securities into equity of a covered BHC or exchanging them for equity in a bridge BHC). See Annex 6 for mathematical examples illustrating this principle.

We agree that it would be appropriate to exclude from EDS any type of long-term debt securities that would be unlikely to remain outstanding and be available to absorb losses and recapitalize the covered BHC at the point of failure. In contrast, there is no reason to exclude from EDS any long-term debt securities that would reliably absorb losses and recapitalize the covered BHC at the point of failure.

For these reasons, the Associations urge the Federal Reserve to amend the proposed rule so that long-term debt securities that otherwise satisfy the conditions for eligible long-term debt are not excluded from EDS or subjected to a 50% haircut merely because they:

- Contain any or all of the acceleration clauses described on the chart attached as Annex 7, which have traditionally been included in the senior debt securities of covered BHCs;
- Are governed by foreign law;
- Have a remaining maturity of between one and two years;[35]
- Are structured notes that are principal protected at par;[36] or
- Are convertible into or exchangeable for any of the covered BHC's equity securities.

For the reasons discussed in Annex 1, all of these types of long-term debt securities are virtually certain to remain outstanding and be available to absorb losses and recapitalize the covered BHC at the point of failure. In addition, there is no uncertainty about the minimum amount of any claim in a bankruptcy or Title II proceeding on any structured notes principal protected at par—the minimum claim will always be the stated principal amount.

The proposed restrictions on the types of long-term debt securities that would qualify as EDS will have a severely adverse impact on the amount of outstanding long-term debt securities that will qualify as EDS. The covered BHCs had $964 billion of long-term debt outstanding as of September 30, 2015. Of this amount, $866 billion, or ***90%***, would not qualify as EDS under the proposed rule, including ***99.8%*** of all plain vanilla senior long-term debt securities. The only long-term debt securities outstanding as of September 30, 2015 that would qualify as EDS under the proposed rule are plain vanilla long-term debt securities that were contractually subordinated to senior debt and 0.2% of outstanding senior plain vanilla long-term debt securities.

Under the assumptions in Annex 3, including that $271 billion of long-term debt securities are replaced with EDS as defined in the proposed rule,[37] the aggregate shortfall as of January 1, 2019 would be $363 billion. This is ***three*** times the Federal Reserve's estimate of $120 billion. If the Federal Reserve makes the modifications to the proposed restrictions on acceleration events, foreign law and structured notes that are principal protected at par that

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[35] While, as discussed above, we do not believe that the proposed rule should contain any minimum long-term debt requirements, if the Federal Reserve nevertheless decides to include minimum long-term debt requirements, we urge the Federal Reserve to amend the proposed rule so that long-term debt securities that otherwise satisfy the conditions for eligible long-term debt are not subjected to a 50% haircut merely because they have a remaining maturity of between one and two years for the reasons more fully set forth in Annex 1.

[36] For purposes of this comment letter, a structured note that is principal protected at par means a structured note, as defined in the proposed rule, that by its terms requires the issuer to pay 100% of the stated principal amount of the structured note upon early termination or acceleration and at maturity.

[37] *See* footnote 8.

we recommend in this comment letter, the aggregate shortfall as of January 1, 2019 would drop to $56 billion.

V. The proposed rule should not treat any capital structure liabilities as "unrelated liabilities" subject to its clean holding company requirements.

Forcing covered BHCs to make any capital structure liabilities structurally or contractually preferred to EDS is inconsistent with the important public policy goal of ensuring a durable end to TBTF because such liabilities can absorb losses and recapitalize a covered BHC at the point of failure without threatening financial stability and because such a requirement has the counterproductive effect of reducing the amount of consolidated capital created by bailing in a covered BHC's EDS and other capital structure liabilities (i.e., converting them into equity of a covered BHC or exchanging them for equity in a bridge BHC).

The amount of consolidated capital created by bailing in a covered BHC's capital structure liabilities is the residual value of the covered BHC or bridge BHC at the time of bail-in—i.e., the difference between the firm's consolidated assets and any of its consolidated liabilities that are excluded from bail-in (e.g., any capital structure liabilities that are required by the proposed rule to be made structurally or contractually preferred to EDS by, for example, causing them to be issued by subsidiaries rather than the parent).

Under the proposed rule, all capital structure liabilities issued to third parties are treated as "unrelated liabilities," unless they are eligible equity securities or EDS. All unrelated liabilities in excess of 5% of the covered BHC's external TLAC amount[38] (the "**5% allowance**") must be made structurally or contractually preferred to EDS. Making any capital structure liabilities structurally or contractually preferred to EDS has the effect of excluding those capital structure liabilities from bail-in. Since the amount of consolidated capital created by bailing in capital structure liabilities is the difference between the firm's consolidated assets and any of its consolidated liabilities excluded from bail-in, treating any capital structure liabilities as "unrelated liabilities" has the effect of reducing the amount of consolidated capital created by bail-in by the amount of such capital structure liabilities in excess of the 5% allowance. See Annex 6 for mathematical examples illustrating these principles.

Indeed, covered BHCs should not be required to make any liabilities structurally or contractually preferred to EDS, unless there is a persuasive reason to do so. There is a persuasive reason to require covered BHCs to make short-term debt and other operating liabilities structurally or contractually preferred to EDS. Otherwise, critical vendors may refuse to perform, cutting off critical services that are essential for a covered BHC's operating subsidiaries to continue to operate, maintain their franchise values or provide critical operations to the market. Similarly, holders of short-term debt and other operating liabilities, such as qualified financial contracts, may run, draining liquidity out of the group and potentially

[38] Proposed Rule § 252.63(b).

forcing it to sell assets at distressed prices. Runs and any resulting sales of assets at distressed prices can also create the sort of contagion that can destabilize the U.S. financial system and harm the wider economy.

In contrast, there is no persuasive argument for protecting any capital structure liabilities of a covered BHC against losses by forcing the covered BHC to make them structurally or contractually preferred to EDS. The holders of such liabilities do not have the legal right or practical ability to require repayment until maturity of the contract. Accordingly, the Associations urge the Federal Reserve to amend the proposed rule so that no capital structure liabilities of a covered BHC are treated as "unrelated liabilities" for purposes of the clean holding company framework in the proposed rule, including any of the following:

- Long-term debt securities that contain any impermissible acceleration provisions;
- Long-term debt securities governed by foreign law;
- Long-term structured notes, whether they are principal protected or not;
- Long-term debt securities that are convertible into or exchangeable for any of the covered BHC's equity securities; or
- Hybrid securities.

There are also practical reasons for limiting "unrelated liabilities" to external operating liabilities and excluding all external capital structure liabilities from that term. First, the covered BHCs are expected to have $36 billion of external operating liabilities as of January 1, 2019, or 2% of the aggregate projected amount of required TLAC of $1,583 billion as of that date. This is well within the 5% allowance. Second, although their total external TLAC amount and operating liabilities may fluctuate, the covered BHCs believe that they can manage their total external TLAC amount and operating liabilities in a way that generally keeps such liabilities well below the 5% allowance, as long as capital structure liabilities are not also treated as "unrelated liabilities."

In contrast, if external capital structure liabilities are treated as "unrelated liabilities" unless they are able to be conformed to meet the currently proposed, highly restrictive definition of EDS, the covered BHCs will have $622 billion of unrelated liabilities, including $36 billion in operating liabilities, as of January 1, 2019, even if the covered BHCs replace all of their outstanding ineligible long-term debt securities that mature in 2017 and 2018 or that are callable before 2019 with EDS. This amounts to 39% of total required TLAC, or almost ***8 times the 5% allowance***, as of January 1, 2019. Moreover, it would be very expensive and perhaps impossible to cure this breach promptly. Such liabilities are by definition long-term and rarely have issuer call rights. It would not only be prohibitively expensive but also impractical to issue enough new EDS to dilute the sum of outstanding capital structure liabilities and outstanding

operating liabilities down to less than 5% of a covered BHC's actual total external TLAC amount by January 1, 2019.

Even if external capital structure liabilities are excluded from unrelated liabilities, there may be inadvertent breaches of the 5% allowance. For example, if a covered BHC suffers an unexpected litigation judgment, its unrelated liabilities could inadvertently exceed the 5% allowance until the judgment is reversed or paid. The covered BHC may reasonably decline to pay the judgment until it has exhausted its legal rights to appeal the judgment. The Federal Reserve should exclude any litigation judgments from unrelated liabilities until any appellate proceedings have been completed. More generally, and for the reasons more fully set forth in Annex 1, the proposed rule should allow at least one year for covered BHCs to cure any inadvertent breaches of the 5% allowance without subjecting them to any supervisory action. Moreover, any supervisory action taken after the permitted cure period should be reasonable and proportional in light of the circumstances giving rise to the advertent breach.

VI. It is vitally important that the Federal Reserve include appropriate grandfathering provisions in the final rule, especially if it decides not to make the modifications to EDS or the clean holding company framework described above.

Grandfathering is not a substitute for the proposed modifications to the definitions of EDS, "unrelated liabilities" and impermissible parent guarantees advocated above or below. But to the extent the final rule does not reflect such proposed modifications, the Associations believe that it is vitally important that the Federal Reserve's final rule include a robust grandfathering provision for several reasons, including for any capital structure liabilities incurred between the date that the proposed rule was first made public and the effective date of the final rule. First, if the Federal Reserve does not grandfather any legacy long-term debt securities from the exclusions from EDS, the covered BHCs will face an aggregate shortfall of $363 billion as of January 1, 2019, or three times the Federal Reserve's estimate of $120 billion. In contrast, if all legacy plain vanilla long-term debt securities and legacy structured notes that are principal-protected at par are permanently grandfathered, the projected shortfall would fall to $56 billion. Similarly, and even more consequentially, if the Federal Reserve does not grandfather all legacy capital structure liabilities that would otherwise be treated as unrelated liabilities under the proposed clean holding company framework, the covered BHCs will have $622 billion of unrelated liabilities, including $36 billion in operating liabilities, as of January 1, 2019, which is 39% of the total amount of expected required TLAC of $1,583 billion at that date, or almost 8 times the 5% allowance of $79 billion. In contrast, if their legacy capital structure liabilities are permanently grandfathered, the amount of unrelated liabilities expected to be outstanding as of January 1, 2019 would fall to $36 billion, or 2% of required TLAC.

Second, such grandfathering would be appropriate because, without it, the proposed rule would apply retroactively to exclude virtually all outstanding senior long-term debt securities from EDS, treat all such ineligible long-term debt securities as unrelated liabilities under the clean holding company framework and, unless the prohibition on parent guarantees

with impermissible cross-defaults is confirmed to apply prospectively only, would treat virtually all legacy parent guarantees as prohibited guarantees. Retroactive application of these provisions would be contrary to ordinary principles of fundamental fairness since those securities and guarantees were issued or entered into in good faith without any indication that the Federal Reserve's proposal would treat them as capped or prohibited liabilities.

Third, in most cases, it would be nearly impossible to conform such securities and parent guarantees to the rule. This is particularly true with respect to outstanding long-term debt securities and parent guarantees for which the covered BHCs have no contractual right to unilaterally amend or, in the case of long-term debt securities, to call. Should the Federal Reserve nevertheless decide to treat legacy ineligible long-term debt securities as "unrelated liabilities" or prohibited liabilities without appropriate grandfathering provisions, covered BHCs would be forced to attempt to repurchase the securities on the open market or obtain holder consents—the successful outcome of which no U.S. G-SIB can assure and which if they do occur will likely require the covered BHCs to pay a substantial "hold-up" premium to investors who know that the covered BHCs have no choice but to conform the securities. The payment of such premiums could reduce the TLAC of the covered BHCs, which would be contrary to the central purpose of the proposed rule, as well as basic safety and soundness considerations. Similarly, if the Federal Reserve treats legacy parent guarantees with impermissible cross-defaults as prohibited guarantees, covered BHCs would be forced to attempt to amend the guarantees to eliminate any impermissible cross-defaults, which would similarly be likely to require covered BHCs to pay substantial "hold-up" premiums to counterparties or investors.

Accordingly, the Associations request that the Federal Reserve include the following grandfathering provisions in the final rule.

- Permanently grandfather all long-term debt and hybrid securities issued before the effective date of the final rule from any of the exclusions from EDS.

- Permanently grandfather all capital structure liabilities, including all long-term debt and hybrid securities, issued before the effective date of the final rule from being treated as unrelated liabilities subject to the 5% allowance.

- Permanently grandfather from the prohibition on short-term debt and from being treated as unrelated liabilities subject to the 5% allowance all securities with an original maturity of one year or more that were issued before the effective date of the final rule but would be treated as short-term debt solely because they contained put options that were exercisable within one year from the date of issuance by the holders of such securities, including puts exercisable only upon the holder's death or because they contain autocallable features.

- Clarify that the flat prohibitions on certain liabilities, including guarantees with impermissible cross-defaults, apply prospectively only to liabilities incurred after the

effective date of the final rule or permanently grandfather any such liabilities incurred before the effective date of the final rule.

- Include an effective date in the final rule that is at least 180 days after the publication date of the final rule, in order to give covered BHCs sufficient time to conform their debt programs and other operations to the requirements of the final rule.

VII. The Associations believe that a variety of technical and other modifications would improve the effectiveness of the proposed rule without undermining the key objectives of TLAC.

For the reasons more fully described in Annex 1, the Associations urge the Federal Reserve to amend the proposed rule as follows:

- Create an exception from the prohibition on short-term debt for secured liquidity provided by the FDIC to facilitate an SPOE or other resolution under Title II of the Dodd-Frank Act.

- Modify the prohibition on cross-defaults in parent guarantees or subsidiary liabilities guaranteed by the parent to permit cross-defaults that are consistent with the ISDA 2015 Universal Resolution Stay Protocol or any future regulations implementing the ISDA Protocol in the United States.

- Clarify that the term qualified financial contract does not include a guarantee of a subsidiary's obligations on a QFC, provided that neither the guarantee nor the QFC contains an impermissible cross-default (as modified by the request in the preceding bullet).

- Extend the phase-in period for any SLR-based TLAC requirements (and if the Federal Reserve retains separate long-term debt requirements, both the risk-based and SLR-based long-term debt requirements) to January 1, 2022, consistent with the proposed phase-in for risk-based and SLR-based requirements under the FSB's international standard.[39]

- Modify the regulatory deduction framework for holdings of certain unsecured debt securities issued by covered BHCs by (i) recognizing an exemption for market-making activity, which is vital to liquidity of debt and equity instruments of financial institutions of all sizes, (ii) limiting the scope of any proposed deduction to holdings of eligible debt securities other than Tier 2 capital instruments that are not included

[39] Financial Stability Board, *Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution: Total Loss-absorbing Capacity (TLAC) Term Sheet* at 21-22 (Nov. 9, 2015).

in the covered BHC's external long-term debt amount and (iii) implementing any proposed deduction for such holdings on a true like-for-like basis more faithful to the principle underlying the existing corresponding deduction approach.

VIII. The Federal Reserve should not impose any domestic internal TLAC or long-term debt requirements for U.S. G-SIBs.

For the reasons more fully described in Annex 1, the Federal Reserve should not impose any domestic internal TLAC or long-term debt requirements on U.S. G-SIBs. But if it were to do so, it should not impose a one-size-fits-all requirement; rather, the U.S. G-SIBs should be allowed to retain the option to satisfy any such internal domestic TLAC requirements with any combination of contributable resources, prepositioned resources or capital contribution agreements.

IX. Description of Annexes and Appendices

The following Annexes to this cover letter form the core of our comment letter and are incorporated into this cover letter by reference.

Annex 1 (Discussion) contains a detailed analysis of our comments and recommendations. Because of the length and complexity of this annex, we have included an interactive table of its contents. By clicking on any item in the table of contents, you will be hyperlinked to the relevant section in Annex 1. Annex 1 also includes the following Appendices.

- **Appendix A (Requests for Comment**) contains our responses to certain of the requests for comment contained in the NPR.
- **Appendix B (Technical Clarifications)** contains a list of our proposed technical clarifications in the proposed rule.

Annex 2 (Glossary) contains a glossary of defined terms used throughout our comment letter.

Annex 3 (Key Data Assumptions) contains the key assumptions underlying the collection of data provided by all eight of the U.S. G-SIBs to TCH and SIFMA and the generation of figures relating to the financial impact of the proposed rule on the U.S. G-SIBs and the impact of our proposed modifications.

Annex 4 (Resiliency and Resolvability) contains slides showing the substantial progress that has been made to increase the resiliency and resolvability of the U.S. G-SIBs.

Annex 5 (SPOE) contains slides with a step-by-step graphical illustration of the two most common versions of an SPOE resolution strategy.

Annex 6 (Mathematical Examples) contains mathematical examples illustrating why making certain capital structure liabilities structurally preferred to EDS reduces the amount of consolidated capital created by bailing in EDS or other capital structure liabilities in an SPOE resolution.

Annex 7 (Covenants, Events of Default and Acceleration Clauses) contains a table summarizing the covenants, events of default and acceleration clauses contained in a representative sample of the outstanding senior and subordinated debt indentures of all eight of the U.S. G-SIBs.

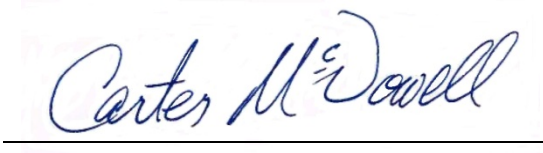
Annex 8 (Associations) contains a description of each of the Associations.

* * * * *

We thank the Federal Reserve for its consideration of our comments. If you have any questions, please do not hesitate to contact any of the undersigned.

Sincerely,

John Court
Managing Director and Deputy General Counsel
The Clearing House Association



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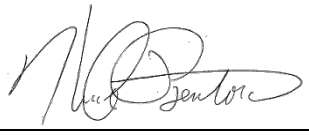

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ANNEX 1

To Cover Letter of Comment Letter on the Notice of Proposed Rulemaking on External TLAC, Long-Term Debt, Clean Holding Company and Other Requirements Applicable to U.S. G-SIBs

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APPENDIX A SELECTED RESPONSES TO REQUESTS FOR COMMENT A-1

APPENDIX B TECHNICAL CLARIFICATIONS TO THE PROPOSED RULE B-1

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This Annex 1 supplements the cover letter to which it is attached (the "**U.S. G-SIB Cover Letter**") and together with that cover letter and all annexes thereto and all appendices hereto constitutes the comment letter of the Associations (the "**U.S. G-SIB Comment Letter**"). All terms defined in the U.S. G-SIB Cover Letter have the same meanings in this Annex 1. Attached for your convenience as Annex 2 to the U.S. G-SIB Cover Letter is a glossary showing all the defined terms in one place.

I. Guiding Principles

The main comments and recommendations made in this comment letter are based on two guiding principles.

> **Principle No. 1**: All long-term debt securities of a covered BHC should count toward minimum TLAC requirements, unless they are unlikely to remain outstanding and be available to absorb losses and recapitalize the covered BHC at the point of failure.

The exclusion of any long-term debt securities from EDS is inconsistent with the important public policy goal of ensuring a durable end to TBTF, unless there is a persuasive reason to do so. Excluding any long-term debt securities from EDS, together with making them structurally or contractually preferred to EDS pursuant to the clean holding company requirement, would be counterproductive because this would simply reduce the amount of consolidated capital created by bailing in EDS (i.e., converting these debt securities into equity of a covered BHC or exchanging them for equity in a bridge bank holding company ("**bridge BHC**")). See Annex 6 for mathematical examples illustrating this principle.

The Associations agree that it would be appropriate to exclude from EDS any type of long-term debt securities that would be unlikely to remain outstanding and be available to absorb losses and recapitalize the covered BHC at the point of failure. In contrast, there is no justification for excluding any long-term debt securities that would exist to absorb losses and recapitalize the covered BHC at the point of failure.

Accordingly and for the reasons more fully set forth in Section IV, the Associations urge the Federal Reserve to amend the proposed rule so that long-term debt securities that otherwise satisfy the conditions for eligible long-term debt are not excluded from EDS or subjected to a 50% haircut merely because they:

- Contain any or all of the acceleration clauses described on the chart attached as Annex 7, which have traditionally been included in the senior debt securities of covered BHCs;

- Are governed by foreign law;
- Have a remaining maturity of between one and two years;[1]
- Are structured notes that are principal protected at par;[2] or
- Are convertible into or exchangeable for any of the covered BHC's equity securities.

All of these types of long-term debt securities are virtually certain to remain outstanding and be available to absorb losses and recapitalize the covered BHC at the point of failure. In addition, there is no uncertainty about the minimum amount of any claim in a bankruptcy or Title II proceeding on any structured notes principal protected at par—the minimum claim will always be the stated principal amount.

The proposed restrictions on the types of long-term debt securities that would qualify as EDS will have a severely adverse impact on the amount of outstanding long-term debt securities that will qualify as EDS. The covered BHCs had $964 billion of long-term debt outstanding as of September 30, 2015. Of this amount, $866 billion, or ***90%***, would not qualify as EDS under the proposed rule, including ***99.8%*** of all plain vanilla senior long-term debt securities. The only long-term debt securities outstanding as of September 30, 2015 that would qualify as EDS under the proposed rule are plain vanilla long-term debt securities that were contractually subordinated to senior debt and 0.2% of outstanding senior plain vanilla long-term debt securities.

Under the assumptions in Annex 3, including that $271 billion of long-term debt securities are replaced with EDS as defined in the proposed rule,[3] the aggregate shortfall as of January 1, 2019 would be $363 billion. This is ***three*** times the Federal Reserve's estimate of $120 billion. If the Federal Reserve makes the modifications to the proposed restrictions on acceleration events, foreign law and structured notes that are principal-protected at par that

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[1] While the Associations have urged the Federal Reserve to eliminate any separate long-term debt requirement for the reasons set forth in Section II, if the Federal Reserve nevertheless decides to retain any separate minimum long-term debt requirements, the Associations urge the Federal Reserve to amend the proposed rule so that long-term debt securities that otherwise satisfy the conditions for eligible long-term debt are not subjected to a 50% haircut merely because they have a remaining maturity of between one and two years.

[2] For purposes of this U.S. G-SIB Comment Letter, a structured note that is principal protected at par means a structured note, as defined in the proposed rule, that by its terms requires the issuer to pay 100% of the stated principal amount of the structured note upon early termination or acceleration and at maturity.

[3] This $271 billion reflects the full amount of the following types of securities issued by the covered BHCs and outstanding as of September 30, 2015: (i) eligible long-term debt securities maturing or callable prior to 2019, (ii) ineligible plain vanilla long-term debt securities maturing in 2017 or 2018 and (iii) ineligible plain vanilla long-term debt securities callable at par prior to 2019.

we recommend in this comment letter, the aggregate shortfall as of January 1, 2019 would drop to $56 billion.

> **Principle No. 2**: All capital structure liabilities[4] of a covered BHC can absorb losses and recapitalize the covered BHC at the point of failure without threatening financial stability, so no capital structure liabilities should be protected against losses by forcing covered BHCs to make them structurally or contractually preferred to EDS, even if they are excluded from EDS.

Forcing covered BHCs to make any capital structure liabilities structurally or contractually preferred to EDS is inconsistent with the important public policy goal of ensuring a durable end to TBTF, because such liabilities can absorb losses and recapitalize a covered BHC at the point of failure without threatening financial stability and because such a requirement has the counterproductive effect of reducing the amount of consolidated capital created by bailing in a covered BHC's EDS and other capital structure liabilities (i.e., converting them into equity of a covered BHC or exchanging them for equity in a bridge BHC). See Annex 6 for mathematical examples illustrating this principle.

Indeed, covered BHCs should not be required to make ***any liabilities*** structurally or contractually preferred to EDS, unless there is a persuasive reason to do so. There is a persuasive reason to require covered BHCs to make short-term debt and other operating liabilities structurally or contractually preferred to EDS. Otherwise, critical vendors may refuse to perform, cutting off critical services that are essential for a covered BHC's operating subsidiaries to continue to operate, maintain their franchise values or provide critical operations to the market. Similarly, holders of short-term debt and other operating liabilities, such as QFCs, may run, draining liquidity out of the group and potentially forcing it to sell assets at distressed prices. Runs and any resulting sales of assets at distressed prices can also create the sort of contagion that can destabilize the U.S. financial system and harm the wider economy.

In contrast, there is no persuasive argument for protecting any capital structure liabilities of a covered BHC against losses by forcing the covered BHC to make them structurally or contractually preferred to EDS. The holders of such liabilities do not have the legal right or practical ability to require repayment until maturity of the contract. Accordingly and for the reasons more fully set forth in Section V, the Associations urge the Federal Reserve to amend the proposed rule so that no capital structure liabilities of a covered BHC are treated as "unrelated liabilities" for purposes of the clean holding company framework in the proposed rule, including any of the following:

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[4] *See* notes 5 and 6 in the U.S. G-SIB Cover Letter to which this Annex 1 is attached for definitions of how the terms "capital structure liabilities" and "operating liabilities" are used in this Annex 1.

- Long-term debt securities that contain any impermissible acceleration provisions;
- Long-term debt securities governed by foreign law;
- Long-term structured notes, whether they are principal protected or not;
- Long-term debt securities that are convertible into or exchangeable for any of the covered BHC's equity securities; or
- Hybrid securities.

There are also practical reasons for limiting "unrelated liabilities" to external operating liabilities and excluding all external capital structure liabilities from that term. First, the covered BHCs are expected to have $36 billion of external operating liabilities as of January 1, 2019, or 2% of the aggregate projected amount of required TLAC of $1,583 billion as of that date. This is well within the 5% allowance. Second, although their total external TLAC amount and operating liabilities may fluctuate, the covered BHCs believe that they can manage their total external TLAC amount and operating liabilities in a way that generally keeps such liabilities well below the 5% allowance, as long as capital structure liabilities are not also treated as "unrelated liabilities."

In contrast, if external capital structure liabilities are treated as "unrelated liabilities" unless they are able to be conformed to meet the currently proposed, highly restrictive definition of EDS, the covered BHCs will have $622 billion of unrelated liabilities, including $36 billion in operating liabilities, as of January 1, 2019, even if the covered BHCs replace all of their outstanding ineligible long-term debt securities that mature in 2017 and 2018 or that are callable before 2019 with EDS. This amounts to 39% of total required TLAC, or almost ***8 times the 5% allowance***, as of January 1, 2019. Moreover, it would be very expensive and perhaps impossible to cure this breach promptly. Such liabilities are by definition long-term and rarely have issuer call rights. It would not only be prohibitively expensive but also impractical to issue enough new EDS to dilute the sum of outstanding capital structure liabilities and outstanding operating liabilities down to less than 5% of a covered BHC's actual total external TLAC amount by January 1, 2019.

II. No Separate Long-Term Debt Requirements

While the Associations strongly support the goal of establishing appropriate and reasonable TLAC requirements for covered BHCs, the Associations believe that the separate long-term debt requirements are completely unnecessary to ensure that the covered BHCs have enough TLAC at the point of failure to be recapitalized at Basel III levels. At the same time, we would oppose any proposal to exclude long-term debt securities from eligible TLAC, effectively limiting eligible TLAC to equity securities. Instead, we believe that covered BHCs should be able to satisfy their minimum TLAC requirements by freely substituting equity for

long-term debt securities and long-term debt securities for equity, subject to applicable regulatory capital requirements.

It is unlikely that any covered BHC would choose to satisfy its entire TLAC requirement with equity rather than long-term debt securities, since long-term debt securities are a less expensive form of loss-absorbing capacity. Based on the initial level of minimum required TLAC in the proposed rule, a covered BHC is virtually certain to have sufficient TLAC at the point of failure to recapitalize the group at Basel III levels without a separate minimum long-term debt requirement. It would be counterintuitive to prohibit a covered BHC from substituting equity for long-term debt securities since equity can absorb losses both inside and outside of a bankruptcy or Title II proceeding, and therefore function as both going-concern and gone-concern capital. In contrast, absent a consensual debt restructuring outside of a bankruptcy or Title II proceeding, long-term debt securities can only absorb losses in a bankruptcy or Title II proceeding, and therefore generally function only as gone-concern capital. Thus, we believe that long-term debt securities should be permitted but not required to satisfy any minimum TLAC requirements in excess of regulatory capital requirements.

We do not believe that a separate minimum long-term debt requirement is necessary in order for the FDIC to be appointed receiver under Title II while a covered BHC still has enough TLAC to be recapitalized at Basel III levels (i.e., satisfy the capital refill goal). It is true that Title II of the Dodd-Frank Act cannot be invoked until a covered BHC is "in default or in danger of default."[5] But that standard does not require the Treasury Secretary to wait until a covered BHC is balance-sheet insolvent, or even unable to pay its debts, before invoking Title II. It allows the Treasury Secretary to invoke Title II before balance-sheet insolvency based on a determination that the covered BHC is unlikely to be able to pay its debts as they come due. Covered BHCs and their supervisors would have a strong incentive to commence a resolution proceeding in advance of balance-sheet insolvency in order to ensure that the covered BHC has enough TLAC to be recapitalized at Basel III levels.

Moreover, the Federal Reserve can respond to a depletion in a covered BHC's TLAC outside of a bankruptcy or Title II through its other regulatory and supervisory tools. In addition, a covered BHC can achieve capital restoration similar to a recapitalization under an SPOE resolution strategy outside of a bankruptcy or Title II proceeding, including pursuant to a capital contingency plan or by activating its recovery plan. Finally, because a covered BHC is permitted to file a voluntary petition under Chapter 11 of the Bankruptcy Code before it becomes balance-sheet insolvent or even before it becomes unlikely to be able to pay its debts

[5] Dodd-Frank Act, § 203(b)(1). The term "in default or in danger of default" is broadly defined to include balance-sheet insolvency or likely insolvency, the failure or likely failure to be able to pay one's debts as they come due or the commencement or likely commencement of a voluntary or involuntary proceeding under the Bankruptcy Code. Id. § 203(c)(4).

as they come due, the covered BHC can achieve the same recapitalization goal by filing a voluntary petition under Chapter 11 and implementing an SPOE recapitalization strategy, without the need for a separate minimum long-term debt requirement.

If the Federal Reserve nevertheless decides to retain separate long-term debt requirements, the Associations believe that the final rule should include a one-year cure period for any breaches of those long-term debt requirements, provided that all minimum TLAC requirements are complied with during the cure period. Such a cure period seems appropriate and reasonable, in our view, in light of the fact that separate long-term debt requirements are unnecessary to ensure that the covered BHCs have enough TLAC at the point of failure to be recapitalized at Basel III levels for the reasons stated above. Moreover, any supervisory action taken after the permitted cure period should be reasonable and proportional in light of the circumstances giving rise to the breach.

III. Calibration

The proposed rule includes a series of minimum external TLAC and long-term debt requirements on covered BHCs. First, it proposes a minimum external TLAC ratio of 18% of RWAs on a fully phased-in basis, plus a TLAC buffer ranging from 3.5%-5% of RWAs, depending on a covered BHC's method 1 G-SIB surcharge. The proposed rule also includes a minimum external TLAC SLR of 9.5% of total Basel III exposures. Finally, it includes a separate long-term debt ratio ranging from 7%-10.5% of RWAs, depending on a covered BHC's method 2 G-SIB surcharge, and a separate long-term debt SLR ratio of 4.5% of total Basel III exposures. The table below summarizes the proposed rule's requirements.

Minimum Ratio or Buffer	Proposed Risk-Based Ratio Requirements (% of covered BHC's RWA)	Proposed SLR Requirements (% of covered BHC's Total Basel III Exposure)
Minimum External TLAC Ratio	18%	9.5%
External TLAC Buffer	2.5% + Method 1 G-SIB surcharge + countercyclical buffer	N/A
Minimum External Long-Term Debt Ratio	6% + Method 2 G-SIB surcharge	4.5%

The NPR explains that the Federal Reserve calibrated its minimum external TLAC and SLR requirements differently from the way it calibrated its external long-term debt requirement. The Federal Reserve established its minimum risk-based TLAC ratio of 18% and its minimum SLR from a variety of methods for estimating expected losses under a severely adverse scenario,

like the one experienced in 2007-2008.[6] In contrast, "[t]he proposed external LTD requirement was calibrated primarily on the basis of the 'capital refill' framework."[7] The NPR explains that "[a]ccording to the capital refill framework, the objective of the external LTD is to ensure that each covered BHC has a minimum amount of eligible external LTD such that, if the covered BHC's going concern capital is depleted and the covered BHC fails and enters resolution, the eligible external LTD will be sufficient to absorb losses and fully recapitalize the covered BHC by replenishing its going-concern capital."[8]

The Associations believe that the Federal Reserve has calibrated its proposed minimum TLAC requirements at levels that are substantially higher than necessary to ensure that covered BHCs would have enough TLAC at the point of failure to be recapitalized under any reasonably conceivable severely adverse scenario.[9] These excessive requirements will increase the cost of borrowing by U.S. G-SIBS, which in turn may increase the cost of credit to the market and run a risk of reducing the amount of credit available to the economy.[10]

The Associations believe that the TLAC requirements set forth in the table below would be sufficient to ensure that covered BHCs would have enough TLAC to be recapitalized at the

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[6] 80 Fed. Reg. at 74932.

[7] 80 Fed. Reg. at 74932.

[8] 80 Fed. Reg. at 74932. The NPR also states that "[t]he proposed calibration of the external long-term debt requirement was also informed by an analysis of the extreme loss tail of the distribution of income for large U.S. bank holding companies over the past several decades." 80 Fed. Reg. at 74933.

[9] The FSB released the results of a quantitative impact study that showed that the worst-case historical cumulative losses suffered by any G-SIB (or likely G-SIB) peaked at 12.8% of RWAs and that the losses at most G-SIBs were far less severe. *See* Financial Stability Board, *Historical Losses and Recapitalisation Needs Findings Report*, Table A1 (Nov. 9, 2015). In fact, the study overestimates the losses in terms of RWAs defined by Basel III since the denominator used for the FSB's estimate was defined more narrowly than the Basel III denominator. Thus, the minimum TLAC ratios proposed by the Associations below would be more than sufficient to cover worst-case historical losses.

[10] Indeed, the Federal Reserve has recognized that that the proposed new TLAC and long-term debt requirements will increase the cost of credit. *See* 80 Fed. Reg. at 74939 (estimating that "covered BHCs would employ an increased lending rate of 1.3 to 3.1 basis points as a result of the proposed external TLAC and long-term debt requirements"). In fact, we believe that the Federal Reserve's estimate substantially understates the likely increase in costs because it only considers the potential impact on the cost of loans extended by U.S. G-SIBs. This approach completely ignores the critical role that U.S. and foreign G-SIBs play in facilitating market-based finance. As the Federal Reserve itself has recognized, in the United States lending by banks is responsible for less than half of total lending. Stanley Fischer, Vice Chairman, Board of Governors of the Federal Reserve System, *The Importance of the Nonbank Financial Sector* at 1 (Mar. 27, 2015). The bulk of lending is done by market purchases of debt securities, and the debt markets cannot function efficiently without a range of services that are supplied nearly exclusively by G-SIBs and predominantly by U.S. G-SIBs. Regulations like minimum TLAC and long-term debt requirements increase the costs to U.S. G-SIBs of providing these services and at least some of those costs are passed on to debt issuers and that surely will have some negative effect on U.S. GDP growth. The Federal Reserve should have recognized this channel of credit in estimating the costs of the proposed rule.

point of failure. This is because, among other reasons, the current proposed calibration needlessly double counts the G-SIB surcharges and over-estimates the appropriate SLR requirement. We therefore urge the Federal Reserve to reduce its minimum TLAC requirements to those proposed in the table below.

Minimum Ratio or Buffer	Proposed Risk-Based Ratio Requirements (% of covered BHC's RWA)	Proposed SLR Requirements (% of covered BHC's Total Basel III Exposure)
Minimum External TLAC Ratio	14% + Applicable Method 1 G-SIB surcharge	8%
External TLAC Buffer	None	N/A
Minimum External Long-Term Debt Ratio	None	None

Based on the Associations' proposed approach, the minimum external TLAC risk-based ratio would be equal to twice the sum of the minimum Common Equity Tier 1 ("**CET1**") requirement of 4.5% and the capital conservation buffer of 2.5% for a total of 14% of RWAs, plus the applicable Method 1 G-SIB surcharge. The minimum TLAC SLR would be equal to twice the normal SLR of 3%, plus the enhanced SLR buffer of 2%, for a total of 8%. The capital conservation buffer would be incorporated into the risk-based TLAC requirement and the G-SIB buffers would be incorporated into both the risk-based and SLR TLAC requirements.[11]

The Associations' proposed TLAC SLR-based ratio is more consistent with the concept of leverage-based standards acting as a *backstop* to risk-based standards rather than as a *binding constraint*. This concept has been endorsed by both the Basel Committee and the Federal Reserve.[12]

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[11] Our proposed TLAC requirements would not include an external TLAC buffer. There is no need for a separate external TLAC buffer (and such a buffer would amount to double counting) because the G-SIB surcharge is already reflected in the proposed risk-based TLAC ratio and the G-SIB enhancement is already reflected in the TLAC SLR. Moreover, covered BHCs are likely to maintain additional TLAC above the minimum requirements in order to reduce the risk of breaching the minimum requirements.

[12] Basel Committee, *Revised Basel III Leverage Framework and Disclosure Requirements (June 2013) at par. 2* (indicating that the purpose of the Basel III leverage ratio is to provide a "simple non-risk based 'backstop'"); Governor Daniel Tarullo, *Dodd-Frank Implementation* (Sept. 9, 2014) (the U.S. enhanced supplementary leverage ratio applicable to U.S. G-SIBs "is appropriate to help ensure that the leverage ratio remains a relevant *backstop* for these firms"). Governor Lael Brainard, *Dodd-Frank at Five: Assessing Progress on Too Big to Fail* (July 9, 2015) ("The higher leverage standard for the systemic banking institutions is designed as a *backstop* to the surcharge-enhanced risk-based capital standard"); and Board of Governors of the Federal Reserve System, *Notice of Final Rule: Amendments to the Capital Plan and Stress Test Rules* (Dec.

The Associations continue to be very concerned with regulatory initiatives that increase the likelihood that a leverage standard will act as more than a backstop and will become the binding constraint. The TLAC SLR-based ratio in the Proposed Rule is one of those standards. The defects in leverage-based capital ratios—principally their lack of risk-sensitivity—are, we realize, well understood by regulators and banks alike. Unlike defects in risk-based standards which can be analyzed and fixed (by adjusting risk-weights and refining models), the risk insensitivity of leverage standards is a fundamental defect that cannot be fixed. It is inherent in the standards, and that is why leverage should only be used as a back-stop. The practical impacts of risk-insensitive leverage standards are exacerbated by the high proportion of their assets that the liquidity coverage ratio forces large banks to hold as high-quality liquid assets. Reliance on leverage standards as more than a back-stop, in our view, should be eliminated or at least dialed-back, not increased.

In addition, while the Associations do not believe the proposed rule should contain any minimum long-term debt requirements, if the Federal Reserve nevertheless decides to include minimum long-term debt requirements, the minimum risk-based long-term debt ratio should be equal to the sum of the minimum CET1 requirement of 4.5% and the capital conservation buffer of 2.5% for a total of 7% of RWAs, less a 1% allowance for balance-sheet depletion, or 6%. The minimum long-term debt SLR would be equal to the normal SLR of 3%, less a 0.5% allowance for balance-sheet depletion, for a total of 2.5%. Under the capital refill method, there is no reason for these minimum ratios to reflect any G-SIB buffers.

Moreover, the market does not have an unlimited capacity to absorb new issuances of long-term debt securities during a given time period. If the TLAC and long-term debt requirements are finalized as proposed, the covered BHCs would be required to issue $634 billion in new EDS between the effective date of the final rule and January 1, 2019 in order to comply with these requirements. This would likely cause the cost of long-term debt to both the covered BHCs and commercial companies to rise substantially compared to the cost that would otherwise prevail. If commercial companies are unable to obtain long-term financing for their projects on acceptable terms or the cost of raising long-term debt rises significantly because of excessive TLAC requirements, those excessive requirements could have an adverse impact on the economy as a whole.

2, 2015) ("The leverage ratio requirement continues to serve as an important *backstop* as it guards against possible weaknesses in the risk-based capital requirements") (emphasis added).

