CREDIT SUISSE

February 19, 2016

By electronic submission to www.federalreserve.gov

Robert de V. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: 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 Unsecured Debt of Systemically-Important U.S. Bank Holding Companies

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

Ladies and Gentlemen:

Credit Suisse AG ("Credit Suisse") appreciates the opportunity to provide comments on the Notice of Proposed Rulemaking (the "NPR" or "proposed rule") by the Board of Governors of the Federal Reserve System (the "Board") regarding total loss-absorbing capacity ("TLAC"), long-term debt ("LTD") and clean holding company requirements for systemically important U.S. bank holding companies ("covered BHCs") and the intermediate holding companies ("covered IHCs") of systemically-important foreign banking organizations ("FBOs").[1]

Credit Suisse has been a leader in advocating for effective bank resolution, which we and others view as the most critical reform of the post-crisis era.[2] We helped to develop the "bail-in"[3] strategy to address this challenge, and have worked closely with regulators in the United States and other jurisdictions to develop it into a practical

[1] 80 Fed. Reg. 74926 (November 30, 2015).

[2] For example, see Ben S. Bernanke, "Causes of the Recent Financial and Economic Crisis," Testimony Before the Financial Crisis Inquiry Commission, Washington, DC, September 2, 2010. Available at: http://www.federalreserve.gov/newsevents/testimony/bernanke20100902a.htm. In his testimony, then-Chairman Bernanke noted that "[i]f the crisis has a single lesson, it is that the too-big-to-fail problem must be solved."

[3] See inter alia Paul Calello and Wilson Ervin, "From Bail-out to Bail-in," The Economist, January 30, 2010.

strategy. Bail-in is essentially a high-speed version of a Chapter 11 reorganization technique that uses TLAC to recapitalize the bank with private capital, not government funds. Critically, this technique also preserves critical functions, thus protecting customers and the real economy. We believe it provides a powerful, effective and workable solution to the challenge of resolving large banking organizations.

Credit Suisse is already moving aggressively to comply with new TLAC standards at the group level. We have issued over $30 billion of contingent capital and other long term debt instruments subject to "bail-in" by the authorities. Together with equity capital, we now have TLAC equal to approximately 23% of risk-weighted assets ("RWA"), a level above both the levels set by the Financial Stability Board ("FSB") and the requirements contained in the proposed U.S. rule (Swiss requirements will actually require further issuance). Although the nature of this funding has increased our interest costs by a meaningful amount,[4] we strongly support the goals of the proposed rule, and the need for a strong TLAC regime.

We believe that TLAC represents the critical final step for a credible end to "perceptions that certain financial companies are 'too big to fail'."[5] While many global systemically important banks ("G-SIBs") have significant bail-in resources today, a strong TLAC requirement will ensure that high-quality bank resolution funding is a durable reform. We commend the Board and its staff for their vision and hard work in getting us to this important milestone.

The Proposed Rule Contributes to Ending Too-Big-To-Fail

Credit Suisse believes that the proposed rule makes major contributions to the goal of ensuring a durable end to the too-big-to-fail ("TBTF") problem. These include:

- Ensuring Robust Sizing: Credit Suisse internal analysis shows that the calibration for external TLAC under the proposed rule is well-sized. For example, it would be more than sufficient to handle the drawdowns observed for any distressed G-SIB in the last financial crisis and restore them to a strong level of solvency.[6]

[4] These costs include the additional spread on holding company debt issued by Credit Suisse Group AG that is now subject to bail-in techniques under the Swiss Banking Act, as well as our contingent capital securities (aka "coco's") that are "bail-inable" under contractual language.

[5] 80 Fed Reg. at 74926.

[6] Credit Suisse examined the losses experienced by major firms in the United States and Europe (current G-SIBs and banks that were possibly G-SIBs at the time), based on a review of public accounting data. We focused our analysis on the recent GFC crisis, but also considered previous events like the 1980s Emerging Markets crisis, and the failure of Continental Illinois. We estimated that the worst case, peak-to-trough "drawdown" of capital resources was equal to approximately 9% of Basel III RWA for both Merrill Lynch and Washington Mutual. Several large European firms also had losses near this magnitude but smaller. We used conservative assumptions including loss of tax shield and no ability to raise fresh capital during this process. The proposed rule more than ensures that resources are available to handle losses of this magnitude (or greater), and also recapitalize a firm to a strong level. The FSB's "Historical Losses and Recapitalization Needs" report uses similar methodology, except that it does not attempt to estimate the size of losses under modern RWA methodology (Basel III), which is more conservative, and is the relevant

- High-Quality Term Structure: The haircut rules in the proposed rule take a conservative approach to term structure that will mean that the actual loss-absorbing resources will likely always exceed the measured TLAC statistic.

- Clear separation of financial and operating liabilities via a holding company ("HoldCo") structure: This feature of the proposed rule helps to promote predictable resolution outcomes and avoid damaging "multiple competing insolvencies" such as those experienced in the Lehman Brothers' bankruptcy. This will help reduce investor panic and deter damaging runs of operating liabilities.

- Workable under both Title I and Title II of the Dodd-Frank Act: The United States has adopted a unique approach to its resolution legal structure: a preferred approach under the bankruptcy code and a backup approach under Federal Deposit Insurance Corporation ("FDIC") control. The proposed rule is designed to work well under either approach.

- Internal TLAC: While we have a number of concerns and proposed modifications (see below), the internal TLAC requirements in the proposed rule provide important economic incentives for cross-border cooperation, as well as a clean legal structure to support a successful global bail-in.

Although we strongly support the major themes of the proposed rule, we feel improvements are needed to ensure that the rule is consistent with both the critical public policy goals of ending TBTF and practical implementation at a large scale. TLAC is a fundamental development that will shape the architecture of international banking for many years; ensuring proper design is therefore critical. We believe a few key refinements to the rule could have important long term policy benefits.

Below are the overarching themes that motivate the more specific comments we provide later in this letter. We have focused principally, but not exclusively, on those aspects of the proposed rule that affect covered IHCs and in particular non-resolution entity IHCs. After setting out these key themes, we offer recommendations for improving the final rule.

The Final Rule Should be Reoriented to the Core Purposes of Internal TLAC

Broadly speaking, we are concerned that the proposed rule does not sufficiently account for the fundamental differences between external TLAC and internal TLAC.[7] External TLAC requirements are intended to ensure that a G-SIB will have

metric for ongoing TLAC management. See Financial Stability Board, "Historical Losses and Recapitalization Needs: Findings Report," November 9, 2015. Available at: http://www.fsb.org/wp-content/uploads/Historical-Losses-and-Recapitalisation-Needs-findings-report.pdf.

[7] Our comments in this letter are designed specifically for single-point-of-entry ("SPOE") firm internal TLAC (i.e. for non-resolution entity IHCs), unless otherwise specified. The purpose of TLAC design for

enough usable TLAC to provide for loss absorption and recapitalization in the event of failure. By contrast, internal TLAC has two primary purposes:

1) For distressed IHC subsidiaries, internal TLAC creates an economic and legal structure that allows losses to be upstreamed, and capital to be downstreamed to stabilize them. It increases the already significant incentives for these transactions to occur, so that local subsidiaries are restored to health.

2) For non-distressed IHC subsidiaries, internal TLAC should facilitate cooperation between home and host jurisdictions during periods of stress, a goal which is achieved by ensuring there is a sufficient amount of pre-positioned or guaranteed capital within the IHC to provide comfort to a host authority.

The primary purpose of internal TLAC is therefore to support and enhance the overall resilience and resolvability of the group, and to ensure that the plan can credibly recapitalize and protect key subsidiaries, including those inside the United States. We recommend that the rule be reoriented to focus on this purpose and avoid undue parallelism with external TLAC requirements.

The Proposed Rule is Unnecessarily Complex and Leads to Super-equivalent Requirements

Both the FSB standard and the proposed rule propose to set internal TLAC ratios at levels below external TLAC requirements, in order to aid group resilience and avoid misallocation risks. However, the number and complexity of specific tests in the proposed rule can drive the effective internal TLAC requirements to a level above the external TLAC requirements for U.S. BHCs (both covered and especially non-covered BHCs). It can also drive requirements above international (e.g., FSB) standards, which can create complications for international firms trying to balance many requirements around the globe. This "super-equivalence" can occur because of the high calibration of internal TLAC, the multiplicity of tests for covered IHCs and the conservative qualification rules. This is partly the result of additional requirements in the proposed rule (such as the extra U.S. Tier 1 Leverage Ratio); partly the result of calibration (e.g., the level of required internal LTD and the fact that the U.S. Supplemental Leverage Ratio ("SLR") significantly exceeds international norms); and partly the result of the interaction of these provisions when a number of these rules are applied in combination.

The Institute of International Bankers ("IIB") has estimated the impact of the proposed rule for a "composite" IHC, approximately equal to an average of input from a number of its members.[8] Because of the multiplicity and complexity of the IHC rules,

multiple-point-of-entry ("MPOE") firms is designed for external recapitalization, and is more akin to external TLAC.

[8] See Institute of International Bankers' comment letter on the proposed rule, "Annex II: Effective TLAC Requirements for Covered IHCs."

the composite firm would be required to maintain internal TLAC equal to 22%- 23.5% of RWA. It is also important to note that this is the effect for a composite firm (near to the average result), which implies that some IHCs would be required to maintain internal TLAC levels even greater than this estimate. The result is that many IHCs will need to issue internal TLAC at a level equal to or above the external requirements required for very large covered BHCs by the U.S. rule, and also well above the FSB requirements.

A super-equivalent outcome does not appear to be the intent of the proposed rule,[9] and will have consequences that are counterproductive. In particular, if other jurisdictions follow the lead of the Board and propose a similarly designed rule, many banking groups could find their "freely allocable" TLAC to be greatly reduced or eliminated. Such a result increases the likelihood of "misallocation risk" or "brittleness" at a group-wide level. Specifically, heavy ex ante TLAC "ring-fencing" can reduce or eliminate a group's ability to mobilize uncommitted resources to rescue a specific troubled subsidiary, potentially leading to an unnecessary failure of that entity. A local failure in one part of a single-point-of-entry ("SPOE") group could lead to a cascade of runs and failures across the group - even when the consolidated entity was strong. In this way, excessive ring-fencing could multiply the impact of local distress dramatically. In some cases, this can result in institutions that are more likely to fail instead of more resilient, which works against the core purpose[10] of the proposed rule. The purpose of the IHC requirements is to ensure global support for local subsidiaries, and we believe it is important to modify the rule to address this concern.