IV. Eligible Debt Instruments

Consistent with Principle No. 1, the Associations believe that all long-term debt securities of a covered BHC should count toward minimum TLAC requirements, unless there is a persuasive reason to exclude them. The Associations agree that it would be appropriate to exclude from EDS any long-term debt securities that would be unlikely to remain outstanding and be available to absorb losses and recapitalize the covered BHC at the point of failure. The Associations also agree that there may be a sufficient reason to exclude certain structured notes—namely, structured notes where the amount of the claim under such notes in a bankruptcy or Title II proceeding is difficult to determine in advance of failure. In contrast, there is no justification for excluding any long-term debt securities that would remain outstanding and be available to absorb losses and recapitalize the covered BHC at the point of failure. Nor is there any justification for excluding any long-term structured notes that are principal protected at par, since the minimum amount of any claim in a bankruptcy or Title II proceeding will always be the stated principal amount of the structured notes.[13]

The Associations therefore urge the Federal Reserve to amend the proposed rule so that long-term debt securities that otherwise satisfy the conditions for eligible long-term debt are not excluded from EDS or subjected to a 50% haircut merely because they:

- Contain any or all of the acceleration clauses described on the chart attached as Annex 7, which have traditionally been included in the senior debt securities of covered BHCs;
- Are governed by foreign law;
- Have a remaining maturity of between one and two years;[14]
- Are structured notes that are principal protected at par;[15] or
- Are convertible into or exchangeable for any of the covered BHC's equity securities.

A. Long-Term Debt with Impermissible Acceleration Clauses

The proposed rule would exclude from EDS any long-term debt securities that contain "a contractual right to accelerate payment of principal or interest on the instrument, except a

[13] *See* note 2.

[14] While the Associations have urged the Federal Reserve to eliminate any separate long-term debt requirement for the reasons set forth in Section II, if the Federal Reserve nevertheless decides to retain any separate minimum long-term debt requirements, the Associations urge the Federal Reserve to amend the proposed rule so that long-term debt securities that otherwise satisfy the conditions for eligible long-term debt are not subjected to a 50% haircut merely because they have a remaining maturity of between one and two years.

[15] *See* note 2.

right that is exercisable . . . in the event of (i) a receivership, insolvency, liquidation, or similar proceeding of the global systemically important BHC or (ii) a failure of the global systemically important BHC to pay principal or interest on the instrument when due."[16] The principal reason given for this exclusion is that an acceleration event might otherwise occur prior to a bankruptcy or Title II proceeding and before an automatic stay could be imposed, resulting in the covered BHC's obligations under the long-term debt securities being paid instead of being available to absorb losses and recapitalize the covered BHC at the point of failure.[17] Specifically, the Federal Reserve is concerned that "[e]arly acceleration clauses, including cross-acceleration clauses, may undermine this prerequisite to orderly resolution by triggering and forcing the covered BHC to make payments prior to its entry into resolution, potentially depleting the covered BHC's eligible external LTD immediately prior to resolution."[18] The NPR justifies acceleration clauses based on payment defaults on the ground that covered BHCs are unlikely to default on payment obligations unless and until they are on the brink of insolvency.[19]

As of September 30, 2015, $786 billion (99%) of the $793 billion of the covered BHCs' outstanding ineligible plain vanilla long-term debt securities had impermissible acceleration clauses. Moreover, no future senior long-term debt securities that contain any acceleration events other than the covered BHC's insolvency or payment default would be counted as EDS. Similarly, no outstanding subordinated long-term debt securities that contain acceleration rights based on the insolvency of a material insured depository institution ("**IDI**") subsidiary will qualify as EDS unless grandfathered, and no future long-term debt securities that contain such an impermissible acceleration clause would be counted as EDS, even though subordinated long-term debt with such an acceleration clause would qualify as Tier 2 capital.

Even assuming that $271 billion of long-term debt securities are replaced with EDS as defined in the proposed rule,[20] the amount of the aggregate shortfall as of January 1, 2019 attributable to the restriction on impermissible acceleration clauses alone would be $263 billion. The effect of this restriction far exceeds the Federal Reserve's total estimated shortfall of $120 billion. If the Federal Reserve makes the modifications to the proposed restrictions on acceleration events that we recommend in this comment letter, the aggregate shortfall would be reduced to $100 billion.

The Associations strongly oppose the proposed rule's limitations on permissible acceleration clauses because these limitations are not justified based on the reasons provided in the NPR—including the concern that early acceleration clauses will force a covered BHC to

[16] Proposed Rule § 252.61 (defining "eligible debt security").

[17] 80 Fed. Reg. at 74936.

[18] 80 Fed. Reg. at 74936.

[19] 80 Fed. Reg. at 74936.

[20] *See* footnote 3.

make payments prior to its entry into resolution. Nor are the limitations justified by the reasons for excluding certain long-term debt securities from EDS provided in our Principle No. 1. Accordingly, for the reasons set forth below, we strongly urge the Federal Reserve to expand the permissible acceleration clauses to include those traditionally contained in senior or subordinated long-term debt securities issued by the covered BHCs, including acceleration clauses based on the insolvency of a material IDI subsidiary.[21]

First, if a covered BHC breaches its senior or subordinated debt covenants (and fails to cure such breach) so as to cause an acceleration event, such an acceleration event is just as likely to mean that the covered BHC is on the brink of insolvency as if the covered BHC had defaulted on a payment obligation. As a result, it is just as unlikely that such an acceleration event would result in a covered BHC's obligations under the long-term debt securities being paid instead of being available to absorb losses and recapitalize the covered BHC at the point of failure. Just as covered BHCs are unlikely to default on their payment obligations unless they are on the brink of insolvency, they are similarly unlikely to breach (and fail to cure) any of the other traditional covenants in their senior or subordinated debt indentures unless they are on the brink of insolvency.

Attached as Annex 7 to the U.S. G-SIB Cover Letter is a table showing these traditional covenants and acceleration events, as contained in a representative sample of the public indentures of the covered BHCs, which govern virtually all of the covered BHCs' outstanding senior debt. The covenants in the senior debt indentures of covered BHCs are generally comparable across a particular firm. As a result, a breach of any covenant in one senior indenture of a covered BHC would likely be a breach of a similar covenant in virtually all of its outstanding senior debt, and failure to cure the breach within the applicable grace period would likely force the covered BHC to file for protection under the Bankruptcy Code or be put into a Title II proceeding, causing the automatic stay to be imposed. Thus, because a breach of a traditional covenant would cause virtually all of the covered BHC's senior debt to accelerate at once, such a breach would cause the covered BHC's insolvency, and in no event could the default "trigger[] and forc[e] the covered BHC to make payments prior to its entry into resolution."[22]

Moreover, a covered BHC would be unlikely to breach any traditional covenants in its senior debt indentures unless it were on the brink of insolvency, and even then, such a breach would be unlikely. As shown in Annex 7 to the U.S. G-SIB Cover Letter, none of these senior

[21] The Associations recognize and agree that some acceleration clauses should be excluded from EDS, such as acceleration based on a breach of a financial covenant. As shown in Annex 7, however, no such clauses currently exist in any of the covered BHCs' outstanding senior or subordinated long-term debt securities.

[22] 80 Fed. Reg. at 74936.

indentures contain any financial covenants or any acceleration rights based on financial covenants. The traditional covenants range from covenants that are impossible to breach inadvertently, such as covenants not to enter into a merger transaction or sell all or substantially all of their assets unless the successor assumes the long-term debt securities or to pledge the stock of material subsidiaries, to process covenants that are administrative and easy to comply with or cure breaches of, such as maintaining paying agents in certain locations. Since covered BHCs have control over whether they breach or cure, they are unlikely to breach and fail to cure any of these traditional covenants unless they face insolvency and cannot comply with or cure them. Covered BHCs are similarly unlikely to experience an acceleration event based on the insolvency of a material IDI subsidiary unless they are on the brink of insolvency themselves.

The historical record provides further evidence that covered BHCs are unlikely to breach and fail to cure any traditional covenants in their senior or subordinated debt indentures unless they are on the brink of insolvency, even in a severely adverse scenario. There is no evidence that any of the covered BHCs has ever breached any of the traditional covenants contained in any of its senior or subordinated indentures that was not cured during the applicable cure period, even during the 2008 financial crisis. Thus, there is no historical basis for concluding that such senior long-term debt securities will not be available to absorb losses and recapitalize the covered BHC at the point of its failure.

Despite this historical record, these traditional covenants and related acceleration rights are important to investors. They have traditionally been demanded and given in the markets for investment-grade senior long-term debt securities issued by covered BHCs. While investors do not expect to exercise their acceleration rights, they expect such rights to deter covered BHCs from breaching any of these traditional covenants, especially those covenants designed to preserve the fundamental nature of the covered BHC's business, such as covenants not to enter into a merger transaction or sell all or substantially all of the covered BHC's assets unless the successor assumes the long-term debt securities or not to pledge the stock of material subsidiaries. Indeed, regulators are also often interested in deterring these activities.

Furthermore, the proposed rule would also be "unduly disruptive of the potential market of eligible external LTD" just as if the Federal Reserve had excluded senior long-term debt securities based on having acceleration rights tied to a payment default.[23] In fact, by defining eligible debt instruments so narrowly, the proposed rule will, together with the clean holding company requirements, disrupt the potential market for eligible external long-term debt securities and unnecessarily restrict the possible market for eligible external long-term debt securities by requiring 99.8% of legacy senior plain vanilla long-term debt securities, outstanding as of September 30, 2015, to be conformed or replaced and by fundamentally

[23] 80 Fed. Reg. at 74936.

changing the terms of future senior and subordinated long-term debt securities compared to the traditional terms.

In addition, as discussed in further detail in Section VII.A below, some long-term debt securities may be impossible or very expensive to conform or redeem (for instance, any non-callable long-term debt securities for which consent could not be obtained).

Finally, excluding senior and subordinated long-term debt securities from EDS based on the proposed impermissible acceleration clauses would inadvertently reverse the hard-won market credibility of U.S. resolution authorities. Over the last three years, U.S. resolution authorities have worked hard to develop an effective strategy using existing debt and to educate investors on the loss absorption risks with existing debt instruments (and thereby eliminate moral hazard risks). A recent report by the GAO suggested that this effort had been largely successful and that it was impossible to discern any clear uplift in the market.[24] Rating agencies have also responded similarly to this effort. It would be highly confusing to the market to suddenly establish rules that imply that such debt is unfit for loss absorption. It would also be contrary to due process to apply such an unfair and costly standard when covered BHCs have been working diligently to establishing credible and workable TLAC stacks in the capital markets.

Thus, the Associations believe that senior long-term debt securities should not be excluded from EDS based on having any of the traditional covenants and related acceleration clauses, and that subordinated long-term debt securities should not be excluded based on having an acceleration event tied to the insolvency of any material IDI subsidiary. See Appendix B for the Associations' proposed revisions to the definition of "eligible debt security" to implement the recommendations of this section. Consistent with Principle No. 1, there is no reason to believe that such securities would not be available to absorb losses upon a covered BHC's failure. A contrary rule would repudiate the NPR's stated goal of "limiting the criteria for eligible external LTD to those necessary to achieve the objectives of the proposal" in order to "retain the broadest possible market for eligible external LTD instruments."[25]

If the Federal Reserve nonetheless disagrees with the Associations' position, the provision limiting permissible acceleration clauses is still overbroad as proposed. The Federal Reserve can take steps to ensure that all long-term debt securities with impermissible acceleration clauses will be available to absorb losses and recapitalize the covered BHC at the point of failure. Even if a covered BHC breaches a covenant with an impermissible acceleration clause, the relevant indentures invariably give the covered BHC a grace period during which to

[24] U.S. Gov't Accountability Office, Large Bank Holding Companies: Expectations of Government Support 24 (July 2014).

[25] 80 Fed. Reg. at 74937.

cure the covenant breach before any acceleration rights can be exercised. The Federal Reserve could require a covered BHC to cure any covenant breaches within the applicable cure period and require it to file for bankruptcy or place it into a Title II receivership if it fails to do so.

B. Long-Term Debt Governed by Foreign Law

The proposed rule would exclude from EDS any long-term debt securities that are not "governed by the laws of the United States or any State thereof."[26] The NPR's only stated rationale for this exclusion is that eligible long-term debt should "consist only of liabilities that can be effectively used to absorb losses during the resolution of a covered BHC under the U.S. Bankruptcy Code or Title II without giving rise to material risk of successful legal challenge,"[27] implying that long-term debt securities governed by foreign law might not be able to be used effectively to absorb losses or recapitalize covered BHCs because any actions taken to do so in a U.S. bankruptcy or Title II proceeding would be vulnerable to successful legal challenge in foreign jurisdictions.

As of September 30, 2015, $95 billion (12%) of the $793 billion of the covered BHCs' outstanding ineligible plain vanilla long-term debt securities were governed by foreign law. Even assuming that $271 billion of long-term debt securities are replaced with EDS as defined in the proposed rule,[28] the amount of the aggregate shortfall as of January 1, 2019 attributable to the restriction on foreign governing law (assuming the acceleration clause restrictions described above are removed) would be $40 billion. If the Federal Reserve makes the modifications to the proposed restrictions on foreign governing law that we recommend in this comment letter, in addition to the modifications to the proposed restrictions on acceleration events that we recommend above, the aggregate shortfall would be reduced to $60 billion.

The Associations do not believe that there is any material risk that any actions taken in a U.S. bankruptcy or Title II proceeding to impose losses on long-term debt securities governed by foreign law or to use them to recapitalize covered BHCs would be subject to successful legal challenge in any of the foreign jurisdictions accounting for 98% of the foreign-law governed long-term debt securities outstanding as of September 30, 2015. As a result, the proposed rule should not exclude such securities from EDS.

First, it is unlikely that a valid order issued in a U.S. bankruptcy or Title II proceeding to impose losses on long-term debt securities governed by foreign law or use them to recapitalize a covered BHC will be disregarded or treated as invalid by foreign courts. As of September 30, 2015, 98% of the aggregate principal amount of outstanding long-term debt securities issued by

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[26] Proposed Rule § 252.61 (defining "eligible debt security").

[27] 80 Fed. Reg. at 74937.

[28] *See* footnote 3.

covered BHCs governed by foreign law were governed by laws of only three jurisdictions—English law (76%), Japanese law (11%) and Australian law (11%). There is no material amount of legacy long-term debt securities issued by covered BHCs governed by any other foreign law.

The United Kingdom ("**U.K.**"), Japan and Australia all have statutes substantially similar to Chapter 15 of the Bankruptcy Code based on the UNCITRAL Model Law on Cross-Border Insolvency (the "**UNCITRAL Model Law**") that each provide a judicial mechanism for recognizing and giving effect to actions taken in a U.S. bankruptcy or Title II proceeding.[29] In addition, the European Bank Recovery and Resolution Directive ("**BRRD**"), which has been largely implemented into the national laws of most member states of the European Union ("**EU**"), contains a provision that allows resolution authorities in the EU to recognize and give effect to actions taken in a Title II proceeding, as a "third country resolution proceeding."[30] The U.K. has implemented the BRRD into national law through substantive amendments to the U.K. Banking Act 2009, including provisions on the recognition of third country resolution proceedings.[31] While the Bank of England, as the relevant U.K. resolution authority, has the right to refuse to recognize third country resolution proceedings in certain limited circumstances,[32] it is expected that Title II proceedings in most scenarios would be recognized as third country resolution proceedings by the Bank of England.

To the extent that other jurisdictions do not currently have a statute that would empower a resolution authority to recognize and give effect to any actions taken in a Title II proceeding to impose losses on long-term debt securities governed by such jurisdiction's laws, the problem would likely be short-lived, since the FSB has urged all jurisdictions to adopt cross-border recognition statutes or other rules that would facilitate "speed and predictability" in resolution.[33] There is significant work underway at the international level to ensure that resolution authorities cooperate in the case of cross-border banks. In addition, the courts in the U.K. and elsewhere have developed jurisprudence influenced by the long-standing doctrine of international comity that would permit recognition and enforcement of actions in a U.S.

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[29] U.K. Cross-Border Insolvency Regulations 2006; Japanese Law on Recognition of and Assistance in Foreign Insolvency Proceedings; Australian Cross-Border Insolvency Act 2008 (Commonwealth). Based on advice from U.K., Japanese and Australian counsel, we understand that both a proceeding under the U.S. Bankruptcy Code and a proceeding under Title II of the Dodd-Frank Act would be recognized and given effect under these laws.

[30] Directive 2014/59/EU, Art. 2, 94 and 95.

[31] U.K. Banking Act 2009 § 89H-89J.

[32] *See* U.K. Banking Act 2009, § 89H(4).

[33] Financial Stability Board, Removing Remaining Obstacles to Resolvability: Report to the G20 on Progress in Resolution at 11 (Nov. 9, 2015).

bankruptcy or Title II proceeding to impose losses on long-term debt securities governed by such jurisdiction's laws in an SPOE resolution.[34]

Second, even if a U.S. bankruptcy or Title II proceeding imposing losses on long-term debt securities governed by foreign law or using them to recapitalize a covered BHC were not formally recognized in the relevant country, the vast bulk of financial market participants are subject to personal jurisdiction of a U.S. court and thus likely to respect a U.S. court order. U.S. bankruptcy law gives the court in which a proceeding is pending jurisdiction over all of the debtor's property, wherever located, and the discharge of debts under a reorganization plan binds all creditors of the debtor and enjoins them from enforcing discharged debts.[35] It is thus unlikely that any substantial creditor would be willing to challenge the discharge even if it is not formally recognized in a given country, as doing so would require a violation of a U.S. court order.

Third, a judgment in a foreign jurisdiction will have no practical impact on a valid order in a U.S. bankruptcy or Title II proceeding imposing losses on long-term debt securities governed by foreign law or using them to recapitalize a covered BHC, unless the covered BHC has any assets located outside the United States. There is no risk that a U.S. court would enforce a foreign judgment against a covered BHC's assets in the United States if that foreign judgment were inconsistent with a valid order issued in a U.S. bankruptcy or Title II proceeding because U.S. courts do not extend comity to foreign proceedings when doing so would be contrary to U.S. public policy.[36] If a covered BHC had assets located outside the United States, however, there would be some risk that a foreign court would enforce a foreign judgment against those assets. Covered BHCs, however, do not typically own significant amounts of assets located outside the United States that can be effectively used to satisfy a judgment against them. Unlike their bank subsidiaries, they do not have foreign branches or other offices outside the United States, nor do they typically directly own securities, real estate, or other assets located outside the United States. They may own shares in foreign operating subsidiaries that are located outside the United States, but those shares are almost always held through U.S. intermediate holding companies.

In addition, excluding long-term debt securities from EDS merely for being governed by foreign law is inconsistent with the NPR's stated goal of "limiting the criteria for eligible

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[34] *See*, *e.g.*, Adams v. Cape Industries plc [1990] Ch. 433.

[35] 28 U.S.C. § 1334(e); 11 U.S.C. § 1141(a).

[36] *Pravin Banker Assocs., Ltd. v. Banco Popular del Peru*, 109 F.3d 850, 854 (2d Cir. 1997) ("courts will not extend comity to foreign proceedings when doing so would be contrary to the policies or prejudicial to the interests of the United States"); *See also Victrix S.S. Co., S.A. v. Salen Dry Cargo A.B.*, 825 F.2d 709, 713 (2d Cir. 1987) (U.S. courts will only defer to foreign proceedings where "enforcement does not prejudice the rights of United States citizens or violate U.S. domestic public policy.").

external long-term debt to those necessary to achieve the objectives of the proposal" in order to "retain the broadest possible market for eligible external long-term debt instruments."[37] In fact, by defining EDS so narrowly, the proposed rule will, together with the proposed clean holding company requirements, unduly disrupt the international debt markets and unnecessarily restrict the possible market for eligible external long-term debt instruments by effectively requiring all legacy long-term debt securities and all future long-term debt securities issued by covered BHCs to be governed by U.S. law. Moreover, requiring EDS to be issued under U.S. law will deny or at least increase the cost of access to those markets by G-SIBs where the convention is to issue long-term debt securities under local law, which could result in an incremental loss of currency and funding diversification. Examples of such long-term debt securities include Samurai bonds (Japan) and Kangaroo bonds (Australia), which are purchased largely by local investors, including pension funds, seeking exposure to foreign issuances of long-term debt securities governed by local law. Furthermore, the proposed requirement would disrupt investor programs offered by covered BHCs for which the use of foreign law governed instruments is inherent to the program and would further restrict covered BHCs' access to investors that seek such debt.

To the extent that the Federal Reserve nevertheless remains concerned that long-term debt securities governed by foreign law might not be able to be used effectively to absorb losses or recapitalize covered BHCs without giving rise to a material risk of a successful legal challenge in a foreign jurisdiction, there is a less restrictive means to address the problem. Covered BHCs could eliminate any material risk of successful legal challenge by including clauses in their prospectively issued long-term debt securities that result in investors consenting to any actions taken in U.S. bankruptcy or Title II proceedings in the event of a covered BHC's failure. Indeed, the FSB's Principles on Loss-Absorbing and Recapitalisation Capacity of G-SIBs in Resolution (the "**International Standard**")[38] permits such a solution, providing that eligible external TLAC may be subject to the laws of a foreign jurisdiction if the application of the home country's resolution tools is made "enforceable on the basis of binding statutory provisions or legally enforceable contractual provisions for recognition of resolution actions."[39]

The European experience with contractual recognition clauses provides a model that can be adapted and used in the United States. Article 55 of the European BRRD requires that liabilities subject to the BRRD's bail-in tool and governed by the law of a non-EU jurisdiction

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[37] 80 Fed. Reg. at 74937.

[38] Financial Stability Board, *Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution: Total Loss-absorbing capacity (TLAC) Term Sheet* (Nov. 9, 2015).

[39] Financial Stability Board, *Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution: Total Loss-absorbing capacity (TLAC) Term Sheet*, at 17 (Nov. 9, 2015).

contain a "contractual recognition of bail-in clause."[40] While Article 55 does not prescribe any specific language, secondary EU legislation, currently in draft form, sets out certain minimum standards that must be met in a contractual recognition of bail-in. Principally, the required clause must include an acknowledgment and acceptance by a counterparty that the financial institution's liabilities under the agreement may be subject to the bail-in process administered by an EU resolution authority. In response, EU financial institutions and law firms worked to develop both firm-specific standard form clauses and industry-wide model clauses, mobilizing around trade associations such as the Association for Financial Markets in Europe ("**AFME**"), International Capital Market Association ("**ICMA**"), Loan Market Association ("**LMA**") and the Loan Syndications and Trading Association ("**LSTA**"). In the U.K. and other jurisdictions which are implementing the International Standard as a subset of the European BRRD's broader "minimum requirement for own funds and eligible liabilities" requirement, the standard forms developed to comply with Article 55 will likely also serve to comply with the FSB International Standard. U.S. regulators could follow this European model to require covered BHCs to incorporate contractual consent language into their long-term debt securities, eliminating any material risk that long-term debt securities governed by foreign law might not be available to absorb losses or recapitalize a covered BHC without giving rise to a material risk of a successful legal challenge in a foreign jurisdiction.

C. 50% Haircut

The proposed rule would apply a 50% haircut to the principal amount of any EDS with a remaining maturity between one and two years for purposes of its proposed minimum long-term debt requirements. The 50% haircut would not apply to long-term debt securities included in the proposed minimum TLAC requirement.

The NPR explains that "the purpose of this restriction is to limit the debt that would fill the external LTD requirement to debt that will be reliably available to absorb losses in the event that the covered BHC fails and enters resolution."[41] According to the NPR, the proposed haircut would accomplish this goal by requiring covered BHCs to hold additional EDS with a remaining maturity of more than two years to comply with their minimum long-term debt requirement.[42] The NPR also explains that a "covered BHC could reduce its reliance on EDS with a remaining maturity of less than two years by staggering its issuance, by issuing eligible external LTD with a relatively long initial maturity, or by redeeming and replacing eligible external LTD once its remaining maturity falls below two years,"[43] suggesting that one motivation for the 50% haircut

[40] European BRRD, Art. 55.

[41] 80 Fed. Reg. at 74936.

[42] 80 Fed. Reg. at 74937.

[43] 80 Fed. Reg. at 74937.

is to prevent all or a large portion of covered BHC debt securities from reaching maturity at the same time.

For the reasons stated in Section II, the Associations believe that any separate long-term debt requirements should be eliminated from the proposed rule. If they are, the 50% haircut would become irrelevant since it only applies to EDS included in the proposed minimum long-term debt requirements.

But if the Federal Reserve decides to retain any separate minimum long-term debt requirements, it should eliminate the 50% haircut applicable to EDS that otherwise count toward such long-term debt requirements. Consistent with Principle No. 1, the Associations agree that EDS should be "reliably available" to absorb losses and to recapitalize the covered BHC at the point of failure, but do not agree that debt securities with a remaining maturity between one and two years would not be reliably available. The debt securities subject to the 50% haircut are limited to eligible long-term debt securities that have already been determined to be reliably available. Moreover, there is already a 100% haircut on eligible long-term debt that has a remaining maturity of less than one year. Thus, no securities that count toward the long-term debt requirements would mature and become unavailable to absorb losses within the first year of a covered BHC experiencing financial distress. The Associations believe this would be a sufficient period of time for the covered BHC to recover, or if necessary, be placed into a bankruptcy or Title II proceeding. Therefore, a 100% haircut on eligible long-term debt with a remaining maturity of less than one year is sufficiently conservative to ensure that calculations of external long-term debt are predictive of how much long-term debt would be available in an SPOE resolution, without the 50% haircut.

In addition, the Federal Reserve's assumption that a covered BHC could reduce its reliance on EDS with a remaining maturity of less than two years by redeeming and replacing such securities once their remaining maturity falls below two years is unrealistic in practice. Only a small amount of the long-term debt securities of the covered BHCs outstanding as of September 30, 2015 are callable at the issuer's option. The investor base for callable debt is relatively small, and given the constraints investors and issuers alike face in purchasing or issuing such instruments, will likely remain a small proportion of new issuances. As a result, covered BHCs are likely to continue issuing predominantly non-callable long-term debt securities.

Finally, there is no material risk that all or most of a covered BHC's debt will reach maturity at the same time. Covered BHCs already ladder the maturities of their long-term debt securities. Any concerns the Federal Reserve may have about the appropriate laddering of long-term debt securities by covered BHCs do not warrant the 50% haircut. Conversely, the market disruption that could be caused by artificially distorting covered BHCs' patterns of debt

issuance—or indeed, the appropriateness of requiring such a distortion—has not been adequately considered.

D. Long-Term Principal-Protected Structured Notes

The proposed rule would also exclude from EDS any long-term "structured note," whether or not it is principal protected. The NPR provides two reasons for excluding structured notes from EDS. The first is that structured notes "contain features that could make their valuation uncertain, volatile, or unduly complex,"[44] which would undermine two important goals:

- Ensuring that the "value [of EDS] is easily ascertainable at any given time" in order to promote resiliency and market discipline;[45] and
- Ensuring that EDS are "able to be valued accurately and with minimal risk of dispute."[46]

The second reason given for excluding structured notes is that structured notes are "typically customer liabilities (as opposed to investor liabilities)."[47] The NPR explains that "customer products" are "sold to purchasers who are primarily seeking exposure to a particular asset class and not seeking credit exposure to the [issuer]."[48] The NPR also states that "the need to impose losses on a financial institution's customers in resolution may create obstacles to orderly resolution."[49]

As a result of this proposed exclusion, $11 billion in structured notes that are principal protected at par will be excluded from EDS under the proposed rule, unless they are grandfathered.

The first rationale given for excluding structured notes is not persuasive with respect to long-term structured notes that are principal protected at par.[50] The amount of a holder's claim on such principal-protected structured notes in a bankruptcy or Title II proceeding is not uncertain, volatile, complex or otherwise difficult to determine in advance of such proceedings. The minimum amount of that claim is simply 100% of the face amount of the structured notes.

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[44] 80 Fed. Reg. at 74935.

[45] 80 Fed. Reg. at 74935.

[46] 80 Fed. Reg. at 74935.

[47] 80 Fed. Reg. at 74935.

[48] 80 Fed. Reg. at 74947.

[49] 80 Fed. Reg. at 74947.

[50] *See* note 2.

It is not affected by the market value, volatility or complexity of the structured notes. As a result, the amount of a holders' claim on such principal protected notes is just as certain, fixed, and simple to determine in advance of bankruptcy or Title II proceedings as the minimum amount of a holder's claim on plain-vanilla notes with a fixed or floating interest rate, and can be converted into or exchanged for equity just as readily.

The second rationale given in the NPR for excluding structured notes from EDS is equally unpersuasive when applied to long-term structured notes that are principal protected at par. The NPR provides no evidence—and the Associations do not believe there is any—that the purchasers of such principal-protected structured notes "are primarily seeking exposure to a particular asset class" and are not relying in any way on the creditworthiness of the issuer.[51] While such purchasers are certainly seeking exposure to a particular asset class, they are also relying on the creditworthiness of the covered BHC to limit their downside risk through the element of principal protection at par. Indeed, the very reason for purchasing structured notes that are principal protected at par instead of purchasing structured notes without such principal protection, or instead of directly purchasing the embedded derivative (such as a call option on the S&P 500) or purchasing another direct investment that is not principal protected (such as an exchanged-traded fund), is to limit the investor's downside exposure based on the creditworthiness of the issuer. In fact, in most cases, the purchaser's largest exposure on long-term structured notes that are principal protected at par is the par value of the structured notes and not the exposure to the embedded derivative.

The NPR also provides no evidence—and the Associations do not believe there is any—that imposing losses on the pool of investors who purchase principal-protected structured notes would result in any material contagion to other covered BHCs or otherwise threaten financial stability. Indeed, the NPR flatly states that imposing losses on structured notes would not threaten financial stability.[52] Other covered BHCs are not among the investors who typically purchase structured notes. Moreover, the proposed regulatory deductions for investing in long-term debt securities issued by other covered BHCs would limit any contagion risk to other covered BHCs. The disclosure and suitability requirements in the U.S. securities laws apply to all types of securities issued by covered BHCs, including structured notes. As a result, there is no reason to believe that the need to impose losses on the purchasers of principal-protected structured notes issued by covered BHCs will create any obstacles to the orderly resolution of the covered BHCs.

Moreover, permitting long-term structured notes that are principal protected at par to be EDS may permit further diversification to the range of EDS, therefore increasing the

[51] 80 Fed. Reg. at 74947.

[52] 80 Fed. Reg. at 74947 (noting that structured notes "could be subjected to losses alongside eligible external TLAC without potentially undermining SPOE resolution").

likelihood that the covered BHCs could raise additional EDS even during periods of severe market distress.

E. Convertible or Exchangeable Debt Securities

The proposed rule would also exclude from EDS any long-term debt securities that provide that they "may be converted into or exchanged for equity of the global systemically important BHC."[53] The NPR explains that convertible or exchangeable debt securities that could convert into or be exchangeable for the covered BHC's equity prior to its resolution needed to be excluded from EDS because the "fundamental objective of the external LTD requirement is to ensure that covered BHCs will have at least a fixed minimum amount of loss-absorbing capacity available to absorb losses upon the covered BHC's entry into resolution."[54] The NPR requested comment, however, on whether convertible or exchangeable debt securities "should be permitted to count as eligible external TLAC even if they are excluded from eligible external LTD."[55] The Associations believe that such securities should either count as eligible external long-term debt or be permitted to count as eligible external TLAC.

As a result of this proposed exclusion, no long-term debt securities that are convertible into or exchangeable for the covered BHC's equity securities will qualify as EDS unless grandfathered. Moreover, since debt securities that are convertible into or exchangeable for a covered BHC's equity securities do not count as equity securities under the Basel III capital requirements until they are converted or exchanged, such securities would not count toward TLAC absent an amendment to the proposed rule. Covered BHCs do not currently have long-term debt with convertible or exchangeable features outstanding. However, this type of long-term debt is may be issued by covered BHCs in times of stress when issuing other types of capital structure liabilities could be difficult, and it would be shortsighted to prevent them from being issued (except to the extent permitted under the 5% allowance on unrelated liabilities).

The Associations believe that the proposed rule should either include convertible or exchangeable long-term debt securities in EDS or treat them as if they were the equity securities into or for which they could be converted or exchanged. Whether these convertible or exchangeable securities are debt instruments or equity instruments at the time of resolution, they should be allowed to absorb losses and recapitalize the covered BHC at the time of any failure.

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[53] 80 Fed. Reg. at 74958; Proposed Rule § 252.61 (defining "eligible debt security").

[54] 80 Fed. Reg. at 74935.

[55] 80 Fed. Reg. at 74936 (Question 18).

F. Consistency with the FSB's International Standard

Implementing our recommendations with respect to EDS would be more consistent with the FSB's International Standard than the Federal Reserve's proposed definition of EDS. The FSB only excludes structured notes from the definition of eligible TLAC. It would not exclude any of the following securities from the definition of eligible TLAC:

- Long-term debt securities with impermissible acceleration clauses;
- Long-term debt securities governed by foreign law;
- Long-term debt securities that are convertible into or exchangeable for the covered BHC's equity; or
- Hybrid securities.

To the extent the Federal Reserve may be concerned about departing from the FSB's International Standard by allowing long-term structured notes that are principal protected at par to be included in EDS when the FSB's International Standard treats them as "excluded liabilities," the departure would be more than justified by four reasons. First, the FSB's International Standard is not binding on the Federal Reserve and could not be legally binding as a matter of U.S. Federal law because its development did not comply with the prior notice and comment requirements of the Administrative Procedure Act ("**APA**"). As noted above, the Associations believe that the concerns raised in the NPR are not valid with respect to structured notes that are principal protected at par.

Second, this modest departure would be justified by the fundamental differences between the direct bail-in model used outside the United States and the indirect bail-in models used in the United States, since the FSB decided to exclude structured notes from eligible TLAC primarily because of the perceived needs of the non-U.S. direct bail-in model.

Third, this departure is modest in comparison to the many ways in which the proposed rule would impose substantially higher gold-plated TLAC requirements on covered BHCs compared to the FSB's International Standard, including by:

- Treating a number of types of long-term debt securities as "unrelated liabilities" that must be made structurally or contractually preferred to EDS under the clean holding company framework of the proposed rule, when structured notes are the only type of long-term debt securities treated as "excluded liabilities" and required to be made contractually, statutorily or structurally preferred to eligible TLAC under the FSB's International Standard;

- Excluding a number of types of long-term debt securities from EDS, such as those with impermissible acceleration clauses, when structured notes are the only type of long-term debt securities excluded from eligible TLAC under the FSB's International Standard;

- Containing separate minimum long-term debt requirements;

- Using the Federal Reserve's Method 2 G-SIB surcharges in the calibration of the minimum long-term debt requirements, which represents gold-plating as compared to surcharges calculated based on the International Standard (which are the same as the Federal Reserve's Method 1 G-SIB surcharges); and

- Prohibiting short-term non-deposit liabilities, parent guarantees with impermissible cross-defaults and upstream guarantees even though none of these would be "excluded liabilities" under the FSB's International Standard.

V. Clean Holding Company Requirements

The proposed rule would also establish a set of "clean holding company" requirements consisting of a requirement that "unrelated liabilities" be made structurally or contractually preferred to EDS (subject to a 5% allowance), a flat prohibition on certain parent liabilities, and certain exempt liabilities. The proposed rule defines "unrelated liabilities" as any "non-contingent liability" to any person other than an affiliate of the covered BHC, except for certain excluded liabilities. The excluded liabilities include any EDS and unrelated liabilities that are made contractually or structurally preferred to EDS. Prohibited parent company liabilities include short-term debt, guarantees of subsidiary liabilities that contain prohibited cross-defaults, upstream guarantees and, perhaps inadvertently, all parent guarantees of QFCs whether they are subject to the ISDA Protocol or not. Exempt liabilities include third-party liabilities expressly excluded from the definition of "unrelated liabilities," contingent liabilities to third parties that are not prohibited liabilities, and liabilities to affiliates ("**related party liabilities**").

The effect of these clean holding company requirements is generally to require covered BHCs to make all prohibited liabilities and almost all unrelated liabilities preferred to EDS, subject to a 5% allowance in the case of unrelated liabilities. Covered BHCs can satisfy the clean holding company requirement for unrelated liabilities by making them structurally or contractually preferred to EDS. This clean holding company requirement would also be satisfied if unrelated liabilities were secured or made statutorily preferred to EDS.[56] Covered BHCs can

[56] Proposed Rule § 252.64(b)(2)(iv).

satisfy the clean holding company requirement for prohibited liabilities only by making them structurally preferred to EDS.

As noted in the U.S. G-SIB Cover Letter to which this Annex 1 is attached, forcing covered BHCs to make any capital structure liabilities structurally or contractually preferred to EDS is inconsistent with the important public policy goal of ensuring a durable end to TBTF because such liabilities can absorb losses and recapitalize a covered BHC at the point of failure without threatening financial stability and because such a requirement has the counterproductive effect of reducing the amount of consolidated capital created by bailing in a covered BHC's EDS and other capital structure liabilities (i.e., converting them into equity of a covered BHC or exchanging them for equity in a bridge BHC). See Annex 6 to the cover letter for mathematical examples illustrating these principles.

Indeed, covered BHCs should not be required to make ***any liabilities*** structurally or contractually preferred to EDS, unless there is a persuasive reason to do so. There is a persuasive reason to require covered BHCs to make short-term debt and other operating liabilities structurally or contractually preferred to EDS. Otherwise, critical vendors may refuse to perform, cutting off critical services that are essential for a covered BHC's operating subsidiaries to continue to operate, maintain their franchise values or provide critical operations to the market. Similarly, holders of short-term debt and other operating liabilities, such as QFCs, may run, draining liquidity out of the group and potentially forcing it to sell assets at distressed prices. Runs and any resulting sales of assets at distressed prices can also create the sort of contagion that can destabilize the U.S. financial system and harm the wider economy.

In contrast, there is no persuasive argument for protecting any capital structure liabilities of a covered BHC against losses by forcing the covered BHC to make them structurally or contractually preferred to EDS. The holders of such liabilities do not have the legal right or practical ability to require repayment until maturity of the contract. Accordingly, consistent with Principle No. 2 and for the reasons more fully set forth in this Section V, the Associations urge the Federal Reserve to amend the proposed rule so that no capital structure liabilities of a covered BHC are treated as "unrelated liabilities" for purposes of the clean holding company framework in the proposed rule, including any of the following:

- Long-term debt securities that contain any impermissible acceleration provisions;
- Long-term debt securities governed by foreign law;
- Long-term structured notes, whether they are principal protected or not;

- Long-term debt securities that are convertible into or exchangeable for any of the covered BHC's equity securities; or

- Hybrid securities.

As noted in Section I, there are also practical reasons for limiting "unrelated liabilities" to external operating liabilities and excluding all external capital structure liabilities from that term. First, the covered BHCs are expected to have $36 billion of external operating liabilities as of January 1, 2019, or 2% of the aggregate projected amount of required TLAC of $1,583 billion as of that date. This is well within the 5% allowance. Second, although their total external TLAC amount and operating liabilities may fluctuate, the covered BHCs believe that they can manage their total external TLAC amount and operating liabilities in a way that generally keeps such liabilities well below the 5% allowance, as long as capital structure liabilities are not also treated as "unrelated liabilities."

In contrast, if external capital structure liabilities are treated as "unrelated liabilities" unless they are able to be conformed to meet the currently proposed, highly restrictive definition of EDS, the covered BHCs will have $622 billion of unrelated liabilities, including $36 billion in operating liabilities, as of January 1, 2019, even if the covered BHCs replace all of their outstanding ineligible long-term debt securities that mature in 2017 and 2018 or that are callable before 2019 with EDS. This amounts to 39% of total required TLAC, or almost ***8 times the 5% allowance***, as of January 1, 2019. Moreover, it would be very expensive and perhaps impossible to cure this breach promptly. Such liabilities are by definition long-term and rarely have issuer call rights. It would not only be prohibitively expensive but also impractical to issue enough new EDS to dilute the sum of outstanding capital structure liabilities and outstanding operating liabilities down to less than 5% of a covered BHC's actual total external TLAC amount by January 1, 2019.

A. Priority Requirement for Unrelated Liabilities

The proposed clean holding company requirements would require covered BHCs to make "unrelated liabilities" structurally or contractually preferred to EDS, subject to an allowance equal to 5% of the covered BHC's eligible TLAC. Consistent with Principle No. 2, the Associations believe that no capital structure liabilities should be required to be made structurally or contractually preferred to EDS, unless there is a persuasive reason to do so. The Associations do not believe there is any such persuasive reason with respect to any capital structure liabilities, including any of the covered BHCs' long-term debt securities.

1. Scope of "Unrelated Liabilities"

The proposed rule defines "unrelated liabilities" as "any non-contingent liability of the [covered BHC] owed to a person other than an affiliate of the [covered BHC] other than":

- Tier 1 equity securities and EDS;
- "Any dividend or other liability arising from" any Tier 1 equity security or EDS;
- An EDS that does not provide the holder with an immediately exercisable put right;[57] or
- A liability to the extent secured or otherwise senior to EDS.[58]

The NPR clarifies that long-term debt securities that "were [EDS] when issued and have ceased to be eligible (because their remaining maturity is less than one year) as long as the holder of the instrument does not have a currently exercisable put right" would not be treated as "unrelated liabilities" for purposes of the clean holding company framework.[59] The NPR also provides that "[t]he liabilities that would be expected to be [treated as unrelated liabilities] subject to the cap would include":

- "[D]ebt instruments with derivative-linked features (i.e., structured notes)";
- "[E]xternal vendor and operating liabilities, such as for utilities, rent, fees for services, and obligations to employees"; and
- "[L]iabilities arising other than through a contract (*e.g.*, liabilities created by a court judgment)."[60]

The NPR did not expressly state that capital structure liabilities would be treated as "unrelated liabilities" for purposes of the clean holding company framework, but the definition of "unrelated liabilities" in the proposed rule would appear to include all capital structure liabilities other than EDS, including:

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[57] The Associations do not believe an EDS would be an unrelated liability even if it gave investors an immediately exercisable put right if the put right was not initially exercisable until more than one year after the issuance date of the EDS. Instead, such a put right, once it becomes exercisable, would be treated the same as any other debt security with a remaining maturity of less than one year. *See* 80 Fed. Reg. at 74935 n. 52. It would be useful if the Federal Reserve could confirm our understanding in its final rule.

[58] 80 Fed. Reg. at 74960; Proposed Rule § 252.64(b)(2).

[59] 80 Fed. Reg. at 74947.

[60] 80 Fed. Reg. at 74947.

- Long-term debt securities with impermissible acceleration clauses;
- Long-term debt securities governed by foreign law;
- Long-term debt securities that are convertible into or exchangeable for the equity securities of a covered BHC; and
- Hybrid securities.

2. Reasons Given for Clean Holding Company Requirements

The NPR justifies the proposed rule's clean holding company requirements that result in unrelated liabilities being made structurally or contractually preferred to EDS (subject to the 5% allowance), and its flat prohibition on certain liabilities, as advancing three related goals of SPOE resolution.[61] None of the reasons advanced, however, is persuasive with respect to the requirement that all capital structure liabilities (other than those specifically excluded from unrelated liabilities) be made structurally or contractually preferred to EDS (subject to the 5% allowance). First, the NPR states that the clean holding company requirements would advance the goal of being able "to impose losses on the creditors of a covered [BHC] without causing material disruption."[62] They would do so by "minimizing the risk of short-term funding runs, asset fire sales and severe losses to other large financial firms that might otherwise be associated with an SPOE resolution of a covered [BHC]."[63] This goal, however, only justifies the parent-company level ban on short-term debt, parent guarantees with impermissible cross-defaults, and other prohibited liabilities that could result in runs, contagion, or the loss of critical operations if they were not insulated from losses by structural subordination. This rationale does not justify the requirement that any long-term debt securities treated as "unrelated liabilities" be made structurally or contractually preferred to EDS (subject to the 5% allowance) because none of these securities gives their holders the legal right or practical ability to run.

Second, the NPR states that the clean holding company requirements would "limit the extent to which the subsidiaries of a covered [BHC] would experience losses as a result of the failure of the covered [BHC]."[64] The second reason only justifies the ban on parent guarantees with impermissible cross-defaults, upstream guarantees, and similar prohibited contingent liabilities that could result in loss upon terminations or, possibly, an immediate drain of cash out of a covered BHC's operating subsidiaries as a result of the covered BHC's insolvency or

[61] 80 Fed. Reg. at 74944.

[62] 80 Fed. Reg. at 74944.

[63] 80 Fed. Reg. at 74944.

[64] 80 Fed. Reg. at 74944.

entry into resolution. This rationale does not justify the requirement that any long-term debt securities treated as "unrelated liabilities" be made structurally or contractually preferred to EDS (subject to the 5% allowance) because none of these securities gives their holders the legal right or practical ability to take cash out of the covered BHC's operating subsidiaries.

Third, the NPR states that the clean holding company requirements would promote the goal of achieving a "rapid recapitalization of the material subsidiaries of a covered [BHC] with minimal disruption to the ordinary operations of those subsidiaries" because "[l]imitations on the types of transactions that a covered [BHC] may enter into serve to limit its legal and operational complexity and thereby facilitate a prompt resolution and recapitalization with minimal uncertainty and delay."[65] This reason appears to be designed to justify the prohibition on structured notes (subject to the 5% allowance). It is, however, overbroad and unpersuasive for both structured notes and any other capital structure liabilities for at least three reasons.

In the final analysis, it is unnecessary to be able to determine the amount of any claims on structured notes (or any other capital structure liabilities for that matter) by Monday morning following resolution weekend in an SPOE resolution under the U.S. Bankruptcy Code or Title II of the Dodd-Frank Act. Indeed, it does not even make any difference on Monday morning what the amount of the claims are. The ultimate decision about how much value each claimant receives in satisfaction of its claims can and will be decided later.

In the context of a two-company SPOE resolution under the Bankruptcy Code or Title II, the only thing that needs to be accomplished by the following Monday morning is exercise of the "core resolution powers" (i.e., creating a bridge BHC and transferring the covered BHC's assets to the bridge BHC and causing the bridge to assume the covered BHC's operating liabilities that must be assumed to preserve the franchise value of the business transferred to the bridge). In the context of a one-company SPOE resolution under the U.S. Bankruptcy Code, the only thing that needs to be done by Monday morning is to impose the automatic stay on all capital structure liabilities.

Long-term structured notes (and all other capital structure liabilities) can bear losses pari passu alongside EDS without creating any threat to financial stability and thus do not need to be assumed by the bridge BHC (or be excluded from the automatic stay in a one-company SPOE resolution under the Bankruptcy Code), whether by Monday morning or otherwise. In particular, it is unnecessary to make any valuations of any structured notes (or any other capital structure liabilities) or determine the amount or holders of the claims on any such structured notes (or any other capital structure liabilities) by Monday morning or within any other constrained time frame. The structured notes (and any other capital structure liabilities) are simply left behind in the bankruptcy estate or Title II receivership subject to an automatic stay

[65] 80 Fed. Reg. at 74944.

pending a determination of the residual value of the covered BHC or bridge BHC and the distribution of that value to the holders of all capital structure liabilities left behind in the bankruptcy estate or Title II receivership in satisfaction of their claims.

Furthermore, even if a bankruptcy court or the FDIC wanted to make a final determination of the amount of any claims on structured notes (or on any other capital structure liabilities) by Monday morning, the due process protections built into the Bankruptcy Code and Title II would not permit them to do so. Both statutes contain provisions that require at least 6 months to conduct a claims process and in practice it often takes much longer to do so. While any material delay in the exercise of "core resolution powers" could be an obstacle to the rapid and orderly resolution of a covered BHC and its subsidiaries and have an adverse impact on financial stability, delays in the completion of the claims process for capital structure liabilities would have no such impact, unless such delays were wholly unreasonable.

Finally, treating structured notes (or any other capital structure liabilities) as unrelated liabilities and requiring covered BHCs to make them structurally or contractually preferred to EDS would be directly contrary to the basic goal of TLAC: to provide sufficient long-term debt securities so that a rapid and orderly resolution can occur through an expeditious recapitalization of operating subsidiaries with minimal disruption. An unduly broad definition of unrelated liabilities would defeat this objective by reducing the amount of consolidated capital created at the covered BHC or bridge BHC level in an SPOE resolution by increasing the amount of consolidated liabilities excluded from conversion or exchange into equity.

3. Specific Reasons for Priority Requirement for Unrelated Liabilities

The NPR also provides a set of reasons specific to the requirement that unrelated liabilities be made structurally or contractually preferred to EDS (subject to the 5% allowance)—namely, that this priority requirement would mitigate issues with two groups of parent liabilities that the Federal Reserve believes could be an obstacle to the orderly resolution of a covered BHC.[66]

a. Operating Liabilities

One group of parent liabilities that the NPR says could create obstacles to resolvability that the priority requirement would mitigate are those like "vendor liabilities and obligations to employees" that may need to be performed during resolution to make sure the covered BHC or a bridge BHC is not "cut off from vital services and resources."[67] The NPR notes that "[i]f these vital liabilities were pari passu with eligible external LTD, protecting these vital liabilities from

[66] 80 Fed. Reg. at 74947.

[67] 80 Fed. Reg. at 74947.

loss would entail treating these liabilities differently from eligible external LTD of the same priority, which could present both operational and legal risk."[68] Requiring covered BHCs to make such unrelated liabilities structurally or contractually preferred to EDS subject to the 5% allowance, the NPR states, will mitigate the operational and legal risk associated with continuing to perform such obligations during resolution.[69]

The Associations agree that this group of liabilities is the type of third-party operating liabilities that should generally be preferred to EDS since they need to be paid when due to preserve the franchise value of the overall group. We generally agree that requiring covered BHCs to make such third-party operating liabilities structurally or contractually preferred to EDS (subject to the 5% allowance) is likely to mitigate the operational and legal risk associated with continuing to perform on such third-party operating liabilities during resolution.

b. Capital Structure Liabilities

The other group of liabilities that the NPR says could create obstacles to resolvability that the priority requirement would mitigate are structured notes, allegedly because of their "greater complexity" or because "their valuation [is] uncertain, volatile, or unduly complex," nevertheless "could be subjected to losses alongside eligible external TLAC without potentially undermining SPOE resolution or financial stability."[70]

Although the only example of non-operating unrelated liabilities identified and discussed in the NPR is structured notes, the definition of the term "unrelated liabilities" in the text of the proposed rule sweeps in all external capital structure liabilities, other than EDS. Thus, we will first discuss the reasons given in the NPR for treating structured notes as unrelated liabilities and then explain why it is counterproductive to treat any capital structure liabilities as unrelated liabilities, including long-term structured notes.

The NPR gives two alternative reasons for treating structured notes as unrelated liabilities subject to the 5% allowance. The first reason is that structured notes "contain features that could make their valuation uncertain, volatile, or unduly complex."[71] Covered BHCs should only be allowed to issue and maintain long-term debt securities in excess of the 5% allowance if they are "able to be valued accurately and with minimal risk of dispute."[72] The second reason is that "structured notes are often customer products sold to purchasers who are primarily seeking exposure to a particular asset class and not seeking credit exposure to the

[68] 80 Fed. Reg. at 74947.

[69] 80 Fed. Reg. at 74947.

[70] 80 Fed. Reg. at 74947.

[71] 80 Fed. Reg. at 74947.

[72] 80 Fed. Reg. at 74947.

covered BHC, and the need to impose losses on a financial institution's customers in resolution may create obstacles to orderly resolution."[73] The NPR concludes that "[t]he proposed cap on structured notes would promote the resolvability of covered BHCs by limiting their issuance of instruments that present these issues."[74]

Consistent with Principle No. 2, the Associations believe that no capital structure liabilities, including long-term structured notes, should be protected against losses by requiring covered BHCs to make them structurally or contractually preferred to EDS, even if they are excluded from EDS or might be unavailable to absorb losses or be used to recapitalize the covered BHC at the point of failure. Protecting investors in such capital structure liabilities against losses in the event of a covered BHC's failure undercuts the important public policy goal of ensuring a durable end to TBTF. The effect of treating any capital structure liabilities as unrelated liabilities subject to the clean holding company framework is to give their holders protection against losses by requiring covered BHCs to make them structurally or contractually preferred to EDS.

Covered BHCs should not be required to make any liabilities structurally or contractually preferred to EDS, unless there is a persuasive reason to do so. There is a persuasive reason to require covered BHCs to make short-term debt and other operating liabilities structurally or contractually preferred to EDS. Otherwise, critical vendors may refuse to perform, cutting off critical services that are essential for a covered BHC's operating subsidiaries to continue to operate, maintain their franchise values or provide critical operations to the market. Similarly, holders of short-term debt and other operating liabilities, such as financial contracts, may run, draining liquidity out of the group and forcing it to sell assets at distressed prices. Runs and any resulting forced sales of assets at distressed prices can also create the sort of contagion that can destabilize the U.S. financial system and harm the wider economy. That is why it is appropriate to treat operating liabilities as unrelated liabilities.

In contrast, there is no persuasive argument for protecting any capital structure liabilities of a covered BHC against losses by forcing the covered BHC to make them structurally or contractually preferred to EDS. The holders of such liabilities do not have the legal right or practical ability to run until maturity of the contract. It might make sense to exclude certain capital structure liabilities from EDS and not count them toward a covered BHC's minimum TLAC and long-term debt requirements, if there is a material risk that they might not be available to absorb losses or recapitalize covered BHCs at the point of failure or it is difficult to determine in advance what the amount of any claims will be under any of these capital structure liabilities in a bankruptcy or Title II proceeding. But, the possibility that any capital structure liabilities might not be available at the point of failure or might be difficult to value

[73] 80 Fed. Reg. at 74947.

[74] 80 Fed. Reg. at 74947.

does not provide even a plausible reason for requiring them to be made structurally or contractually preferred to EDS.

Allowing any capital structure liabilities to rank pari passu alongside EDS will not impede the rapid and orderly resolution of a covered BHC and its subsidiaries in any way, even if there is a possibility they might disappear before the point of failure or might be difficult to value. If some capital structure liabilities are no longer available to bear losses at the point of failure, their unavailability will not impede the ability to impose losses on EDS or any other capital structure liabilities that are still available relative to requiring covered BHCs to make them structurally or contractually preferred to EDS. Indeed, requiring covered BHCs to make certain capital structure liabilities structurally or contractually preferred to EDS will make it 100% certain that such liabilities will not be available to bear losses alongside EDS or recapitalize covered BHCs at the point of failure.

Requiring any capital structured liabilities to be made structurally or contractually preferred to EDS has the counterproductive effect of simply reducing the amount of consolidated capital created by bail-in by increasing the amount of consolidated liabilities excluded from bail-in. The amount of consolidated capital created by bail-in is the value of the consolidated assets of the covered BHC (or bridge BHC) at the time of bail-in less any of its consolidated liabilities excluded from bail-in. Any capital structure liabilities that are treated as unrelated liabilities and forced to be made structurally or contractually senior to EDS simply increases the amount of consolidated liabilities excluded from bail-in, thereby reducing the amount of consolidated capital created by bail-in.

In contrast, allowing all capital structure liabilities to rank pari passu alongside EDS would at least preserve the possibility that they can act as an additional source of loss-absorbing capacity at the point of failure supplementing the loss-absorbing capacity of EDS, and does absolutely no harm relative to the harm that would be caused by requiring covered BHCs to make certain capital structure liabilities structurally or contractually preferred to EDS.

This analysis of capital structure liabilities applies just as forcefully to long-term structured notes as it does to any other capital structure liabilities, whether or not:

- The structured notes are principal protected or non-principal protected;
- The embedded derivative could reduce the principal amount of the structured notes;
- The value of the structured notes fluctuates or is volatile; or
- The process for determining the amount of any claims on the structured notes is complex.

While it would be possible for the claim on certain non-principal-protected structured notes to be zero at the point of any covered BHC's failure, it is impossible for the claim to be negative. As a result, allowing non-principal-protected structured notes to rank pari passu alongside EDS can never reduce the total loss-absorbing capacity of a covered BHC relative to having the structured notes be made structurally or contractually preferred to EDS. If the non-principal-protected structured notes have any value at all at the point of failure, on the other hand, they will increase the amount of capital created by converting or exchanging EDS and such structured notes into or for equity.

Accordingly, and consistent with Principle No. 2, the Federal Reserve should amend the proposed rule so that no capital structure liabilities of a covered BHC are treated as "unrelated liabilities" for purposes of the clean holding company framework in the proposed rule, including any of the following:

- Long-term debt securities that contain any impermissible acceleration provisions;
- Long-term debt securities governed by foreign law;
- Long-term structured notes, whether they are principal protected or not;
- Long-term debt securities that are convertible into or exchangeable for any of the covered BHC's equity securities; or
- Hybrid securities.

4. Remedies for Inadvertent Breaches of the 5% Allowance

Even if external capital structure liabilities are excluded from unrelated liabilities, there may be certain unexpected, unintentional or otherwise inadvertent breaches of the 5% allowance beyond the reasonable control of a covered BHC. For example, suppose that after the effective date of the final rule a covered BHC has operating liabilities equal to 2.5% of its total external TLAC amount and issues certain LTD securities that do not qualify as EDS amounting to 2% of its total external TLAC amount. The covered BHC would have unrelated liabilities equal to 4.5% of its total external TLAC, consistent with the 5% allowance. Now suppose that the covered BHC suffers an unexpected litigation judgment equal to 2% of its total external TLAC. Its unrelated liabilities now equal 6.5% of its total external TLAC amount, exceeding the 5% allowance until the judgment is reversed or paid. The covered BHC may reasonably decline to pay the judgment until it has exercised its rights to appeal the judgment. The Federal Reserve should exclude any litigation judgments from unrelated liabilities until any appellate proceedings have been completed.

We believe that there are other ways in which covered BHCs could unexpectedly, unintentionally or otherwise inadvertently breach the 5% allowance that are beyond their

reasonable control. We do not believe it would be fair to impose supervisory sanctions on covered BHCs for such inadvertent breaches of the 5% allowance without allowing them to exhaust their legal rights (e.g., in the case of litigation judgments on appeal) and without giving them a reasonable period to cure such breaches. We believe that the proposed rule should allow at least one year for covered BHCs to cure any inadvertent breaches of the 5% allowance without subjecting them to any supervisory action. Moreover, any supervisory action after the permitted cure period should be reasonable and proportional in light of the circumstances giving rise to the inadvertent breach.

5. Consistency with the FSB's International Standard

Implementing our recommendations with respect to "unrelated liabilities" would be more consistent with the FSB's International Standard than the Federal Reserve's proposed rule. The FSB would only treat structured notes as "excluded liabilities" that are required to be made contractually, statutorily or structurally preferred to eligible TLAC. It would not treat any of the following types of capital structure liabilities as "excluded liabilities" or otherwise require resolution entities to make them contractually, statutorily or structurally preferred to eligible TLAC:

- Long-term debt securities with impermissible acceleration clauses;
- Long-term debt securities governed by a law other than the law of the resolution entity's home jurisdiction;
- Long-term debt securities that are convertible into or exchangeable for the covered BHC's equity; or
- Hybrid securities.

To the extent the Federal Reserve may be concerned about departing from the FSB's International Standard by excluding structured notes from "unrelated liabilities" and the requirement to make them structurally or contractually preferred to EDS, the departure would be more than justified by four reasons. First, the FSB's International Standard is not binding on the Federal Reserve and could not be binding as a matter of U.S. Federal law because its development did not comply with the prior notice and comment requirements of the APA. Second, the Federal Reserve's departure would be modest. It would only exclude one type of liability from its priority requirement that would be subject to the FSB's priority requirement. Third, this modest departure would reflect the fundamental differences between the direct bail-in model used outside the United States and the SPOE models used in the United States under the Bankruptcy Code or Title II of the Dodd-Frank Act. Fourth, this modest departure

would be more than offset by the many ways in which the proposed rule is far more restrictive than the FSB's International Standard, including by:

To the extent the Federal Reserve may be concerned about departing from the FSB's International Standard by excluding structured notes from "unrelated liabilities" and the requirement to make them structurally or contractually preferred to EDS, the departure would be more than justified by four reasons. First, the FSB's International Standard is not binding on the Federal Reserve and could not be legally binding as a matter of U.S. Federal law because its development did not comply with the prior notice and comment requirements of the APA. Second, the Federal Reserve's departure would be modest. It would only exclude one type of liability from its priority requirement that would be subject to the FSB's priority requirement. Third, this modest departure would be justified by the fundamental differences between the direct bail-in model used outside the United States and the indirect bail-in models used in the United States, since the FSB decided to exclude structured notes from eligible TLAC primarily because of the perceived needs of the non-U.S. direct bail-in model. Fourth, this modest departure would be more than offset by the many ways in which the proposed rule would impose substantially higher, gold-plated TLAC requirements on covered BHCs compared to the FSB's International Standard, including by

- Containing separate minimum long-term debt requirements; and
- Flatly prohibiting short-term liabilities, parent guarantees with impermissible cross-defaults and upstream guarantees even though none of these would be "excluded liabilities" under the FSB's International Standard.

B. Prohibited Parent-Level Liabilities

The proposed clean holding company requirements would also flatly prohibit a covered BHC from *directly* issuing short-term debt to a third party, entering into QFCs with a third party, guaranteeing the liabilities of any subsidiary if the guarantee or underlying liability includes an impermissible cross-default, benefitting from any upstream guarantees, or incurring certain other impermissible liabilities. As indicated above, the prohibitions would apply whether or not the prohibited liabilities are secured or otherwise made senior to EDS by statute or contract. In contrast, it would not apply to liabilities that are made structurally preferred to EDS such as liabilities issued by operating subsidiaries, other than upstream guarantees.

1. Third-Party Short-Term Debt

The Associations agree that the proposed ban on issuances of short-term debt by covered BHCs is generally consistent with the U.S. public policy goal of ensuring a durable end to TBTF. As explained in Principle No. 2, a ban on new issuances of short-term debt by covered

BHCs, while permitting their subsidiaries to continue issuing and retaining short-term debt, ensures that the group's short-term debt is structurally preferred to the covered BHC's EDS. This structural preference for a U.S. G-SIB group's short-term debt makes the EDS issued by a covered BHC usable for purposes of absorbing losses or recapitalizing the covered BHC without causing harmful runs.

Consistent with the important goals of ending TBTF, the Associations believe that the Federal Reserve must include an exception to its ban on short-term debt issued by covered BHCs for secured liquidity provided by the FDIC during periods of market distress or to facilitate an SPOE resolution under Title II of the Dodd-Frank Act. As written, the ban on short-term debt would prohibit covered BHCs from obtaining secured liquidity from the FDIC, even during periods of market distress or to facilitate SPOE resolution.

For example, it would prohibit covered BHCs, including covered BHCs that are bridge holding companies in a Title II proceeding, from obtaining temporary secured liquidity from the Orderly Liquidation Fund ("**OLF**"), which would effectively prevent the FDIC from using the OLF to stabilize a covered BHC or bridge BHC in a Title II proceeding. Of course, a recapitalized bank subsidiary of a covered BHC or bridge BHC should be able to obtain temporary secured liquidity from the private sector or the Federal Reserve's Discount Window, if it satisfies the conditions for Discount Window access. A recapitalized subsidiary of any kind, including a broker-dealer subsidiary, should be able to obtain temporary secured liquidity from the private sector or a broadly available secured liquidity facility established by the Federal Reserve under Section 13(3) of the Federal Reserve Act if the conditions for providing such secured liquidity have been satisfied. But the proposed rule would prevent the FDIC from using a covered BHC or bridge BHC as a conduit to make secured liquidity available to their IDI, broker-dealer or insurance subsidiaries, which may be necessary since all three types of subsidiaries are excluded from the definition of the term "covered subsidiary"[75] and Title II does not authorize the FDIC to make extensions of credit under the OLF to any company other than the covered company, a covered subsidiary or a bridge financial company in a Title II proceeding.[76] Since IDIs, broker-dealers and insurance companies are all excluded from the term "covered subsidiary,"[77] the FDIC would not be able to use the OLF to provide secured liquidity to any of them except by using the covered BHC or bridge BHC as a conduit. The proposed rule would prohibit covered BHCs and related bridge BHCs from incurring short-term debt, even during periods of financial distress or in resolution and even when fully secured with good collateral.

We do not believe that the Federal Reserve intended to prohibit covered BHCs from obtaining temporary secured liquidity from the FDIC under these circumstances. In particular,

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[75] Dodd-Frank Act, § 201(a)(9).

[76] Dodd-Frank Act, § 204(d), 210(h)(4), (9), (n).

[77] Dodd-Frank Act, § 201(a)(9).

we do not believe that the Federal Reserve intended to prevent the FDIC from using covered BHCs or bridge BHCs as conduits for making secured liquidity available to their IDI, broker-dealer or insurance subsidiaries under the OLF in a Title II proceeding. Such a prohibition would be inconsistent with the strong U.S. public policy interest in ensuring a durable end to TBTF because it would prevent the FDIC from stabilizing a U.S. G-SIB whose parent is in a Title II resolution proceeding. Accordingly, the Associations urge the Federal Reserve to create a narrow exception from this prohibition for secured liquidity provided by the FDIC during periods of market distress or to facilitate SPOE resolution.

In addition, the text of Section 252.64(a)(1) of the proposed rule—providing that a covered BHC "may not directly . . . issue any debt instrument with an original maturity of less than 365 days"—quite clearly applies prospectively from the date of effectiveness of the final rule. The Associations agree with this approach and request that the Federal Reserve confirm our understanding in the preamble to the final rule that the plain reading of this language is the correct reading.

2. Guarantees that are Subject to Cross-Defaults

The proposed rule would prohibit covered BHCs from issuing any parent guarantee of subsidiary liabilities to third parties if they contain a cross-default based on the covered BHC's insolvency or entry into resolution. The NPR states that this prohibition on cross-defaults is to "advance the key SPOE resolution goal of ensuring that a covered BHC's subsidiaries would continue to operate normally."[78] The NPR states that "[t]his goal would be jeopardized if the covered BHC's entry into resolution or insolvency operated as a default by the subsidiary and empowered the subsidiary's counterparties to take default-related actions, such as ceasing to perform under the contract or liquidating collateral"[79] and that "[w]ere the counterparty to take such actions, the subsidiary could face liquidity, reputational, or other stress that could undermine the ability to continue operating normally."[80] Finally, the NPR describes the prohibition as "a complement to other work that has been done or is underway to facilitate SPOE resolution through the stay of cross-defaults, including the ISDA 2014 Resolution Stay Protocol."[81]

Given the NPR's reference to the ISDA 2014 Resolution Stay Protocol, the Associations believe that the Federal Reserve intended to limit the prohibition on guarantees with cross-defaults to those that are inconsistent with the ISDA 2014 Resolution Stay Protocol, as subsequently amended by the ISDA 2015 Universal Resolution Stay Protocol (the "**ISDA**

[78] 80 Fed. Reg. at 74946.

[79] 80 Fed. Reg. at 74946.

[80] 80 Fed. Reg. at 74946.

[81] 80 Fed. Reg. at 74946.

Protocol"). However, as drafted, the proposed rule is not so limited and, as a result, is overbroad and unnecessary. The ISDA Protocol overrides cross-defaults in instruments subject to the ISDA Protocol with counterparties that have signed the ISDA Protocol if certain conditions are satisfied. The Federal Reserve and other banking supervisors around the world are in the process of expanding the range of instruments and counterparties to which the ISDA Protocol would apply both by regulation and further amendments to the ISDA Protocol. Thus, the prohibition would be unnecessary for any guarantees of instruments covered by the ISDA Protocol if the guaranteed subsidiary's counterparty has agreed to adhere to the ISDA Protocol.[82]

Even in situations where the ISDA Protocol would not apply, the prohibition would still be overbroad and unnecessary to the extent it prohibits cross-defaults that are subject to the same conditions as the ISDA Protocol. Thus, the prohibition should not apply to guarantees with cross-defaults based on the covered BHC's insolvency or entry into resolution where the cross-default provision is consistent with the ISDA Protocol—i.e., the right to exercise the cross-default would be suspended for 48 hours after the covered BHC's insolvency or entry into resolution and during the 48-hour period the guarantee is elevated to administrative claims status (or equivalent) in the covered BHC's bankruptcy or other resolution proceeding or the guarantee is assumed by a well-capitalized bridge financial company.

Moreover, even for instruments not subject to the same conditions as the ISDA Protocol, the prohibition would be unnecessary in a resolution proceeding under Title II of the Dodd-Frank Act. Section 210(c)(16) of Title II gives the FDIC authority to override any cross-defaults if they are triggered by a covered BHC's insolvency or entry into resolution under Title II and certain conditions are satisfied.[83] The prohibition may also become unnecessary in a U.S. bankruptcy proceeding, if bills pending in both Houses of Congress are passed—those bills would amend the Bankruptcy Code to override such cross-defaults if certain conditions are satisfied.[84]

Furthermore, prohibiting such guarantees would be contrary to ordinary principles of fundamental fairness, unless outstanding guarantees are permanently grandfathered. The proposed clean holding company requirements would require covered BHCs to conform or

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[82] 80 Fed. Reg. at 74945-46, n. 79 & 81.

[83] Dodd-Frank Act, §210(c)(16).

[84] Financial Institution Bankruptcy Act of 2015, HR 2947, 114th Cong., 1st Sess. (2015); Taxpayer Protection and Responsible Resolution Act of 2015, S 1840, 114th Cong., 1st Sess. (2015). Similar bills were passed in the House in 2014 and introduced in the Senate in 2013. *See* Financial Institution Bankruptcy Act of 2014, HR 5421, 113th Cong., 1st Sess. (2014); Taxpayer Protection and Responsible Resolution Act of 2013, S 1861, 113th Cong., 1st Sess. (2013).

replace all of their outstanding parent-guaranteed subsidiary liabilities with impermissible cross-defaults.

If the Federal Reserve nonetheless prohibits all guarantees with cross-defaults to the covered BHC's insolvency in its final rule, the Associations request an exception to this prohibition, which would permit such guarantees, subject to prior regulatory approval, should such a guarantee become needed and prudent under a special circumstance.

Finally, the Associations urge the Federal Reserve to ensure that the limitations imposed on cross-defaults in guarantees or guaranteed liabilities in the proposed rule, the future regulations implementing the ISDA Protocol and the Title I resolution planning process are all consistent with our comments in this letter. In particular, the Associations would appreciate coordinated and consistent compliance deadlines among these three initiatives so that covered BHCs can develop a uniform approach to conformance and to its required negotiations with counterparties to such liabilities.

3. Guarantees of Third-Party QFCs of Subsidiaries

The proposed rule prohibits covered BHCs from entering QFCs with third-parties.[85] QFCs are defined by reference to Title II of the Dodd-Frank Act, "which defines QFCs to include securities contracts, commodities contracts, forward contracts, repurchase agreements, and swap agreements."[86] The proposed rule also references definitions in certain other statutes, including the Securities Exchange Act, the Commodities Exchange Act and the Federal Deposit Insurance Act. Because of the definitions referenced in those statutes, the Federal Reserve's definition of QFCs, as proposed, appears to include guarantees by the covered BHC of subsidiary QFCs.

The Associations believe that the Federal Reserve did not intend to capture parent guarantees of subsidiary QFCs in the definition of QFCs. Indeed, the preamble suggests that the only guarantees that the Federal Reserve intended to exclude were those that contained impermissible cross-defaults to the parent's insolvency.[87] Furthermore, conforming outstanding subsidiary QFCs to a rule prohibiting parent guarantees of subsidiary QFCs within the conformance period would be impracticable.

Finally, the Associations do not believe there is any reason to prohibit parent guarantees of subsidiary QFCs unless they contain impermissible cross-defaults. First, if the subsidiary

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[85] 80 Fed. Reg. at 74945; Proposed Rule § 252.64(a)(3).

[86] 80 Fed. Reg. at 74945; 12 U.S.C. § 5390(c)(8)(D).

[87] 80 Fed. Reg. at 74946 (noting that the proposed prohibition on guarantees with cross-defaults to the parent's insolvency would be a compliment to the ISDA 2014 Resolution Stay Protocol, which applies in large part to parent guarantees of subsidiary QFCs).

issuing the QFC being guaranteed is recapitalized pursuant to an SPOE or other resolution strategy, there will be no direct default by the subsidiary on the underlying QFC, the parent guarantee will be assumed by a bridge BHC in a two-company SPOE in a bankruptcy or Title II proceeding or elevated to administrative claims status in a one-company SPOE in a bankruptcy proceeding. In either case, the guarantees will not be drawn upon. Second, if the relevant subsidiary fails and enters into its own bankruptcy or resolution proceeding, there will be a direct default by the subsidiary on the underlying QFC and the parent guarantee can be left behind in the covered BHC's bankruptcy proceeding or receivership to absorb losses pro rata with the covered BHC's EDS without adversely affecting financial stability.[88] See Appendix A for the Associations' proposed amendment to the definition of QFCs to exclude parent guarantees.

4. Consistency with the FSB's International Standard

Implementing our recommendations with respect to prohibited liabilities would be more consistent with the FSB's International Standard than the Federal Reserve's proposed rule. The FSB's International Standard would not treat all short-term debt as "excluded liabilities," but only short-term deposit liabilities. That standard would not prohibit resolution entities from issuing or maintaining any short-term debt to the extent it is secured or otherwise made contractually or statutorily preferred to eligible TLAC. It would not treat any guarantees as "excluded liabilities." Nor would it prohibit resolution entities from incurring or maintaining liabilities to third parties on QFCs as long as such liabilities are secured or otherwise made contractually or statutorily preferred to eligible TLAC.

VI. Regulatory Deductions

The proposed rule would amend the Federal Reserve's Basel III capital rules to require any "Board-regulated institution" to deduct from regulatory capital certain of its investments in unsecured debt securities other than Tier 2 instruments—whether or not the securities qualify as eligible debt securities—issued by a "covered BHC" ("**covered debt instruments**").[89] A

[88] If financial stability is adversely affected by the direct default on the underlying QFCs, allowing the counterparties on the underlying QFCs to bear losses on the parent guarantee pro rata with the parent's EDS will not add to that adverse impact in any material way.

[89] The Federal Reserve's Basel III capital rules are set forth in Regulation Q, 12 C.F.R. Part 217. They apply to any "**Board-regulated institution**", defined as any U.S. bank holding company ("**BHC**") or covered savings and loan holding company ("**SLHC**") (other than any BHC subject to the Federal Reserve's Small Bank Holding Company Policy Statement, which applies to any BHC with total consolidated assets less than $1 billion); state member bank; and U.S. IHC of a foreign banking organization. The proposed amendment uses the Basel III capital rules' existing defined term, "global systemically important BHC," which has the same meaning as "covered BHC" under the proposed rule. A "global systemically important BHC" is any BHC that is identified as a global systemically important BHC pursuant to 12 C.F.R. § 217.403, which is the general G-SIB surcharge provision of the Federal Reserve's Basel III capital rules.

complete deduction would be required for a covered BHC's net holdings[90] of its own covered debt instruments, any investment in a covered debt instrument that is a reciprocal cross-holding with another covered BHC, or, for a Board-regulated institution that holds a significant investment in any covered BHC's common stock (i.e., more than 10% of the outstanding common stock of the covered BHC), any investment in the covered debt instruments of that covered BHC. If a Board-regulated institution holds a non-significant investment in a covered BHC's capital (i.e., an investment in the covered BHC's capital where the Board-regulated institution holds 10% or less of the covered BHC's outstanding common stock), any investment in the covered debt instruments of that covered BHC is subject to the threshold deduction approach, which means that the Board-regulated institution would only deduct from its regulatory capital the amount by which the sum of all of its non-significant investments in the capital of unconsolidated financial institutions and in covered debt instruments of covered BHCs, taken together, exceeds 10% of its CET1 capital (after applying certain regulatory adjustments and deductions). Any deduction would follow an amended version of the corresponding deduction approach, under which investments made in capital instruments are generally deducted from the category of regulatory capital for which the instrument would qualify if it were issued by the Board-regulated institution itself; under the proposed rule, covered debt instruments would be treated as Tier 2 capital for purposes of the corresponding deduction approach.

The Associations believe that the proposed deduction framework is flawed in three main respects:

- First, although the proposal would recognize—consistent with the existing deduction framework of the Basel III capital rules—a limited underwriting exemption, it would not recognize an exemption for market-making activity, a result at cross-purposes with the self-evident need to ensure that there is a sufficiently deep and liquid market in covered BHCs' external long-term debt;

- Second, the proposal is overbroad in scope in that it applies to exposures to any unsecured debt security issued by a covered BHC that does not qualify as Tier 2 capital, regardless of whether that debt is an eligible debt security included in the covered BHC's external long-term debt; and

[90] A Board-regulated institution is required to calculate its holdings for purpose of these deductions based on its "net long position," which is in turn calculated by determining its "gross long position" and making certain limited adjustments to reflect a short position in the same instrument. *See* 12 C.F.R. §217.22(h).

- Third, the proposal unnecessarily deviates from the corresponding deduction approach of the Basel III capital rules by requiring deductions from regulatory capital for instruments that do not themselves qualify as regulatory capital.

The preamble to the proposed rule is silent on any rationale underlying the exclusion of an exemption for market-making activities, even though Question 67 specifically invites comments on the issue.[91] This is a surprising omission in light of both the fact that the Basel Committee on Banking Supervision ("**Basel Committee**") specifically addressed the issue in its Consultative Document on *TLAC Holdings* dated November 2015 (in which the Basel Committee noted that, since "one of the aims of the Basel III deduction threshold is to permit a limited level of activity, such as market making, to occur without banks being subject to a deduction," it would consider an adjustment to the existing 10% of CET1 capital threshold)[92] and the obvious need for a sufficiently deep and liquid market for covered BHCs' eligible debt securities if they are to meet their external long-term debt requirements under the proposed rule.

The preamble to the proposed rule is similarly silent on the proposed deduction for a covered BHC's holdings of its *own* covered debt instruments. However, the Associations understand that the rationale underlying the proposed deduction for a covered BHC's holdings of its *own* covered debt instruments is the same as for a Board-regulated institution's holdings of its own regulatory capital instruments: "To avoid the double-counting of regulatory capital, the proposal would have required a banking organization to deduct the amount of its investments in its own capital instruments, including direct and indirect exposures, to the extent such instruments are not already excluded from regulatory capital."[93] As for the purpose of the proposed deduction for holdings of covered debt instruments issued by *other* covered BHCs, like that of the related deduction framework under the existing U.S. Basel III capital rules, it is to address financial sector "contagion" risk—i.e., the potential of these holdings to transmit risk throughout the banking system in the event of the failure of a covered BHC.[94]

The Associations believe that all of these purposes would be more appropriately served by a modified deduction framework implementing the following recommended changes:

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[91] 80 Fed. Reg. at 74952.

[92] *See* Basel Committee, *TLAC Holdings*, at 2 (Nov. 2015).

[93] *See* 78 Fed. Reg. 62018, 62061 (Oct. 11, 2013) (Supplementary Information to the final Basel III capital rules). *See also* Basel Committee, *TLAC Holdings* at 2 & n.5, 3 ("This [corresponding deduction] approach has the effect of removing the double-counting of capital, which can act as a significant source of contagion in the banking and financial sectors.").

[94] 80 Fed. Reg. at 74950. *See* Basel Committee, *TLAC Holdings*, at 2 ("Without deduction, cross holdings of capital can mean that the failure of one institution can lead to the erosion of capital, and potential failure, of an investing bank").

- Recognizing an exemption from the deduction framework for holdings related to market-making activities;

- Limiting the scope of any proposed deduction to holdings of eligible debt securities other than Tier 2 capital instruments ("**non-capital eligible debt securities**") that are included in the covered BHC's external long-term debt amount, as these are the only debt securities that can absorb losses and transmit them to holders; and

- Since a covered BHC's external long-term debt does not count as regulatory capital, modifying the corresponding deduction approach to (i) require deduction from external long-term debt for a Board-regulated institution that is itself a covered BHC and (ii) permit a Board-regulated institution that is not a covered BHC to choose among having sufficient eligible debt securities outstanding, taking a deduction from Tier 2 capital or applying a higher risk weight to the exposure.