The proposed rule does not arise in isolation, but rather in combination with a number of other new enhanced prudential requirements, including IHC leverage ratios, IHC CCAR requirements, and others. Each of these additional IHC requirements may have some initial appeal in forcing foreign banks to dedicate greater resources to their operations in the United States. However the accumulation of such requirements can add to the brittleness concern noted above. That could push instability into the global system, which is adverse for a large participant like the United States, and we believe a more balanced calibration of the proposed rule could do much to ameliorate that concern.

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[9] See, for example, 80 Fed Reg. at 74941 which notes that the calibration is intended to provide "support for the preferred SPOE resolution of the foreign G-SIB, which requires that the foreign G-SIB be allowed to have some internal loss-absorbing capacity at the parent level that can be freely allocated to whichever subsidiaries have incurred the greatest losses (including non-U.S. subsidiaries). See also the discussion on 80 Fed Reg. at 74948, which describes this issue in the context of domestic pre-positioning.

[10] We agree with Governor Tarullo that the internal TLAC requirements in the proposed rule are designed to "enhance the prospects of an orderly firm-wide global resolution of an FBO by its home country resolution authority" (see Daniel K. Tarullo, "Shared Responsibility for the Regulation of International Banks," November 5, 2015. Available at: http://www.federalreserve.gov/newsevents/speech/tarullo20151105a.htm). However, as we discuss in this letter, super-equivalent requirements have the potential to create pressures that can make global resolution more difficult. The other stated purpose of the internal TLAC requirements is to make resources available to U.S. authorities "if home jurisdiction resolution proves unsuccessful". However, as discussed in the "Source-of-Strength" section, we believe that this latter concern is can be solved at lower levels and via many tools, and that applying a TLAC requirement only to foreign owned banks for this purpose is unfair and discriminatory.

Foreign banks have contributed greatly to the resilience and diversity of the U.S. financial system. For example, in the recent crisis, Credit Suisse and many other FBOs provided an important safe haven alternative for many customers and clients in the United States. Foreign banks also provide an important competitive alternative to consumers in many sectors, which helps ensure that an increasingly concentrated U.S. marketplace remains competitive. However, in recent years, the footprint of many FBOs has started to decline, in part due to the advent of many new regulatory requirements. A more balanced calibration of the rule that does not discriminate against FBO-owned entities would help preserve the benefit of robust foreign bank participation.

Adverse tax treatment for IHCs is a particular area where the effect of the proposed rule could lead to super-equivalence. The rule mandates deep subordination and conversion/cancellation features, creating a significant risk to normal tax deductibility. This adverse treatment would cause overall costs to rise significantly at an IHC, and increase consolidated costs for the group as a whole. Since this rule would not affect U.S. BHCs, competitive equality would be distorted, adding a further burden that is contrary to national treatment. As in other areas, we would recommend that a few of the more problematic features be removed, to preserve standard deductibility treatment for U.S. tax purposes and not unnecessarily disadvantage covered IHCs relative to covered BHCs.

We believe the proposed rule would benefit from a less complex framework and more proportional calibration. With respect to internal TLAC, we suggest that certain requirements be dropped for simplicity and that the final rule take a more inclusive approach to eligibility for some instruments. For example, we suggest that preferred stock should be permitted to count as eligible internal LTD, as it satisfies the core requirements of subordination, simplicity and usability set out in the proposed rule. We also suggest that other tools, such as capital contribution agreements, guarantees or keepwells would help expand the scope and diversity of internal TLAC, and could have important properties of resilience that would help achieve the Board's objectives.

<u>The Proposed Rule Should Recognize – not Punish – Parent Source-of-Strength</u>

The proposed rule includes covered IHCs because of the size and importance of their <u>consolidated</u> organization, despite the fact that the IHC itself is far smaller. The proposed rule then largely ignores the strength of the parent organization in terms of the requirements imposed – treating the IHC largely as if it was a standalone BHC. Despite smaller size and greater parent support capacity, IHCs are treated more harshly than similarly sized U.S. BHCs.

The IIB comment letter on this proposed rule highlights this disparity.[11] It shows that the average asset footprint for the big six U.S. G-SIBs is $1,641 billion, while the five largest non-G-SIBs average $298 billion, with the largest at $416 billion. The largest

[11] See Institute of International Bankers' comment letter, p. 6. Note that the G-SIB group excludes the two smallest U.S. G-SIBs because their G-SIB qualification is not related to balance sheet activity, but rather due to their very large custody activities, which are not a relevant issue for the other groups.

banks are subject to full TLAC requirements, while none of the non-G-SIBs are subject to any requirements under the proposed rule. The covered IHCs average $224 billion, with the largest at $328 billion, showing that this group of covered IHCs is vastly different in scope from the US GSIB class and about 25% smaller than the larger non-GSIB class. However the covered IHCs are not grouped with the non-G-SIBs, but instead are subject to rules that are comparable to the G-SIB class. Indeed, as mentioned above, some IHCs are effectively subject to requirements that even exceed the G-SIB class. This onerous treatment of IHCs appears to be based solely on their foreign ownership by a major bank, despite the fact that this has traditionally added a major source of strength to IHC activities.

The fact that the requirements for covered IHCs closely approximate those applied to standalone G-SIBs has a number of consequences: it grossly overstates the risks posed by covered IHCs, particularly non-resolution entities; it leads to inequitable national treatment; and, most important, could even exacerbate some risks to the U.S. financial system. None of the covered IHCs has the systemic profile to qualify as a covered BHC under the terms of the proposed rule on a standalone basis.[12] However, unlike covered IHCs, U.S. BHCs of comparable size and scope are not subject to any LTD or TLAC requirements under the proposed rule. Such a result is a clear violation of the principal of national treatment. It is illogical and unfair to subject the naturally safer firm (because of source-of-strength) to a far tougher standard than a similarly-sized competitor with no possibility of parent support.

This treatment also ignores the history of source-of-strength[13] support that FBOs have received from their parents over many years. Even during the most severe recent events, such as the 2008 crisis, G-SIB parent support has proven highly reliable. Parent support has occurred for many reasons, including the substantial franchise value of key subsidiaries, which are typically far more valuable as going-concerns than they are in liquidation. Maintaining an integrated operation and a strong brand are also critical for most SPOE institutions. For example, Credit Suisse has always supported its critical subsidiaries, and during the most recent crisis maintained a strong global position and shifted resources to key subsidiaries – including those in the United States - to absorb local market shocks that took place at different times.

This going-concern policy is supported by similar 'gone-concern' policy set out by Swiss regulation. The policy of Swiss regulators[14] is to use our group TLAC to

[12] See Institute of International Bankers' comment letter, pp. 5-7

[13] In this discussion, we refer to "source-of-strength" as the ability and incentive of a foreign parent to support U.S. operations, which have significant franchise value. We recognize that the term "source-of-strength" has a particular meaning under U.S. law, such as section 38A of the Federal Deposit Insurance Act that applies to holding companies of insured depository institutions. Nevertheless, we think the term appropriately reflects the history of, and overwhelming incentive for, foreign parent support of U.S. operations, whether or not the foreign parent owns an insured depository institution.

[14] See, for example, FINMA, "Resolution of Global Systemically Important Banks: FINMA position paper on Resolution of G-SIBs", August 7, 2013, p. 3. Available at: https://www.finma.ch/en/news/2013/08/mm-pos-sanierung-abwicklung-20130807/. The paper states that "FINMA's preferred resolution strategy for

recapitalize the bank, and protect our operations around the world, including the United States. This source-of-strength makes covered IHCs more resilient than comparably-sized standalone entities that enjoy no such support. It also has a strong grounding both in economic theory and in historical practices, and has acted to further the financial stability of the United States. Despite this strong grounding, the proposed rule seeks to subject foreign-owned entities to tougher rules than similarly-sized domestic ones that frankly have a more mixed record of resilience. We suggest that covered IHCs – especially those with strong capital and TLAC requirements[15], a good historical track record and clear SPOE resolution priorities - should be treated differently.

Ironically, by penalizing institutions that enjoy source-of-strength support from well-funded G-SIB parents, the proposed rule could exacerbate risks to the financial system. Consider a mid-sized U.S. financial firm (a covered IHC) that is owned by a strong, large SPOE parent. Under the proposed rule, the IHC would be subject internal TLAC requirements, in addition to other capital requirements. However, if the FBO divested this IHC, it would lose the protection of parent support and become more vulnerable. However, this newly vulnerable standalone institution would be effectively "rewarded" under the terms of the proposed rule and freed from its internal TLAC requirements. This is an illogical incentive to build into a national regulatory structure.

Should such a mid-sized standalone bank fail, regulators would naturally seek a solution – presumably a private sector sale or a "purchase and assumption" transaction. Yet such a private sector solution could be difficult to execute: U.S. G-SIBs are subject to statutory restrictions[16] that would make an equity investment virtually impossible, and smaller banks are unlikely to have sufficient resources. Other large enterprises active in the financial sector[17] have recently been divesting their financial assets in the hope of shedding their status as a systemically-important institution; they would be unlikely buyers. Purchase by a foreign G-SIB might also be difficult, in part because of the

these financial groups consists of a resolution led centrally by the home supervisory and resolution authority and focused on the top-level group company. This is called the "single point of entry" ("SPE") approach. Creditors of the parent bank or top-level holding company bear a share of the losses, allowing the entire financial group to be recapitalised. This re-capitalisation must be sufficient to meet the needs of all group companies in Switzerland and abroad."

[15] We note that the new Swiss "too big to fail" requirements subject the largest banks (e.g., the two G-SIBs) to a TLAC requirement equal to 28.6% of RWA and 10% of the SLR. See FINMA, "New 'too-big-to-fail' capital requirements for global systemically important banks in Switzerland," October 21, 2015. Available at: https://www.finma.ch/en/news/2015/10/mm-tbtf-20151021/.

[16] For example, Section 622 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which establishes a financial sector concentration limit (codified at 12 U.S.C. § 1852).

[17] The potential for financial institutions undertaking transformative reorganizations in response to arguably disproportionate regulatory burdens is not theoretical. For example, two nonbank financial companies designated by the Financial Stability Oversight Council for Federal Reserve supervision have announced intentions to divest material operations in response to the capital and other requirements resulting from designation. See General Electric Press Release, dated 10 April 2015, available at http://www.genewsroom.com/press-releases/ge-create-simpler-more-valuable-industrial-company-selling-most-ge-capital-assets. See also: MetLife Press Release, dated 12 January 2016, available at https://www.metlife.com/about/press-room/index.html?compID=192215.

additional costs that would be incurred as a result of the proposed rule (since the acquired institution would become subject to internal LTD and TLAC requirements, among others). In short, the rule mistakenly treats foreign ownership and support capacity as a "problem" to be addressed by extra regulation rather than a positive driver of resilience; this leads to illogical outcomes that are adverse for resolvability.

The Proposed Rule Should Maximize Scope, Diversity and Liquidity of Funding

Issuing G-SIBs will require access to large, deep and liquid markets in order to fund their LTD and TLAC requirements, and achieve the high level of loss absorbency required by the proposed rule and similar rulemakings in other jurisdictions. Globally, we estimate that the aggregate external TLAC requirements for G-SIBs will amount to approximately $4 trillion (excluding the Chinese G-SIBs, who will comply later).

As initially envisioned, bail-in was designed to utilize existing markets and structures wherever possible, in order to provide greater resiliency and to build upon large, well-known market structures. More specifically, the goal was to add convertibility procedures to senior debt instruments, so they could rebuild a firm's pool of equity. Unfortunately, the prescriptive nature of the proposed rule could exclude much of the U.S. BHC debt issued in in existing markets, and we do not believe such a strict standard is necessary for this purpose.

In particular, we believe certain external TLAC restrictions, notably those regarding foreign-law debt, principal-protected structured notes, and debt with standard acceleration clauses are unnecessary to achieve the Board's objectives, and together could create major, market-wide refinancing challenges for covered BHCs at the same time.[18] We are also concerned that the proposed rule imposes unduly restrictive conditions that limit the diversity of TLAC funding sources. We recommend that the Board amend the proposed rule to expand the presumption that existing instruments qualify as eligible debt securities wherever possible to get greater overall TLAC coverage established as quickly as possible with minimal disruption.

The proposed rule also contains several features that could constrain market making. While some limits are necessary to avoid excessive contagion risk, robust liquidity is also an important aim, and is critical for such a large public market to function properly. In particular, we seek to modify the requirement that any long positions in a firm's own eligible debt be deducted immediately from regulatory capital – a departure from the corresponding deduction approach, and likely a significant problem for market liquidity for some firms.

[18] See comment letter relating to covered BHCs of The Clearing House Association "The Clearing House," Securities Industry and Financial Markets Association "SIFMA," the American Bankers Association "ABA," Financial Services Roundtable "FSR", and the Financial Services Forum "FSF" (collectively "the Associations") for a more extensive discussion of these issues. We also note that the 50% haircut on LTD with a 1-2 year remaining maturity acts as a further effective restriction, which we believe is unnecessary and burdensome.

In these and other areas, we recommend that the complexity of the proposed rule be reduced and that existing resources at the G-SIBs be utilized more fully. We believe that it would be in the Board's interest to have TLAC in place as quickly and efficiently as possible, to ensure the resiliency and resolvability of G-SIBs. We are concerned that in its current form the proposed rule may cause TLAC to become a needlessly complex and expensive restructuring exercise for G-SIBs. It would lose the benefits of a large pool of existing loss-absorbent debt, which the Federal Reserve and the FDIC have promoted successfully as a strong and workable solution for a distressed G-SIB.

Recommendations

In the text that follows, we have included a number of specific comments and recommendations that we have grouped as follows:

I: Super-Equivalence, Complexity, and Fairness

In Part I, we highlight our concerns about the super-equivalency, complexity and fairness of the requirements contained in the proposed rule. In order to mitigate these problems, we recommend streamlining the current "six-pronged" test in the proposed rule to a simpler two-pronged test centered on internal TLAC. We believe that a simpler internal TLAC-based rule would be fully sufficient to achieve the aims of this project. Specifically we would:

- Remove the unnecessary internal LTD requirements for covered IHCs. If internal LTD requirements are nevertheless retained, the Board should reduce their calibration, and permit preferred stock to fully qualify as eligible internal LTD.
- Remove the additional U.S. Tier 1 leverage test for covered IHCs already subject to the SLR.
- Eliminate the conversion/cancelation requirement, which unfairly imposes increased costs on covered IHCs relative to covered BHCs. Should the Board decline to take this step, we believe it should (a) modify the internal LTD requirements so that internal LTD would have priority over equity of the covered IHC and (b) actively work with the industry, the U.S. Department of Treasury and the Internal Revenue Service and potentially re-propose this aspect of the rule for public comment.

II: Calibration of Internal TLAC

In our view, the proposed requirements would lead to a reduced level of group resilience, by ring-fencing excessive amounts of capital. This outcome would increase brittleness, undermining global, and ultimately U.S., financial stability. To avoid this, we recommend:

- Internal TLAC for non-resolution entities should be calibrated at a level equal to a maximum of 75% of the RWA requirements applicable to covered BHCs. Similarly, the SLR requirement for covered IHCs should be 75% of the requirement applicable to covered BHCs, after adjusting for the 2% SLR buffer requirement that is not applicable to IHCs, and for balance sheet depletion effects.[19]

- We recommend elimination of the internal LTD requirement. But, if the Board decides to retain internal LTD requirements, these should also be reduced to approximately 33% of the final internal TLAC level, consistent with the international standard set by the FSB.
- Half of a non-resolution IHC's LTD requirement (if retained by the Board in the final rule) or up to a quarter of its internal TLAC requirement may by met through legal parent obligations (such as capital contribution agreements, guarantees or keepwells) which would contribute assets to the covered IHC upon certain triggers that would precede resolution.

III: Consideration of Source-of-Strength

In addition to the foregoing recommendations, we recommend that the final rule incorporate some discount for parent funding and robust home country standards, to reflect the benefit that parent source-of-strength brings for non-resolution IHCs:

- Should the Board not choose to re-adjust the calibration of internal TLAC to a maximum of 75% of the equivalent external TLAC requirement for covered BHCs, we recommend the Board extend it to non-resolution IHCs whose parents are subject to home-country standards that equal or exceed U.S. capital requirements.
- Similarly, should the Board choose not to extend the foregoing to all non-resolution IHCs, we strongly recommend that it should nevertheless permit this same subset of non-resolution IHCs to be able to satisfy half of their internal LTD requirements (if retained by the Board in the final rule) or up to a quarter of their internal TLAC requirements through legal parent obligations to contribute assets to the covered non-resolution entity IHC upon certain triggers that would precede resolution.

IV: Maximizing Scope, Diversity, and Liquidity of Funding

A broad, deep and liquid market will be important to achieve the high level of loss absorbency required by the proposed rule and similar rulemakings in other jurisdictions. In pursuit of that objective, we recommend the Board revise the final rule to:

- Include an exemption for market-making under the cross-holdings capital deduction framework in order to support market liquidity and ensure the breadth of TLAC market (at a minimum, we believe that such an exemption be extended to market-making in "own" TLAC issued by the covered firms, and that any remaining positions be treated under a corresponding deduction approach).
- Remove the exclusion of foreign-law LTD from the definition of eligible debt securities (we suggest, however, that future issuance under foreign law should include contractual language whereby investors recognize the resolution/bail-in powers of the relevant U.S. regulators);

[19] See the Institute for International Bankers' comment letter on the proposed rule, Annex 1 for a fuller description of these calculations.

- Eliminate the 50 percent haircut on eligible debt securities with a remaining maturity of between one and two years;
- Permit principal-protected long-term structured note instruments to count as eligible LTD. In addition, in our view, the Board should exclude all long-term structured notes from the 5% cap under the Clean Holding Company framework;
- Grandfather in existing LTD and hybrid securities in order to avoid wide-scale market disruption.

We believe these changes would streamline the proposed rule to avoid unintended consequences and would better meet the Board's core objectives.

Annex I: Responses to Select Questions Posed in the NPR

We also provide responses to a wide range of questions posed by the Board in the NPR, which echo the key recommendations we make in the body of the letter.

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We thank the Federal Reserve Board for its considerations of our comments. If you have any questions, please do not hesitate to contact the undersigned or Peter J. Ryan (202-626-3306; peter.ryan.3@credit-suisse.com).

D. Wilson E

D. Wilson Ervin
Vice Chairman,
Group Executive Office

cc: Mark Van der Weide, Felton Booker

Contents

I: Super-Equivalence, Complexity, and Fairness

The multiplicity and complexity of tests that apply to covered IHCs under the proposed rule may, inadvertently, result in the imposition of super-equivalent requirements on such institutions and should be reconsidered. Several of these requirements – especially the internal LTD requirement and the U.S. Tier 1 leverage test – are unnecessary to achieve the Board's stated goals for covered IHCs. Simplifying these elements of the proposed rule would mitigate the disparate treatment imposed on the IHCs, without diminishing the effectiveness of the rule. Finally, we ask that the Board not place covered IHCs at a competitive disadvantage by remedying the disparate tax treatment of internal LTD that results from the language contained in the proposed rule.

A: Multiplicity of Tests: LTD and Leverage Requirements

i) Combination of Requirements in Proposed Rule Lead to Super-Equivalent Requirements for Covered IHCs

Under the proposed rule, covered IHCs would be required to maintain six separate minimum ratios:

- An internal LTD ratio as a percentage of risk-weighted assets ("RWA");
- An internal LTD ratio as a percentage of total leverage exposure (i.e. SLR);
- An internal LTD ratio as a percentage of average total consolidated assets (i.e. U.S. Tier 1 leverage ratio);
- An internal TLAC ratio as a percentage of RWA;
- An internal TLAC ratio as a percentage of SLR; and
- An internal TLAC ratio as a percentage of U.S. Tier 1 leverage;

While covered IHCs are subject to this "six-pronged test," covered BHCs are subject to fewer constraints, since they are not subject to the separate U.S. Tier 1 leverage requirement. Moreover, the FSB Term Sheet[20] only envisioned a "two-pronged test," since it did not contain a specific LTD requirement. The number and severity of extra constraints will tend to increase the effective internal TLAC requirements when compared to a less complex system, in some cases materially. For some types of IHCs, the multiplicity of tests could even result in a higher effective TLAC requirement than it would for a standalone covered BHC. This is at odds with the stated philosophy behind internal TLAC, and we believe has an unintended and counterproductive effect.