A. Exemption for Market-Making Activities

The Associations recommend that the proposed rule be modified to provide for a separate and specific exemption from the deduction framework for Board-regulated institutions, including covered BHCs, to engage in market-making activities with respect to their own and other financial institutions' covered debt instruments and capital instruments. Without such an exemption, the Associations are concerned that the Basel III capital rules and the proposed rule's amendments to the capital rules would work at cross-purposes with one of the key, self-evident objectives of the proposal, which must be to ensure that there is a sufficiently deep and liquid market in eligible debt securities and capital instruments of covered BHCs to allow them to satisfy their respective capital, TLAC and external long-term debt requirements. Recent market developments demonstrate the potential for substantial volatility and even disruption when markets become less liquid. Although the reasons for the current decline in liquidity—including the extent to which increased regulation may be a contributing factor—may be debatable, this trend makes it all the more important that banking agencies not create any additional restraints on the liquidity of these instruments.

A broader market-making exemption for capital instruments and other securities of entities meeting the definition of "financial institution" in Section 217.2 of the Basel III capital rules is necessary, because otherwise what limited room there is for this activity will become increasingly constrained by the expansion of the instruments that would be subject to the existing threshold of 10% of CET1 capital, below which a Board-regulated institution is not required to deduct the aggregate holdings of non-significant investments in the capital of unconsolidated financial institutions.

Currently the Basel III capital rules provide that the aggregate net holdings of non-significant investments in the capital of unconsolidated financial institutions are not subject to any deductions from capital provided that they represent less than 10% of the CET1 capital of the relevant Board-regulated institution, net of certain required deductions and adjustments (the "**10% threshold**").[95] The definition of "investment in the capital of an unconsolidated financial institution," as corrected in the proposed rule, consists of a net long position in capital instruments of a regulated financial institution or in the GAAP equity of an unregulated financial institution, including direct, indirect and synthetic exposures to capital instruments and excluding underwriting positions held for five or fewer business days.[96] As a result, the 10% threshold is currently available to accommodate investments in the capital instruments or GAAP equity of unconsolidated financial institutions. Any excess above the 10% threshold must be deducted from capital.[97]

Under the proposed rule, however, an entirely new category of instruments—any investment in a covered debt instrument issued by an unconsolidated financial institution—is also subject to the 10% threshold.[98] To avoid a deduction from capital under the proposal, both a Board-regulated institution's aggregate net holdings of capital instruments and GAAP equity of unconsolidated financial institutions and its aggregate net holdings of covered debt instruments must, together, still fit within the same 10% threshold.[99]

Absent an exemption for covered debt instruments or an expansion of the 10% threshold, Board-regulated institutions' current market-making activity in capital instruments would likely be curtailed in order to free up capacity under the 10% threshold for market-making activity in covered debt instruments or vice-versa. Either way, without (i) a broader market-making exemption or (ii) an expansion of the existing deduction threshold (and/or a more appropriate approach to calculating a net long position), the proposed rule's inclusion of net holdings of covered debt instruments in the aggregate amount of net holdings subject to the 10% threshold will have the effect of either constraining market-making capacity in the very same eligible debt securities that covered BHCs must issue and maintain outstanding to meet their external long-term debt and TLAC requirements or in the capital instruments of a broader range of financial institutions.

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[95] 12 C.F.R. § 217.22(c)(4). Any holdings not subject to deduction under this provision must be risk weighted in accordance with subparts D (standardized approach), E (market risk), or F (advanced approaches) of the U.S. capital rules, as applicable.

[96] 12 C.F.R. § 217.2 (defining "investment in the capital of an unconsolidated financial institution").

[97] 12 C.F.R. § 217.22(c)(4).

[98] Proposed Rule § 217.22(c)(4)(i).

[99] Proposed Rule § 217.22(c)(4)(i).

The same rationale applies to covered BHCs' holdings of their own covered debt instruments, although solely to the extent that any such holdings are recognized as liabilities that count as Tier 2 capital instruments or as non-capital eligible debt securities. As noted above, covered BHC's net holdings of their own capital instruments and covered debt securities are subject to full deduction from regulatory capital, without the benefit of any deduction threshold. Yet the normal expectation in the capital markets is for a covered BHC to stand ready to make a market in its own debt, and a covered BHC would normally have the greatest incentive to do so. Absent a market-making exemption sufficiently broad to include covered BHCs' own covered debt securities and own capital instruments, (to the extent these could still count as non-capital eligible debt securities or capital instruments, respectively) the proposed rule will act as a disincentive for covered BHCs to make markets in their own securities and thus will make it potentially more difficult for covered BHCs to satisfy their own capital, TLAC and external long-term debt requirements.

The Associations note that the Basel Committee's recent final standard, *Minimum capital requirements for market risk* (January 2016), specifically contemplates that national banking supervisors may establish a market-making exemption for holdings of other firms' capital instruments held in the trading book: "Where a bank demonstrates that it is an active market-maker, then a national supervisor may establish a dealer exception for holdings of other banks', securities firms', and other financial entities' capital instruments in the trading book."[100] In light of the critical need for deep and liquid markets in not just the covered debt instruments of covered BHCs, but also the capital instruments of a broad array of regulated and even unregulated financial institutions, the Associations support the modification of the proposed rule to provide for a blanket exemption for dealing and market-making activities, as suggested in Question 67 of the NPR. Existing procedures and infrastructures used for Volcker Rule compliance could be leveraged to efficiently implement such an exemption. The benefit of a market-making exemption would be to preserve (rather than hinder) the depth of the market and the liquidity for both covered debt instruments and other important loss-absorbing instruments.

In the alternative, absent an exemption, at the very least the Federal Reserve should raise the 10% threshold under the existing capital rules. The current 10% threshold was calibrated to apply only to investments in capital instruments, not debt instruments more broadly. The proposed rule would substantially increase the volume of instruments subject to the 10% threshold. Yet the proposal would not correspondingly increase the scale of the deduction threshold for holdings of these instruments, which could force some Board-regulated institutions to cut back on their net holdings of other covered BHCs' covered debt or capital instruments held for either market-making or investment purposes—a result that could

[100] Basel Committee, Final Standard, *Minimum capital requirements for market risk* ¶ 5 (January 2016).

negatively affect the market for and liquidity of these securities. Consequently, if the Federal Reserve does not permit a market-making exemption as discussed above, it should instead recalibrate the 10% threshold to accommodate the broader range of holdings that would be newly subject to the deduction framework.

B. Scope of Instruments Subject to the Proposed Deduction

The scope of instruments subject to the proposed deduction is overbroad and should be limited to net holdings of non-capital eligible debt securities that are included in a covered BHC's external long-term debt. The purpose of the external long-term debt requirement is to identify long-term debt securities that are available to absorb losses in the event of a failure of a covered BHC, including by exchange of the instrument for equity under an SPOE resolution of the covered BHC. Only covered debt instruments meeting the eight definitional requirements listed in Section 252.61 of the proposed rule are eligible debt securities, and only eligible debt securities may satisfy a covered BHC's external long-term debt requirement. Logically, covered debt instruments that are not eligible debt securities and cannot qualify as external long-term debt are deemed to have insufficient loss-absorbing capacity from the perspective of the covered BHC that issues them. Yet in defining the term "covered debt instrument" to include **any** unsecured debt security issued by a covered BHC other than a Tier 2 capital instrument, the proposed rule does not distinguish between a covered BHC's non-capital eligible debt securities and its other non-capital unsecured debt securities—including any short-term unsecured debt securities that clearly would **not** count towards the covered BHC's external long-term debt.

1. Own Holdings of Covered Debt Instruments

With respect to a covered BHC's net holdings of its own covered debt instruments, the consequence of the proposed deduction framework goes beyond the avoidance of "double counting" and becomes affirmatively punitive. The covered BHC is unable to recognize covered debt instruments that are not eligible debt securities as part of its external long-term debt, but it must nonetheless deduct its own holdings of any such covered debt instruments. The analogous provisions in the Basel III capital rules require a deduction for a Board-regulated institution's own holdings of regulatory capital instruments; they do not require a deduction for own holdings of securities that do not count toward regulatory capital.[101]

Since a covered BHC does not recognize any benefit, in terms of satisfying its external long-term debt requirement, from holding any position in its own covered debt instruments that are not eligible debt securities, by definition a covered BHC cannot "double count" holdings in its own covered debt instruments as external long-term debt and cannot use them

[101] *See* 12 C.F.R § 217.22(c)(1) ("A Board-regulated institution must deduct an investment in the Board-regulated institution's own **capital instruments** as follows…") (emphasis added).

to artificially inflate its external long-term debt. The Associations therefore recommend revising the definition of "covered debt instrument" to refer solely to any unsecured debt security issued by a covered BHC, other than a Tier 2 capital instrument, that qualifies as an eligible debt security for purposes of the covered BHC's external long-term debt and external TLAC requirements.

2. Investments in Covered Debt Instruments of Covered BHCs

Similarly, with respect to a Board-regulated institution's investments in a covered BHC's covered debt instruments that are not eligible debt securities, it is unclear why the Board-regulated institution should be subject to the same potential partial or full deductions to "remov[e] the double counting of capital, which can act as a significant source of contagion in the banking and financial sectors."[102] If the covered BHC cannot recognize these covered debt instruments as eligible debt securities because they are deemed to be insufficiently loss-absorbing, the corollary is that the Board-regulated institution making the investment is less exposed to the risk of being bailed in and having to absorb losses of the covered BHC than if it had invested in a capital instrument issued by the covered BHC. Yet the proposed deduction treatment is the same as if the Board-regulated institution had made an investment in the covered BHC's Tier 2 capital.

The Associations believe that an investment in covered debt instruments of a covered BHC that do not qualify as external long-term debt, such as short-term debt securities, pose no more than the normal credit and market risk and thus should be addressed not by a new capital deduction, but by the existing Basel III capital rules' provisions for calculating risk-weighted assets for credit and market risk.[103]

Limiting the definition of "covered debt instrument" under the proposed deduction framework for investments in the capital of other covered BHCs to non-capital eligible debt securities would address financial sector contagion risk in a way that is not only more logically consistent with the purpose of the external long-term debt requirement (as discussed above), but also more consistent with the approach to identifying instruments subject to the existing capital deduction framework. By limiting the scope of the deduction to non-capital eligible debt securities, this approach would require a Board-regulated institution applying the deduction framework to determine whether an instrument it holds qualifies as a non-capital eligible debt security from the perspective of the covered BHC that is the issuer. This treatment is consistent with the corresponding deduction approach under the existing capital deduction

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[102] *See* Basel Committee, *TLAC Holdings*, at 2.

[103] *See, e.g.*, 12 C.F.R. § 217.32 (general risk weights under standardized approach); 12 C.F.R. § 217.132 (general mechanics for calculating wholesale and retail risk-weighted assets under advanced approaches); 12 C.F.R. §217.204 (measure for market risk).

framework, whereby a Board-regulated institution must identify the tier of capital "for which the underlying instrument would qualify if it were issued by the Board-regulated institution itself."[104] Any operational concerns related to implementing this approach could be mitigated by a simple disclosure regime. For example, covered BHCs could be required under the external long-term debt requirements or their pillar 3 disclosure requirements to identify which of its securities qualify as non-capital eligible debt securities.[105]

C. Revisions to the Deduction Framework

The deduction framework under the existing Basel III capital rules consistently incorporates a principle of like-for-like deductions, whereby deductions for net holdings of Tier 2 capital are first made from Tier 2 capital, with equivalent deductions for Additional Tier 1 and CET1 capital instruments.[106] The proposed rule deviates from this principle by requiring a Board-regulated institution to deduct its net holdings of covered debt instruments—which by definition do not include any Tier 2 capital instruments—first from the institution's Tier 2 capital.[107]

The Associations submit that there is no justification for requiring a Board-regulated institution to deduct either its own net holdings in non-capital eligible debt securities included in external long-term debt or any net holdings in another covered BHC's non-capital eligible debt securities included in external long-term debt first from Tier 2 capital. Instead, in the case of a Board-regulated institution that is itself a covered BHC, any deduction should first be made from its own external long-term debt and should only be made from its Tier 2 capital in the unlikely event that the covered BHC did not have enough external long-term debt to cover the full amount of the deduction. In the case of a Board-regulated institution that is not a covered BHC, it should be permitted to choose among having sufficient eligible debt securities

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[104] 12 C.F.R. § 217.22(c)(2).

[105] Although issuance-specific disclosure requirements are not generally part of the existing regulatory capital framework, there is a precedent under the existing capital rules for such issuance-specific disclosures. Under existing rules, advanced approaches banking organizations must disclose in the governing agreement, offering circular or prospectus for an issuance qualifying as additional tier 1 or tier 2 capital "that the holders of the instrument may be fully subordinated to the interests held by the U.S. government in the event that the [banking organization] enters into receivership, insolvency, liquidation or similar proceeding." 12 C.F.R . §§ 217.20(c)(1)(xiv) (for additional tier 1 instruments) and 217.20(d)(1)(xi) (for tier 2 instruments).

[106] *See* 12 C.F.R. §§ 217.22(c)(1) (for investments in an institution's own capital instruments, requiring deductions from the identical tier of capital), 217.22(c)(2) and (f) (under the corresponding deduction approach, requiring that all deductions be made first from the same tier of capital for which the instrument would qualify if issued by the Board-regulated institution itself, with deductions only to be applied to a higher-quality tier in the event the institution lacks sufficient capital of that particular tier).

[107] Proposed Rule §§ 217.22(c)(1)(iv) (proposed requirement with respect to holdings of a covered BHC's own covered debt instruments), 217.22(c)(4) (proposed requirement with respect to non-significant investments in the capital of other covered BHCs).

outstanding, taking a deduction from Tier 2 capital or applying a higher risk weight to the exposure. The Associations believe that modifying the proposed rule's deduction framework in this way would strike an appropriate balance between reducing the incentive for Board-regulated institutions to make these investments (thereby reducing contagion risk in the case of investments in other covered BHCs) and ensuring that the deduction is not so punitive as to go beyond eliminating "double counting" and negatively affect the depth and liquidity of the market for covered BHCs' external long-term debt.

1. Investments in Covered Debt Instruments of Covered BHCs

In describing the rationale for requiring a Board-regulated institution to treat an investment in covered debt instruments issued by a covered BHC in a similar manner to an investment in a Tier 2 capital instrument, the Federal Reserve emphasized the need to create a disincentive for such investments.[108] However, in light of the fact that the non-capital eligible debt securities of covered BHCs do not count as Tier 2 capital and that the corresponding deduction approach applicable to both significant and non-significant investments in the capital of covered BHCs require deductions at least from Tier 2 capital, the proposed rule's deduction framework clearly goes beyond preventing "double counting". Neither the covered BHC issuing the non-capital eligible debt securities nor the Board-regulated institution investing in them derives any regulatory capital benefit—yet in a departure from the principle of like-for-like deductions underlying the corresponding deduction approach, the Board-regulated institution is required to make a deduction from its regulatory capital.

The Associations believe that a more logical approach is to apply the corresponding deduction approach to instruments comparable to the covered BHC's non-capital eligible debt securities. If the Board-regulated institution is itself a covered BHC, any required deduction, such as in the case of a non-significant investment in the capital of another covered BHC, for investments in the latter's non-capital eligible debt securities would be made from the Board-regulated institution's own external long-term debt. This would require the Board-regulated institution to maintain a sufficient amount of external long-term debt outstanding to effectively offset the impact of the investment in the other covered BHC's non-capital eligible debt securities. Since the Board-regulated institution would itself be subject to the external long-term debt and TLAC requirements, the impact of the deduction, by reducing the amount of its own external long-term debt and thus TLAC, should act as a sufficient disincentive to the holding of large amounts of such investments.

[108] 80 Fed. Reg. at 74950 ("The proposed deduction requirement would substantially reduce the incentive of a Board-regulated institution to invest in unsecured debt issued by a covered BHC, thereby increasing the prospects for an orderly resolution of a covered BHC by reducing the risk of contagion spreading to other Board-regulated institutions.").

In the case of a Board-regulated institution that is not itself a covered BHC and thus is not subject to the minimum TLAC and external long-term debt requirements, the Associations believe that a comparable result could be reached by permitting the Board-regulated institution to choose among three possible options:

- First, it must have outstanding external debt, which meets the requirements of eligible debt securities and external long-term debt as if the requirements applied to the institution, in an amount at least equal to the amount of any required deduction that would otherwise apply to Tier 2 capital;

- Second, it must take any required deduction from its regulatory capital, first from Tier 2 capital, in accordance with the proposed rule; or

- Third, it must recognize a higher risk weight for its investment in non-capital eligible debt securities of a covered BHC than the normal provisions for calculating risk-weighted assets would require. This approach would be consistent with the recognition that, although the non-capital eligible debt securities are not themselves capital instruments, because they qualify as a covered BHC's external long-term debt they are more susceptible to becoming loss-absorbing and transmitting losses to the holders than covered debt instruments that are not eligible debt securities.[109]

In its proposed standard on the TLAC holdings deduction, the Basel Committee explicitly considered extending the corresponding deduction approach to require G-SIBs to deduct their investments in other G-SIBs' TLAC from their own TLAC resources, but rejected this approach on the basis that non-G-SIBs would not be subject to the TLAC regime and might not have sufficient resources from which to make their deductions.[110] The Basel Committee gave four reasons for requiring all banks to treat their investments in G-SIBs' TLAC as if it were investments in Tier 2 capital for purposes of the deduction framework, each of which is addressed below.

First, the Basel Committee stated that because on average the cost of Tier 2 capital is higher than the cost of other debt, "the approach can be expected to provide sufficient disincentive for banks to invest in TLAC, thus reducing potential contagion from the failure of a G-SIB."[111] As noted above, the Associations believe that, for a Board-regulated institution that is itself a covered BHC, a deduction from its external long-term debt for any investment in the

[109] For example, the risk weight could be higher than the 100% risk weight for debt issued by corporates but lower than the 250% risk weight for significant investments in the capital of unconsolidated financial institutions in the form of common stock that are not deducted from regulatory capital.

[110] Basel Committee, *TLAC Holdings*, at 2.

[111] Basel Committee, *TLAC Holdings*, at 3.

non-capital eligible debt securities of another covered BHC, with its direct impact on the institution's ability to meet its minimum long-term debt and TLAC requirements, should similarly act as a sufficient disincentive against extensive holdings in other covered BHCs' non-capital eligible debt securities. As for other Board-regulated institutions, the Associations' proposed approach of requiring them to maintain a sufficient amount of debt meeting the requirements of eligible debt securities to offset such holdings, applying any required deduction to Tier 2 capital as proposed, or else applying a higher risk weight to any such exposures, should have the same effect.

Second, the Basel Committee stated that the amount of Tier 2 capital a bank would "need to maintain to absorb the deduction will help to reduce contagion from the failure of a G-SIB."[112] In the case of Board-regulated institutions that are covered BHCs, since the whole point of the proposed rule's external long-term debt requirement is to ensure that the covered BHCs have sufficient loss-absorbing capacity in the form of eligible debt securities, exactly the same can be said for the amount of external long-term debt they will need to maintain. Similarly, since Board-regulated institutions would be required to maintain sufficient amounts of long-term debt or Tier 2 capital to absorb any deduction, or else maintain higher levels of capital against the higher risk weightings applicable to those exposures, they would also be better protected against the risk of contagion.

Third, the Basel Committee stated that the approach of requiring a deduction from Tier 2 capital "can be applied consistently by both G-SIBs and non-G-SIBs, thus avoiding the creation of any level playing field issues."[113] The proposed rule itself, the G-SIB surcharge and the enhanced Supplementary Leverage Ratio, all of which will or do apply to covered BHCs but not to other Board-regulated institutions, are evidence of the reality that covered BHCs are subject to more onerous capital and other requirements than other Board-regulated institutions. Modifying the proposed rule's corresponding deduction approach to conform more closely to the like-for-like deduction principle underlying the approach does not create an uneven playing field; it simply recognizes that covered BHCs are subject to minimum TLAC and external long-term debt requirements, while other Board-regulated institutions are not. In any event, as noted above, the Associations have proposed a comparable modification applicable to non-G-SIB Board-regulated institutions to permit them to avoid making deductions from Tier 2 capital if they have issued debt securities meeting the requirements of eligible debt securities or if they apply higher risk weights to their holdings of covered BHCs' non-capital eligible debt securities.

Fourth, the Basel Committee stated that the approach reflected in the proposed rule "utilizes the current provisions of Basel III, meaning it can be implemented with minimal

[112] Basel Committee, *TLAC Holdings*, at 3.

[113] Basel Committee, *TLAC Holdings*, at 3.

changes."[114] The approach recommended by the Associations is based on the like-for-like deduction principle underlying the corresponding deduction approach as currently applied under the Basel III capital rules. The modifications required to implement covered BHCs' deductions from external long-term debt rather than Tier 2 capital and other Board-regulated institutions deductions from equivalent senior debt or Tier 2 capital, or to apply higher risk weights to these exposures, would not be extensive and would essentially consist of modifying existing provisions of the proposed rule or the Basel III capital rules.

2. Own Holdings of Covered Debt Instruments

With respect to a covered BHC's net holdings of its own non-capital debt securities, to the extent any such securities qualify to be included in a covered BHC's external long-term debt, there should be no deduction from its Tier 2 capital because the covered BHC cannot count the securities as part of its own regulatory capital. As already noted in part VI.C.1 above, since the rationale underlying the existing deduction for investments in own capital instruments is to avoid "double counting", a covered BHC's deduction should be made from its external long-term debt, not from its Tier 2 capital, because the covered BHC could only "double count" any such holdings by counting them toward its external long-term debt requirement in the first place.[115]

VII. Grandfathering

The NPR invites comment on whether any outstanding liabilities that would not qualify as EDS or would be limited under the clean holding company requirement as a prohibited or unrelated liability should be grandfathered from any of these provisions.[116] Consistent with Principles No. 1 and 2 as well as ordinary principles of fundamental fairness, the Associations believe that it is vitally important that all capital structure liabilities that were issued or incurred by covered BHCs before the effective date of the final rule should be grandfathered from the provisions of the final rule and that the grandfathering should be permanent.

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[114] Basel Committee, *TLAC Holdings*, at 3.

[115] A covered BHC should only have to make such a deduction to the extent that a holding of its own non-capital eligible debt securities would continue to qualify as external long-term debt pursuant to Section 252.62 of the proposed rule. As the Federal Reserve has specifically noted: "The term 'external' refers to the fact that the requirement would apply to loss-absorbing instruments issued by the covered BHC to third-party investors, and the instrument would be used to pass losses from the banking organization to those investors in case of failure." 80 Fed. Reg. at 74928 (emphasis added). If a covered BHC's own holding of non-capital eligible debt securities does not qualify as external long-term debt because it is not considered to be issued to a third party, there is no basis to require the covered BHC to deduct it because the covered BHC would not be counting it toward its external long-term debt requirement.

[116] 80 Fed. Reg. at 74936 (Question 16); 80 Fed. Reg. at 74948 (Question 56).

Without either modifying the EDS criteria as recommended in Section IV of the letter or grandfathering, compliance with the proposed rule would be extremely challenging. If the Federal Reserve does not grandfather any legacy long-term debt securities from the exclusions from EDS, the covered BHCs will face an aggregate shortfall of $363 billion as of January 1, 2019, or three times the Federal Reserve's estimate of $120 billion. In contrast, if all legacy plain vanilla long-term debt securities and legacy structured notes that are principal-protected at par are permanently grandfathered, the projected shortfall would fall to $56 billion. Similarly, and even more consequentially, if the Federal Reserve does not grandfather all legacy capital structure liabilities that would otherwise be treated as unrelated liabilities under the proposed clean holding company framework, the covered BHCs will have $622 billion of unrelated liabilities, including $36 billion in operating liabilities, as of January 1, 2019, which is 39% of the total amount of expected required TLAC of $1,583 billion at that date, or almost 8 times the 5% allowance of $79 billion. In contrast, if their legacy capital structure liabilities are permanently grandfathered, the amount of unrelated liabilities expected to be outstanding as of January 1, 2019 would fall to $36 billion, or 2% of required TLAC.

Not only would such grandfathering be consistent with the Principles No. 1 and 2, but also applying the proposed rule retroactively to exclude virtually all outstanding senior long-term debt securities from EDS, treating all such ineligible long-term debt securities as unrelated liabilities under the clean holding company framework and, unless the prohibition on parent guarantees with impermissible cross-defaults is confirmed to apply prospectively only, treating virtually all legacy parent guarantees as prohibited guarantees would be contrary to ordinary principles of fundamental fairness since those securities and guarantees were issued or entered into in good faith without any indication that the Federal Reserve's proposal would treat them as capped or prohibited liabilities. Furthermore, in most cases, and as described in greater detail below, it would be nearly impossible to conform such securities to the rule. Accordingly, the Associations request that the Federal Reserve include the following grandfathering provisions in the final rule:

- Permanently grandfather all long-term debt and hybrid securities issued before the effective date of the final rule from any of the exclusions from EDS.

- Permanently grandfather all capital structure liabilities, including all long-term debt and hybrid securities, issued before the effective date of the final rule from being treated as unrelated liabilities subject to the 5% allowance.

- Permanently grandfather from the prohibition on short-term debt and from being treated as unrelated liabilities subject to the 5% allowance all securities with an original maturity of one year or more that were issued before the effective date of the final rule but would be treated as short-term debt solely because they contained put options that were exercisable within one year from the date of issuance by the

holders of such securities, including puts exercisable only upon the holder's death or because they contain autocallable features.

- Clarify that the flat prohibitions on certain liabilities, including guarantees with impermissible cross-defaults, apply prospectively only to liabilities incurred after the effective date of the final rule or permanently grandfather any such liabilities incurred before the effective date of the final rule.

- Include an effective date in the final rule that is at least 180 days after the publication date of the final rule, in order to give covered BHCs sufficient time to conform their debt programs and other operations to the requirements of the final rule.

A. Capital Structure Liabilities

The Federal Reserve should permanently grandfather all capital structure liabilities issued by covered BHCs before the effective date of the final rule from any of the restrictions on what long-term debt securities qualify as EDS and from the 5% cap on unrelated liabilities. Such legacy capital structure liabilities would include:

- Long-term debt securities with impermissible acceleration clauses;

- Long-term debt securities governed by foreign law;

- Long-term structured notes, whether principal protected or non-principal protected;

- Long-term debt securities convertible into or exchangeable for equity securities of a covered BHC; or

- Hybrid securities.

Such legacy capital structure liabilities should be grandfathered from the conditions for qualifying as EDS. For the reasons provided in Section IV above and consistent with Principle No. 1, there is no reason to believe that any of these liabilities would be unavailable to absorb losses and recapitalize a covered BHC upon the covered BHC's failure. Moreover, for the reasons provided in Section IV, there is no reason to believe that it would be difficult to determine at any time the minimum amount of any claims on structured notes that are principal protected at par in a future bankruptcy or Title II proceeding. The minimum amount of such claim would simply be the stated principal amount of such structured notes.

The Associations also believe that the Federal Reserve should permanently grandfather all capital structure liabilities issued or incurred by a covered BHC before the effective date of

the final rule from being treated as "unrelated liabilities" that would be required to be made structurally or contractually preferred to EDS (subject to the 5% allowance). First, for the reasons given in Section V.A.3.b and consistent with Principle No. 2, even if the Federal Reserve believes that it cannot depend on these liabilities to be available to absorb losses upon the covered BHC's failure, there is no persuasive justification to make these capital structure liabilities structurally or contractually preferred to EDS because they are unable to run and will therefore be available to absorb losses.[117] Indeed, subjecting their holders to losses would not destabilize the U.S. financial system any more than subjecting the holders of EDS to losses.

Second, the grandfathering provision is needed to satisfy ordinary principles of due process and fundamental fairness, to avoid unduly disrupting the public debt markets, and to avoid imposing unnecessary compliance costs and burdens on covered BHCs or their subsidiaries. Far from providing covered BHCs with "greater discretion to manage their own affairs," without a grandfathering provision, covered BHCs would be required to conform or early redeem and replace almost all of their capital structure liabilities that fit the definition of "unrelated liabilities" to permit compliance with the proposed rule.

Early redemption and replacement of such liabilities, however, would be impractical, and in some cases, impossible, to do during the conformance period. Many long-term debt securities are simply not callable because they do not have a discretionary call option. As a result, there is no way to force holders of the bonds to sell, and in many cases, such holders are widely and globally dispersed investors that may be prevented from selling due to accounting restrictions or may simply be unwilling to sell. Many other long-term debt securities could only be called at great expense to the covered BHC because the redemption schedule on the debt would require the covered BHC to pay a high premium to permit the debt to be called. Even for those long-term debt securities that have discretionary call features that permit them to be called at par within the conformance period, replacing such securities would be imprudent, as it would require covered BHCs to flood the market with conforming replacement securities within the conformance period over the next three years. Thus, achieving full conformance by replacing the non-conforming long-term debt securities would be impractical, and in some cases, impossible, because almost no outstanding long-term debt securities have issuer call rights.

Similarly, conforming such liabilities through amendments to the legacy long-term debt securities would be equally impractical, and may also be impossible or prohibitively expensive. For a covered BHC to amend its outstanding long-term debt securities to achieve compliance with the clean holding company requirement, such covered BHC would need to obtain consent

[117] For example, instruments which contain redemption rights for a holder's estate in the event of the holder's death are unable to run simply because the issuer is in financial difficulty, and are highly likely to be available to absorb losses in the event of a resolution.

from a substantial number of separate voting groups of the holders of such securities. In many cases, consent of a supermajority of the holders of each of these voting groups would be required to amend the acceleration clauses, remove related covenants on outstanding long-term debt securities or amend governing law. Obtaining such consent would be cumbersome, time-consuming, and expensive, and in many cases would not be possible to achieve. By grandfathering all legacy capital structure liabilities from this priority requirement, the Federal Reserve would avoid the extraordinary costs to covered BHCs and disruption to the public capital markets without sacrificing its goal of minimizing legal and practical hurdles to bail-in, as discussed at length in Principle No. 2 and Section V.A.3.b.

If the Federal Reserve believes there needs to be a limit on these grandfathering provisions, it should not use average or median maturity of the legacy capital structure liabilities. We believe that the grandfathering should be permanent.

At an absolute minimum, all long-term debt securities issued and outstanding *before the effective date of the final rule* should be grandfathered from the limitations on eligible long-term debt or, in the case of convertible or exchangeable debt securities, from the limitations on eligible long-term debt or TLAC. The Federal Reserve should also treat new issuances between the date the proposed rule was made public and the effective date of the final rule for grandfathering purposes in the same manner as it treats long-term debt securities that were outstanding as of the date the proposed rule was made public. Taking any other view would be unfair to the covered BHCs because it would effectively deprive them of a fair opportunity to comment on the proposal before being required to comply with it.

B. Prohibited Liabilities

With respect to liabilities that would be prohibited under the clean holding company requirement, the text of the proposed rule strongly implies that the prohibitions on short-term debt, guarantees with prohibited cross-defaults, and QFCs with third parties would only apply prospectively and such legacy liabilities would be grandfathered from the proposed rule's prohibition. The Associations agree that the prohibitions should only apply prospectively from the effective date of the final rule and request that the Federal Reserve either confirm our understanding or amend the text of the final rule to make clear that this is so.

The Associations believe that applying the clean holding company prohibitions retroactively to any prohibited liabilities would violate ordinary principles of due process and fundamental fairness. The Associations are particularly concerned that applying the prohibitions retroactively to impermissible debt or guarantees with impermissible cross-defaults would be extremely costly, burdensome, or impossible to comply with. Accordingly, the Associations alternatively request that the Federal Reserve permanently grandfather these

liabilities from both the clean holding company prohibitions and the limitations on unrelated liabilities.

1. Guarantees that are Subject to Cross-Defaults

As discussed in further detail in Section VII.A, it would be extremely difficult, and in some cases, impossible, for a covered BHC's subsidiaries to conform the impermissible cross-defaults for legacy guarantees of subsidiary liabilities, especially long-term debt securities. In most cases, unless the long-term debt securities were callable at the issuer's option, the subsidiary would need to obtain consent from a substantial number of separate voting groups of the debtholders to amend the terms of the securities, and obtaining such consent would be expensive because of "hold-out" premiums, and sometimes impossible, to achieve. If debtholder consent is not forthcoming, subsidiaries would face the expensive proposition of having to buy back all outstanding notes with impermissible cross-defaults before their scheduled maturities, which also may be practically impossible to achieve if the securities are not callable during the conformance period.

The Federal Reserve's cost-benefit analysis does not appear to take into consideration the significant cost of amending or buying back all guaranteed subsidiary debt with non-compliant cross-defaults, making such compliance appear substantially less burdensome and disruptive than it would be in reality.[118] Indeed, by not taking into account any costs that would be incurred to conform guaranteed subsidiary debt with non-compliant cross-defaults, the Federal Reserve's cost-benefit analysis would assume that such guaranteed debt would be grandfathered.[119]

Furthermore, even if the Federal Reserve clarifies in its final rule that ISDA compliant guarantees are not prohibited, as discussed in further detail in Section V.B.2, grandfathering would still be required. Many outstanding guarantees that would be prohibited by the clean holding company requirement relate to non-debt security-related transactions, such as derivatives. Even if a covered BHC stopped all future trades with a counterparty that refused to adhere to the ISDA Protocol, the legacy trades with that counterparty would not be covered by the ISDA Protocol. These legacy trades should be grandfathered and thereby allowed to remain on the balance sheet and roll off as they expire.

Moreover, even for those trading contracts that will be subject to the ISDA Protocol, it is unlikely that all such contracts will become ISDA compliant by January 1, 2019, as there is

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[118] 80 Fed. Reg. at 74937–39 (the Federal Reserve's analysis looked at the shortfall relative to the TLAC and long-term debt requirements and the increased costs of funding for covered BHCs, but not at the costs to conform legacy liabilities that are prohibited under the proposed rule, including liabilities of subsidiaries with non-compliant cross-defaults).

[119] 80 Fed. Reg. at 74937–39.

currently no incentive for contract counterparties that are not currently subject to the Protocol to adhere to it. As a result, covered BHCs will need to negotiate with a voluminous number of counterparties to make such outstanding trading contracts to be ISDA Protocol compliant, a process which may take years without specific public regulatory guidance. The Associations believe that it would be more effective to achieve adherence to the ISDA Protocol via regulation specifically aimed at that purpose rather than by placing the burden on BHCs to persuade all their counterparties to remove the cross-default as part of the final rule on TLAC.

2. Legacy Long-Term Debt Securities with Put Options and Autocallable Features

The Associations believe that all legacy long-term debt securities with an original maturity of one year or more that were issued before the effective date of the final rule and would be treated as short-term debt solely because they contained put options that were exercisable within one year from the date of issuance or that would have been exercisable due to an event that could have occurred within a year of the creation of the liability—including puts exercisable upon the death of the security holder and autocallables—should be grandfathered from the clean holding company requirements, including the prohibition on short-term debt and the limitations on unrelated liabilities subject to the 5% allowance.

As discussed in more detail in Section VII.A, it would be extremely difficult, and in cases where such legacy long-term debt securities lack an issuer call option, impossible, for a covered BHC to conform these legacy long-term debt securities if the clean holding company requirements applied retroactively. As with guaranteed debt, if these long-term debt securities do not include issuer call features, covered BHCs would need to obtain consent from substantial numbers of separate voting groups of security holders to amend the terms of the long-term debt securities. Obtaining such consent would be expensive, and sometimes impossible, to achieve. If the consent of the holders of a requisite number of legacy long-term debt securities is not forthcoming, covered BHCs would face the expensive proposition of having to buy back all of these legacy long-term debt securities before their scheduled maturities, which may also be practically impossible to achieve.

Furthermore, it is highly likely that these legacy long-term debt securities will be outstanding and available to absorb losses to recapitalize a covered BHC at the point of failure. For instance, while it is possible that an investor in a security puttable upon the death of the security holder would pass away within one year, it is extremely unlikely that this will occur simultaneously for a meaningful proportion of the U.S. G-SIBs' long-term debt securities with such a survivor put right, and most issuance programs contain annual caps on the notional amount that can be redeemed through the exercise of survivor puts. Accordingly, it is unlikely that a covered BHC would be required to redeem these otherwise long-term debt securities within one year. Similarly, autocallable long-term debt securities that are automatically callable

only when stock prices go up are unlikely to be called when a covered BHC is at the point of failure since G-SIBs generally fail when stock prices are falling, not when they are rising.

C. Phase-in for Requirements Other than the Risk-Based TLAC Requirement

The Associations believe that the final rule should include a phase-in period for the SLR-based minimum TLAC requirement and, if the Federal Reserve retains separate long-term debt requirements, both the risk-based and SLR-based long-term debt requirements, consistent with the proposed phase-in for risk-based and SLR-based requirements under the FSB International Standard. For several covered BHCs, the RWA-based requirement will not be the binding constraint. The Associations do not believe there is any good reason that such covered BHCs with low RWAs should be penalized relative to other covered BHCs for having a less-risky balance sheets. Thus, the SLR requirement should be subject to a phase-in similar to that of the phase-in permitted for the risk-based requirement. Similarly, several covered BHCs face a greater shortfall with respect to the minimum long-term debt minimum requirement, whether risk- or SLR-based, than with respect to the minimum TLAC requirement. Thus, the risk-based minimum long-term debt requirement should be subject to a similar phase-in.

D. Regulatory Deductions

The Associations believe that banking organizations' holdings of covered debt instruments acquired before the effective date of the final rule and classified for accounting purposes as Held-to-Maturity ("**HTM**") investments should be grandfathered from the proposed regulatory deduction requirements. HTM investments are debt securities for which the holder has "the positive intent and ability to hold to maturity," with the consequence that such securities are carried on the balance sheet at amortized cost, rather than fair value.[120] If legacy HTM investments are subject to the proposed regulatory deduction framework, this could prevent a banking organization from having the intent to hold these investments to maturity, which would require a reclassification from HTM to available-for-sale securities. This reclassification—caused solely by a regulatory requirement and not by any voluntary change in the banking organization's intent with respect to holding the securities—would unfairly result in an immediate write-up or write-down of the holdings to their fair value, causing unfair balance sheet volatility. Therefore, legacy HTM investments that would otherwise be subject to the proposed deduction for covered debt instruments should be grandfathered from the deduction requirement.

[120] Federal Reserve, Instructions for the Preparation of Reporting Form FR Y-9C, at GL-75 (Mar. 2013 ed.).

VIII. Consideration of U.S. Domestic Internal TLAC and Long-Term Debt Requirements

The Federal Reserve requests comment on "whether the [Federal Reserve] should impose domestic internal TLAC requirements on covered [BHCs]."[121] The NPR notes that an effective and minimally disruptive resolution of a U.S. G-SIB requires both adequate loss absorbing capacity at the parent level of the covered BHC and "adequate mechanisms for transferring severe losses up from . . . operating subsidiaries to the covered [BHC]."[122] The NPR explains that while the proposed rule "is intended to ensure that covered [BHCs] issue a sufficient amount of loss-absorbing resources," it does not address the second step to ensure that operating subsidiary losses can be "passed up" to the covered BHC.[123]

The NPR states that, were a domestic internal TLAC requirement to be implemented, it would subject certain subsidiaries of covered BHCs ("**covered subsidiaries**") to having a certain quantum of domestic internal total loss-absorbing capacity ("**domestic internal TLAC**"). Such domestic internal TLAC could take two forms: "contributable resources" or "prepositioned resources". Contributable resources would be assets held by the covered BHC and contributed to "covered subsidiaries that incur severe losses."[124] The NPR suggests that contributable resources could be required to consist entirely or substantially of assets that would qualify as "high-quality liquid assets ("**HQLA**"s) under the U.S. liquidity coverage ratio rule."[125] According to the NPR, requiring HQLA would "provide the subsidiary with additional liquidity as well as capital" and would ensure that limitations on the types of assets subsidiaries are permitted to hold would "not pose an obstacle to recapitalization because the firm will be able to convert the assets into cash and then contribute the cash to its subsidiaries."[126] Prepositioned resources would be held at the covered subsidiary level in the form of covered BHC equity and debt investments that "would transfer losses from the subsidiary to the holding company" automatically, in the case of an equity investment, or through forgiveness or conversion into equity, in the case of a debt investment.[127] Prepositioned debt could be required "to be unsecured, be plain vanilla, have a remaining maturity of at least one year, and be of lower priority than all third-party claims on the subsidiary."[128]

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[121] 80 Fed. Reg. at 74949.

[122] 80 Fed. Reg. at 74948.

[123] 80 Fed. Reg. at 74948.

[124] 80 Fed. Reg. at 74949.

[125] 80 Fed. Reg. at 74949.

[126] 80 Fed. Reg. at 74949.