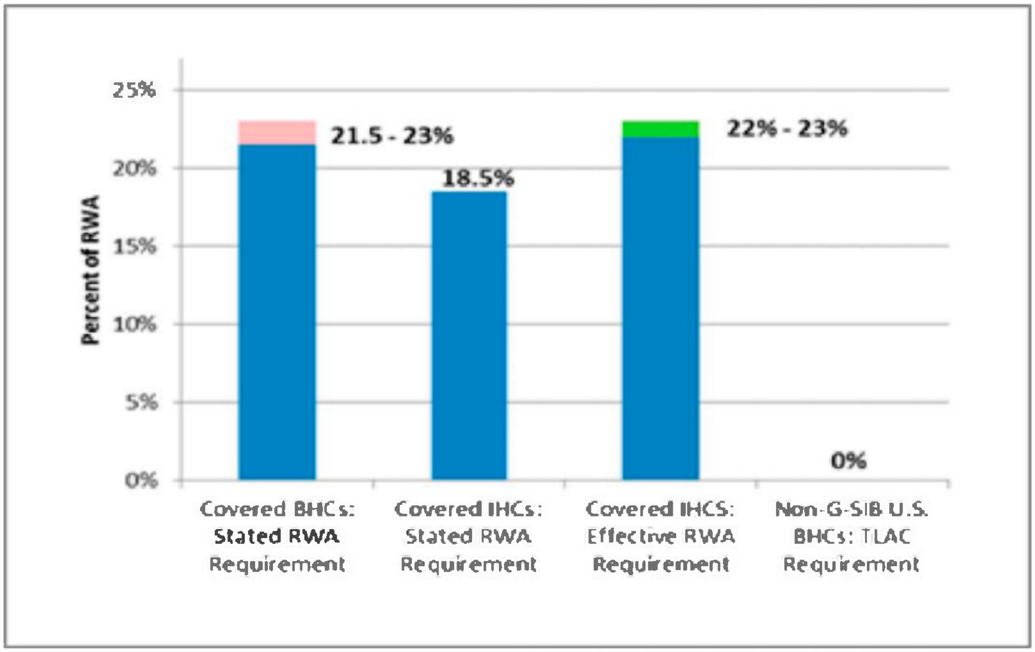
This multiplicity of tests will have particularly significant effects on non-resolution IHC firms, which are often specialized in certain U.S. business areas that support their global operations. The rules for covered BHCs appear to be designed in such a way that they are primarily driven by the RWA test, with the other components acting as a backstop. However, because non-resolution IHCs often operate a different business model with lower-risk assets, they are more prone to be captured by other

[20] Financial Stability Board, "Principles on Loss-Absorbing and Recapitalization Capacity of G-SIBs in Resolution," November 9, 2015. Available at: http://www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf.

requirements, including the leverage requirements that covered BHCs do not need to meet at all.

The following chart, which is based upon data provided in the IIB comment letter on the proposed rule,[21] illustrates this effect, and shows how IHCs can be required to maintain an internal TLAC / RWA ratio that is equal to a full external BHC requirement, or even higher if the full range of submitting firms was considered:

Figure 1: Comparison of Proposed Rules to Effective RWA Requirements



In sum, the interaction of these numerous requirements can result in an effective binding internal TLAC level that is well above the nominal levels required by the proposed rule, and even higher than the effective binding external TLAC requirements for covered BHCs. We believe that this problem could be easily solved by removing requirements that create unnecessary complexity and are not necessary for the Board to achieve its stated objectives (see below).

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[21] See Institute of International Bankers' comment letter, p. 8. Figure 1 compares the effective TLAC levels for this "composite covered IHC" to the stated levels in the proposed rules for covered IHCs, covered BHCs (taking into account the range of possible calibrations as a result of the G-SIB surcharge, as shown in the pink bar) and non-G-SIB U.S. BHCs (which would not be subject to any TLAC requirements under the proposed rule). This composite covered IHC would be required to maintain internal TLAC equal to 22% of its RWA and would, as a practical matter, need to hold a maintenance buffer of additional LTD to ensure that it did not breach its requirements, which could increase its effective TLAC levels to 23% of its RWA, as shown in the green bar. This high level of effective TLAC excludes any effects of the 50% amortization haircut for LTD with a maturity between one and two years under the Proposed Rules, which could increase effective TLAC levels for covered IHCs by as much as 1.5% of RWA. For more detail on the methodology and data used here, please refer to Section II.B and Annex II of the IIB letter.

ii) An Internal LTD Requirement is Unnecessary to Satisfy the Board's Objectives

The proposed rule states that the Board's objective in proposing an internal LTD requirement on covered IHCs "is generally parallel to the rationale for the proposed external LTD requirement."[22] While there is a plausible rationale for having a separate external LTD requirement as part of the overall external TLAC requirement, there is no benefit to imposing such a requirement on a non-resolution covered IHC entity.

A primary justification for the internal LTD component of the rule is to ensure a) a trigger that could help with initiating resolution and b) an additional resource that could be converted to equity at that point. If the internal TLAC resource is already in the form of equity, the recapitalization objective is moot. Indeed, we believe it would be somewhat perverse for the rule to sanction a firm that met all internal TLAC and capital requirements just because it held slightly too much of its internal TLAC in the form of equity.

A secondary – but important – justification for the LTD requirement for covered BHCs is that it establishes a class of publicly-traded securities whose investors are concerned primarily about the risk of failure. Spread information from this class will provide valuable information to supervisors, and help discipline management. Indeed, we expect that the ability to refinance TLAC in the capital markets will become a primary indicator of a group's health over time, in the manner that subordinated debt was supposed to do. Monitoring of external debt issued at the top of an SPOE firm (or from a resolution-entity multiple-point-of-entry ("MPOE") entity) will be an important benefit of the rule; investors understand that these external liabilities carry the primary risk of failure and will price debt with this in mind.[23] However internal TLAC for non-resolution IHCs will not be publicly-traded, and therefore would not provide any such signal or monitoring benefit. In this case, the rule should be adapted to recognize the fundamental difference between external TLAC, and the internal TLAC used for non-resolution IHCs, which is used to support global resilience.

As a result, we do not see the need for a separate internal LTD requirement, at least for covered IHCs. In our view, the Board can achieve its objectives more simply and effectively through the internal TLAC requirements contained in the proposed the rule, together with other supervisory powers. Adopting this simpler approach would remove some of the unnecessary complexity and burden associated with the proposed rule, and would also improve international consistency.

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[22] 80 Fed. Reg. at 74940.

[23] Government Accountability Office, "Large Bank Holding Companies: Expectations of Government Support" July 2014. Available at: http://www.gao.gov/products/GAO-14-621.

iii) If an Internal LTD Requirement is Retained, Preferred Stock Should Be Considered Eligible

We believe that preferred stock should fully qualify as internal LTD. It satisfies the critical requirements set out by the Board in terms of qualification logic. Preferred stock is deeply subordinated, and has an easily estimable fixed value. It is equally as loss-absorbing as LTD and, because it is a known and observable quantity of the covered IHC's capital stack, would provide the transparency benefits that the Board seeks. As such, we believe that preferred stock meet all of the important elements that are necessary for this part of the rule to function as intended. Including this element of flexibility would reduce some of the super-equivalent effects noted above and enhance the funding options open to a group. In short, it would reduce the burden on IHC entities without compromising the strength of the rule.

iv) The 50% Haircut for LTD with a Maturity of 1-2 Years Should be Eliminated

The proposed rule would apply a 50% haircut to the principal amount of any eligible debt security with a remaining maturity between one and two years. As a result, covered IHCs may only count half of the principal amount of the eligible debt securities in this maturity window toward their minimum LTD requirement. As we note in Part IV below (in reference to external LTD), this additional discount is cumbersome and unnecessary; it will create discontinuities between U.S. requirements and international requirements. It also raises the impact of the internal LTD requirement further when compared to the TLAC tests, which we believe should move in the other direction for all banks, and especially for IHCs.

The existing discount of all otherwise eligible debt securities within one year is already conservative in our view, and it would be better if the Board adopted the international standard in this instance. As such, we recommend that the Board should eliminate the 50 percent haircut on eligible debt securities with a remaining maturity of between one and two years.

v) Additional Leverage Test is Superfluous and Results in Unfair Treatment Relative to Covered BHCs

As noted above, the proposed rule also introduces a U.S. Tier 1 leverage requirement for IHCs, in addition to the SLR test that is required for both BHCs and IHCs. This aspect of the proposed rule appears to have been included because some firms may not be able to calculate an SLR, thereby leading to possible competitive effects among IHCs. However this requirement actually introduces a larger competitive distortion between IHCs and all U.S. firms, since the latter group is not subject to an additional tier 1 leverage test at all. This is deeply unfair to a group of covered IHCs that already are subject to the SLR, and again adds unnecessary complexity to proposed rule.

In our view, a better remedy than this blanket imposition of a Tier 1 leverage requirement would be to require the SLR test for those institutions already subject to the supplemental leverage ratio, but remove the superfluous U.S. Tier 1 leverage ratio test.

Other IHCs could either choose to calculate an SLR denominator, or utilize the Tier 1 leverage test as an alternative fallback.

B: The Conversion/Cancellation Requirement Should Be Eliminated, as it is Unnecessary and Unfairly Imposes Increased Costs on Covered IHCs Compared to Covered BHCs

As noted above, we believe a separate internal LTD requirement is unnecessary and should be eliminated. However, we expect that many firms will still choose to meet some of their TLAC requirement with eligible internal LTD, provided that the final rule contains a workable definition of internal LTD. For the reasons explained more fully below, we urge the Board to eliminate the need for a contractual provision pursuant to which the Board could require a covered IHC to cancel internal LTD or convert it into common equity tier 1 capital on a going-concern basis (the "conversion/cancellation requirement").[24] In particular, we think the conversion/cancellation requirement (i) is unnecessary and inappropriate to achieve the Board's stated objectives, (ii) would unfairly increase funding costs of covered IHCs as compared to covered BHCs and (iii) could unfairly increase tax costs of covered IHCs as compared to covered BHCs.

i) Conversion/cancellation requirement is unnecessary and inappropriate

The Board states that "the principal purpose" of the conversion/cancellation requirement "is to ensure that losses incurred by the covered IHC are shifted to a foreign parent without the covered IHC's having to enter a resolution proceeding."[25] We think this purpose is achieved without the conversion/cancellation requirement for two reasons:

- First, because the parent FBO is the sole holder of the IHC's internal LTD and other TLAC, the parent FBO will always bear the first losses should the covered IHC fail. That is, if the IHC were to enter into a resolution proceeding, the parent FBO's equity interest in the IHC would be in a first loss position and the internal LTD would next absorb any remaining losses. Thus, the parent FBO will have an incentive to cancel internal LTD or otherwise provide additional capital to the covered IHC prior to resolution to avoid such losses, thereby pushing losses up to the parent FBO consistent with the Board's stated objectives. The conversion/cancellation requirement is not necessary to achieve this result. The

[24] We request that the Board make a technical clarification to the proposed regulatory text. Specifically, as proposed, the internal LTD requirement provides that without the prior approval of the Board, a covered IHC "may not redeem or repurchase any outstanding eligible internal debt security," if that redemption or repurchase would lead to the IHC failing to meet its internal LTD requirement. 12 CFR 252.162. The preamble, however, provides additional clarity, saying: "Covered IHCs would be prohibited from redeeming eligible internal LTD prior to its stated maturity date without obtaining prior approval from the Board where such redemption would cause the covered IHC's eligible internal LTD to fall below its internal LTD requirement." 80 Fed. Reg. at 74940 (emphasis added). We respectfully request that the Board revise the regulatory text to include the phrase "prior to its stated maturity date" that is included in the preamble. This clarification would avoid any confusion that the maturity of internal LTD on its terms does not require Board approval.