[127] 80 Fed. Reg. at 74949.

[128] 80 Fed. Reg. at 74949.

The Federal Reserve requests comment on all aspects of such a potential future domestic internal TLAC and long-term debt requirement, including whether such a requirement should be in the form of contributable resources or prepositioned resources and what the scope and calibration of the requirement should be.

The Associations believe the Federal Reserve should not impose any domestic internal TLAC or long-term debt requirements on U.S. G-SIBs. If the Federal Reserve were to do so, however, it would need to issue another NPR describing the proposal in detail and soliciting public comment on the specific proposal. In addition, it should not impose a one-size-fits-all requirement; rather, the U.S. G-SIBs should be allowed to retain the option to satisfy any such internal domestic TLAC requirements with any combination of contributable resources, prepositioned resources or capital contribution agreements. We do not believe there are any material legal risks associated with a covered BHC contributing assets to solvent operating subsidiaries in order to maximize their franchise values.

First, the Associations believe a rule prescribing domestic internal TLAC or long-term debt requirements is not needed because there are already regulatory and supervisory processes in place to ensure that operating subsidiary losses will be "passed up" to the covered BHC in an SPOE resolution. In particular, the Federal Reserve and the FDIC already require covered BHCs to plan for how they would recapitalize material operating subsidiaries that suffer severe losses as part of the resolution planning process under Title I of the Dodd-Frank Act. As a result, several covered BHCs already have mechanisms in place to ensure that operating subsidiary losses are borne by creditors of the covered BHC and do not adversely impact subsidiary operations in resolution. In part to ensure that they have sufficient assets to implement these strategies and in part simply to meet increased regulatory liquidity requirements, covered BHCs have also substantially increased the amount and quality of liquid assets on their balance sheets over the past several years.[129] The Associations believe that these significant improvements obviate the need for a separate domestic internal TLAC or long-term debt requirement.

Moreover, in the United States, there are additional reasons why domestic internal TLAC would be unnecessary to facilitate SPOE. U.S. regulators should not be concerned that other U.S. regulators will ring-fence or act in a way during resolution that would be detrimental to U.S. financial stability, and therefore can count on the regulators of domestic operating subsidiaries to cooperate with an SPOE resolution. Moreover, the source-of-strength doctrine, which was codified into law by the Dodd-Frank Act, already ensures that the holding company

[129] *See* Annex 4 for an illustration of these balance sheet improvements.

will serve as a source of strength for depository institution subsidiaries, further reducing the need for domestic internal TLAC for subsidiaries that are U.S. banks.[130]

Second, if the Federal Reserve nonetheless chooses to impose domestic internal TLAC requirements, it should not prescribe rigid requirements for covered BHCs to have a certain amount of either contributable resources or prepositioned resources, but rather should give covered BHCs the flexibility to satisfy a domestic internal TLAC requirement with any combination of contributable resources, prepositioned resources and capital contribution agreements. Because there are both benefits and drawbacks to each of these potential approaches to a domestic internal TLAC requirement, and because each covered BHC has a unique organizational structure and resolution strategy as developed through the resolution planning and other supervisory processes, such a flexible approach will allow each institution to maximize the benefits and minimize the costs of domestic internal TLAC.

According to the NPR, prepositioned resources could be advantageous because they would "be available if and when [they are] needed," could reduce operational risk and could "mitigate possible legal risk associated with insolvency law."[131] We do not agree with the NPR. There are significant costs associated with prepositioning that militate against a rule that would require covered BHCs to hold a certain level of only prepositioned resources. The NPR recognizes that a fundamental flaw of prepositioning is misallocation risk, explaining that "an investment that has been prepositioned with a particular subsidiary cannot easily be used to recapitalize a different subsidiary that incurs unexpectedly high losses."[132] In particular, prepositioning would therefore create "operational risks and other potential limitations on the firm's ability to move the assets to the parts of the organization that need them most."[133] A prepositioning requirement could actually undermine an SPOE resolution, therefore, by committing assets to a particular subsidiary that become unusable to recapitalize another subsidiary that may be in greater need during resolution. A pre-positioning requirement could also create operational rigidities that would diminish a covered BHC's ability to withstand a period of market stress, decreasing its resiliency.

In addition, if the Federal Reserve were to impose a domestic internal long-term debt requirement, it may raise the issue of whether eligible internal long-term debt could be properly characterized as debt for U.S. federal or state income tax purposes. If eligible internal long-term debt were treated as equity for U.S. federal or state income tax purposes, its impact on a financial institution will depend on the institution's structure and on which entity issues the long-term debt. Accordingly, the potential differences in tax treatment of internal long-

[130] *See* § 616(d) of the Dodd-Frank Act.

[131] 80 Fed. Reg. at 74949.

[132] 80 Fed. Reg. at 74949.

[133] 80 Fed. Reg. at 74949.

term debt also weigh in favor of a flexible, rather than prescriptive, domestic internal TLAC requirement.

Contributable resources, by contrast, could be viewed as superior to prepositioned resources because, as the NPR acknowledges, they "avoid the 'misallocation risk' associated with prepositioned resources."[134] The NPR explains that contributable resources are advantageous because they "can be flexibly allocated among subsidiaries in light of the losses they suffer," and they could "avoid operational risks and other potential limitations on the firm's ability to move the assets to the parts of the organization that need them most."[135] Accordingly, contributable resources would support SPOE by allowing a covered BHC to allocate resources efficiently among its subsidiaries by re-directing resources where most needed, and would avoid the costs associated with misallocated pre-positioning.

Although the NPR suggests that contributable resources should be limited to HQLA, the Associations believe that such a requirement would be too restrictive and recommend that the Federal Reserve allow any assets to count as contributable resources if they are capable of valuation. Many other assets would be freely contributable and be capable of valuation, such as intercompany receivables. They should count toward any contributable resource requirement because such assets can be used to recapitalize a covered BHC's subsidiaries. A covered BHC should not be prevented from contributing available assets to a covered subsidiary that has experienced severe losses, nor should a covered BHC be prevented from counting such available assets towards a requirement if such assets are capable of valuation.

As noted above, the NPR states that limiting domestic internal TLAC assets to HQLA would both provide subsidiaries with additional liquidity and allow for conversion to cash in order to avoid restrictions on what types of assets operating subsidiaries can hold. The purpose of domestic internal TLAC is to "pass up" losses to a covered BHC, not to provide liquidity to operating subsidiaries. Contributable intercompany receivables and parent-company assets can accomplish this purpose as well as HQLA. In addition, requiring all contributable resources to be HQLA would introduce a rationale for HQLA (i.e., "plugging liquidity holes" caused by losses at operating subsidiaries) that would contrast with and may contradict the primary purpose of holding HQLA, as currently understood (i.e., acting as a liquidity source for BHCs' potential net cash outflows during a period of distress). To the extent that the Federal Reserve and the FDIC believe that additional liquidity is needed for a particular institution's operating subsidiaries to be successfully resolved through such institution's specific, tailored resolution strategy—or that limitations on certain operating subsidiary asset holdings present an obstacle to a particular resolution strategy—those issues should be addressed through the supervisory

[134] 80 Fed. Reg. at 74949.

[135] 80 Fed. Reg. at 74948.

process rather than through a one-size-fits-all rule aimed at concerns that are in any event ancillary to the primary purposes of TLAC.

APPENDIX A
SELECTED RESPONSES TO REQUESTS FOR COMMENT

II. External TLAC and Long-Term Debt Requirements for U.S. GSIBs

E. Core Features of Eligible External Long-Term Debt

4. Minimum Remaining Maturity and Amortization

Question 19: The Board invites comment on whether the proposed treatment of eligible external LTD with a remaining maturity of less than two years is appropriate. How would a different remaining maturity requirement or amortization schedule better achieve the objectives of the proposal?

The Associations believe that the Federal Reserve should eliminate the 50% haircut applicable to EDS that have a remaining maturity between one and two years, and would oppose any other remaining maturity requirement or amortization schedule. As explained in greater detail in Annex 1, Section IV.C., long-term debt securities with a remaining maturity between one and two years would be reliably available to absorb losses and recapitalize the covered BHC at the point of failure, and are limited to eligible long-term debt securities that have already been determined to be reliably available. Moreover, there is already a 100% haircut on eligible long-term debt that has a remaining maturity of less than one year. Thus, no securities that count toward the long-term debt requirements would mature and become unavailable to absorb losses within the first year of a covered BHC experiencing financial distress. The Associations believe this would be a sufficient period of time for the covered BHC to recover, or if necessary, be placed into a bankruptcy or Title II proceeding. Therefore, a 100% haircut on eligible long-term debt with a remaining maturity of less than one year is sufficiently conservative to ensure that calculations of external long-term debt are predictive of how much long-term debt would be available in an SPOE resolution, without the 50% haircut. Accordingly, the Associations further believe that an amortization schedule is unnecessary.

Question 20: The Board invites comment on whether a specific eligible external LTD issuance schedule or similar requirement should be imposed on covered BHCs by regulation. If so, how should the requirement be structured to maximize benefits and minimize costs?

The Associations do not believe that the Federal Reserve should impose a specific eligible external long-term debt issuance schedule or similar requirement on covered BHCs. Adopting such a requirement would increase costs and reduce the flexibility covered BHCs should have to meet their funding needs. Moreover, as explained in Annex 1, Section IV.C., there is no material risk that all or most of a covered BHC's debt will reach maturity at the same time. Covered BHCs already ladder the maturities of their long-term debt securities. Any

concerns the Federal Reserve may have about the appropriate laddering of long-term debt securities by covered BHCs are unjustified. Conversely, the market disruption that could be caused by artificially distorting covered BHCs' patterns of debt issuance—or indeed, the appropriateness of requiring such a distortion—has not been adequately considered. Therefore, the Associations believe that a specific eligible external long-term debt issuance schedule or similar requirement is unnecessary.

6. Contractual Subordination

Question 23: Should the Board require that eligible external LTD be contractually subordinated to the general unsecured liabilities of the covered BHC?

The Associations do not believe that requiring contractual subordination of eligible external long-term debt to general unsecured liabilities of the covered BHC would advance the goals of the proposed rule and agree with the Federal Reserve's justifications for not including such a requirement. The structural subordination of a covered BHC's investors in eligible long-term debt to the creditors and counterparties of a covered BHC's subsidiaries would sufficiently ensure that eligible external long-term debt will absorb losses ahead of the liabilities of subsidiaries in an SPOE resolution. Moreover, the Associations agree with the Federal Reserve that giving covered BHCs flexibility to comply with the external long-term debt requirement by either contractual or structural subordination allows for efficient compliance and adaptation to investor risk preferences, and limits the need to re-issue long-term debt that would otherwise be outstanding and available to absorb losses.

IV. Clean Holding Company Requirements

A. Third-Party Short Term Debt Instruments

Question 42: The Board invites comment on whether the purpose of the proposed prohibition would be served by a further requirement that covered holding companies not redeem or buy back their liabilities without prior regulatory approval, to prevent covered holding companies from doing so to preserve their franchise in response to creditor requests, which could hasten a failure by draining liquidity or requiring asset firesales.

The Associations believe that that the prior approval requirement suggested in Question 42 is unnecessary to promote the purposes of the rule and would only disrupt the efficient operations and funding of a covered BHC. Covered BHCs are already required under the proposed rule to obtain prior regulatory approval before redeeming or repurchasing any outstanding EDS if such redemption or repurchase would cause the institution to fall below its minimum TLAC or long-term debt requirements. proposed rule § 252.62(c). Accordingly, the

proposed rule already ensures that redemptions or repurchases will not cause a covered BHC to fall below its minimum TLAC or long-term debt requirements.

To the extent the purpose of such a prior approval requirement is to address potential liquidity concerns, these concerns are already sufficiently addressed by the U.S. Basel III liquidity coverage ratio ("**LCR**") requirements. The LCR rule requires covered BHCs to maintain, on a daily basis, a sufficient amount of HQLA to cover net cash outflows over a 30-day stressed period. If a redemption or repurchase would cause a covered BHC to breach its LCR requirement for three consecutive business days (or earlier, if the breach were material), this would trigger a requirement to submit a liquidity compliance plan to the Federal Reserve. A failure to remediate the breach on a timely basis could result in additional supervisory or enforcement actions by the Federal Reserve. Thus, the LCR rule and related enforcement mechanisms already address the very same liquidity concerns of the type raised in Question 42.

Finally, the suggested prior approval requirement would be disruptive to a covered BHC's normal asset and liability management operations and funding mechanisms. In particular, if a covered BHC determined that it no longer needed a certain issuance (or portion of an issuance) as a funding source or for any regulatory reason, or that profitability and operational efficiency would be enhanced by redeeming the liability, it should be able to do so. Liabilities are redeemed frequently in the normal course of business, and notwithstanding the good faith efforts of regulators, it takes time to request and obtain approvals that could constrain the ability of covered BHCs to react to market conditions.

B. Qualified Financial Contracts with Third Parties

Question 44: The Board invites comment with respect to whether the prohibition on third-party QFCs should be subject to an exception for derivatives contracts that are intended to hedge the exposures of the covered holding company and, if so, the appropriate scope of any such exception. The Board also invites comment on whether the definition of "qualified financial contracts" provides an appropriate scope for this prohibition and, in particular, whether the scope should be narrowed to permit covered holding companies to enter into certain third-party QFCs or broadened to prohibit additional classes of transactions.

The proposed rule would prohibit a covered BHC from entering into any QFCs with third-parties.[1] The Federal Reserve states that without such a prohibition, a covered BHC's counterparties would respond to a covered BHC's default by "immediately liquidating their collateral and seeking replacement trades with other dealers, which could cause firesale effects and propagate financial stress to other firms that hold similar assets."[2] The Federal Reserve

[1] Proposed Rule § 252.64(a)(3); *see also* 80 Fed. Reg. at 74945.

[2] 80 Fed. Reg. at 74945.

states that the proposed restriction on third-party QFCs "will materially diminish the firesale risk and contagion effects associated with the failure of a covered [BHC]."[3]

The Associations believe that this rationale is not applicable to cleared derivatives. When a derivative contract is cleared, a well-regulated clearinghouse—rather than the initial counterparty—becomes responsible for paying amounts due under the derivative to the covered BHC. Variation (mark-to-market) payments are exchanged with the clearinghouse daily, which limits a covered BHC to having intraday exposure to the clearinghouse, and significant amounts of initial margin are posted to the clearinghouse as a performance bond against default. The clearinghouse is also required to have robust financial safeguards and a default waterfall, which includes payments by members into a guarantee fund, to ensure that the clearinghouse will be able to continue to pay amounts due on cleared derivatives notwithstanding the default of large members.[4] Thus, as recognized by the G-20 in their 2009 commitment to implement central clearing in the over-the-counter derivatives markets,[5] and Congress in adding mandatory swap and security-based swap clearing requirements to the Dodd-Frank Act,[6] mandatory clearing protects the financial system from exactly the types of firesale risks and contagion that concern the Federal Reserve. As an example, during the failure of Lehman Brothers in September 2008, LCH.Clearnet Ltd. was able to wind down Lehman's positions and continue payments with only one-third of the initial margin that Lehman had posted.[7] Thus, there is no reason to prohibit covered BHCs from entering into cleared derivatives.

In addition, as a result of the proposed restriction, covered BHCs would not be permitted to enter into QFCs with third-parties that are intended to hedge the covered BHC's own exposures. The Associations believe that the proposed restriction is overbroad and is more restrictive than necessary to promote its stated purpose. Indeed, a prohibition on all third-party QFCs would hamper covered BHCs' ability to engage in sound risk management practices through trades with third-parties, including by limiting flexibility to optimize counterparty exposure when hedging their own exposures to plain-vanilla long-term debt, without materially diminishing firesale risk or contagion effects. In addition, new margin

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[3] 80 Fed. Reg. at 74945.

[4] *See, e.g.*, CFTC Regulation 39.11, 17 C.F.R. § 39.11.

[5] G20 Leaders Statement: The Pittsburgh Summit, September 24-25, 2009, Pittsburgh, http://www.g20.utoronto.ca/2009/2009communique0925.html ("All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest.")

[6] *See* Dodd-Frank Act § 723, 763 (2010). *See also* Letter from Senators Christopher Dodd and Blanche Lincoln to Congressmen Barney Frank and Collin Peterson (June 30, 2010) (''Congress determined that clearing is at the heart of reform—bringing transactions and counterparties into a robust, conservative, and transparent risk management framework.'')

[7] Natasha De Terán, *How LCH.Clearnet got clear of Lehman*, WALL ST. J. EUR., Oct. 14, 2008.

requirements applicable to many swaps and security-based swaps significantly limit the exposure of covered BHCs to their counterparties on certain derivatives, and thus provide protection against the exact types of firesale and contagion risks that the QFC prohibition is meant to avoid. A prohibition on entering into any third-party QFCs would only limit a covered BHC's ability to manage its risk flexibly and prudently, without any material benefit.

To address the overbreadth of the proposed restriction, the Associations recommend that covered BHCs be permitted to enter into third-party QFCs if such QFCs are for hedging purposes or if they are cleared. We believe permitting covered BHCs to enter into QFCs in these limited circumstances would be narrow enough in scope to avoid firesale effects of the magnitude that could create contagion, and would instead promote sound risk management practices at the BHC and financial stability.

Please see Section V.B.3 for a discussion of our recommendation with respect to the definition of qualified financial contract.

C. Guarantees that Are Subject to Cross-Defaults

Question 46: The Board invites comment on the appropriate definition of ''default right'' in the proposed regulations, and on whether the definition of this term should specifically exclude contracts that provide for termination on demand. The Board also invites comment on whether, for the purposes of this proposal, contractual provisions that require the parties to negotiate new terms (e.g., Annex III (Term Loans) of the Global Master Securities Lending Agreement) should be treated the same as a right to terminate on demand.

Question 47: The Board invites comment on whether a covered holding company should be permitted to guarantee the liabilities of its subsidiaries if such liabilities permit a person to terminate the contract on demand or at its option at a specified time, or from time to time, without the need to show cause. Should a covered holding company be permitted to guarantee any particular class or classes of liabilities of its subsidiaries that include such provisions?

The Associations believe that the definition of "default right" in the proposed rule appropriately excludes contracts that provide for termination on demand, which is consistent with the definition used in Section 2 of the ISDA Protocol. For the same reason, the Associations believe that covered BHCs should be permitted to guarantee liabilities of their subsidiaries that allow for termination on demand or at a specified time. The ability to exercise an early termination right is important for the counterparty's ability to meet its investing and risk management objectives. In addition, altering the economics of these transactions to include a stay in bankruptcy could create an incentive to exercise the termination right against a firm in distress earlier than usual because of the risk of becoming subject to a stay.

E. Cap on Other Third-Party Liabilities

Question 53: The Board invites comment on the appropriate definition of "structured notes," and whether the provisions of the definition are adequate to achieve the goals expressed above. The Board invites comment on use and scope of the term "assets" as used in the definition *of structured note, and whether a different term would be more appropriate in this context.*

The Associations believe the Federal Reserve should amend the proposed definition of "structured note" to clarify what is *not* included in that term. The preamble states that the definition of "structured note" is not intended to include:

- "[N]on-dollar-denominated instruments or instruments whose interest payments are linked to an interest rate index . . . that satisfy the other proposed requirements in all other respects,"[8] or

- "[D]ebt instruments that pay interest based on the performance of a single index."[9]

The proposed definition of "structured note" does not, however, include such a clarification. Instead, it would simply define a structured note as any debt instrument that:

- Has a principal amount, redemption amount, or stated maturity that is subject to reduction based on the performance of any asset, entity, index, or embedded derivative or similar embedded feature;

- Has an embedded derivative or similar embedded feature that is linked to one or more equity securities, commodities assets, or entities;

- Does not specify a minimum principal amount due upon acceleration or early termination; or

- Is not classified as debt under GAAP.[10]

The Associations believe that a safe harbor should be added to this definition to reflect the clarification in the preamble in the text of the proposed rule. We have proposed a way to do this in Appendix B to this U.S. G-SIB Comment Letter.

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[8] 80 Fed. Reg. at 74935.

[9] 80 Fed. Reg. at 74947.

[10] Proposed Rule § 252.61 (defining "structured note").

APPENDIX B

TECHNICAL CLARIFICATIONS TO THE PROPOSED RULE

The Associations recommend the following revisions to the proposed rule. Suggested revisions to the rule text are shown below in **blue underlined** text.

Conforming maturity requirement in definition of "eligible debt security" to maturity requirement for treatment as eligible external long-term debt

Eligible debt security means, with respect to a global systemically important BHC, a debt instrument that:…

(3) Has a maturity of greater than **or equal to** 365 days (one year) from the date of issuance;…

Acceleration clauses in the definition of "eligible debt security"

Eligible debt security means, with respect to a global systemically important BHC, a debt instrument that:…

(5) Does not provide the holder of the instrument a contractual right to accelerate payment of principal or interest on the instrument~~, except~~ **based on a cross-acceleration clause or a right that is exercisable upon the breach of a financial covenant, but may provide the holder with, among other acceleration rights,** a right that is exercisable on one or more dates that are specified in the instrument or in the event of (i) a receivership, insolvency, liquidation, or similar proceeding of the global systemically important BHC or (ii) a failure of the globally systemically important BHC to pay principal or interest on the instrument when due;…

Definition of "qualified financial contract"

Qualified financial contract has the same meaning as in section 210(c)(8)(D) of Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. § 5390(c)(8)(D)), including any

(i) "swap" defined in section 1a(47) of the Commodities Exchange Act (7 U.S.C. § 1a(47)) and in any rules or regulations issued by the Commodity Futures Trading Commission pursuant to such section;

(ii) any "security-based swap" defined in section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. § 78c(a)) and in any rules or regulations issued by the Securities and Exchange Commission pursuant to such section; and

(iii) any securities contract, commodity contract, forward contract, repurchase agreement, swap agreement, and any similar agreement that the Federal Deposit Insurance Corporation determines by regulation to be a qualified financial contract as provided in 12 U.S.C. § 5390(c)(8)(D)(i),

provided that the term "qualified financial contract" shall not include any arrangement or other credit enhancement related to any agreement or transaction referred to in the statutory provisions, rules and regulations referenced in this definition, including any guarantee or reimbursement obligation in connection with any agreement or transaction referred to in the statutory provisions, rules and regulations referenced in this definition.

Definition of "Structured Notes"

Structured note means a debt instrument that:

(1) Has a principal amount, redemption amount, or stated maturity that is subject to reduction based on the performance of any asset, entity, index, or embedded derivative or similar embedded feature;

(2) Has an embedded derivative or similar embedded feature that is linked to one or more equity securities, commodities, assets, or entities;

(3) Does not ~~specify~~ **have** a minimum principal amount due **and payable** upon acceleration or early termination; or

(4) Is not classified as debt under GAAP,

provided that an instrument shall not be a structured note solely because it is any one or more of the following:

(a) a non-dollar-denominated instrument, or

(b) an instrument whose return is based on an interest rate index.

ANNEX 2

Glossary to U.S. G-SIB Comment Letter

Term / Acronym	Meaning
5% allowance	Allowance for "unrelated liabilities" equal to 5% of the covered BHC's total external TLAC amount, as defined in Section 352.63(b) of the proposed rule
10% threshold	10% of the CET1 capital of the relevant Board-regulated institution, net of certain required deductions and adjustments
ABA	American Bankers Association
AFME	Association for Financial Markets in Europe
APA	Administrative Procedure Act
Associations	TCH, SIFMA, ABA, FSR and FSF
Basel Committee (BSBC)	Basel Committee on Banking Supervision
BHC	bank holding company
Board-regulated institution	any U.S. BHC or covered SLHC (other than any BHC subject to the Federal Reserve's Small Bank Holding Company Policy Statement, which applies to any BHC with total consolidated assets less than $1 billion; state member bank); and U.S. IHC of a foreign banking organization
bridge BHC	bridge bank holding company
BRRD	European Bank Recovery and Resolution Directive
capital structure liabilities	all equity, hybrid and long-term debt securities. This term does not include short-term debt and other operating liabilities
CET1	Common Equity Tier 1
covered BHC	top-tier bank holding company of a U.S. G-SIB

Term / Acronym	Meaning
covered debt instrument	unsecured debt securities other than Tier 2 instruments issued by a covered BHC
covered IHC	U.S. intermediate holding company of a foreign G-SIB
covered subsidiaries	subsidiaries of covered BHCs that, if a domestic internal TLAC requirement were to be proposed, would be subject to such a requirement. This term does not mean a "covered subsidiary" as defined in Section 201(a)(9) of the Dodd-Frank Act.
critical services	services provided by critical vendors to a covered BHC's operating subsidiaries that are required for them to be able to continue to operate, maintain their franchise values and provide their critical functions to the market under an SPOE or other resolution strategy
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act
domestic internal TLAC	Domestic internal total loss-absorbing capacity
EDS	eligible debt securities
EU	European Union
FDIC	Federal Deposit Insurance Corporation
foreign G-SIB	foreign global systemically important banking group
FSB	Financial Stability Board
FSR	Financial Services Roundtable
FSF	Financial Services Forum
GAO	Government Accountability Office
HQLA	high quality liquid asset
HTM	held-to-maturity
ICMA	International Capital Market Association

Term / Acronym	Meaning
IDI	insured depository institution as defined in Section 3 of the Federal Deposit Insurance Act
International Standard	international TLAC standard established by the FSB in its Principles on Loss-Absorbing and Recapitalisation Capacity of G-SIBs in Resolution (Nov. 9, 2015)
ISDA	International Swaps and Derivatives Association
ISDA Protocol	ISDA 2015 Universal Resolution Stay Protocol
LCR	liquidity coverage ratio
LMA	Loan Market Association
long-term debt securities	debt securities with an original maturity of one year or more.
LSTA	Loan Syndications and Trading Association
non-capital eligible debt security	EDS that does not qualify as tier 2 capital
NPR	notice of proposed rulemaking
OLF	Orderly Liquidation Fund as defined in Section 210(n) of the Dodd-Frank Acct
operating liabilities	short-term debt, liabilities on most financial contracts, liabilities for rent, utilities and similar other critical services, and liabilities arising other than by contract such as those arising from litigation judgments
QFC	qualified financial contract as defined in Section 210(c)(7)(D)(i) of the Dodd-Frank Act
related party liabilities	liabilities owed to affiliates

Term / Acronym	Meaning
run	a cascade of withdrawal requests on demand deposit accounts, a general refusal by short-term creditors and counterparties on repurchase agreements and other QFCs to roll over or renew the short-term debt, repos or other QFCs at maturity, a demand for additional cash collateral that is enforceable in the short-term and even actions to seek repayment of short-term debt before maturity
RWA	Risk-weighted asset
shared services	services, such as legal, compliance, intellectual property or data processing services, provided by one or more legal entities within an affiliated group to one or more other legal entities within the group
short-term debt	debt with an original maturity of less than one year or with a put option exercisable by the debt holder in less than one year after the original issuance of the debt, including demand deposits and other short-term deposits.
SIFMA	Securities Industry and Financial Markets Association
SLR	supplementary leverage ratio
SLHC	savings and loan holding company
SPOE	single-point-of-entry
TBTF	too big to fail
TCH	The Clearing House Association
TLAC	total loss-absorbing capacity
U.K.	United Kingdom
UNCITRAL Model Law	UNCITRAL Model Law on Cross-Border Insolvency
U.S. G-SIB	U.S. global systemically important banking group

Term / Acronym	Meaning
U.S. G-SIB Comment Letter	letter filed by the Associations in response to the proposed rule as it would apply to covered BHCs, including the U.S. G-SIB Cover Letter and all annexes and appendices thereto
U.S. G-SIB Cover Letter	cover letter to the U.S. G-SIB Comment Letter

ANNEX 3

Key Data Assumptions

1. References to the maturity of a debt security mean the stated final maturity date of the security. References to callable long-term debt securities mean long-term debt securities that are callable at par, and references to the call date of such securities refers to the earliest date on which a U.S. G-SIB may redeem the security at par. Calling or redeeming ineligible long-term debt securities, even at par, could come at a significant cost to the U.S. G-SIBs, which cost is not included in the analysis. There are also constraints that can impede the ability of the U.S. G-SIBs to exercise call or redemption rights, such as the need to obtain the consent of the bondholders.

2. Assumptions about the replacement of maturing or callable debt:

    a. Plain vanilla long-term debt securities that are not eligible debt securities maturing in Q4 2015 and in 2016 are replaced with plain vanilla long-term debt securities that are not EDS maturing in 2020 and 2021, respectively. Similarly, EDS maturing in Q4 2015 or in 2016 are replaced with eligible debt securities maturing in 2020 and 2021, respectively.[1]

    b. All plain vanilla long-term debt securities maturing in 2017 and 2018, regardless of current eligibility per the NPR, are replaced with eligible debt securities maturing after 2023.

    c. All plain vanilla long-term debt securities that are callable at par prior to 2019, including in Q4 2015 or in 2016, are called in 2017 or 2018 and are replaced with eligible debt securities maturing after 2023.

3. Risk-weighted assets and total leverage exposure as of September 30, 2015 remain constant over time.[2]

4. The NPR is finalized as proposed (unless otherwise noted). All shortfalls are shown relative to fully phased-in requirements assuming the countercyclical buffer remains at zero.

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[1] These reissuance assumptions are based on the U.S. G-SIBs' continuing current issuance practices until January 1, 2017, which would be consistent with the rule being finalized in the second half of 2016.

[2] This is a simplifying assumption due to the difficulty of making accurate projections about the future size and composition of the balance sheet of each U.S. G-SIB, particularly in view of offsetting factors.

ANNEX 4

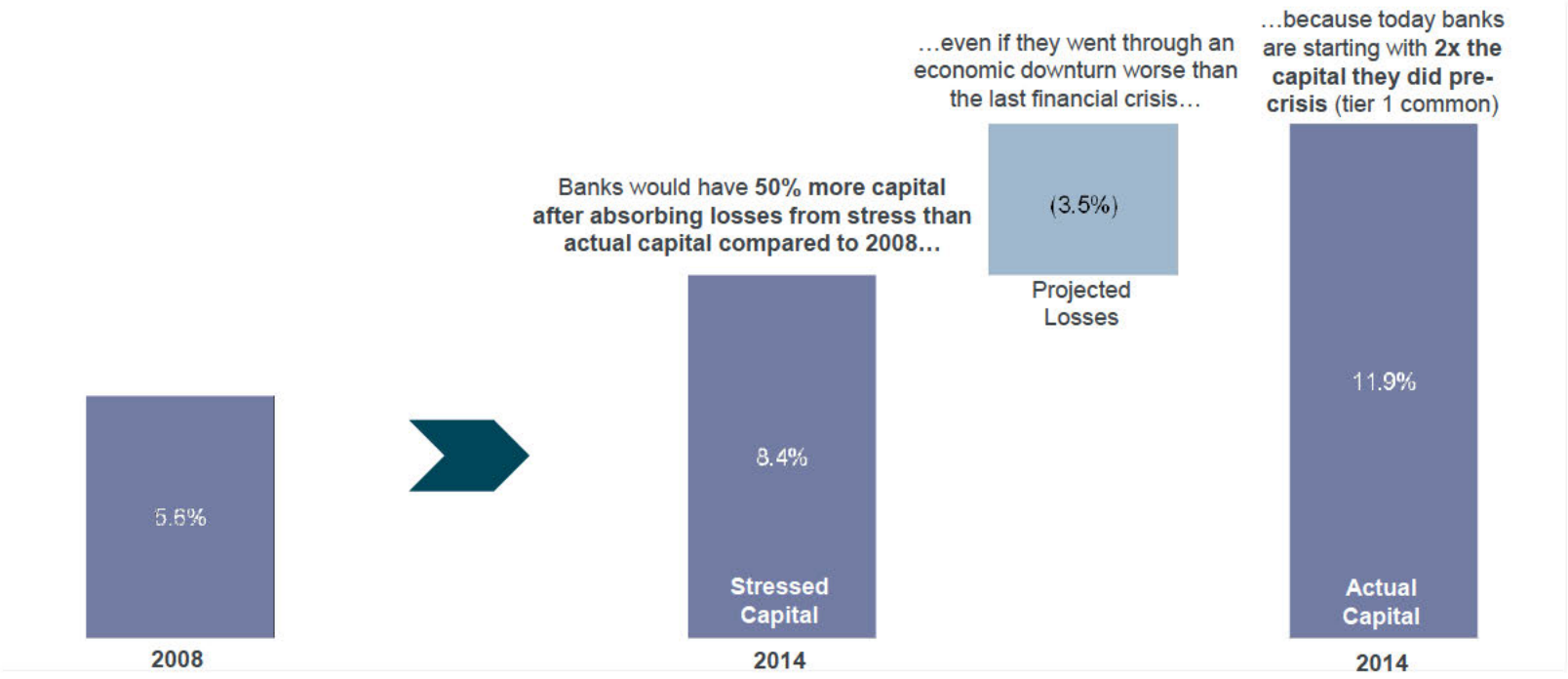
Progress on Improving the Resiliency and Resolvability of U.S. G-SIBs

February 2016

Increased Resiliency

U.S. G-SIBs have more stressed capital than they had actual capital in August 2008

U.S. G-SIBs have higher capital today in a stressed environment than actual capital in August 2008…



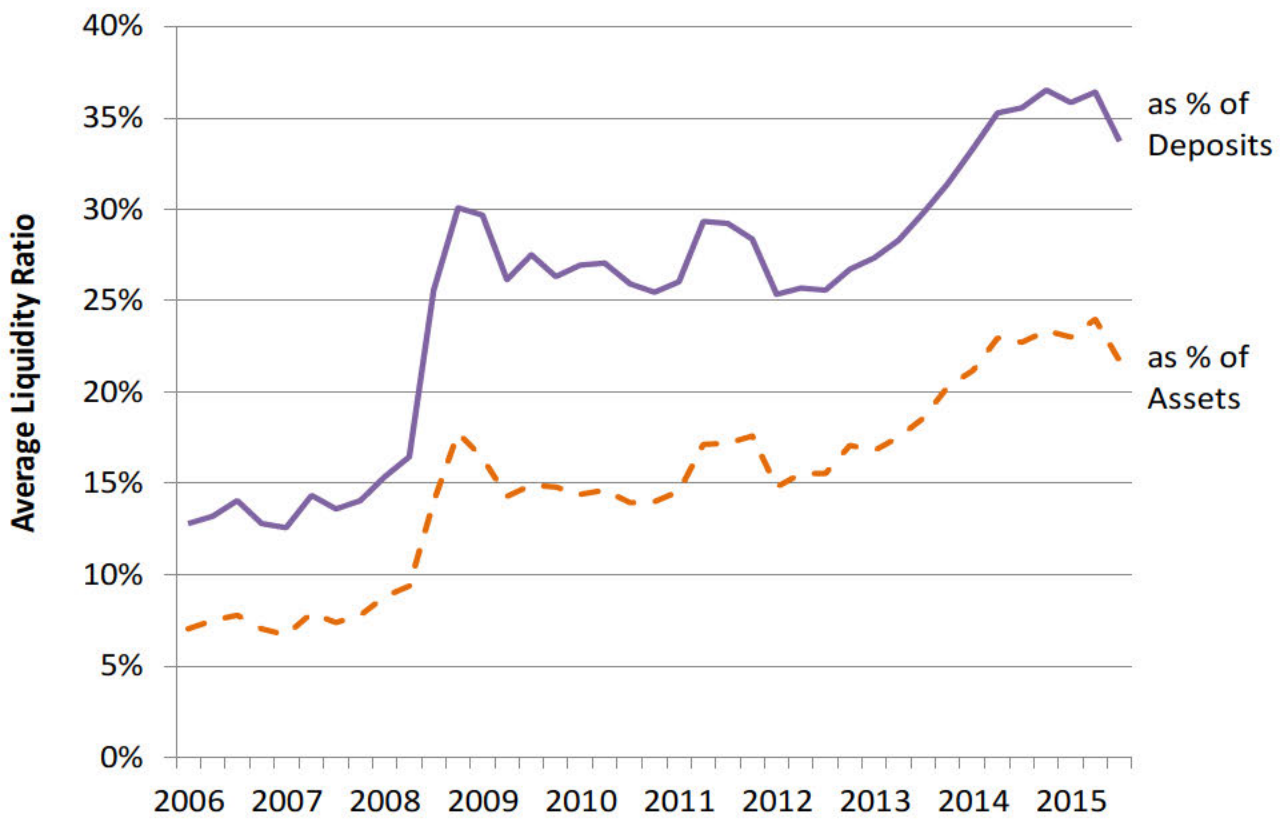
…making them more resilient against insolvency…
…which has been noted by regulators: Quotes from Fed Chairs Janet Yellen and Ben Bernanke

- "From **early 2009 through 2014, capital held** by the eight most systemically important U.S. bank holding companies **more than doubled, reflecting an increase of almost $500 billion** in the strongest form of capital held by these companies" – Janet Yellen
- "Even under the severely adverse scenario of the latest stress test, **the estimate of these firms' post-stress tier 1 common capital ratio is more than 2 percentage points higher than actual capital levels at the end of 2008**." – Ben Bernanke

Note: Actual and stressed tier 1 capital ratios reflective of CCAR banks in 2015 DFAST stress test
Source: *Federal Reserve, SNL Financial.*

U.S. G-SIBs have significantly more liquid balance sheets, making them more resilient against runs and contagion

U.S. G-SIBs have nearly 3 times the amount of liquid assets (consisting of cash, U.S. Treasuries and bank deposits) than they had just before the 2008 financial crisis and more than they had at the peak of their "liquidity hoarding" during the financial crisis…



…which has been noted by regulators: Quote from Fed Chair Janet Yellen

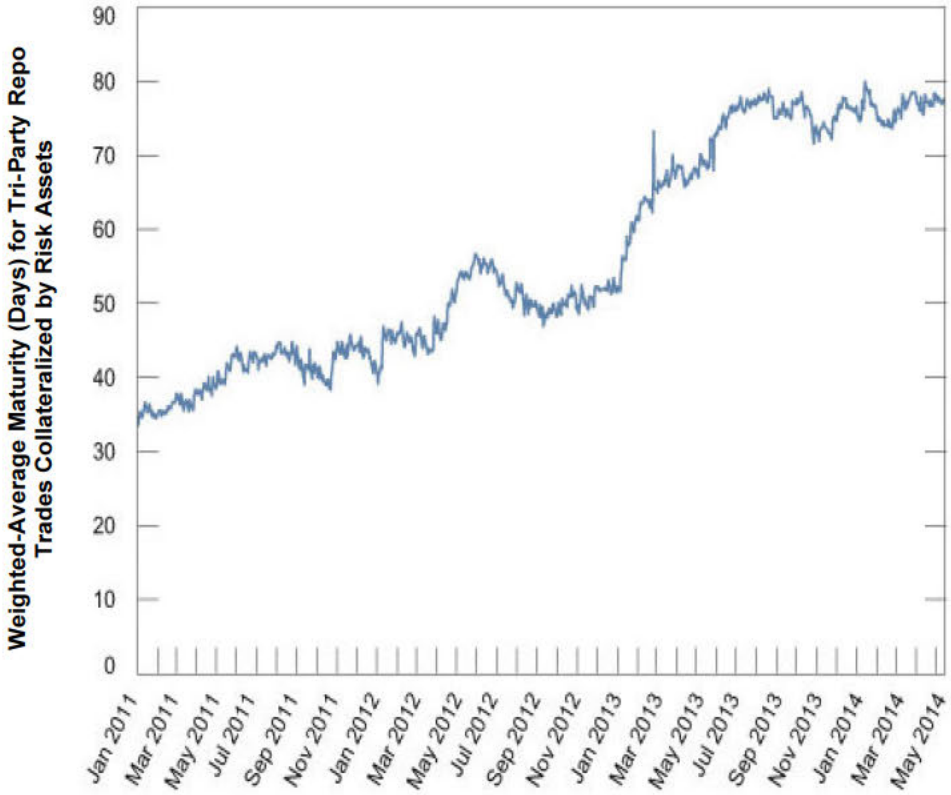
- "Likewise, the Federal Reserve's increased focus on liquidity has contributed to significant increases in firms' liquidity. The **high-quality liquid assets** held by [the] eight [U.S. G-SIB] firms **has increased by roughly one-third since 2012**, and their **reliance on short-term wholesale funding has dropped considerably**." – Janet Yellen