[25] 80 Fed. Reg. at 74943.

requirement that any internal LTD be subordinate to existing operating liabilities, which we do not propose to change, is fully sufficient to achieve the Board's underlying objectives.

- Second, the Board has broad supervisory authorities that could be used to achieve the same effect as the conversion/cancellation requirement. If the Board believed that losses incurred at the covered IHC needed to be shifted to the parent FBO, the Board could impose a wide range of conditions to achieve this end. Further, the Board would have significant leverage in exercising its supervisory authority, given that the Board can, as a last resort, seek to recommend a Title II resolution of the covered IHC. The FBO parent always will have an incentive to avoid failure of the covered IHC, given the first loss position of equity, followed by internal LTD (even without a conversion/cancellation requirement).

  Further, the conversion/cancellation requirement contravenes the globally-agreed standard that resolution regimes should respect creditor hierarchy and that "equity should absorb losses first."[26] This principle – known as "no creditor worse off" – also is embodied in the Dodd-Frank Act's Title II Orderly Liquidation Authority ("OLA"). The Board should not depart from this global norm, particularly where doing so is unnecessary to advance the Board's stated objectives.[27]

For the reasons noted above, we think the conversion/cancellation requirement is unnecessary and inappropriate as a policy matter. In addition, any marginal policy benefit that the requirement arguably provides is far outweighed by increased funding and tax costs that the requirement imposes on covered IHCs as compared to covered BHCs, as discussed below.

ii) Conversion/cancellation requirement unfairly increases funding costs of covered IHCs

Even without the conversion/cancellation requirement, internal LTDs will be deeply subordinated debt instruments without any acceleration rights. The conversion/cancellation requirement could result in internal LTDs not only being subordinated to all creditors, but also potentially subordinated to (or pari passu with) equity of the issuer, which is highly unusual for a debt instrument. A third-party investor would be expected to demand a significantly increased yield over the IHC's normal funding costs (i.e. the covered IHC would need to pay a substantial funding premium) to accept a note that, in effect, could be subordinated to (or pari passu with) equity of the issuer. Because parent FBOs typically transact with their subsidiaries around the globe on market terms, the covered IHC would incur the cost of this funding premium. The external TLAC issued by covered BHCs, in contrast, would not be required to include the conversion/cancellation requirement. As a result, covered IHCs would unnecessarily face a higher funding cost than covered BHCs. The inequitable nature of this cost is

[26] Financial Stability Board, "Key Attributes of Effective Resolution Regimes for Financial Institutions" § 5.1, October 15, 2014.

[27] Dodd-Frank Act § 210(a)(7)(B) (a creditor under OLA "shall, in no event, receive less than the amount that the creditor is entitled to receive under" liquidation proceedings).

exacerbated in light of the fact that many covered IHCs are the same size as regional BHCs, which are not subject to <u>any</u> TLAC requirements.

<u>iii) Conversion/cancellation requirement could unfairly increase tax costs to covered IHCs</u>

The conversion/cancellation requirement raises serious concerns as to whether internal LTD will be treated as debt, rather than as equity, for U.S. tax purposes. These concerns are raised, first and foremost, by the potential subordination (or pari passu status) of internal LTD to equity of the issuer as a result of the conversion/cancellation requirement. A fundamental characteristic of debt for U.S. tax purposes is that it has priority to equity of the issuer, both on a going-concern basis and in the event of bankruptcy or liquidation. In addition, because the conversion/cancellation requirement would occur outside of a bankruptcy setting, it raises a serious question as to the treatment of internal LTD as debt for U.S. tax purposes, even if it did not cause the internal LTD to be subordinated to (or pari passu with) the equity of the issuer.

If internal LTD were treated as equity, rather than as debt, for U.S. tax purposes, payments of interest on the internal LTD would be treated as non-deductible dividends and also not be deductible for state and local income tax purposes. They would also be subject to U.S. withholding tax at a rate of not less than 5 percent under the U.S.-Swiss tax treaty. In addition, payments of principal on internal LTD (unlike payments of principal on instruments treated as debt for U.S. tax purposes) generally would also be treated for U.S. tax purposes as dividends subject to U.S. withholding tax at a rate not less than 5%.[28] These increased tax costs make internal LTD significantly more expensive than debt issued by covered BHCs that are able to treat external LTD as debt for U.S. tax purposes, with the result that payments of interest by covered BHCs are generally deductible for U.S. tax purposes and payments of principal and interest by covered BHCs generally are not subject to U.S. withholding tax. This disparate treatment would be inherently unfair to covered IHCs.

At a minimum, we believe IHCs and U.S. BHCs should be subject to substantially similar funding costs and U.S. tax treatment on LTD they are required to issue under the Board's rules. The Board could resolve the funding cost and tax issues noted above by eliminating the conversion/cancellation requirement, which we believe is the appropriate result and is consistent with Board's objectives. <u>If the Board declines to eliminate the conversion/cancellation requirement, we urge the Board (a) to modify the internal LTD requirements so that internal LTD would have priority over equity of the covered IHC and (b) to actively work with the industry, the U.S. Department of Treasury and the Internal Revenue Service and potentially re-propose this aspect of the rule for public comment</u> to ensure that covered IHCs do not face these substantial increased funding and tax costs relative to covered BHCs.

[28] These withholding taxes would likely not be creditable in Switzerland by Credit Suisse.

II. Calibration of Internal TLAC

i) Internal and External TLAC Have Fundamentally Different Purposes

In our view, the proposed rule does not go far enough in acknowledging the differences between external TLAC and internal TLAC, particularly for non-resolution entities. External TLAC requirements are intended to ensure that a resolution entity will have enough usable TLAC to provide for recapitalization in the event of a resolution. By contrast, internal TLAC for non-resolution IHCs is primarily designed to facilitate cooperation between home and host jurisdictions during periods of stress, a goal which is achieved by ensuring there is a sufficient amount of pre-positioned or guaranteed capital in the IHC subsidiary.

We strongly support the concept of internal TLAC for this reason. However, we are concerned that the proposed calibration and composition of internal TLAC and LTD for non-resolution entity IHCs is misaligned, thus potentially leading to ring-fencing and brittleness. As has already been discussed, the multiplicity of requirements under the proposed rule will lead to super-equivalent standards for covered IHCs. Even if these requirements are simplified, the high calibration of both the internal LTD and internal TLAC requirements, particularly if replicated in other jurisdictions, would greatly increase the risk of brittleness; that is, the cushion provided by a central reserve could be squeezed, potentially to zero as capital is ring-fenced in different subsidiaries owing to a high pre-placement of internal TLAC. As a result, the group's ability to rescue a single troubled subsidiary could become difficult or potentially impossible, triggering a cascade if runs and failures across the group – even when the consolidated entity was strong. In this way, excessive ring fencing multiplies the sources of potential distress dramatically, and makes institutions more brittle instead of more resilient. This undermines the very purpose of this rule and should be avoided.

We are also concerned that inappropriately calibrated internal LTD and TLAC requirements for non-resolution IHCs could lead to a breakdown in cooperation between home and host authorities. After a certain threshold there will be an inverse relationship between the amount of parent assets trapped in a host country and the incentive of host-country supervisors to cooperate with a G-SIB's home-country resolution authority to maximize the residual value of the G-SIB for the benefit of all of its stakeholders. If the conversion or write-down of prepositioned debt is sufficient to recapitalize the non-resolution entity IHC as a going-concern, or if the liquidation value of the non-resolution entity IHC after converting or writing-down LTD held by the foreign parent is sufficient to satisfy all the liabilities of the non-resolution entity IHC, host-country supervisors will have no economic incentive to cooperate with home-country resolution authorities. Instead, there would be a strong incentive for host-country regulators to impose a hard ring-fence, or even place the non-resolution entity IHC in local resolution proceedings. Such levels of ex-ante prepositioning could result in an improperly fragmented resolution of a G-SIB with an SPOE strategy and could be a serious impediment to successful SPOE resolution.

ii) Overall Calibration of Internal LTD and TLAC Needs to be Reconsidered

The proposed rule sets out internal TLAC and LTD requirements for non-resolution IHCs that are approximately 90% of the TLAC requirements and 100% of the LTD requirements applicable to resolution entity IHCs. The non-resolution IHC ratio requirements are similarly severe when are compared to covered BHCs (except for buffer calculations). The nominal requirements for internal TLAC for covered IHCs are therefore at the very top of the range set by the Financial Stability Board ("FSB") in their final Term Sheet, published November 9, 2015.[29] Indeed, the internal LTD to RWA requirement does not provide any discount for covered IHCs, and is also set well above FSB requirements (especially when the additional haircuts for LTD calculations are factored in).

In addition, as we have already noted, the multi-pronged tests required by the proposed rule noted above will make it likely that the effective requirements for some covered IHCs will increase, potentially beyond the external TLAC requirements that are applied to covered BHCs. This effect is further compounded by the tough qualification standards, such as the additional 50% haircut of 1-2 year LTD, which would disqualify otherwise qualifying and fully-loss absorbing debt (a topic discussed later in this letter).

In our view, this high calibration of internal TLAC will produce excessive brittleness that would reduce group resilience rather than strengthen it. Moreover, we feel it is likely that other jurisdictions will follow the Board's example and mandate similar internal TLAC requirements for subsidiaries in their jurisdictions. This might occur in deference to the expertise of the Board in this area, or potentially as a defensive mechanism to maintain parity with a major host regulator. Such replication would only create further unnecessary brittleness, "locking down" capital in specific subsidiaries and therefore creating virtual certainty that capital will not be in the right place in the right proportion. This "misallocation risk" could lead to unnecessary failures, and potentially make a successful resolution of the global entity more difficult. It could also lead to super-equivalence on a global basis i.e. resulting in internal TLAC levels exceeding group external TLAC requirements. We believe it is important that the United States, as a global leader, sets a replicable standard that promotes global resilience, a goal which is ultimately critical to enhancing US financial stability.

In short, we believe that there is a need to achieve a balance between the goal of facilitating cooperation during periods of stress and avoiding excessive brittleness that could undermine global and US financial stability. In our view, internal TLAC (and internal LTD requirements, should the Board chose to retain them) for non-resolution entities should be calibrated at a level equal to a maximum of 75% of the requirements applicable to covered BHCs after adjusting for the 2% SLR buffer requirement that is not applicable to IHCs, and for balance sheet depletion effects. As discussed earlier, we also recommend elimination of the internal LTD requirement. But, if the Board decides to retain internal LTD requirements, we additionally recommend they be reduced to

[29] Financial Stability Board, "Principles on Loss-Absorbing and Recapitalization Capacity of G-SIBs in Resolution," November 9, 2015.

approximately 33% of the final internal TLAC level consistent with the standards set out in the FSB Term Sheet.[30] Doing so will ensure consistency with international standards and help to improve cross-border coordination.

iii) Capital Contribution Agreements, Guarantees and Keepwells Should Count Toward Internal TLAC Requirement

We also recommend that non-resolution entity covered IHCs be given more flexibility to satisfy their internal TLAC (and LTD, if retained) requirements in order to reduce the potential for misallocation risk. This flexibility should include unfunded support from a covered IHC's parent via capital contribution agreements ("CCAs"), legally binding keepwells or guarantee mechanisms, which would be capable of being applied toward the covered IHC's internal TLAC requirement. Specifically, we recommend that up to half of a covered IHCs LTD requirement (if retained by the Board in the final rule) or up to a quarter of its TLAC requirement by met through legal parent obligations to contribute assets to the covered IHC upon certain triggers that would precede resolution.[31] In our view, such CCAs, guarantees or keepwell agreements would provide additional flexibility and resilience, thereby reducing the risk of brittleness. It would clearly align legal duties and economic incentives with SPOE principles.

Such a hybrid system – one that includes both funded and unfunded internal TLAC – would provide the Board with a better tool to help ensure that losses are up-streamed from distressed legal entities, and that capital is down-streamed to help stabilize them. For non-distressed entities, it will bolster incentives for jurisdictions to work cooperatively with one another. Internal guarantees are more likely to absorb losses or create equity outside of insolvency proceedings than the LTD of covered BHCs, which must negotiate with third-party investors to impose losses on holders of these instruments. As such, unfunded instruments should be recognized as powerful tools that also enhance the flexibility of internal TLAC, mitigating unnecessary failure risk that could occur from excessive pre-placement of cash-based internal TLAC.

While unfunded commitments may, on the surface, seem less reliable in extreme cases than pre-placed cash, they are nevertheless binding legal requirements, meaning that a default of the covered IHC would also represent the default of the parent entity. Therefore these commitments should provide additional comfort to the Board alongside pre-placed internal TLAC. In our view, the United States financial system will ultimately benefit from a more balanced global allocation of capital and more resilient G-SIBs.

[30] Financial Stability Board, "Principles on Loss-Absorbing and Recapitalization Capacity of G-SIBs in Resolution," November 9, 2015, p. 12.

[31] We do not believe that guarantees need to be collateralized or specifically allocated to individual jurisdictions, in order to reduce misallocation risk. However we understand that the Board may wish to impose some further requirements in this direction to strengthen this tool.

III. Consideration of "Source-of-Strength"[32]

The proposed rule provides very little credit to covered IHCs with global SPOE parent firms (i.e. non-resolution IHCs), treating them much like (much larger) standalone entities. This ignores the fact that these institutions enjoy source-of-strength support from their parent. The proposed rule also does not take into account variations in the stringency of the parent's home country capital requirements. In our view, the Board should provide a greater allowance for source-of-strength support in cases where a non-resolution IHC's parent is well-funded and subject to strong home-country capital requirements.

<u>i) Non-resolution Covered IHCs Enjoy Parent Support, in Contrast to Covered BHCs</u>

Non-resolution Covered IHCs are not standalone entities; they enjoy financial support from their parent firms that would be available during periods of stress and during resolution. However, under the proposed rule, non-resolution covered IHCs are effectively treated very similarly to standalone covered BHCs.

This financial support has proved robust throughout a number of historical cycles. During the Global Financial Crisis of 2007-2008 – the most severe in recent history – foreign banks stood by their U.S operations, and provided a pillar of support during a time of turmoil for the U.S. system. This support from the parent firm derives from several motivations: non-resolution IHCs are owned by parents who operate an integrated firm and the failure of a component would damage the whole. They perceive a reputational connection between their IHC and their overall reputation. They also have significant investments in their IHCs. All of these considerations serve to establish a strong bond of support from parent banks to their non-resolution IHCs.

While we support the concept of internal TLAC, we respectfully submit that the high calibration under the proposed rule does not appear necessary on the basis of historical analysis, or on the basis of FBO incentives. It is also not grounded in parity. The proposed rule does not require any TLAC or LTD resources for similarly-sized domestic institutions (since none are covered by the proposed rule).

<u>ii) Parent Funding and Home Country Capital Requirements Should be Considered in the Calibration of Internal LTD and TLAC</u>

Moreover, the proposed calibration of internal TLAC and LTD does not take into account the stringency of home country requirements and strength of parent funding. In the case of Switzerland, the two Swiss G-SIBs will be expected to meet a 28.6% TLAC baseline in RWA terms, as well as a strong leverage requirement. Both requirements are above U.S. BHC requirements. This level of capital should provide substantial assurance to U.S. authorities that, in the event of extreme distress, the Swiss authorities will be able

[32] To reiterate, in this letter, we use this term to refer to the ability and incentive of a foreign parent to support U.S. operations, which have significant franchise value. See our fuller discussion of the meaning of "source-of-strength" in footnote 12.

to execute an effective and robust recapitalization. The Swiss authorities have also provided clear evidence of their intentions to pursue such a course.[33]

We respectfully suggest that the Board reevaluate its calibration of internal TLAC and especially internal LTD in this context. However, we recognize that a case-by-case approach to evaluating source-of-strength would be difficult to implement. Should the Board not agree to a broad re-calibration of internal TLAC and LTD as suggested above, we suggest the following:

- The Board should permit a reduction of TLAC and LTD as recommended in Section I and Section II above for non-resolution IHCs with parents that meet or exceed U.S. requirements.
- We also strongly recommend that the Board give extra consideration to this subset of non-resolution IHCs with strong parents, and permit them to satisfy half of their internal LTD requirements (if retained by the Board in the final rule) or up to a quarter of their internal TLAC requirements through legal parent obligations to contribute assets to the covered IHC upon certain triggers that would precede resolution.

IV. Maximizing Scope, Diversity, and Liquidity of Funding

A broad, deep and liquid market will be important for the industry to achieve the high level of loss absorbency required by the proposed rule and similar rulemakings in other jurisdictions. The proposed rule imposes unnecessary restrictions on market making that could limit the scope and diversity of funding sources. While some limits are necessary to avoid excessive contagion risk, it is also essential that this market be well-structured and liquid.

We also believe that the proposed rule imposes unnecessarily restrictions on the eligibility requirements for external LTD, excluding important markets that provide valuable and usable loss absorbency. The current exclusion criteria would likely disqualify most, if not all, of the existing stack of outstanding LTD issued by BHCs. This would multiply the Board's estimate of future financing needs by a large factor, and increase the costs of transition significantly. Finally it would confound the current loss-bearing assessment of this debt by investors, who have been (rightly) convinced that the US now has an effective strategy to impose loss and recapitalization needs on the existing BHC debt stack. This has been an important policy achievement of the last few years in the United States[34], and it would be unfortunate to reverse this. Below, we comment on eligibility criteria for external LTD and TLAC.

[33] See FINMA, "New 'too-big-to-fail' capital requirements for global systemically important banks in Switzerland," October 21, 2015.

[34] See the GAO analysis in its report "Large Bank Holding Companies: Expectations of Government Support," published July 2014 (available at: http://www.gao.gov/assets/670/665162.pdf). Our own analysis indicates that this improvement in market risk pricing has gone further since that report, when estimated by

A: The Final Rule Should Include a Market-Making Exemption from the Cross-Holdings Capital Deduction Requirement

i) Importance of promoting robust liquidity for TLAC

We estimate that the market for global TLAC will amount to roughly $4 trillion, even before the emerging market G-SIBs are included. To attract and support an investor base of this size in the capital markets will require robust market making. Fixed income markets in particular have been historically built upon market making by dealers, and some aspects of the current rule could make such market making more difficult.[35]

ii) Market-Making Exemptions to the Cross-Holdings Capital Deduction Requirement

In our view, there should be allowance for market-making under the cross-holdings capital deduction framework in order to support market liquidity and ensure breadth of the TLAC market. The deduction framework presents an obstacle to the development of an efficient market for TLAC-eligible LTD. We acknowledge the risk of contagion and agree that cross-holding risks should be managed for prudential reasons. Banks, however, need to be able to play a critical market-making role to offer investors liquidity that supports an orderly and deep secondary market. This intermediation role is one that banks have traditionally played and is subject to a number of limits, including the Volcker Rule's requirement that market-making inventory be designed not to exceed reasonably expected near-term customer demand.

By our estimation, very little TLAC-eligible LTD is held in U.S. bank treasury department portfolios for investment purposes. In contrast, the participation of banks in the capital markets and secondary trading for TLAC-eligible LTD is necessary and substantial. Such participation is important to ensure efficient pricing and global distribution of such debt. Investors take confidence in primary market offerings that are underwritten by a large syndicate of banks. Investors are further reassured by the number of secondary trading desks that are willing to quote markets and transact in the outstanding debt of other banking institutions as well as their own bank. These factors directly contribute to a stable and deep market as investors trust that changes in investment strategy can be executed efficiently.

To ensure the transition of the debt market to one that accepts write-down features and absorbs the projected volumes, capital markets functions must have the capacity to hold TLAC eligible debt in inventory. The inventory will have a high degree of turnover as the aim is market support and not buy-and-hold. Contagion risk will be addressed by

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comparing the relative trend of 2 indices – one for large bank credit spreads, and the other for small-to-mid-sized bank credit spreads

[35] The estimated RWA for the global G-SIBs is $16.5 trillion (June 2015 figures, ex China). Assuming a global TLAC requirement of 18% of TLAC plus capital conservation buffer, G-SIB buffer and a modest management buffer, we estimate that the cumulative requirement will amount to $3.9 trillion before the effect of other tests (such as the US LTD test), exclusions and haircuts, and possible national "gold plating" (such as Switzerland) are considered.

market and credit risk oversight functions within a bank, which generally monitor single name, industry, and country exposures as well as price sensitivity metrics, and would also be subject to large exposure constraints. Numerous regulatory restrictions also apply, and the toughness of the current regime has been noted frequently in the recent concerns over reduced dealer capacity. Disciplined market making capability by banks is crucial for aforementioned investor confidence that results in a large and diverse group of investors. Indeed, fostering and sustaining this larger global demand for TLAC eligible LTD will help distribute TLAC more widely and prevent the build-up of risk concentrations in the hands of a few investors, minimizing the potential for contagion amid distress in the banking industry.

iii) Market-Making Exemptions for "own" TLAC

A particularly salient issue is the treatment of own-TLAC issued by covered BHCs. The proposed rule would require covered BHCs that make a market in their own TLAC to immediately deduct any such holdings against total capital. This feature is inherently unreasonable, and violates the traditional corresponding deduction approach. In fact, it would result in a worse outcome than never issuing the TLAC in the first place. Banks are often major market-makers in their own issues and this approach would severely disrupt the substantial liquidity that is provided by bank issuers today.