Liquidity = Cash and Due From Banks + U.S. Treasuries (held to maturity and available for sale).
Average as % Deposits = Arithmetic average of liquidity / total deposits for BAC, BK, C, JPM, STT, WFC
Average as % Assets = Arithmetic average of liquidity / total assets for BAC, BK, C, JPM, STT, WFC
Source: *SNL Financial*

U.S. G-SIBs have reduced their reliance on short-term wholesale funding, making them more resilient against runs and contagion

Banks have significantly lowered their reliance on short-term wholesale funding…

…and pushed out the duration of any remaining short-term wholesale funding



Note: Left chart, short term financing defined as commercial paper, trading liabilities, <1 yr borrowings, repurchase agreements, reflective of all U.S. G-SIBs.
Source: *SNL Financial, Regulatory Filings, FRBNY, Liberty Street Economics' Paper "What's Your WAM? Taking Stock of Dealers' Funding Durability" published 6/9/2014*

Stronger U.S. regulatory standards increase with size and complexity of U.S. banks…

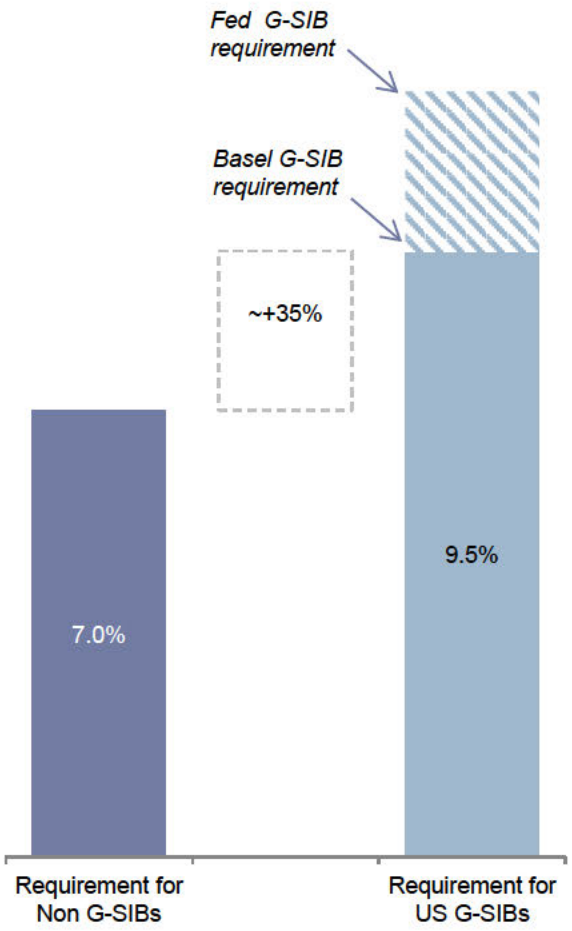
Regulation	Less than $10bn assets	$10-$50bn	$50-$250bn	>$250 (not G-SIBs)	U.S. G-SIBs
Recovery Plans					✓
TLAC Requirement					✓
G-SIB Capital Surcharges					✓
Supplementary Leverage Ratio (5% / 6% requirement)[1]					✓
AOCI included in Basel 3 capital				✓	✓
Full Liquidity Coverage Ratio				✓	✓
Supplementary Leverage Ratio (3% requirement)				✓	✓
Advanced Approach RWA				✓	✓
Resolution Plans			✓	✓	✓
Early Remediation Tools			✓	✓	✓
Modified Liquidity Coverage Ratio			✓	✓	✓
Annual Fed-run Capital Plan and Stress Test			✓	✓	✓
Annual Company-run Stress Test		✓	✓	✓	✓
Durbin (interchange) Amendment		✓	✓	✓	✓
Subject to Regulation by CFPB	Certain Products	✓	✓	✓	✓
Prompt Corrective Action Tools	✓	✓	✓	✓	✓
Volcker Rule	✓	✓	✓	✓	✓

[1] 5% requirement at the holding company, 6% at insured depository institutions

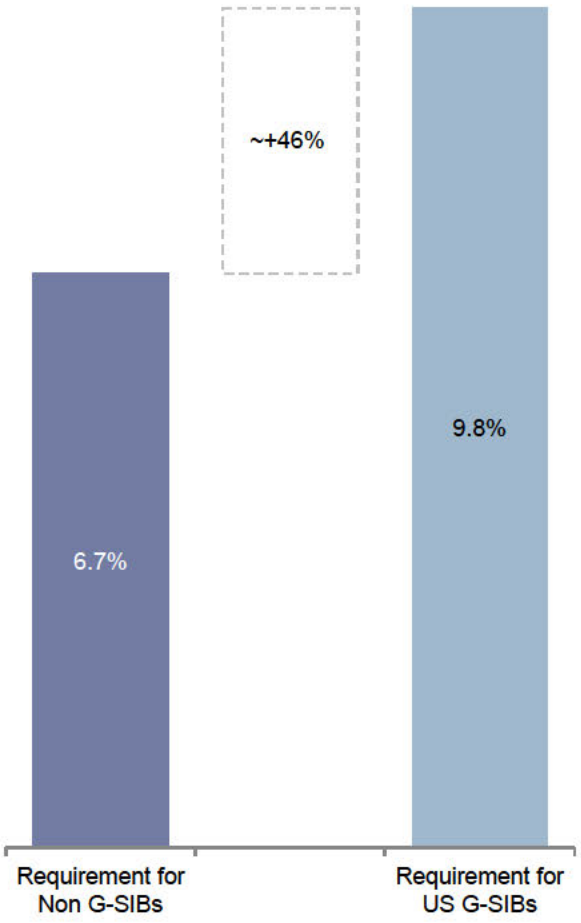
Source: *Federal Reserve, FDIC.*

…including U.S. capital requirements, which increase with size and complexity of U.S. banks

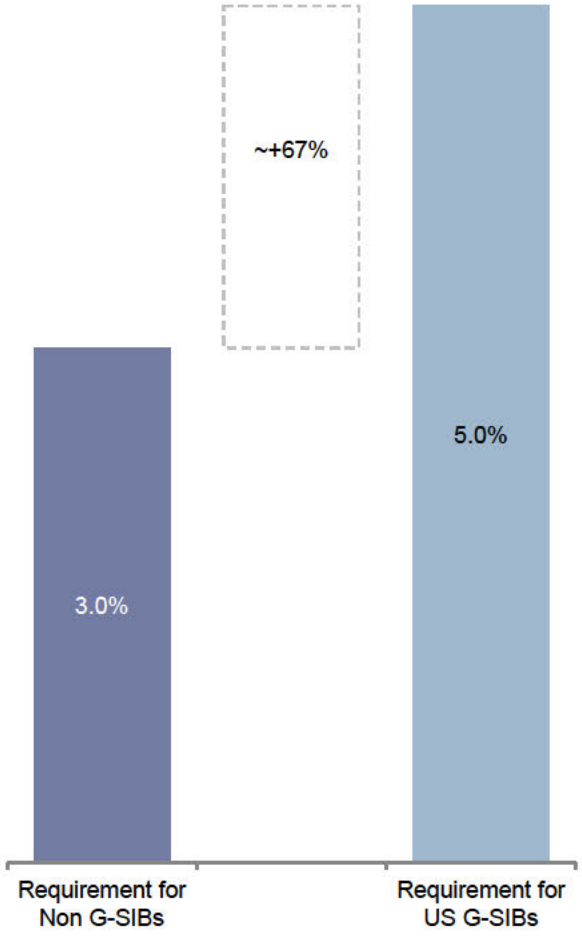
Higher capital requirements for U.S. G-SIBs were first codified under Basel 3…



… and have been reinforced under CCAR [1]…



… and amplified with the supplementary leverage ratio [2]



1) *Based on capital ratio losses (170bp for U.S. non-G-SIBs, 480bp for U.S. G-SIBs starting vs ending T1C ratio) from 2015 DFAST results over 5% T1C minimum*
2) *Based on a 3% requirement for U.S. non-G-SIBs on the basic leverage ratio and a 5% requirement for U.S. G-SIBs under the enhanced supplementary leverage ratio (6% at bank sub), which could be conservative as banks could see asset inflation due to the inclusion of off-balance sheet exposures in the eSLR calculation. Source: Federal Reserve, Company Documents.*

U.S. G-SIBs are subject to early remediation tools, which become more demanding with size and complexity

All U.S. banks are subject to prompt correction action (PCA) framework

- If PCA triggers are hit, regulators can require capital restoration plans; restrict growth, dividends and executive compensation; replace directors and officers; or divest risky assets

U.S. banks with assets > $50 bn are also subject to Dodd-Frank's enhanced early remediation tools

- Requires Fed to establish early remediation triggers based on liquidity measures and forward-looking indicators, rather than backward-looking indicators

U.S. G-SIBs are also required to prepare recovery plans

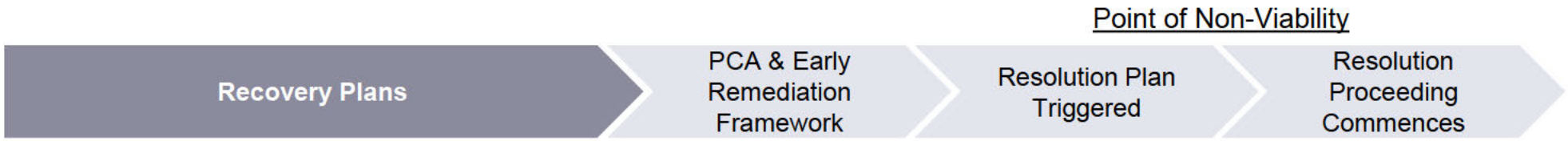
- Recovery plans are different from and in addition to resolution plans
- Recovery plans establish the actions a firm will take to return to a position of financial stability once it is experiencing or is likely to encounter considerable financial distress
- Recovery plans are designed to develop a menu of options that would enable a firm to maintain the confidence of market participants during a range of stress scenarios

Recovery planning by U.S. G-SIBs designed to ensure early remediation well before resolution plans are needed

Recovery Plans

Since 2009, Federal Reserve has required the U.S. G-SIBs to develop recovery plans, which establish the actions a firm will take to return to a position of financial stability once it is experiencing or is likely to encounter considerable financial distress.

The OCC proposed complementary recovery planning standards in 2015 that would apply to certain banks with at least $50 billion in assets, which includes many U.S. G-SIBs' bank subsidiaries.



- Recovery plans identify a range of options that must be taken to restore safe capital and liquidity levels, including possible sale of valuable assets (Federal Reserve SR 14-8, 9/25/14).
- They require U.S. G-SIBs to address financial weaknesses well before the point of non-viability, thus substantially reducing the risk of bankruptcy
- Recovery plans thus act as a buffer against loss of public confidence in individual firms or the broader financial system

- Federal Reserve has continued to test and require improvements in the recovery plans, and expanded the range of banks required to develop them
- Recovery plans are different from, and in addition to, resolution plans, which are not triggered until a firm approaches the point of non-viability (i.e., runs out or is likely to run out of capital or liquidity)
- Recovery plans would be invoked well before a U.S. G-SIB or bank reaches the point of non-viability

Demonstrating Resolvability in the 2015 Title I Resolution Plans

Most U.S. G-SIBs Rely on SPOE to Show Resolvability
Firms that exit SPOE are smaller and simpler

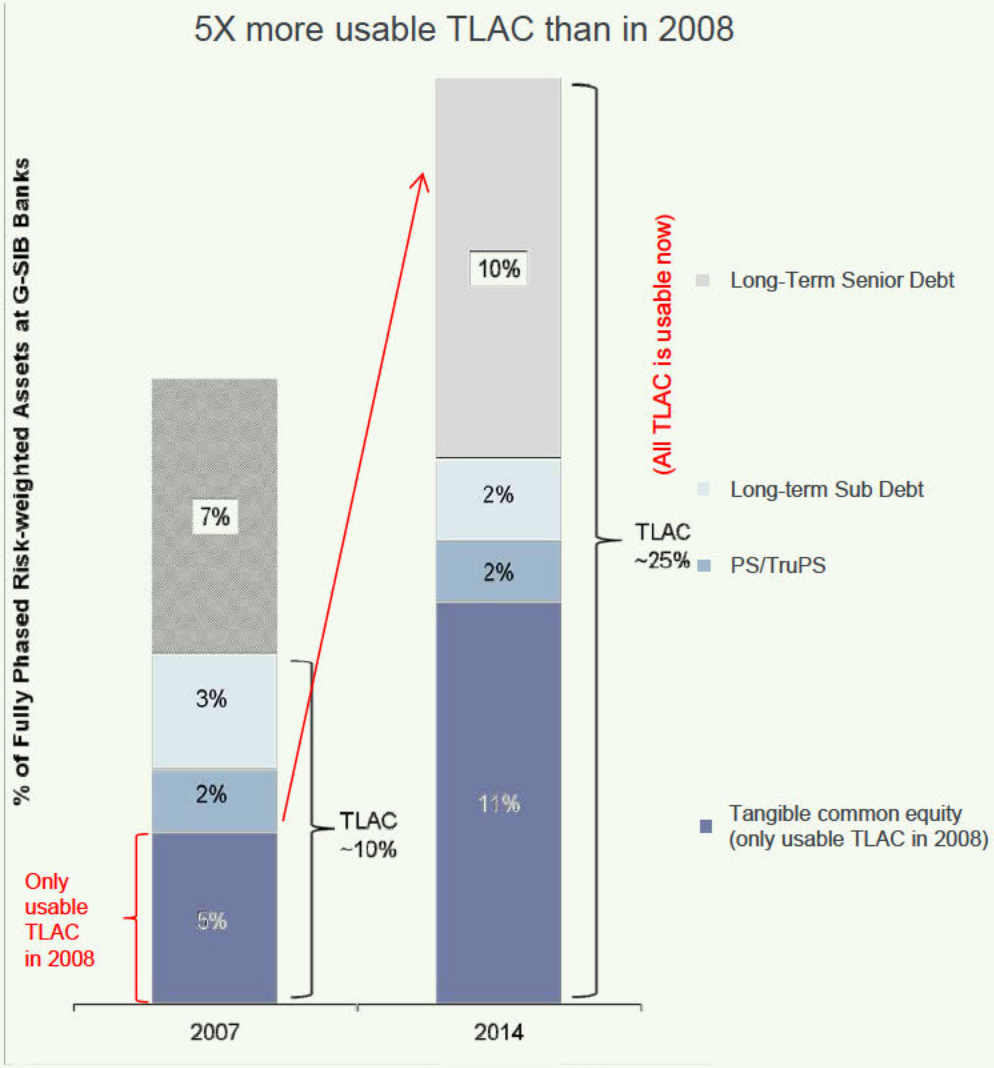
- SPOE widely recognized as most promising solution to TBTF
- Keeps operating subsidiaries out of insolvency. Preserves critical operations.
- Firms that exit SPOE are substantially smaller and simpler than the U.S. G-SIBs that entered SPOE.

U.S. G-SIBs 2015 Title I Resolution Plans—Public Section Description of Post-Resolution Firm

Bank of America - SPOE	BNY Mellon – FDIC Receivership / Bridge Bank	Citigroup – SPOE	Goldman Sachs – SPOE (except 3 subs)
• ~40% reduction in overall assets, including **1/3 reduction in main bank** ME's assets and **80% reduction** in **non-bank** ME's asset • Reduction of product offerings, global footprint and customers • Wind down, sale or simplification of certain CBLs	• **Nothing will remain** of firm upon completion of resolution: ○ business lines and critical operations housed in bridge bank would be sold to third parties; and ○ broker-dealer and asset management entities would be sold.	• **Banking businesses divested**; each divested business is significantly smaller and less systematically important • **Broker-dealers** either **sold** as going concerns or subject to **solvent wind-down**	• Firm would **cease to exist** post-resolution; all assets would be sold or unwound • Only surviving businesses would be asset management and merchant banking businesses, which would have been sold
JPMorgan – SPOE (except 1 sub)	**Morgan Stanley - SPOE**	**State Street - SPOE**	**Wells Fargo – FDIC Receivership / Bridge Bank**
• ~ **1/3 reduction** in **main bank** ME's assets (including ME branches). • ~ **2/3 reduction** in **broker-dealer** MEs' assets; none would be systemically important. • Reduced demand for services shrink service entities. • Certain MEs disposed of as part of parent liquidation.	• Firm would **cease to exist** post-resolution • CBLs would either be sold or wound down	• ~ **50% reduction** of **bank** ME's balance sheet by one year after idiosyncratic stress event • Firm's size and operational footprint may shrink further due to the potential sale of investment management business	• **~70% reduction** in **main bank** ME's assets. • Parent would sell certain businesses and seek to reorganize around any remaining businesses; however, if there are no remaining businesses, parent would liquidate its remaining assets and cease to exist

Usable TLAC: The most important structural change that you have never heard of . . . and the key to SPOE

U.S. G-SIBs have substantially increased and restructured their equity and long-term unsecured debt so that all of it can now be used to absorb losses without threatening financial stability



- Total loss-absorbing capacity (TLAC) consists of equity plus long-term unsecured debt that can be converted to common equity in bankruptcy
- In 2008, long-term senior debt not usable without causing contagion; losses could not be legally imposed on LT senior debt without doing so on short-term debt
- Even subordinated debt, preferred stock and trust preferred securities (TruPS) unusable in 2008 because market confusion about loss waterfall
- U.S. G-SIBs have restructured themselves to make long-term senior debt structurally subordinate to short-term debt
- Long-term senior debt can now be converted to common equity without converting short-term debt or causing contagion or financial instability
- U.S. G-SIBs now have **5X more usable TLAC**
- No more market confusion about loss waterfall
- Enough TLAC to recapitalize U.S. G-SIBs at full Basel III capital levels under conditions twice as severe as 2008 financial crisis

Note: TLAC estimate reflects all U.S. G-SIBs.
Source: Federal Reserve, SNL Financial, Regulatory Filings.

Both market and regulators expect SPOE and usable TLAC to make U.S. G-SIBs resolvable under the Bankruptcy Code

During 2008 financial crisis, market expected both long-term debt and short-term debt of U.S. G-SIBs to be bailed out because losses could not be imposed on long-term debt without imposing losses pro rata on short-term debt, which would have fostered contagion and threatened financial stability

- Moody's and S&P have eliminated uplift on ratings of U.S. G-SIBs from expected government support, because government bailouts no longer expected
- No more market confusion about loss waterfall
- Market understands that long-term unsecured debt will act as a private-sector buffer against losses by short-term unsecured debt
- Spreads on long-term debt of U.S. G-SIBs are now higher than spreads on long-term debt of other U.S. banks

"Rather than relying on public funds to bail-out one of [the U.S. G-SIBs], we expect that bank holding company creditors will be bailed-in and thereby shoulder much of the burden to help recapitalize a failing bank."

- Robert Young, Moody's Managing Director (April 2013)

"We believe the U.S. resolution framework is now 'effective,' which implies that the probability that a U.S. GSIB would receive extraordinary government support if it came under stress is lower. … The amount of TLAC that U.S. GSIBs will be required to hold was one of the key factors in whether we would deem the U.S. as having an effective and actionable resolution regime."

- S&P (December 2015)

- Current amount of usable TLAC should make SPoE and other resolution strategies feasible under ordinary bankruptcy laws
- FSB has issued final TLAC international standard
- Fed recently issued a proposed TLAC / LTD rule

"[S]uccessful resolution without taxpayer assistance would be most effectively accomplished if a firm has sufficient long-term unsecured debt to absorb additional losses and to recapitalize the business transferred to a bridge operating company. The presence of a substantial tranche of long-term unsecured debt that is subject to bail-in during a resolution and is structurally subordinated to the firm's other creditors should reduce run risk by clarifying the position of those other creditors in an orderly liquidation process."

- Fed Governor Tarullo (Senate Testimony, September 2014)

"[I]t is notable that, at present, large U.S. firms have substantial amounts of long-term debt on their balance sheets."

- Fed Governor Tarullo (December 2012)

U.S. G-SIBs have made substantial efforts to comply with all five requirements of joint Fed/FDIC Aug 2014 guidance

Category	Regulatory Requirement	Status
Holdco Structure	■ Holding company structure that supports resolvability	■ Restructured long-term unsecured debt to be structurally subordinate to short-term unsecured debt so that all TLAC is usable to absorb losses without threatening financial stability; usable TLAC now 5X more than in 2008 ■ Created "clean" holdcos
Legal Entity Structure	■ More rational, less complex legal structures	■ Reduced interconnectedness; increased separability; projects for other simplifications underway
Financial Contracts	■ Amend financial contracts to impose temporary stay on direct defaults and override cross-defaults under SPoE and other resolution strategies	■ All 8 of the U.S. G-SIBs are among the 23 G-SIBs that have adhered to ISDA Resolution Stay Protocol; they have also encouraged regulations that would expand principles to broader range of counterparties and financial contracts
Shared Services	■ Ensure continuity of shared services for critical operations and core business lines throughout resolution process	■ Shared services organized in service companies or operating subs that survive under preferred strategy, and governed by improved SLAs
Operational Capabilities	■ Improve operational readiness for resolution, including better management information systems (MIS) during resolution	■ Enhanced management information systems (MIS), direct engagement with FMUs, and other improvements

U.S. G-SIBs have made other significant structural changes to improve resolvability

Simplification	■ Reorganized critical operations and core business lines to be less interconnected and more separable in failure scenarios ■ Where appropriate, projects to separate retail from wholesale operations
Restructured Assets	■ Concentrate assets at parent holdco to be available wherever needed to recapitalize affiliates throughout group regardless of which affiliates suffer losses ■ Now have enough assets to recapitalize affiliates in severely adverse scenario
Restructured Liquidity	■ Concentrate excess liquidity at parent holdco to be available wherever needed throughout group in resolution scenario ■ Now have enough liquidity for resolution strategies to be feasible without government liquidity
Cross-border Cooperation	■ Plans to consider internal TLAC requirements to foster trust between home and host-country resolution authorities and discourage ring-fencing

ISDA Resolution Stay Protocol: addresses obstacle from early termination issues in financial contracts

ISDA Protocol and Regulations

- All 8 of the U.S. G-SIBs are among 23 G-SIBs adhering to new ISDA Stay Protocol
- Protocol imposes temporary stay on direct defaults and overrides cross-defaults in existing and future ISDA contracts among 23 G-SIBs
- ISDA Protocol is expected to be reflected in all new financial contracts
- Support regulations to expand principles of ISDA Protocol to more counterparties and financial contracts
- No similar mechanism existed during the 2008 crisis

Eliminate Impediment to Resolution

- Overriding cross-defaults prevents cash drains from direct counterparty operating subsidiary when parent fails but direct counterparty operating subsidiary could still perform on financial contracts
- Temporary stay gives bankruptcy courts more time to avoid value destruction from early termination without undermining risk management function of financial contracts
- Pause in the collection of swaps collateral could give U.S. G-SIBs enough time to re-capitalize and avoid the kind of panic that followed the 2008 failure of Lehman Brothers

"This is a major achievement, by the industry….With the adoption of the protocol by the top 18 dealer G-SIBs in November, over 90% of their OTC bilateral trading activity will be covered by stays of either a contractual or statutory nature."

- Financial Stability Board, Press Release (October 2014)

"This initiative is an important step toward mitigating the financial stability risks associated with the early termination of bilateral, OTC derivatives contracts triggered by the failure of a global banking firm with significant cross-border derivatives activities."

- Federal Reserve Board and FDIC Joint Press Release (October 2014)

U.S. G-SIBs have made structural and other changes to ensure the continuity of material shared services

What Are Shared Services?

An example of shared services is when back office operations such as payments and cash management are performed by one affiliate for another affiliate.

See table below for visual explanation where three affiliates are supported by a fourth affiliate for payments and cash management.

Affiliate 1	Affiliate 2	Affiliate 3
Banking activities	Securities activities	Asset management
Affiliate 4		
Payments		
Cash Management		

Fed/FDIC Requirement

Fed/FDIC release: "ensuring the continuity of shared services that support critical operations and core business lines throughout the resolution process"

How U.S. G-SIBs Have Responded

- **Organization**: Have organized many shared services that support critical operations and core business lines into service companies or operating subsidiaries that survive under preferred strategy
- **Service Level Agreements (SLAs)**: Have established SLAs for material shared services
- **Amended terms:** Have restructured terms of SLAs that assure continuity of the supply of services in resolution
- **Improvements**: Projects to remedy any open issues within reasonable time frame

U.S. G-SIBs have made substantial changes to operational readiness, including MIS and FMU access

What is Operational Readiness?

"[The] Federal Reserve … has observed a range of capabilities which are critical to … operational resilience and contingency planning …. Specifically, a bank holding company subject to this guidance should have:

- Effective processes for managing, identifying, and valuing collateral it receives from and posts to external parties and affiliates;
- A comprehensive understanding of obligations and exposures associated with payment, clearing, and settlement activities;
- The ability to analyze funding sources, uses, and risks of each material entity and critical operation, including how these entities and operations may be affected under stress;
- Demonstrated management information systems capabilities for producing certain key data on a legal entity basis that is readily retrievable and controls in place to ensure data integrity and reliability; and
- Robust arrangements in place for the continued provision of shared or outsourced services needed to maintain critical operations that are documented and supported by legal and operational frameworks."

- Federal Reserve, SR 12-14 (January 24, 2014)

FMU Activities

"Describe the Covered Company's strategies for meeting its payment, clearing, and settlement obligations in the event access to some, or all, services provided by critical FMUs … and/or third party agents is restricted or unavailable in resolution. The discussion should **consider the imposition of higher margin and collateral requirements**, restrictions on clearing and settlement activity across different product types, and the impact of suspension or termination of the Covered Company's membership across any or all entities."

- 2013 Federal Reserve & FDIC Guidance

Fed/FDIC Requirement

Fed/FDIC release: "ensuring the continuity of shared services that support critical operations and core business lines throughout the resolution process"

How U.S. G-SIBs Have Responded

- Enhancing management information systems (MIS) to provide U.S. G-SIBs and their supervisors with timely access to reliable information during resolution
- Direct engagement with FMUs on resolution-related initiatives

G-SIBs have responded in good faith to guidelines provided by the regulators

- Developed a variety of resolution strategies under the Bankruptcy Code, the FDIA, SIPA or other normal insolvency laws

Single-point-of-entry (SPoE) and other recapitalization within resolution strategies using Section 363 of the Bankruptcy Code	Orderly wind-down strategies
Solvent wind-down strategies	Bridge bank strategies under the FDIA

- Eliminated or provided additional support for assumptions identified by regulators as unrealistic or inadequately supported in 2013 living wills

The U.S. regulators have made substantial progress in cross-border cooperation

Progress	Description
FSB Initiatives	• FDIC and Federal Reserve regularly participate in FSB initiatives that are designed to improve regulatory cooperation and coordination of the cross-border resolution of G-SIBs • They also regularly participate in Crisis Management Groups consisting of the U.S. and foreign regulators of the U.S. G-SIBs and their material U.S. and foreign operating subsidiaries
Memorandum of Understanding	• The FDIC has entered into a memorandum of understanding and engaged in resolution war games with the UK, the most important host-country jurisdiction for most U.S. G-SIBs
U.S. G-SIB Encouragement	• The U.S. G-SIBs have consistently encouraged more cooperation and coordination among U.S. and foreign resolution authorities • The U.S. G-SIBs have consistently encouraged the FDIC to identify SPOE as its preferred strategy and otherwise give host-country supervisors confidence that resolution will be carried out in a predictable way that will minimize any losses to foreign subsidiaries in order to foster cross-border cooperation and discourage ring-fencing

"[T]he FDIC has worked closely with all the major financial jurisdictions, including the United Kingdom, Germany, France, Switzerland, and Japan as well as European entities including the new Single Resolution Board and Single Supervisory Mechanism. This cooperation is essential to identifying issues and to addressing obstacles to cross-border resolution."

-FDIC Chairman Gruenberg (May 2015)

The regulators have recognized the progress the U.S. G-SIBs have made in improving their resolvability

"I would suggest that there has been no greater or more important regulatory challenge in the aftermath of the financial crisis than developing the capability for the orderly failure of a systemically important financial institution. While there is still a lot of work to do, looking at where we were and where we are today, in my view the progress has been impressive…

"While there is still much work to do, if there is one point I would like to conclude with today it is that there has been a transformational change in the United States and internationally since the financial crisis in regard to the resolution of systemically important financial institutions that perhaps has been underappreciated."

- FDIC Chairman Gruenberg (May 2015)

"Work on the use of the resolution mechanisms set out in the Dodd-Frank Act, based on the principle of a single point of entry … holds the promise of making it possible to resolve banks in difficulty at no direct cost to the taxpayer.

"[C]onsiderable progress has been made … in developing suitable resolution regimes for financial institutions"

- Fed Vice Chairman Fischer (August 2014)

"My view is that those steps have made the system safer, sounder and more resilient—and by a wide margin. It's frankly hard to overestimate the impact of Dodd-Frank. The Volcker Rule, the Financial Stability Oversight Council, risk retention, enhanced resolution authority—these and a dozen other important provisions of that historic law laid the groundwork for a safer and more stable financial system."

- Comptroller of the Currency Curry (June 2015)

"[W]e established a set of enhanced standards for large U.S. banking organizations to help increase the resiliency of their operations and thus promote financial stability. … These and other measures have already created a financial regulatory architecture that is much stronger and much more focused on financial stability than the framework in existence at the advent of the financial crisis."

- Fed Governor Tarullo (September 2014)

"The single-point-of-entry approach offers the best potential for the orderly resolution of a systemic firm …, in part because of its potential to mitigate run risks and credibly impose losses on parent holding company creditors and, thereby, to enhance market discipline."

- Fed Governor Tarullo (October 2013)

What is a “credible” living will?

- Title I of the Dodd-Frank Act requires all BHCs with > $50 bn in assets to submit annual resolution plans (living wills) showing how they can be resolved under the Bankruptcy Code
- Fed/FDIC decide whether these living wills are “not credible” or would not facilitate and orderly resolution under the Bankruptcy Code
- In August 2014, FDIC determined that all of the 2013 living wills submitted by the first-wave filers* were “not credible”
- Fed did not make a credibility determination, but joined FDIC in identifying shortcomings in the 2013 living wills
- Agencies need to articulate clear, reasonable and transparent benchmarks

“[T]he living will process is **intended to be iterative**..."
Janet Yellen, Testimony, U.S. Senate (July 15, 2014)

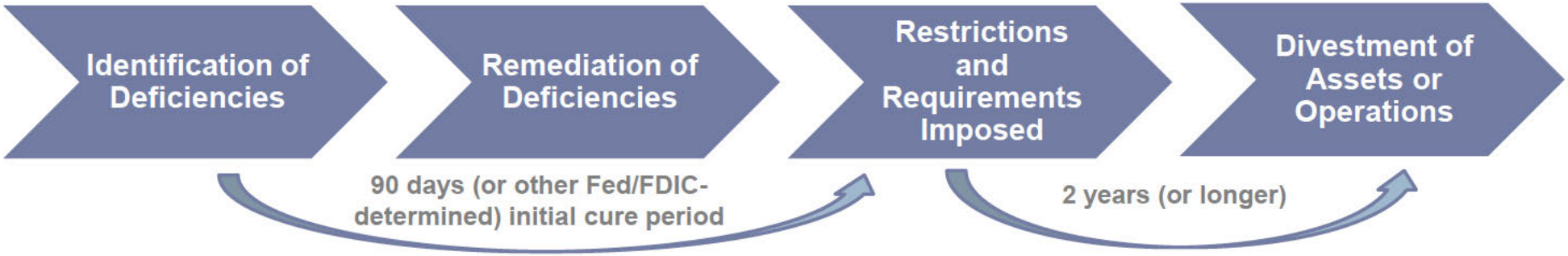
“[We]… expect the process of submission and review of the initial resolution plan iterations to include an ongoing dialogue with firms”
12 C.F.R. Part 381 (September 9, 2011)

Rule (2011)	Plan (2012)	First Wave Industry-Wide Guidance (2013)	Plan (2013)	Plan (2014)	First Wave Individualized Guidance (2014)	Plan (2015)
• November 1, 2011 – Regulations issued by the FDIC and Federal Reserve under Section 165(d)	• July 1, 2012 – Nine “First Wave” filers submitted first Resolution Plans • October 1, 2012 – Remaining two “First Wave” filers submitted Resolution Plans	• April 2013 – “First Wave” filers receive industry-wide guidance identifying required assumptions and key obstacles to address	• September 30, 2013 – “First Wave” filers submitted Second Resolution Plan	• July 1, 2014 – “First Wave” filers submitted third Resolution Plan	• August 5, 2014 – The FRB and FDIC issue a joint release indicating they have issued “First Wave” filers firm specific feedback	• July 1, 2015 – “First Wave” filers submit fourth Resolution Plan

* The first-wave filers included all of the U.S. G-SIBs, except Wells Fargo.

What happens if the agencies determine that some or all of the 2015 living wills are "not credible"?

- U.S. G-SIBs have developed strategies and made enough structural changes to demonstrate that they could be resolved under the Bankruptcy Code without government support or threatening financial stability
- But what happens if the Fed/FDIC nevertheless jointly determine that one or more of the 2015 living wills are "not credible"?



- The Fed and the FDIC must identify the deficiencies
- The firm that submitted the plan would be given an opportunity to cure the identified deficiencies
- If the firm failed to cure the identified deficiencies within specified cure period, the Fed and the FDIC could jointly impose various restrictions and requirements depending on the nature of the deficiency
  - Presumably, the remedy would be different if the identified deficiency was inadequate MIS versus inadequate TLAC or liquidity
- If the firm failed to cure the identified deficiencies within a **two-year period** after the Fed and the FDIC jointly imposed any restrictions or requirements, then the Fed and the FDIC, in consultation with FSOC, could jointly order it to divest certain assets or operations if that would facilitate an orderly resolution of the firm under the Bankruptcy Code

ANNEX 5

A Step-by-Step Illustration of SPOE Resolution

February 2016

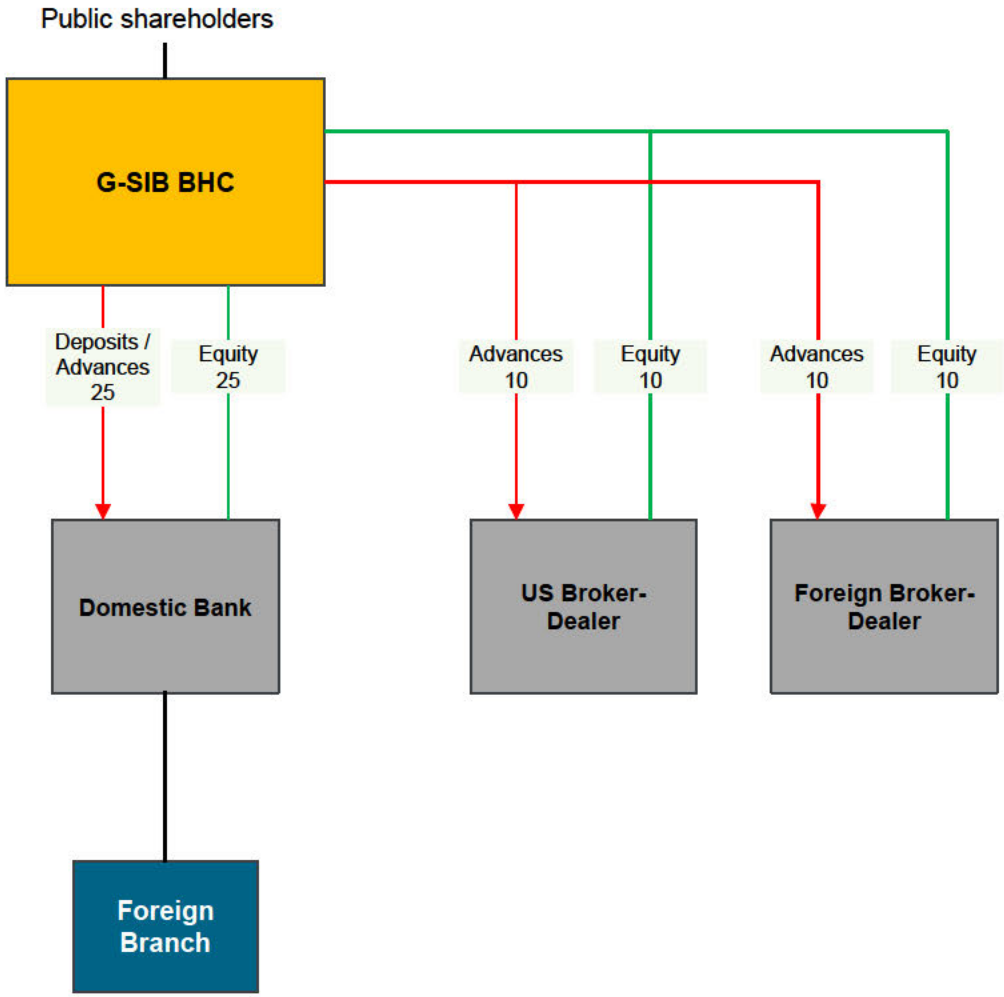
Group Structure and Hypothetical Losses Leading to Failure

Group Structure and Losses Leading to Failure

Step 1: Group Structure Before Failure

Parent Only Balance Sheet

Deposits / advances to subs	45	Unsecured long-term debt	50
Equity in subs	45	Unsecured short-term debt	0
Other assets	10	Secured liabilities	0
Total	**100**	Other liabilities	5
		Equity	45
		Total	**100**



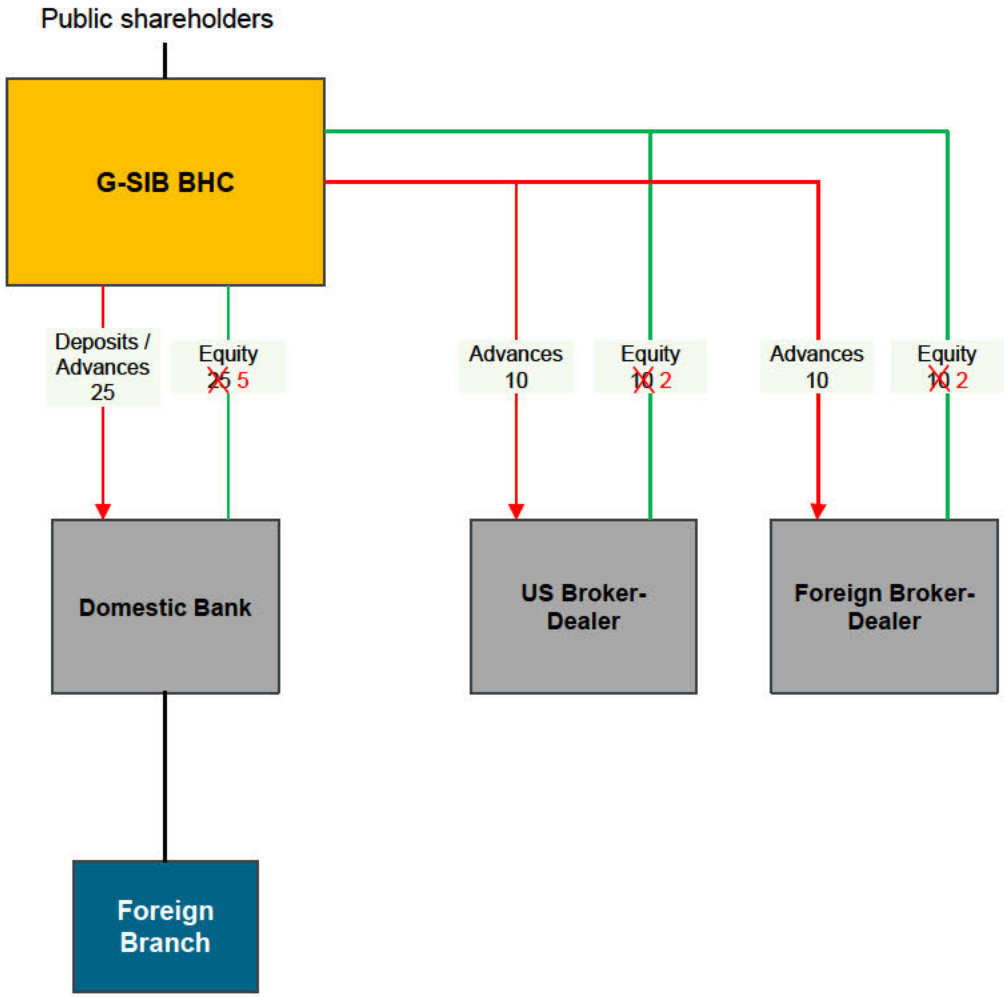
Group Structure and Losses Leading to Failure

Step 2: Hypothetical Losses Resulting in Failure

- Total hypothetical losses: 41
- Model assumes losses are spread evenly among operating subsidiaries
- Model assumes that failure is based on the likely inability of the G-SIB BHC to pay its obligations as they come due in the ordinary course of business because of insufficient liquidity or access to liquidity as a result of the losses
- Red font indicates figures that changed as a result of losses

Parent Only Balance Sheet

Deposits / advances to subs	45	Unsecured long-term debt	50
Equity in subs	9	Unsecured short-term debt	0
Other assets	5	Secured liabilities	0
Total	59	Other liabilities	0
		Equity	9
		Total	59

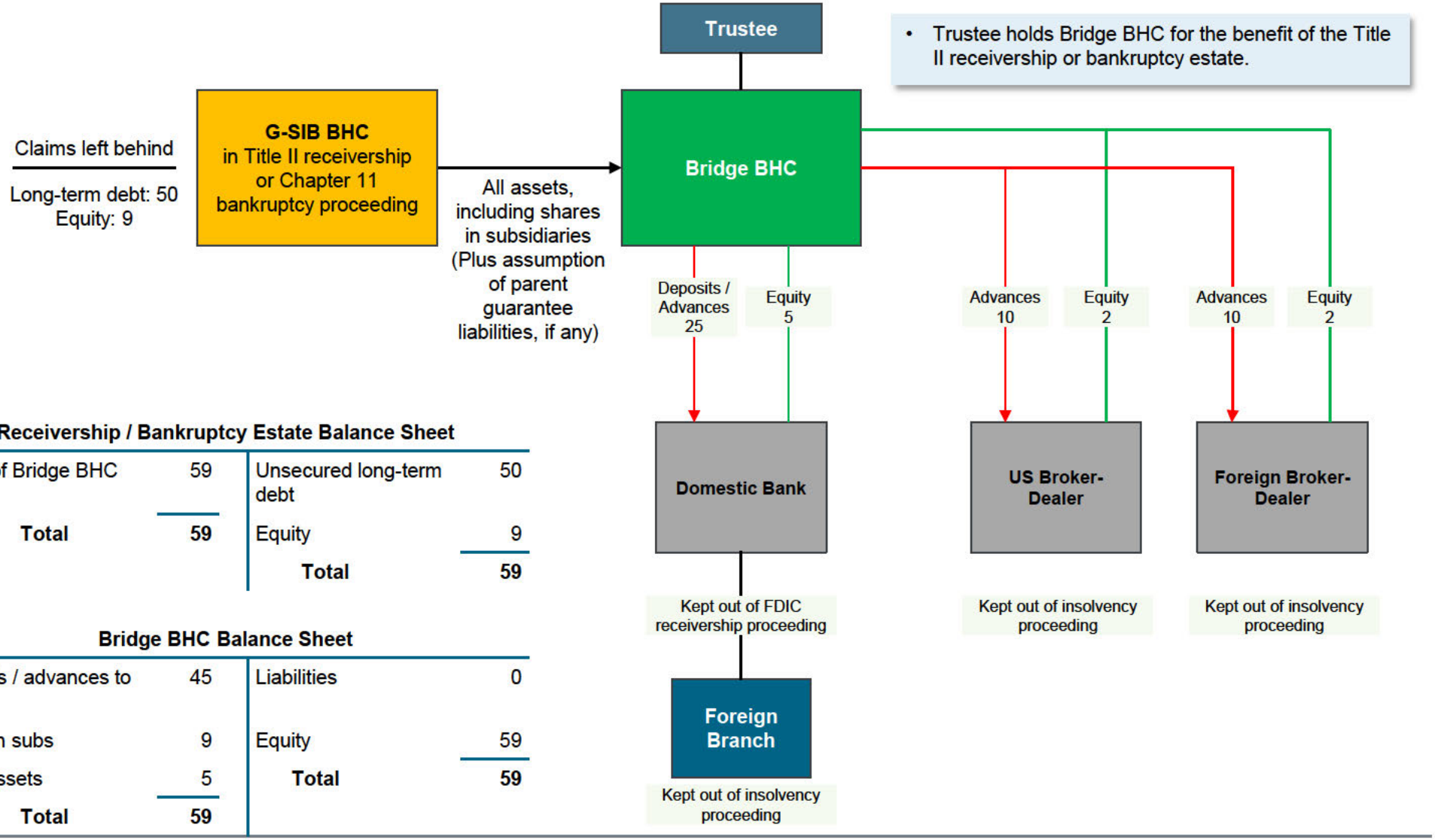


Two-Company SPOE Resolution Strategy*

* A two-company SPOE resolution strategy can be carried out under either Title II of the Dodd-Frank Act or Chapter 11 of the Bankruptcy Code. These slides assume it is being carried out under Title II. If it were being carried out under Chapter 11, Step 4A would likely occur before the G-SIB BHC files under Chapter 11 and transfers its assets to a Bridge BHC as illustrated in Step 3A in order to maximize the value of its operating subsidiaries for the benefit of its creditors and other stakeholders in the Chapter 11 proceeding.