Current accounting principles generally require that firm who repurchase their own securities to net them down against the relevant balance sheet liability. However many banks are also permitted to have a short market making period before complicated extinguishment procedures are executed.[36] In the event that the proposed rule was applied, the firm would be subject to two calculations – a deduction against total capital in an initial market making period, and a net-down treatment (effectively a corresponding deduction calculation) after the market making period had elapsed. This would lead to unnecessary volatility in capital calculations, and – strangely – treat short term trading positons more harshly than longer term positions.

There are several possible solutions to this concern, in addition to the general cross-holdings recommendations above. One strategy that would provide an effective safe harbor for proportionate market making – without compromising the goals of the TLAC minimum requirement – would be as follows:

- G-SIBs are likely to have a significant amount of bail-in TLAC-type instruments that do not count as TLAC because of having fallen below the one-year threshold (i.e. a 100% haircut). On average, this is likely to represent an average 10-20% of the bank's non-equity TLAC, assuming a typical new-issue maturity of 5-10 years.

[36] For example, assets and liabilities need to be transferred between legal entities before they can be netted down; income statements and equity accounts have to be adjusted for discounts or premia, etc. Some of these can lead to unnecessary volatility in important disclosures like capital accounts. However, our understanding is that the allowance for any such suspension of normal net down procedures is typically limited and only allowed for a short period.

- While such positions do not count as TLAC, they do constitute substantial resources available for bail-in at the moment of resolution.
- Banks that hold short-term, market-making asset positions in their own paper should be able to first offset this against the bail-in resources provided by TLAC liabilities in the 100% haircut zone. Such an approach would still ensure that the institution always had a net surplus of bail-in liabilities, above the minimum standard. Further conservatism could be added, if desired, by adding a cutoff below, say, 60 days liabilities.

We believe this system could provide a useful market making safe harbor without jeopardizing the resolution resourcing provided by TLAC. In the event that there was any residual asset holdings (i.e. that were not offset by the above mechanism), they should be deducted from issued TLAC, not against total capital (i.e. a corresponding deduction approach). In any case, we believe that the capital-deduction approach proposed in the rule is unwarranted and unnecessarily complex and onerous, and that a corresponding deduction approach would be much more appropriate.

B: The Governing Law Restriction on Foreign Debt Should be Removed

Under the proposed rule, debt securities that are not "governed by the laws of the United States or any State thereof" are excluded from eligible debt securities.[37] The NPR states that the rationale for this provision is that eligible debt securities 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."[38] This rationale is therefore premised on a concern that LTD securities governed by foreign law may not be available to absorb losses because any actions taken to do so under a U.S. bankruptcy or Title II proceeding could be subject to successful legal challenge in foreign jurisdictions. As a result of this restriction, significant amounts of LTD, including plain vanilla LTD securities, will not qualify as eligible LTD.

We wish to associate ourselves with the more detailed points made in the The Clearing House Association "The Clearing House," Securities Industry and Financial Markets Association "SIFMA," the American Bankers Association "ABA," Financial Services Roundtable "FSR", and the Financial Services Forum "FSF" (collectively "the Associations") relating to covered BHCs.[39] In short, we agree with the Associations that there is not "any material risk that any actions taken in a U.S. bankruptcy or Title II proceeding to impose losses on LTD securities governed by foreign law or to use them to recapitalize covered firms would be subject to successful legal challenge in foreign jurisdictions." Therefore, in the interest of maximizing the amount of available LTD and TLAC, we recommend that the Board remove from its final rule the exclusion of foreign-law LTD from the definition of eligible debt securities.

[37] 80 Fed. Reg. at 74937.

[38] 80 Fed. Reg. at 74937.

[39] See The Associations' U.S. G-SIB Comment Letter, Part IV "Eligible Debt Instruments," Section B.

However, we also suggest that future issuance under foreign law should include contractual language whereby investors recognize the resolution/bail-in powers of the relevant U.S. regulators. This would provide an additional degree of legal comfort and also further the objectives of transparency sought by the Board.

C: The 50 Percent Haircut on External LTD Should be Eliminated

As noted earlier, the proposed rule would apply a 50% haircut to the principal amount of any eligible debt security with a remaining maturity between one and two years. As a result, covered BHCs may only count half of the principal amount of the eligible debt securities in this maturity window toward their minimum LTD 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."[40]

Per our earlier discussion in the context of internal LTD, this additional discount is cumbersome and unnecessary and will create discontinuities between U.S. requirements and international requirements, which is especially relevant for a rule that is primarily intended to improve cross-border coordination. The existing discount of all otherwise eligible debt securities within one year is already conservative in our view, and it would be better if the final rule adopted the international standard in this instance. As such, we recommend that the Board eliminate the 50 percent haircut on eligible debt securities with a remaining maturity of between one and two years

D: Principal-Protected Structured Notes Should be Eligible for Inclusion as External LTD

Structured notes ("STNs") instruments provide important loss capacity and increase the scale and diversity of TLAC. The global market for structured notes is estimated at approximately $600 billion, and this investor base is more sophisticated than that for vanilla bonds.

We feel that a crisper – and more appropriate - definition of structured notes would restrict the term strictly to instruments that are subject to principal reduction based on the performance of a derivative or index calculation. Such non-principal-protected STNs can still bear loss (and should not be discouraged in clean holding company calculations) but are difficult to count in a reliable way for TLAC, simply because the amount of recapitalization resources can vary. In contrast, we believe principal protected structured notes provide a usable, stable, and important source of loss bearing capacity and that the rule should be stated clearly to permit them. In our view, the proposed rule's prohibition on the inclusion of principal-protected long-term STN instruments as eligible LTD should be removed. In addition, all long-term STNs should be excluded from the 5% cap under the Clean Holding Company framework.

[40] 80 Fed. Reg. at 74936.

In our view, the justifications in the proposed rule for excluding principal protected STNs from eligible debt instruments are unpersuasive. The NPR states that STNs include "features that could make their valuation uncertain, volatile, or unduly complex." However, the holder's claim in a principal-protected STN is as certain, fixed & simple to determine as the amount of a holder's claim on plain vanilla notes with a fixed or floating interest rate under a principal-protected STN.

The proposed rule also justifies its exclusion of STNs because they are "typically customer liabilities (as opposed to investor liabilities)."[41] However principal-protected STN investors are a widely dispersed pool of sophisticated, high-net-worth investors that actively seek an instrument with a risk-return profile. They are also typically unleveraged. They are therefore generally well suited to evaluate and absorb losses. Moreover, they add diversity to TLAC composition, and provide an additional channel of issuance. Therefore, inclusion of principal-protected STNs can help avoid cases of an unnecessary buffer breach. To the extent that the Board is concerned about exposing small-scale customer holdings to resolution losses, such concerns could be easily addressed by other suitability tests, such as minimum denomination requirements.

A better solution would be to define structured notes as any note or portion of a note, where the principal may be reduced due to a linkage to a derivative index or instrument (plus a clarification that denomination in a foreign currency would not trigger such disqualification). This would permit principal-protected STNs to be eligible as external LTD. Other STNs could still be issued out of the HoldCo, but would be in the "gray bucket" i.e. not characterized as "excluded liabilities", but rather treated in a similar fashion to eligible debt that is has less than one year of remaining maturity left.

E: Legacy LTD should be Grandfathered Under the Final Rule

An unnecessary exclusion of the existing senior debt stack could have adverse effects for the credibility of the U.S. resolution regime. The U.S. authorities have educated investors on the loss absorption risks inherent in existing debt instruments, and achieved hard-won market credibility around their powers and intent in the market and with rating agencies.[42] It is our view that the Board should, at a minimum, grandfather existing LTD and hybrid securities in order to avoid wide-scale market disruption.

[41] 80 Fed. Reg. 74935

[42] See, for example: Government Accountability Office, "Large Bank Holding Companies: Expectations of Government Support," July 2014. Credit Suisse trend data for different U.S. bank sectors indicates that these market trends have continued – even strengthened since the date of the report. See also: Martin J. Gruenberg, "A Progress Report on the Resolution of Systemically Important Financial Institutions," Speech at the Peterson Institute for International Economics, May 12, 2015; Paul Tucker, Oral Remarks at Ending Too Big to Fail: Reform and Implementation, a conference co-sponsored by the Hoover Institution and the Bipartisan Policy Center, January 22, 2016 (available at: http://www.hoover.org/events/ending-too-big-fail-reform-and-implementation); Paul Tucker, Solving Too Big to Fail—Where Do Things Stand On Resolution?, Remarks at the Institute of International Finance 2013 Annual Membership Conference, October 12, 2013 (available at: http://www.bankofengland.co.uk/publications/Documents/speeches/2013/speech685.pdf) – "U.S. authorities could resolve most US SIFIs right now."

Failure to do so could also confuse markets and reverse the hard-won market credibility of U.S. resolution techniques, who have successfully educated investors and ratings agencies on the loss absorption risks with existing debt instruments.

We believe that the exclusions in the currently proposed rule would invalidate much of the outstanding debt stock of the US covered BHCs, and create impacts significantly beyond what the estimates set out in the proposed rule, in terms of the estimated quantitative gap to compliance. It would substantially increase the difficulty and cost of compliance, and does not justified by an essential policy requirement.

We also believe that the existing LTD of most covered BHCs provides a very large amount of usable loss absorption and recapitalization capacity. The investor market has been conditioned to value them and tread them with this expectation. The gradual elimination of the "too big to fail" market uplift is an important policy objective, and our data shows this to have been largely or fully achieved with the effort of many years.[43]

Exclusion of existing BHC LTD could also create confusion over historical communications by the US authorities, which rightly promoted their ability to execute SPOE (for example under Title 2) with existing bank securities today. Credibility and consistency is an important regulatory asset. We believe a retreat from this achievement would be unfortunate in many dimensions. BHCs would likely need to issue a new class of more junior securities (with potential legal or market complications), or buy back / restructure existing debt (or both) to meet the compliance standard in time. Such outcomes would inadvertently reward skeptics who believed their debt holdings would be protected via bail-outs. For many reasons, both policy and practical, we recommend that the proposed rule be modified, and that the final rule should adopt some combination of changes to debt qualification and permanent grandfathering of otherwise usable debt.

V. Conclusion

We believe that the development of a TLAC requirement in the United States is a crucial milestone in the elimination of the TBTF problem, and will ensure the durability of a successful reform. The rule will also have profound implications for the structure of the world's largest international banks and for major funding markets. Implementation at scale and across market cycles is essential for ultimate success.