Two-Company SPOE Resolution

Step 3A: Recapitalizing Business Transferred to Bridge BHC



Receivership / Bankruptcy Estate Balance Sheet

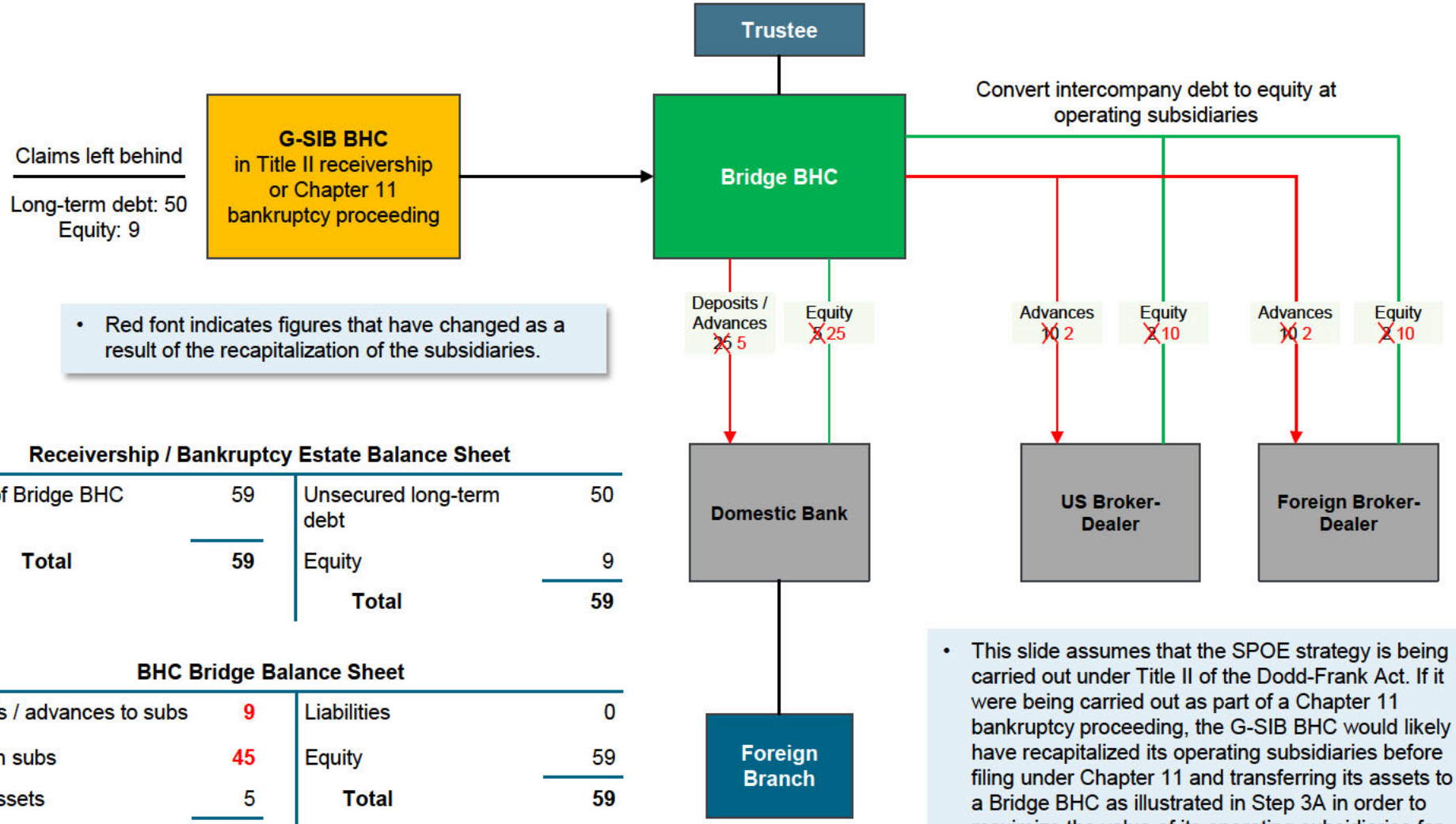
Equity of Bridge BHC	59	Unsecured long-term debt	50
Total	**59**	Equity	9
		Total	**59**

Bridge BHC Balance Sheet

Deposits / advances to subs	45	Liabilities	0
Equity in subs	9	Equity	59
Other assets	5	**Total**	**59**
Total	**59**		

Two-Company SPOE Resolution

Step 4A: Recapitalizing Operating Subsidiaries



- Red font indicates figures that have changed as a result of the recapitalization of the subsidiaries.

Receivership / Bankruptcy Estate Balance Sheet

Equity of Bridge BHC	59	Unsecured long-term debt	50
Total	**59**	Equity	9
		Total	**59**

BHC Bridge Balance Sheet

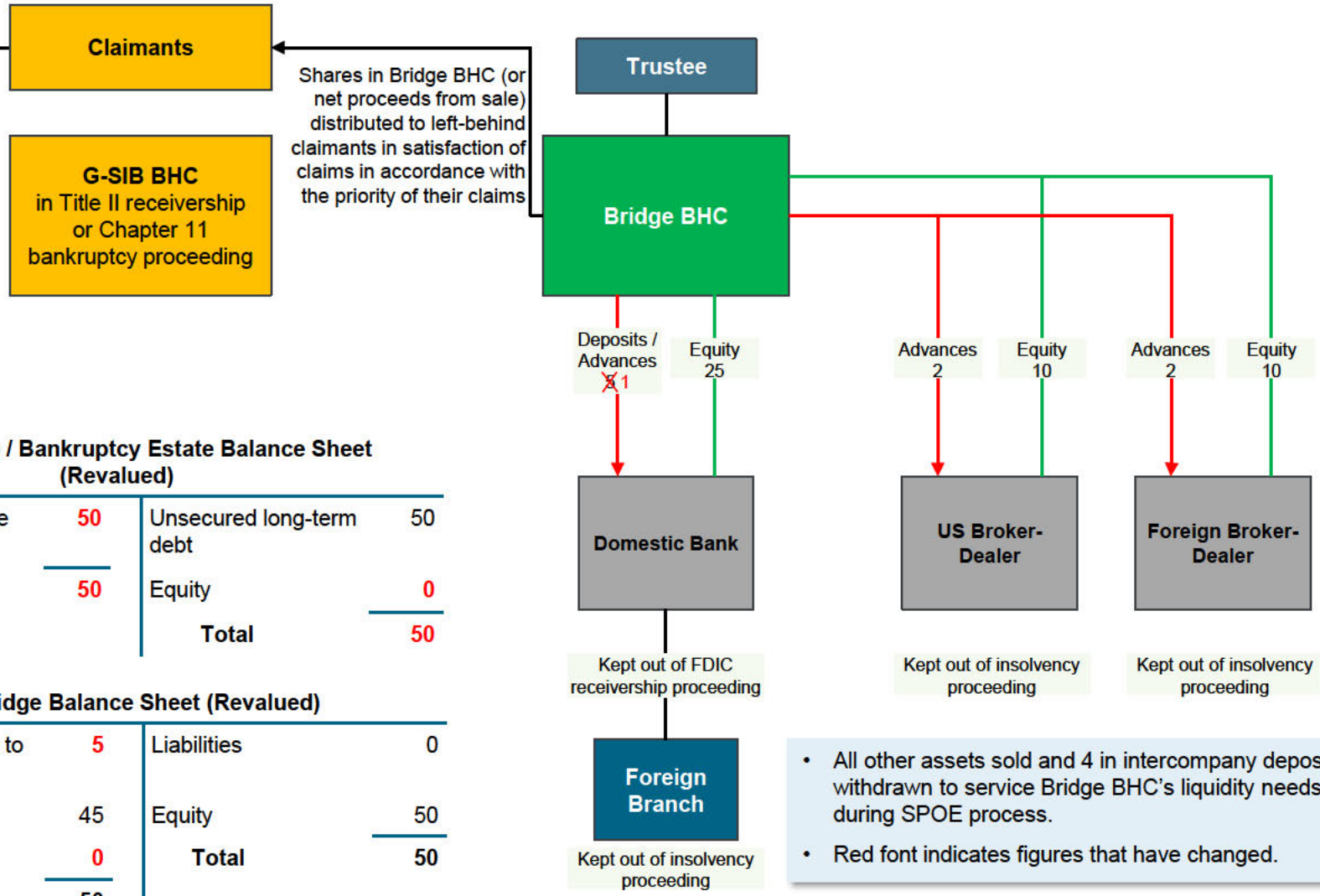
Deposits / advances to subs	**9**	Liabilities	0
Equity in subs	**45**	Equity	59
Other assets	5	**Total**	**59**
Total	**59**		

- This slide assumes that the SPOE strategy is being carried out under Title II of the Dodd-Frank Act. If it were being carried out as part of a Chapter 11 bankruptcy proceeding, the G-SIB BHC would likely have recapitalized its operating subsidiaries before filing under Chapter 11 and transferring its assets to a Bridge BHC as illustrated in Step 3A in order to maximize the value of its operating subsidiaries for the benefit of its creditors and other stakeholders in the Chapter 11 proceeding.

Two-Company SPOE Resolution

Step 5A: Distribution of Equity (or Net Proceeds from Sale) in Satisfaction of Claims

- Unsecured long-term debt claimants receive Bridge BHC shares worth 50 (or the net proceeds from a public or private sale) in satisfaction of their claim for 50
- Equity: 0



Receivership / Bankruptcy Estate Balance Sheet (Revalued)

Equity of BHC Bridge	50	Unsecured long-term debt	50
Total	50	Equity	0
		Total	50

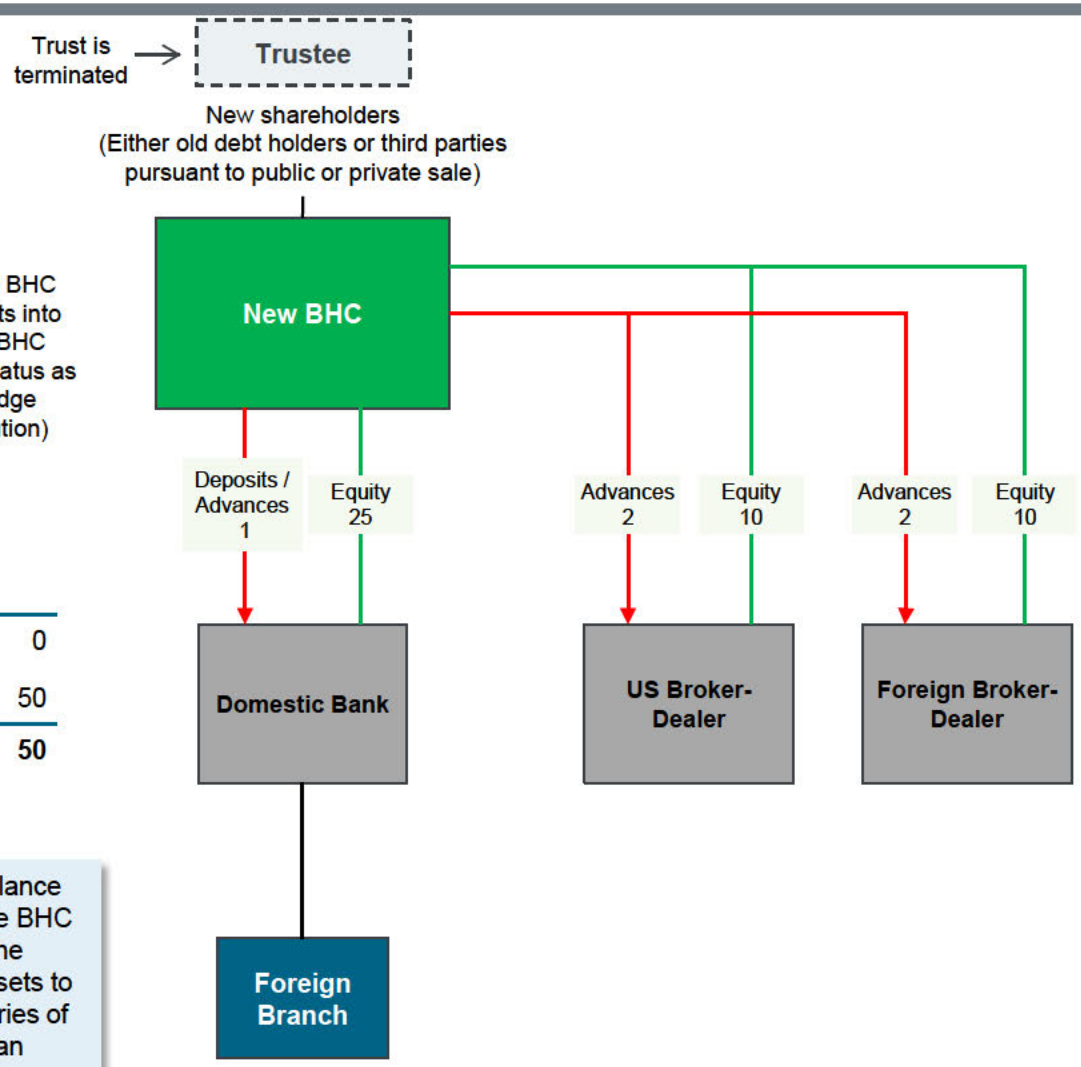
BHC Bridge Balance Sheet (Revalued)

Deposits / advances to subs	5	Liabilities	0
Equity in subs	45	Equity	50
Other assets	0	**Total**	50
Total	50		

- All other assets sold and 4 in intercompany deposits withdrawn to service Bridge BHC's liquidity needs during SPOE process.
- Red font indicates figures that have changed.

Two-Company SPOE Resolution

Step 6A: Termination of Bridge Status



New BHC Balance Sheet

Deposits / advances to subs	5	Liabilities	0
Equity in subs	45	Equity	50
Other assets	0	**Total**	**50**
Total	**50**		

- In this example, the new BHC that exits SPOE has half the balance sheet of the failed G-SIB BHC that entered SPOE. Indeed, the BHC that exits SPOE is virtually always substantially smaller than the BHC that entered SPOE because of losses and the sale of assets to provide liquidity during the SPOE process. See public summaries of 2015 Title I Resolution Plans of the G-SIB BHCs, which you can access here.

One-Company SPOE Resolution Strategy*

* A one-company SPOE resolution strategy can be carried out under Chapter 11 of the Bankruptcy Code with the G-SIB BHC as debtor-in-possession, but not under Title II of Dodd-Frank.

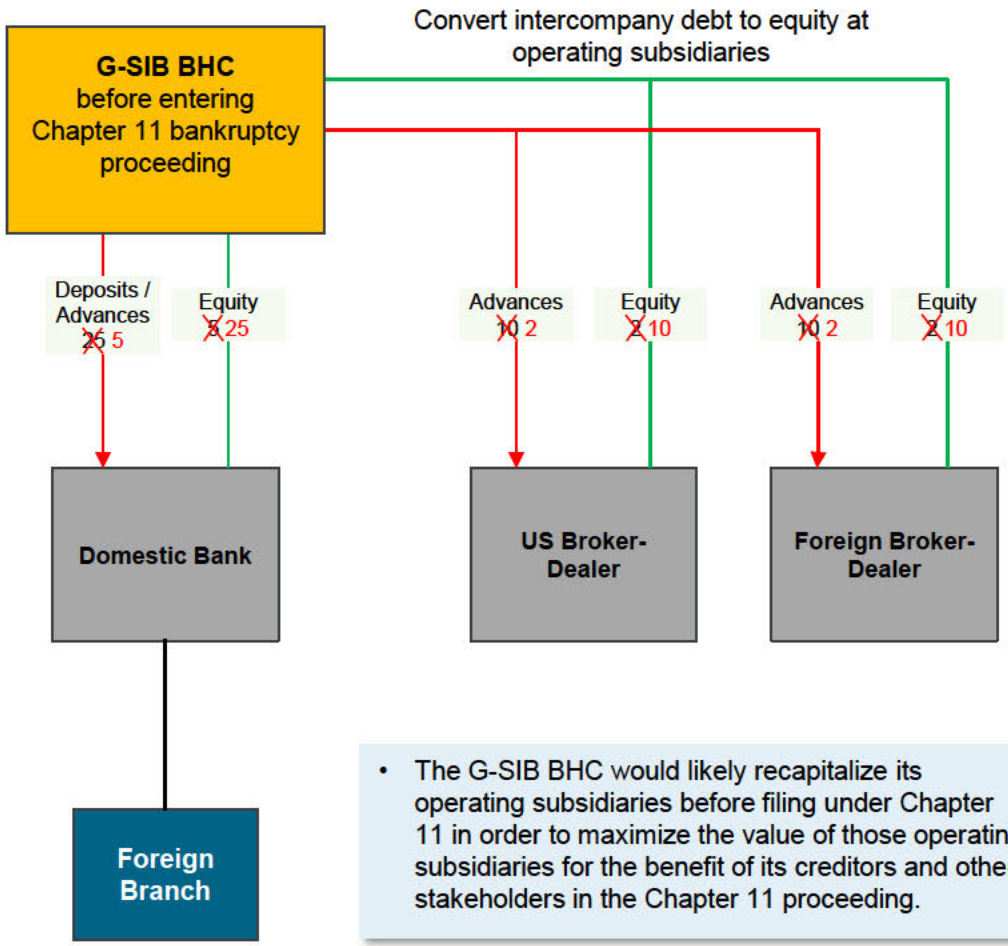
One-Company SPOE Resolution

Step 3B: Recapitalizing Operating Subsidiaries

- Red font indicates figures that have changed as a result of the recapitalization of the subsidiaries.

G-SIB BHC Balance Sheet

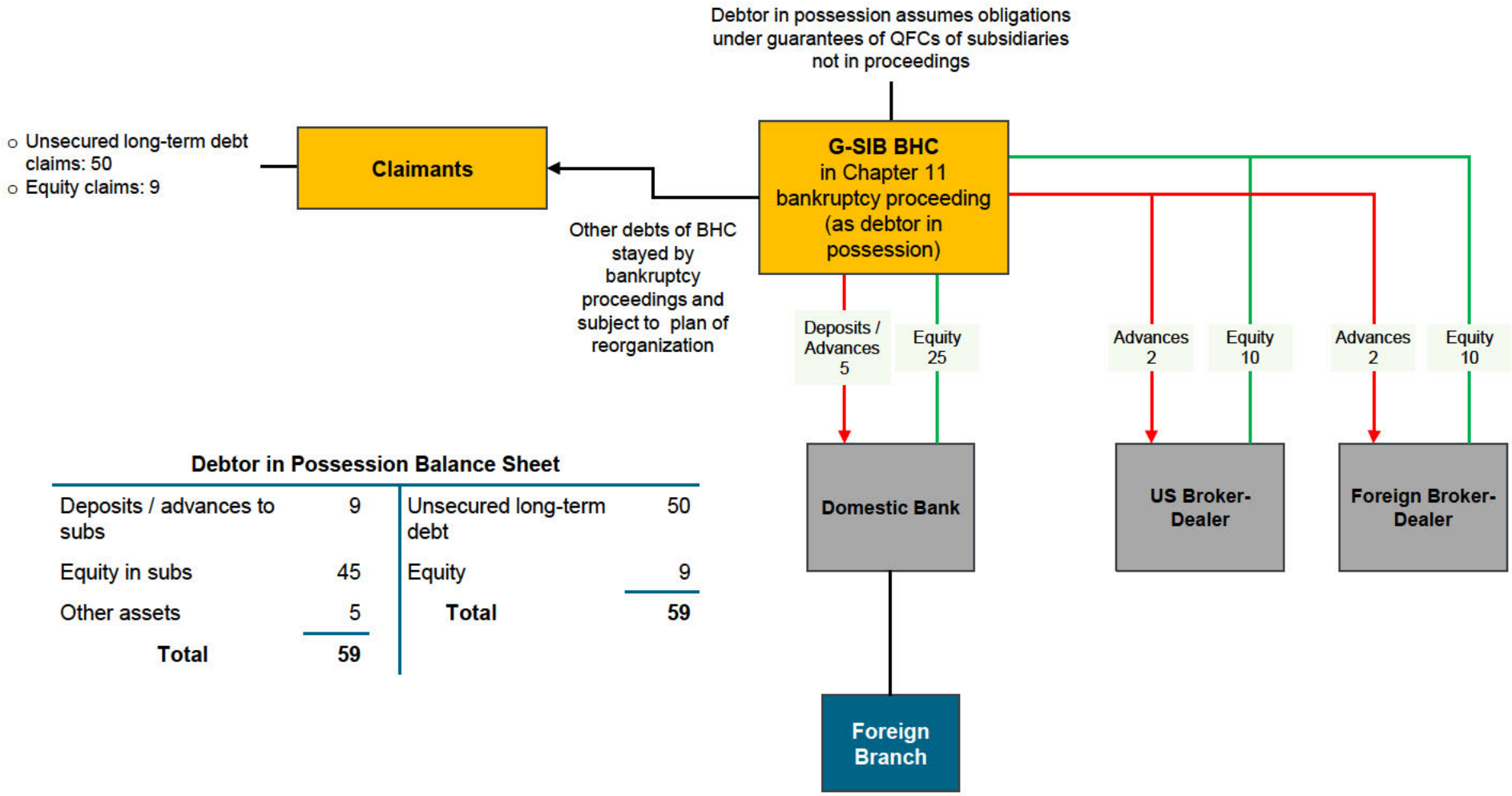
Deposits / advances to subs	9	Unsecured long-term debt	50
Equity in subs	45	Equity	9
Other assets	5	**Total**	**59**
Total	**59**		



- The G-SIB BHC would likely recapitalize its operating subsidiaries before filing under Chapter 11 in order to maximize the value of those operating subsidiaries for the benefit of its creditors and other stakeholders in the Chapter 11 proceeding.

One-Company SPOE Resolution

Step 4B: G-SIB BHC Enters Bankruptcy as Debtor in Possession



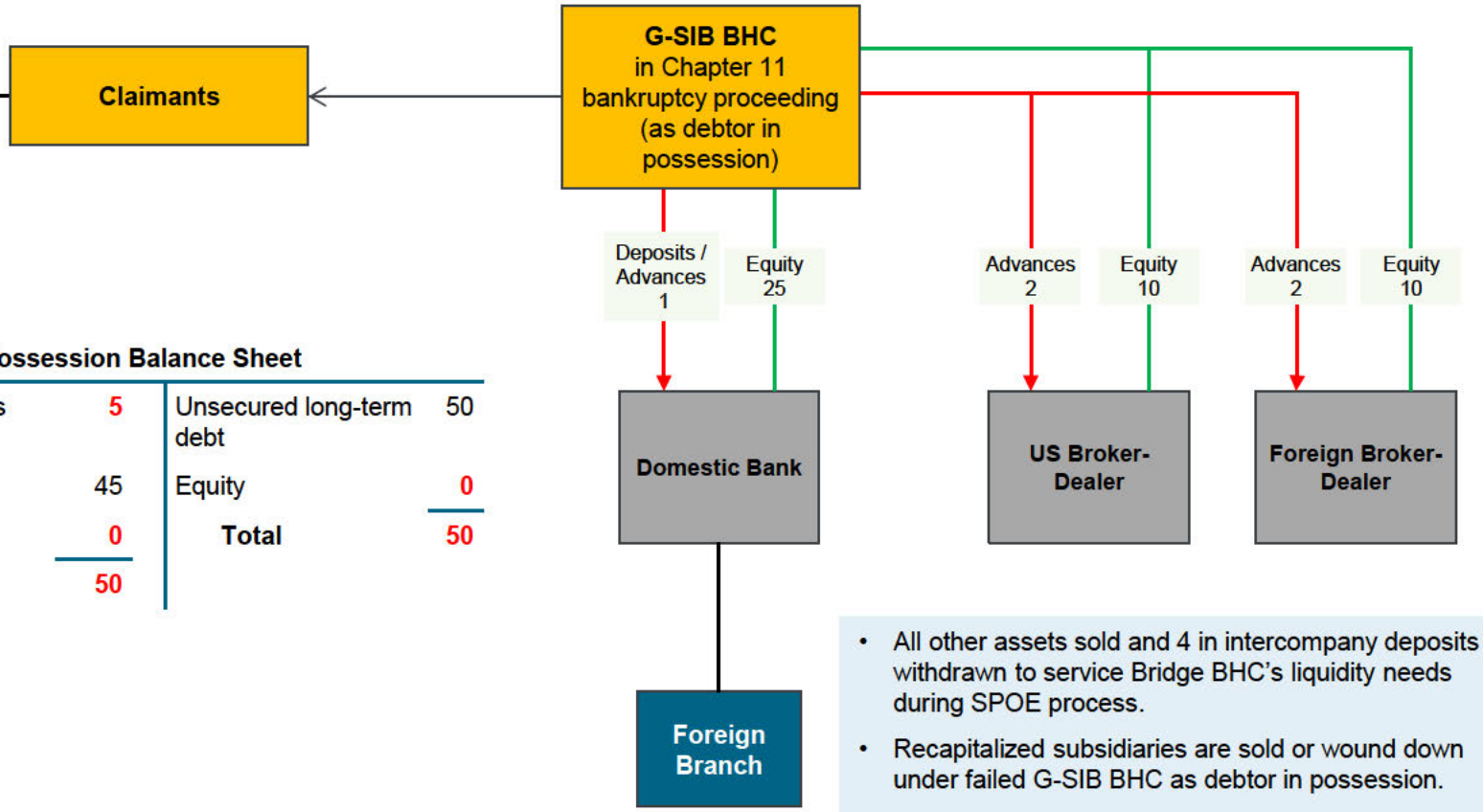
Debtor in Possession Balance Sheet

Deposits / advances to subs	9	Unsecured long-term debt	50
Equity in subs	45	Equity	9
Other assets	5	**Total**	**59**
Total	**59**		

One-Company SPOE Resolution

Step 5B: G-SIB BHC Operates as Debtor in Possession while Selling or Winding Down Operating Subsidiaries

- Unsecured long-term debt claims: 50
- Equity claims: 0



Debtor in Possession Balance Sheet

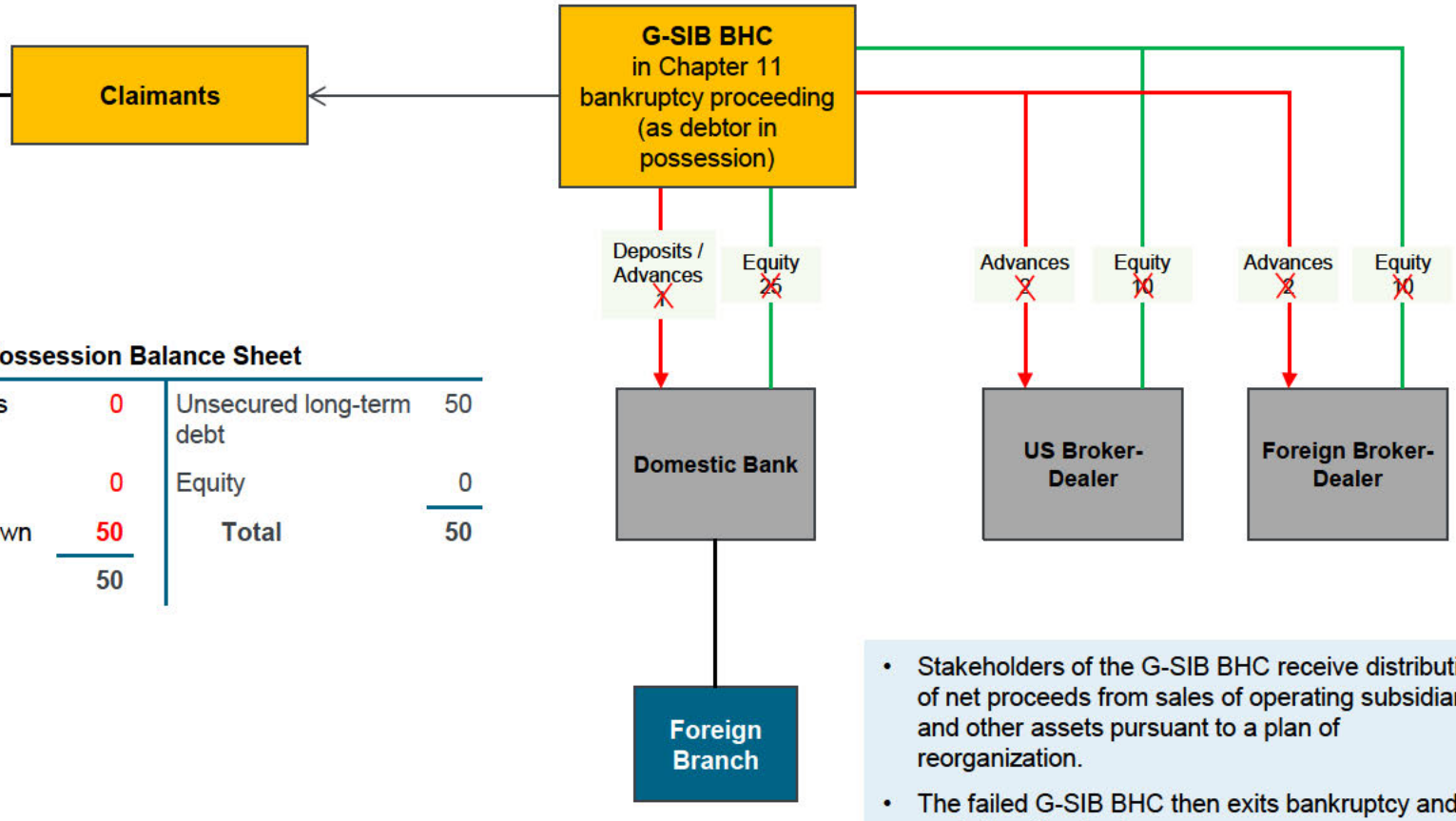
Deposits / advances to subs	5	Unsecured long-term debt	50
Equity in subs	45	Equity	0
Other assets	0	**Total**	50
Total	50		

- All other assets sold and 4 in intercompany deposits withdrawn to service Bridge BHC's liquidity needs during SPOE process.
- Recapitalized subsidiaries are sold or wound down under failed G-SIB BHC as debtor in possession.
- Red font indicates figures that have changed.

One-Company SPOE Resolution

Step 6B: Distribution of Net Proceeds from Sales in Satisfaction of Claims and Termination of Bankruptcy

- Unsecured long-term debt claimants receive net proceeds from sales worth 50 in satisfaction of their claim for 50, pursuant to a plan of reorganization
- Equity: 0



Debtor in Possession Balance Sheet

Deposits / advances to subs	0	Unsecured long-term debt	50
Equity in subs	0	Equity	0
Cash from sales or wind-down	50	**Total**	**50**
Total	**50**		

- Stakeholders of the G-SIB BHC receive distributions of net proceeds from sales of operating subsidiaries and other assets pursuant to a plan of reorganization.
- The failed G-SIB BHC then exits bankruptcy and would be dissolved.

ANNEX 6

MATHEMATICAL EXAMPLES

The mathematical examples in this Annex 6 demonstrate two points about bailing in EDS (i.e., converting them into the equity of a covered BHC or exchanging them for equity in a bridge BHC)[1]:

- First, the amount of consolidated capital created by bailing in EDS is not the amount of the EDS, but is instead the residual value of the covered BHC or bridge BHC at the time of bail-in—i.e., the difference between the firm's consolidated assets and any of its consolidated liabilities that are excluded from bail-in (e.g., LTD securities that are required by the Proposed Rule to be made structurally or contractually preferred to EDS by, for example, causing them to be issued by subsidiaries).

- Second, given an amount of total LTD securities issued to third parties, excluding any LTD securities from EDS has the effect of decreasing the amount of consolidated capital that is created through bail-in.

Under the Proposed Rule, all LTD securities issued to third parties are treated as "unrelated liabilities" unless they are EDS. All unrelated liabilities in excess of the 5% allowance must be made structurally or contractually preferred to EDS. Making LTD securities structurally or contractually preferred to EDS has the effect of excluding those LTD securities from bail-in. Since the amount of capital created by bailing in EDS is the difference between the firm's consolidated assets and any of its consolidated liabilities excluded from bail-in, excluding any LTD securities from EDS has the effect of reducing the amount of consolidated capital created by bail-in. This conclusion is true whether or not the covered BHC is balance-sheet insolvent at the time it files for bankruptcy or is placed in a Title II proceeding.

[1] For simplicity, these examples assume that bail-in is effected pursuant to either (1) a two-company SPOE strategy in a bankruptcy or Title II proceeding, by transferring all of the assets of the failed covered BHC, including its ownership interests in operating subsidiaries, to a single bridge BHC, with all of the claims on the covered BHC's outstanding equity securities and EDS being left behind in the bankruptcy proceeding or receivership of the covered BHC, with such claims eventually being exchanged for equity in the bridge BHC in accordance with the priority of their claims and in satisfaction of their claims or (2) a one-company SPOE strategy in a bankruptcy proceeding, by subjecting to the automatic stay and eventually converting into equity of the covered BHC all of the covered BHC's EDS .

Example 1

Assume that, prior to a loss event, the covered BHC has the following initial consolidated balance sheet:

Initial Consolidated Balance Sheet

Assets		100
Demand Deposits and Other Operating Liabilities		60
LTD Securities		20
EDS subject to bail-in	20	
LTD excluded from EDS and bail-in	0	
Equity		20

Now suppose that the covered BHC suffers losses of 25, reducing the value of its consolidated assets to 75, but the amount of its consolidated liabilities remain constant, resulting in balance-sheet insolvency immediately before bail-in as follows:

Post-Loss Consolidated Balance Sheet Immediately Before Bail-in

Assets		75
Demand Deposits and Other Operating Liabilities		60
LTD Securities		20
EDS subject to bail-in	20	
LTD excluded from EDS and bail-in	0	
Equity		(5)

Upon the bail-in of all of the EDS, the covered BHC (or bridge BHC) would have the following resulting consolidated balance sheet:

Consolidated Balance Sheet Upon Bail-in

Assets		75
Demand Deposits and Other Operating Liabilities		60
LTD Securities		0
EDS subject to bail-in	0	
LTD excluded from EDS and bail-in	0	
Equity		15

Notice that the amount of capital created is not 20 (the amount of EDS), since the value of the covered BHC's consolidated assets fell to 75 while the amount of its consolidated liabilities was still 80 immediately before bail-in. Rather, the amount of consolidated capital created by bailing in the EDS is simply the residual value of the firm at the time of bail-in—i.e., the value of its consolidated assets minus the amount of its consolidated liabilities excluded from bail-in. In this example, the residual value of the firm and the consolidated capital created by bail-in is 15 (i.e., 75 – 60). The amount of EDS subject to

bail-in simply determines how the residual value of 15 is distributed to the holders of equity and EDS in accordance with the priority of their claims. The holders of EDS receive equity securities worth 75% of the face amount of their debt claims (i.e., 15 / 20) in satisfaction thereof and the holders of equity receive zero.

Example 2

Assume the same initial consolidated balance sheet and loss event as in Example 1, except that the Proposed Rule excludes 10 of the covered BHC's LTD securities from EDS and requires them to be made structurally or contractually preferred to EDS in order to comply with the clean holding company framework. Assume further that the covered BHC chooses to comply with this requirement by causing the excluded LTD securities to be issued by one of its operating subsidiaries in order to make the LTD securities structurally preferred to EDS. Here is how the covered BHC's initial consolidated balance sheet would look to reflect this change in assumption.

Initial Consolidated Balance Sheet

Assets		100
Demand Deposits and Other Operating Liabilities		60
LTD Securities		20
EDS subject to bail-in	10	
LTD excluded from EDS and bail-in	10	
Equity		20

Now suppose that the covered BHC suffers the same loss event of 25, reducing the value of its consolidated assets to 75 while the amount of its consolidated liabilities remain constant, resulting again in balance-sheet insolvency immediately before bail-in as follows:

Post-Loss Consolidated Balance Sheet Immediately Before Bail-in

Assets		75
Demand Deposits and Other Operating Liabilities		60
LTD Securities		20
EDS subject to bail-in	10	
LTD excluded from EDS and bail-in	10	
Equity		(5)

Upon the bail-in of all of the EDS, the covered BHC (or bridge BHC) would have the following resulting consolidated balance sheet:

Consolidated Balance Sheet Upon Bail-in

Assets		75
Demand Deposits and Other Operating Liabilities		60
LTD Securities		10
EDS subject to bail-in	0	
LTD excluded from EDS and bail-in	10	
Equity		5

Again, notice that the amount of capital created is <u>not</u> 10 (the amount of EDS), since the value of the covered BHC's consolidated assets fell to 75 while the amount of its consolidated liabilities was still 80 immediately before bail-in. Rather, the amount of consolidated capital created by bailing in the EDS is simply the residual value of the firm at the time of bail-in of 5 (i.e., 75 – 70).

This example shows that if the Proposed Rule excludes 10 of the LTD securities from EDS and requires them to be made structurally preferred to EDS, then the amount of capital created by bail-in will be reduced from 15 to 5. As before, the amount of EDS subject to bail-in simply determines how the residual value of 5 is distributed to the holders of equity and EDS in accordance with the priority of their claims. The holders of EDS receive equity securities worth 50% of the face amount of their debt claims (i.e., 5 / 10) in satisfaction thereof and the holders of equity receive zero.

<u>Example 3</u>

Just as in Example 1, assume that the covered BHC has the following initial balance sheet:

Initial Consolidated Balance Sheet

Assets		100
Demand Deposits and Other Operating Liabilities		60
LTD Securities		20
EDS subject to bail-in	20	
LTD excluded from EDS and bail-in	0	
Equity		20

Now suppose that the covered BHC suffers losses of only 15. Although the covered BHC remains solvent at the time of bail-in, assume that it has filed for bankruptcy or been put into a Title II proceeding because it is unlikely to be able to pay its debts as they come due. The loss event reduces the value of its consolidated assets to 85 while the amount of its consolidated liabilities remain constant, resulting in the following balance-sheet immediately before bail-in:

Post-Loss Consolidated Balance Sheet Immediately Before Bail-in

Assets		85
Demand Deposits and Other Operating Liabilities		60
LTD Securities		20
EDS subject to bail-in	20	
LTD excluded from EDS and bail-in	0	
Equity		5

Upon the bail-in of all of the EDS, the covered BHC (or bridge BHC) would have the following resulting consolidated balance sheet:

Consolidated Balance Sheet Upon Bail-in

Assets		85
Demand Deposits and Other Operating Liabilities		60
LTD Securities		0
EDS subject to bail-in	0	
LTD excluded from EDS and bail-in	0	
Equity		25

Notice that the resulting amount of capital is <u>not</u> 20 (the amount of EDS), since the value of the covered BHC's consolidated assets fell to 85 while the amount of its consolidated liabilities was still 80 immediately prior to bail-in. Rather, the amount of consolidated capital resulting from bailing in the EDS is simply the residual value of the firm at the time of bail-in of 25 (i.e., 85 – 60).

Relative to Example 1, this Example 3 shows that, even where the covered BHC is balance sheet solvent at the time of bail-in, the resulting consolidated capital is still equal to the residual value of the firm at the time of bail-in. As before, the amount of EDS subject to bail-in simply determines how the residual value of 25 is distributed to the holders of equity and EDS in accordance with the priority of their claims. The holders of EDS receive equity securities worth 100% of the face amount of their debt claims (i.e., 20 / 20) in satisfaction thereof and the holders of equity receive the remainder of 5.

<u>Example 4</u>

Assume the same initial consolidated balance sheet and loss event as in Example 3, except that the Proposed Rule excludes 10 of the covered BHC's LTD securities from EDS and requires them to be made structurally or contractually preferred to EDS in order to comply with the clean holding company framework. Assume further that the covered BHC chooses to comply with this requirement by causing the excluded LTD securities to be issued by one of its operating subsidiaries in order to make the LTD securities

structurally preferred to EDS. Here is the covered BHC's initial consolidated balance sheet reflecting this change in assumption.

Initial Balance Sheet

Assets		100
Demand Deposits and Other Operating Liabilities		60
LTD Securities		20
EDS subject to bail-in	10	
LTD excluded from EDS and bail-in	10	
Equity		20

Now supposed that the covered BHC suffers the same loss event of 15, reducing the value of its consolidated assets to 85 while the amount of its consolidated liabilities remain constant. Although not insolvent, assume as in Example 3 that the covered BHC has filed for bankruptcy or been put into a Title II proceeding because it is unlikely to be able to pay its debts as they come due. Here is the consolidated balance sheet immediately before bail-in:

Post-Loss Consolidated Balance Sheet Immediately Before Bail-in

Assets		85
Demand Deposits and Other Operating Liabilities		60
LTD Securities		20
EDS subject to bail-in	10	
LTD excluded from EDS and bail-in	10	
Equity		5

Upon the bail-in of all of the EDS, the covered BHC (or bridge BHC) would have the following resulting consolidated balance sheet:

Consolidated Balance Sheet Upon Bail-in

Assets		85
Demand Deposits and Other Operating Liabilities		60
LTD Securities		10
EDS subject to bail-in	0	
LTD excluded from EDS and bail-in	10	
Equity		15

Again notice that the resulting amount of capital is <u>not</u> 10 (the amount of EDS), since the value of the covered BHC's consolidated assets fell to 85 while the amount of its consolidated liabilities was still 80 immediately before bail-in. Rather, the amount of consolidated capital resulting from bailing in the EDS is simply the residual value of the firm at the time of bail-in of 15 (i.e., 85 – 70).

Relative to Example 3, this Example 4 shows that if the Proposed Rule excludes 10 of the LTD securities from EDS and requires them to be made structurally preferred to EDS, then the amount of capital created by bail-in falls from 25 to 15. As in Example 3, the amount of EDS subject to bail-in simply determines how the residual value of 15 is distributed to the holders of equity and EDS in accordance with the priority of their claims. The holders of EDS receive equity securities worth 100% of the face amount of their debt claims (i.e., 10 / 10) in satisfaction thereof and the holders of equity receive the remainder of 5.

Davis Polk

Davis Polk Analysis Based on Public Documents as of November 20, 2015

Annex 7

U.S. G-SIBs – Select Registered Debt Indenture Review

Issuer	Indenture	Acceleration EoDs[1]				Key Covenants[2]												
		Bankruptcy	Payment default	Other covenant breach	Other	Payment	Maintain offices for notices / payments etc.	Provisions as to paying agent / holding in trust	Deliver / file statements as to compliance	Maintain corporate existence	Limitations on disposition (e.g., sale or pledge) or issuance of subsidiary stock	Negative pledge[3]	Covenants related to holder lists and reports by the issuer	No waiver of stay or extension laws etc.	Pay compensation and expenses of trustee / indemnify trustee / paying agent	Merger / asset transfer covenant	Covenants related to collection of indebtedness	Additional key covenants
Bank of America Corporation	*Senior*	✓	✓	✓		✓	✓	✓	✓	✓	✓		✓	✓	✓	✓	✓	
	Senior (InterNotes)	✓	✓	✓		✓	✓	✓			✓		✓	✓	✓	✓	✓	
	Subordinated	✓				✓	✓	✓	✓	✓			✓	✓	✓	✓	✓	
	Subordinated (InterNotes)	✓				✓	✓	✓					✓	✓	✓	✓	✓	
The Bank of New York Mellon Corporation	*Senior*	✓ (includes lead bank)	✓	✓	Default under other indebtedness / on other instruments (includes lead bank)	✓	✓	✓	✓	✓	✓		✓	✓	✓	✓	✓	Pay taxes and other claims
	Senior subordinated	✓				✓	✓	✓	✓	✓			✓	✓	✓	✓	✓	Pay taxes and other claims
Citigroup Inc.	*Senior*	✓	✓	✓		✓	✓	✓	✓			✓	✓		✓	✓		
	Subordinated	✓				✓	✓	✓	✓				✓	✓	✓	✓	✓	
The Goldman Sachs Group, Inc.	*Senior*	✓	✓	✓		✓	✓	✓	✓			✓	✓	✓	✓	✓	✓	
	Subordinated	✓	✓ (under terms of indenture; overridden in the note for actual issuances)	✓ (under terms of indenture; overridden in the note for actual issuances)		✓	✓	✓	✓				✓	✓	✓	✓	✓	

[1]Check indicates events of default that can trigger acceleration. [2]Check indicates key covenants contained in the indenture, irrespective of whether a breach can trigger acceleration. Note: Covenants and events of default may be amended by supplemental indenture. [3]Includes only covenants that generally restrict pledging property as security for indebtedness unless the notes of all series issued under that indenture are equally and ratably secured.

Issuer	Indenture	Acceleration EoDs[1]				Key Covenants[2]												
		Bankruptcy	Payment default	Other covenant breach	Other	Payment	Maintain offices for notices / payments etc.	Provisions as to paying agent / holding in trust	Deliver / file statements as to compliance	Maintain corporate existence	Limitations on disposition (e.g., sale or pledge) or issuance of subsidiary stock	Negative pledge[3]	Covenants related to holder lists and reports by the issuer	No waiver of stay or extension laws etc.	Pay compensation and expenses of trustee / indemnify trustee / paying agent	Merger / asset transfer covenant	Covenants related to collection of indebtedness	Additional key covenants
GS Finance Corp. (with The Goldman Sachs Group, Inc. as guarantor)	*Senior*	✓ (but only with respect to issuer and not guarantor)	✓	✓ (but only with respect to issuer and not guarantor)		✓	✓	✓	✓			✓	✓	✓	✓	✓	✓	
JPMorgan Chase & Co.	*Senior*	✓ (includes lead bank)	✓	✓		✓	✓	✓	✓	✓	✓		✓		✓	✓	✓	
	Senior (structured note indenture)	✓	✓	✓		✓	✓	✓	✓				✓		✓	✓	✓	Make certain notice publications in Luxembourg
	Subordinated	✓				✓	✓	✓	✓	✓			✓		✓	✓	✓	
Morgan Stanley	*Senior*	✓	✓	✓		✓	✓	✓	✓			✓	✓		✓	✓	✓	Make certain notice publications in Luxembourg
	Subordinated	✓				✓	✓	✓	✓				✓		✓	✓	✓	Make certain notice publications in Luxembourg
State Street Corporation	*Senior*	✓ (includes lead bank)	✓	✓		✓	✓	✓	✓	✓	✓		✓	✓	✓	✓	✓	
	Subordinated	✓				✓	✓	✓	✓	✓			✓	✓	✓	✓	✓	
Wells Fargo & Company	*Senior*	✓	✓	✓		✓	✓	✓	✓		✓		✓	✓	✓	✓	✓	
	Subordinated	✓				✓	✓	✓	✓				✓	✓	✓	✓	✓	

ANNEX 8

A DESCRIPTION OF EACH OF THE ASSOCIATIONS

The Clearing House. The Clearing House is a banking association and payments company that is owned by the largest commercial banks and dates back to 1853. The Clearing House Payments Company L.L.C. owns and operates core payments system infrastructure in the United States and is currently working to modernize that infrastructure by building a new, ubiquitous, real-time payment system. The Clearing House is the only private-sector ACH and wire operator in the United States, processing nearly $2 trillion in U.S. dollar payments each day, representing half of all commercial ACH and wire volume. Its affiliate, The Clearing House Association L.L.C. is a nonpartisan organization that engages in research, analysis, advocacy and litigation focused on financial regulation that supports a safe, sound and competitive banking system.

The Securities Industry and Financial Markets Association. SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the U.S., serving clients with over $20 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit www.sifma.org.

The American Bankers Association. The American Bankers Association is the voice of the nation's $15 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $12 trillion in deposits and extend more than $8 trillion in loans.

Financial Services Roundtable. *As advocates for a strong financial future*™, FSR represents 100 integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. FSR member companies provide fuel for America's economic engine, accounting directly for $98.4 trillion in managed assets, $1.1 trillion in revenue, and 2.4 million jobs. For more information, please visit www.fsroundtable.org.

The Financial Services Forum. The Financial Services Forum is a non-partisan financial and economic policy organization comprising the CEOs of 16 of the largest and most diversified financial services institutions with business operations in the United States. The purpose of the Forum is to pursue policies that encourage savings and investment, promote an open and competitive global marketplace, and ensure the opportunity of people everywhere to participate fully and productively in the 21st-century global economy.

ANNEX 9

Impact of the Federal Reserve's Proposed Rule Imposing External Total Loss-Absorbing Capacity (TLAC), Long-Term Debt (LTD) and Clean Holding Company Requirements on U.S. G-SIBs

March 28, 2016

The Clearing House Association (TCH) and the Securities Industry and Financial Markets Association (SIFMA) have prepared this document as a supplement to the comment letter dated February 19, 2016, that TCH, SIFMA and three other financial services trade associations submitted to the Federal Reserve in connection with this proposed rule. This document is intended to be read in conjunction with that comment letter.

Key findings

1. **90% of nearly $1 trillion of Total LTD outstanding as of September 30, 2015 would be ineligible under the proposal.** The largest drivers of ineligibility are impermissible acceleration clauses (99% of Ineligible Plain Vanilla LTD) and non-U.S. law (12% of Ineligible Plain Vanilla LTD).[1]
2. **Even assuming[2] that $271 billion of maturing and callable Plain Vanilla LTD is refinanced in eligible form before 2019, $586 billion, or 63%, of Total LTD outstanding on January 1, 2019 still would be ineligible.**
3. **This would result in a projected Aggregate Combined Shortfall of $363 billion on January 1, 2019, requiring the 8 U.S. G-SIBs to issue an estimated gross total of $634 billion of Eligible LTD within a three-year period to comply with the proposal.**
4. **Unrelated Liabilities are projected to be almost *8 times* the 5% allowance on January 1, 2019.** Specifically, Unrelated Liabilities are projected to be $622 billion, exceeding the 5% allowance by $543 billion.
5. **Elimination of acceleration clause, non-U.S. law and Structured Note eligibility restrictions as recommended in the TCH-Sifma comment letter would reduce the Aggregate Combined Shortfall by $307 billion, or 85%, to $56 billion and reduce Aggregate Unrelated Liabilities by $586 billion, or 94%, to $36 billion.**
6. **If the eligibility restrictions are not eliminated as recommended, then grandfathering of outstanding LTD will be essential.**

[1] Capitalized terms used in this document are defined in Appendix A on page 10 of this presentation.
[2] Key assumptions made in connection with this impact assessment are listed in Appendix B on page 11 of this presentation.

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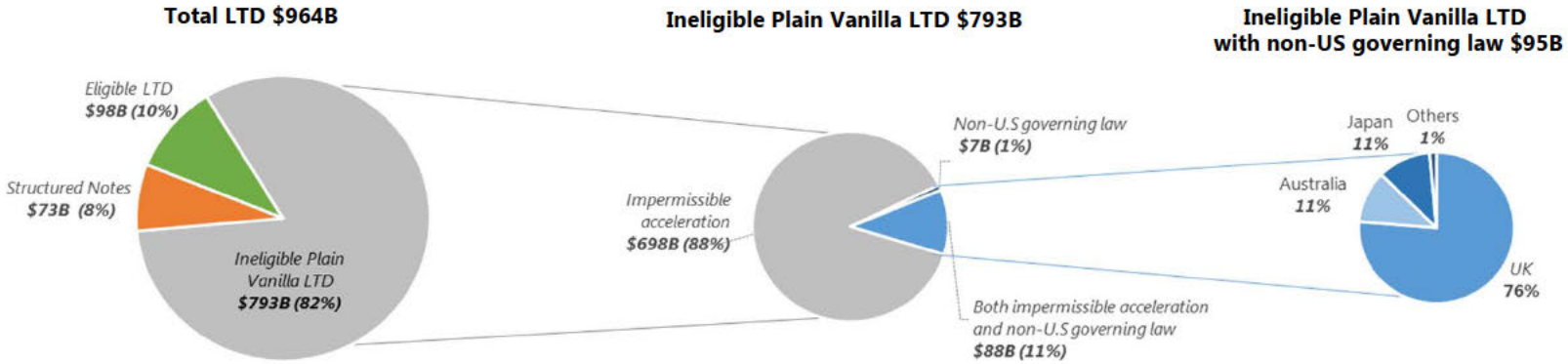
90% of nearly $1 trillion of Total LTD outstanding as of September 30, 2015 would be ineligible under the proposal



- 99% of Ineligible Plain Vanilla LTD contains impermissible acceleration clauses.
- 12% of Ineligible Plain Vanilla LTD is subject to non-U.S. governing law.
- 11% of Ineligible Plain Vanilla LTD is subject to both impermissible acceleration and non-U.S. governing law.

Plain Vanilla LTD maturity schedule as of September 30, 2015[1]

[1] LTD is depicted at the earliest of maturity or first callable at par date.
Note : This slide does not include $22B of hybrid securities outstanding as of September 30, 2015.

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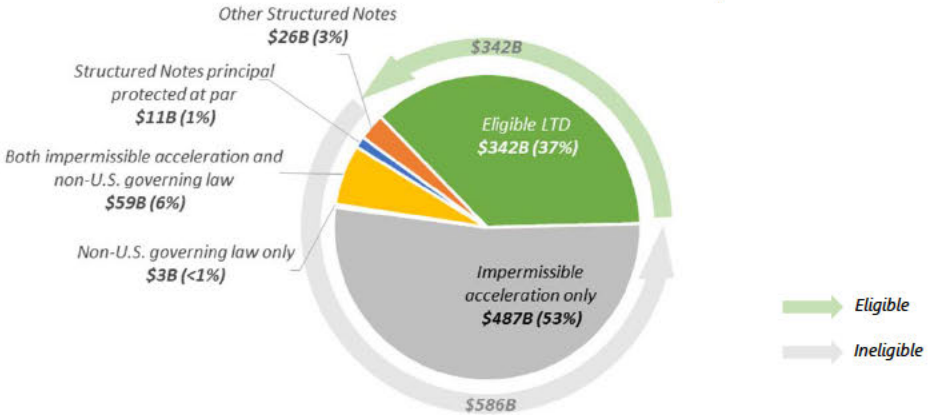
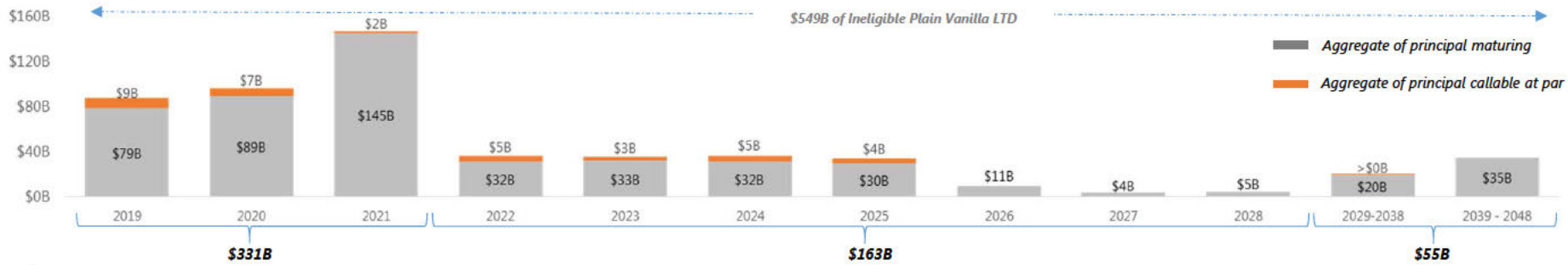
Even assuming that $271[1] billion of maturing and callable Plain Vanilla LTD is refinanced in eligible form before 2019, $586 billion, or 63%, of Total LTD outstanding on January 1, 2019 still would be ineligible…

Breakdown of Total LTD of $928B, as of January 1, 2019



Ineligible Plain Vanilla LTD maturity schedule as of January 1, 2019, after giving effect to Reissuance Assumptions in Appendix B[2]



[1] This $271 billion figure is a product of the Reissuance Assumptions listed in item 2 in Appendix B on page 11 of this presentation.
[2] All LTD that is callable at par is shown at the earliest call date

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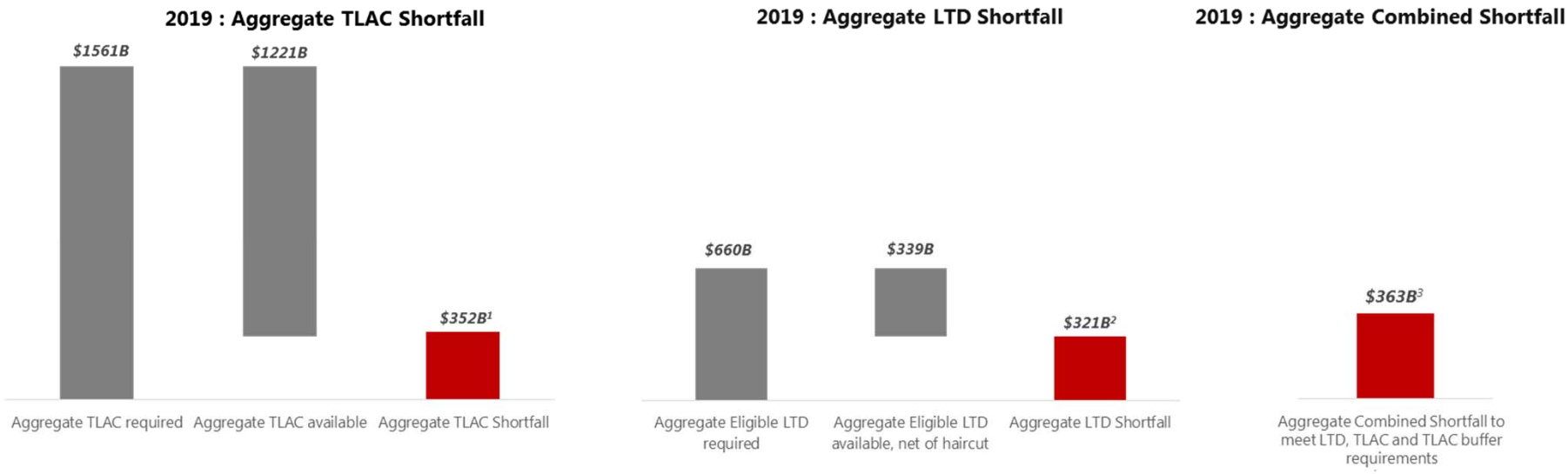
… this would result in a projected Aggregate Combined Shortfall of $363 billion on January 1, 2019, requiring the 8 U.S. G-SIBs to issue an estimated gross total of $634 billion of Eligible LTD within a three-year period to comply with the proposal.



[1] The TLAC Shortfall ($352B) is greater than the difference between aggregate minimum TLAC required and aggregate TLAC available ($340B) because, when aggregates are subtracted, the surplus at some of the GSIBs ($12B) reduces the Aggregate TLAC Shortfall. In reality, surplus at one GSIB cannot reduce the shortfall at another, so the surplus is added back to determine the total TLAC Shortfall ($352B). [$1533-$1221+$12=$352]

[2] The LTD Shortfall ($321B) is computed by subtracting total available Eligible LTD of $ 339B from total LTD requirement of $660B.

[3] Aggregate Combined Shortfall of $363B is less than the sum of the separate Aggregate TLAC Shortfall and the Aggregate LTD Shortfall because of substantial overlap between the two requirements (i.e., because Eligible LTD would also count toward the TLAC requirement).

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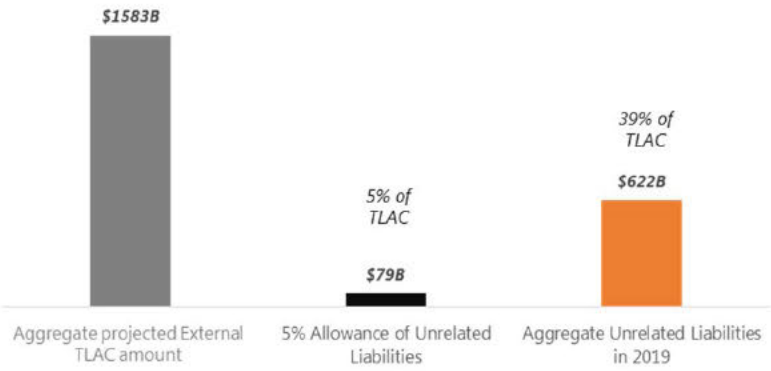
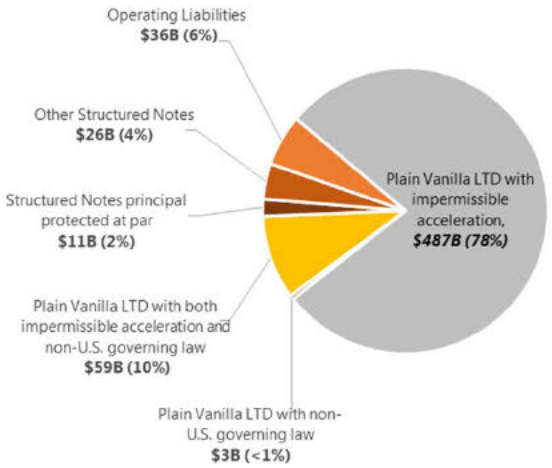
Unrelated Liabilities are projected to be almost 8 times the 5% allowance on January 1, 2019.

- Aggregate Unrelated Liabilities as of January 2019 are projected to be $622B or 39% of TLAC, as compared to the 5% of TLAC allowance in the NPR.
- All 8 GSIBs will exceed 5% allowance.
- Structured Notes of $37 billion outstanding as of January 1, 2019, will represent almost half of the 5% allowance.

Comparison of Aggregate Unrelated Liabilities to 5% TLAC allowance as of January 1, 2019[1,2]



Breakdown of Aggregate Unrelated Liabilities as of January 1, 2019[1]



[1] The projected amount of Aggregate Unrelated Liabilities as of January 1, 2019 does not include $20B of hybrid securities and at least $7B of long-term debt securities puttable upon the death of the security holder (known as "survivor puts").
[2] Projected External TLAC is calculated, for each U.S. GSIB, as the amount of TLAC (in either capital instruments or LTD) that the GSIB would need to maintain to simultaneously meet the TLAC and LTD requirements.

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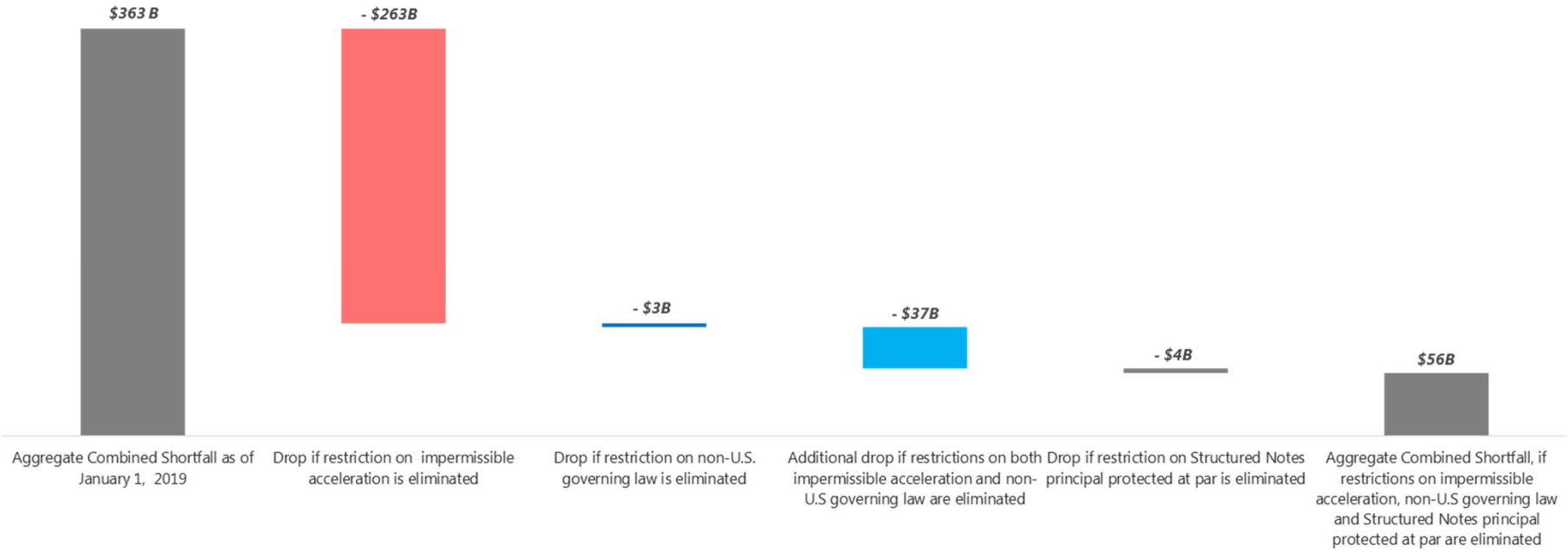
Elimination of acceleration clause, non-U.S. law and Structured Note eligibility restrictions as recommended in the TCH-Sifma comment letter would reduce the Aggregate Combined Shortfall by $307 billion, or 85% to $56 billion …



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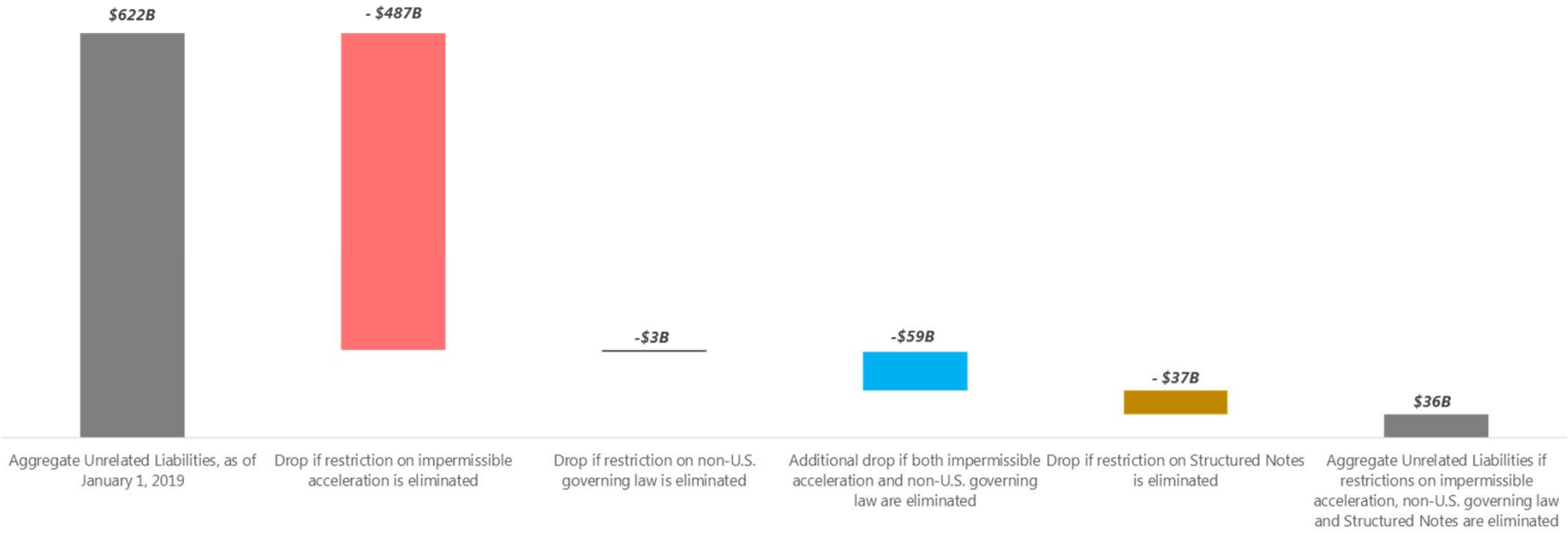
... and reduce Aggregate Unrelated Liabilities by $586 billion, or 94%, to $36 billion.



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If the acceleration clause, non-U.S. law and Structured Note eligibility restrictions are not eliminated as recommended, then grandfathering of outstanding LTD will be essential.

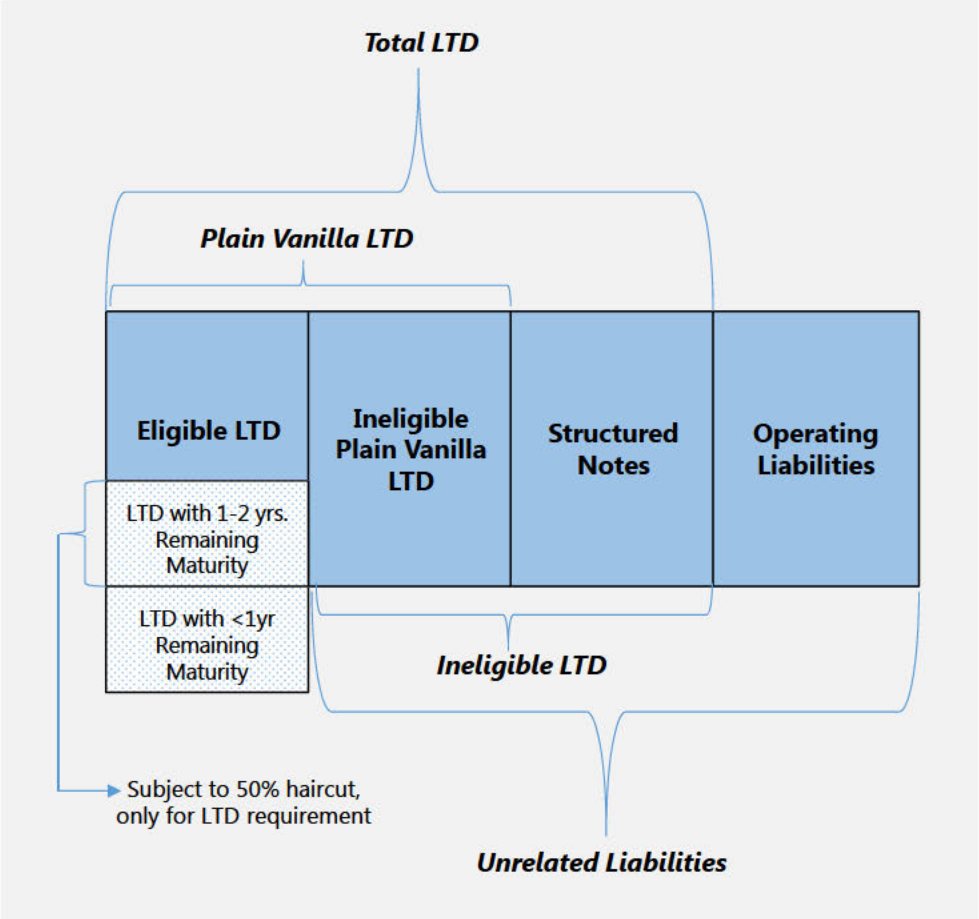
- Grandfathering all Ineligible Plain Vanilla LTD and principal-protected (at par) Structured Notes outstanding post January 1, 2019 would reduce the Aggregate Combined Shortfall by 84%, or $307B, to $56B, as of January 1, 2019.
- Grandfathering all Ineligible LTD would reduce Aggregate Unrelated Liabilities by 94%, or $586B, as of January 1, 2019.

Grandfathering[1] Scenarios	LTD Outstanding January 1, 2019		Aggregate Combined Shortfall (USD B)	Unrelated Liabilities	
	Eligible[2] (USD B)	LTD treated as Unrelated Liabilities[2] (USD B)		Aggregate (USD B)	Aggregate (as % of TLAC)
No grandfathering	*$342*	*$586*	*$363*	*$622*	39%
Permanent grandfathering	*$902*[3]	*$0*[3]	$56	*$36*[3,4]	2.3%[4]

[1] Grandfathering means that LTD that has been issued prior to the effective date of the rule is not counted in Unrelated Liabilities. The projected amounts presented are for the scenario where all Ineligible Plain Vanilla LTD and structured notes principal protected at par are grandfathered.
[2] The categories Eligible and LTD treated as Unrelated Liabilities, are mutually exclusive but are not collectively exhaustive. There are $26B of structured notes that are not principal protected at par which are not part of either category.
[3] All Structured Notes are considered to be grandfathered with respect to Unrelated Liabilities, but only principal protected at par structured notes are considered to be Eligible LTD.
[4] If all Ineligible LTD is grandfathered, some, but not all, of the G-SIBs, would meet the 5% allowance for Unrelated Liabilities.

Appendix A - Defined Terms

1. **Aggregate.** When used with respect to any measure, the total of that measure across all 8 U.S. G-SIBs.
2. **Combined Shortfall.** For each U.S. G-SIB, the greater of the LTD Shortfall and the TLAC Shortfall.
3. **Eligible LTD.** Eligible debt securities (as defined in the proposed rule) other than those with a remaining maturity of less than one year.
4. **Ineligible LTD.** Ineligible Plain Vanilla LTD and Structured Notes.
5. **Ineligible Plain Vanilla LTD.** Debt securities that would be Eligible LTD but for one of the following disqualifying characteristics under the proposed rule: (i) standard, but impermissible, acceleration clauses, (ii) governed by non-U.S. law, or (iii) convertible or exchangeable into the parent's equity.
6. **LTD Shortfall.** For each U.S. G-SIB, the additional LTD required to meet the LTD requirement under the proposed rule.
7. **Operating Liabilities.** Unrelated Liabilities that are not Ineligible LTD.
8. **Plain Vanilla LTD.** Eligible LTD and Ineligible Plain Vanilla LTD.
9. **Structured Notes.** Debt securities that meet the definition of "structured notes" under the proposed rule.
10. **TLAC Shortfall.** For each U.S. G-SIB, the additional TLAC, required to meet the TLAC requirement, including the TLAC buffer, under the proposed rule.
11. **Total LTD.** Eligible LTD and Ineligible LTD.
12. **Unrelated Liabilities.** Liabilities that meet the definition of "unrelated liabilities" under the proposed rule.



Appendix B - Key Assumptions

1. References to the maturity of a debt security mean the stated final maturity date of the security. References to callable LTD mean LTD securities that are callable at par, and references to the call date of such securities refer to the earliest date on which a G-SIB may redeem the security at par. Note that calling or redeeming such securities, even at par, could involve substantial legal complexities and significant economic cost, neither of which is addressed in this analysis.

2. Assumptions about the replacement of maturing or callable debt (Reissuance Assumptions)[1]:
   a. Eligible LTD securities maturing or callable prior to 2019 are replaced with Eligible LTD maturing five years from reissuance.
   b. Ineligible Plain Vanilla LTD securities maturing in 2017 and 2018, are replaced with Eligible LTD maturing after 2023.
   c. Ineligible Plain Vanilla LTD securities callable at par prior to 2019, including in Q4 2015 or in 2016, are called in 2017 or 2018 and are replaced with Eligible LTD maturing after 2023.
   d. Ineligible Plain Vanilla LTD securities maturing in Q4 2015 or in 2016, are replaced with Ineligible Plain Vanilla LTD maturing in 2020 and 2021, respectively.

3. Risk-weighted assets and total leverage exposure remain constant at their September 30, 2015 levels.[2]

4. The rule is finalized as it was proposed (unless otherwise noted). All shortfalls are shown relative to fully phased-in requirements, assuming the countercyclical buffer remains at zero.

[1] These Reissuance Assumptions are based on the US G-SIBs continuing current issuance practices until January 1, 2017, which would be consistent with the rule being finalized in the second half of 2016.
[2] Simplifying assumption due to the difficulty of making accurate projections about the future size and composition of the balance sheet of each U.S. G-SIB, particularly in view of offsetting factors.