In our comment letter, we suggest a few areas where we believe that the rule may have unintended and adverse consequences. In particular, we believe that internal TLAC for non-resolution IHCs should be focused on the essential purpose of supporting cross-border SPOE resolution. We seek to remedy certain aspects of the proposed rule that treat IHCs unfairly compared to U.S. firms – treating them much more harshly than similarly sized BHCs despite having a historically reliable source of strength from their parent firms. We suggest a few critical fixes that we believe would result in a simpler, yet stronger, final rule

[43] Ibid.

I. Address super-equivalence, complexity and fairness concerns by focusing the rule on the two primary TLAC requirements (RWA and SLR) and eliminating the other tests (the LTD requirement and the Tier 1 leverage test). We also seek to eliminate the current conversion/cancellation requirement in order to avoid substantial cost increases, including material tax costs that are unfair relative to those imposed on covered BHCs. We also suggest that preferred stock should count towards internal LTD, in the event that the internal LTD requirement is retained.

II. Recalibrate internal TLAC to a revised standard that will improve group resilience, and enhance global financial stability. The level of internal TLAC should be reduced to 75% of the ratio for covered BHCs (i.e. the external TLAC requirement), and a portion of this requirement should be met through legal parent contribution agreements. If internal LTD requirements are retained by the Board, we recommend that they be reduced to no more than 33% of the final internal TLAC limit.

III. Robust parent "source of strength" should be considered as an important positive factor. In the event that the recommendations set out above are not altered for all IHCs operating in the U.S., we believe that they should be allowed for FBOs whose parents are subject to standards that are deemed equivalent to or above U.S. standards for covered BHC's.

IV. With respect to external TLAC, we believe that it is critical to maximize the scope, diversity and liquidity of funding. We recommend that the final rule remove three of the existing requirements that could unnecessarily frustrate the qualification of much of the U.S. debt stack, or at least grandfather these securities. We also recommend certain elements to support robust market making capacity.

We believe these suggestions would strengthen the final rule materially, and we respectfully submit them for consideration.

Annex 1: Responses to Select Questions

Question 6: Should eligible external LTD with a remaining maturity between one and two years be subject to a 50 percent haircut for purposes of the external TLAC requirement, by analogy to the treatment of such eligible external LTD for purposes of the external LTD requirement.

The additional complexity and conservatism introduced by the 50% haircut for LTD with a maturity of one-to-two years is unnecessarily burdensome for both TLAC and LTD purposes. It is inconsistent with FSB standards, which will affect the relative position of U.S. bank ratios, and could also lead to difficulties when compared to internal TLAC when applied on a cross-border basis. The full deduction of debt with a maturity of less than one year is already amply conservative, and would ensure adequate LTD in the event that a failure is prolonged.

The proposed deduction regimes might also be considered valuable for the purpose of establishing a smooth maturity profile, which was not unduly subject to spikes at particular maturity dates. This is a reasonable consideration but could be managed more easily by simple oversight of the maturity ladder

Question 10: The Board invites comment on the benefits or drawbacks of permitting long-term debt issued by a subsidiary of a covered BHC to count as eligible external LTD, and on whether there are other means to ensure that the debt be available to absorb losses anywhere within the banking organization.

For SPOE firms with multiple significant subsidiaries, we suggest that only HoldCo debt (or similarly situated Special Purpose Vehicle ("SPV") issued debt) should count as eligible external LTD. For MPOE firms, or firms based around a single subsidiary, it is possible to see the rationale for inclusion of subsidiary LTD, provided it provided the requisite amount of subordination when compared to the operating liabilities in that resolution entity chain.

We also note that there may be transitional situations where counting subsidiary debt may be important. For example, if BHC with outstanding external TLAC is purchased by another entity, this element of the rule could immediately disqualify the entirety of its existing eligible LTD. The Board may want to consider means whereby outstanding loss absorbency and TLAC qualification from existing debt could be maintained for a transitional period, until this debt could be refinanced by the purchasing entity.

Question 12: The Board invites comment on the proposed definition of eligible external TLD, including whether such debt securities should be allowed to include any of the features discussed above. The Board also invites comment as to the impact that the proposed restrictions would have on the bindingness of the proposal for covered BHCs. Please provide data supporting your answer.

As noted in Part IV of the main body of our letter, the definition of eligible external LTD in the proposed rule is unnecessarily tight, and excludes important markets that provide valuable and usable loss absorbency. We agree with the comments made in the Associations' letter[44] concerning U.S. G-SIBs that the prohibitions on non-U.S. law debt, structured notes, and debt with acceleration clauses are inappropriate and unnecessary.

Exclusion would likely disqualify most, if not all, of the existing stack of outstanding LTD issued by BHCs. This would multiply the Board's estimate of future financing needs by a large factor, and increase the costs of transition significantly. Finally it would confound the current assessment of this debt by investors, who have been (rightly) convinced that the United States now has an effective strategy to impose loss and recapitalization needs on the existing BHC debt stack. This has been an important policy victory of the last few years in the United States,[45] and it would be highly unfortunate to reverse this, and confuse investors on such an important issue.

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?

A sensible maturity ladder is an important regulatory objective. However, we believe that a hard quantitative requirement is unnecessary and possibly counterproductive. The existing sanctions for non-compliance are substantial, and management will be incentivized to issue additional TLAC to avoid them. Reasonable supervision of the maturity ladder should provide further and sufficient assurance.
We oppose a hard rule on maturity distribution because shifting conditions may dictate different solutions. For example, in a period of extreme stress, markets may well force some shortening of the maturity profile, with additional supply coming primarily at short maturities. This may be the "least bad" solution to such an environment, and this would

[44] As noted earlier, "the Associations" refers to The Clearing House Association "The Clearing House," Securities Industry and Financial Markets Association "SIFMA," the American Bankers Association "ABA," Financial Services Roundtable "FSR", and the Financial Services Forum "FSF."

[45] See the GAO analysis in "Large Bank Holding Companies: Expectations of Government Support," July 2014. Our own analysis indicates that this improvement in market risk pricing has gone further since that report, when estimated by comparing the relative trend of 2 indices – one for large bank credit spreads, and the other for small-to-mid-sized bank credit spreads.

still ensure a large quantum of loss absorbing capacity is maintained even at a difficult time.

Question 25: The Board invites comment on alternative approaches for determining the scope of application of the proposed internal TLAC and LTD requirements. Should the Board apply the proposed internal TLAC and LTD requirements to all U.S. intermediate holding companies required to be formed under the IHC rule rather than limiting it to U.S. intermediate holding companies that are controlled by foreign G-SIBs?

As noted in Part I of our letter, it is unfair to subject covered IHCs to a much higher standard than similarly sized domestic firms. IHCs are generally much smaller than covered BHCs.

The stated purpose of the rule is to ensure the financial stability of the United States.[46] Given this purpose, the primary focus of qualification should be on the size, interconnectedness and other attributes of IHCs when compared to the footprint of U.S. financial entities that they compete with. The current rule places tough standards on IHCs which are not applied to similarly-sized domestic firms – despite the fact that an IHC with a strong parent will be stronger, ceteris paribus, than an entity with no economic source of strength. The strong history of foreign owned firms provides strong testament in this regard. We believe that the current rule is fundamentally misguided and unfair on this point.[47]

As a more general point, it would also be helpful to modify the underlying architecture of qualification and calibration for IHCs. The current rule produces a significant discontinuity – an on-off switch – when a bank becomes a G-SIB. This discontinuity affects both covered BHCs and covered IHCs, despite the fact that the underlying risks of resolvability are not similarly discontinuous. It would be better to establish resolution-based requirements on a more graduated basis. For example, foreign banks that are near-G-SIBs with a material presence in the US should qualify for a moderated version of the rule. We also recommend that the rule should provide for a simple gradation to reflect the source of strength benefits from firms that are subject to strong consolidated requirements.[48]

In this regard, we recommend consideration of an approach similar to that taken by the Bank of England, which separates UK banks into three tiers for the purpose of calibrating its Minimum Requirement for Own Funds and Eligible Liabilities ("MREL")

[46] See, for example, the cover note to the Board by Governor Tarullo dated 22 October 2015 to introduce the rule.

[47] As noted in our cover letter, we acknowledge and support the need for some (re-designed) internal TLAC to promote an effective global resolution of SPOE banks such as Credit Suisse for the purpose of global stability and home country stability.

[48] For example, the Swiss "too-big-to-fail" requirements set out a TLAC standard of 28.6% in RWA terms, well above the FSB and even the U.S. standards.

& TLAC requirements. In that framework, no TLAC requirements are applied to the smallest tier of banks, which are required only to fulfil normal capital requirements. In contrast, full TLAC requirements are applied to the largest tier of banks, and a graduated calibration is applied to the middle tier. Such an approach would help avoid discontinuities, and possible gaps in the resolvability of mid-sized institutions. It would also help with transitions over time as institutions shift in size.

Question 26: Is the proposed method for determining whether a foreign banking organization is a foreign GSIB—application of the relevant portion of the Board's G-SIB surcharge rule to the foreign banking organization's balance sheet—an appropriate method for making that determination? Would an alternative method for identifying foreign G-SIBs—such as looking to whether the foreign banking organization has been classified as a GSIB by its home supervisory authority or by the FSB—be more appropriate?

We believe that the FSB standard for identifying foreign G-SIBs is fully sufficient, and that requiring a backup calculation is unnecessary, burdensome, and largely redundant.

Moreover, as discussed in the text of our letter and our response to question 25 above, we believe that the proposed rule's focus on the global size of the institution is unfair and inappropriate. It mostly ignores the size of the U.S. footprint, especially in comparison to like-sized U.S. financial institutions. But if retained, the existing global qualification provides a very large margin of safety for the scope of application, and would identify and include even fairly small IHC entities that pose no substantive danger to the U.S. financial system. This buffer provides an additional reason that a separate U.S. calculation is excessive and unnecessary.

Question 28: The Board invites comment on all aspects of the proposed calibration of the internal TLAC and LTD requirements, including any impact on the internal funding structures of the covered IHC's parent foreign bank.

As we discuss in our cover letter and in Part II of the main body of our letter, internal TLAC is fundamentally different than external TLAC, and exists primarily to incentivize and ensure the support of US operations by a foreign parent, and – if necessary – the success of an efficient global SPOE resolution. The proposed rule does not take this into account sufficiently, and thereby creates unnecessary costs and several risks. In particular, the size and nature of a heavy, fully-funded internal TLAC requirement creates greater misallocation risk, which could reduce the resilience of G-SIBs. We strongly believe that the proper intent of the rule is to strengthen global financial resilience and that improvements to this element of the rule would provide important benefits and help meet the Board's overall objective.

Our specific recommendations and arguments are set out in more detail in our letter but they include:

- Elimination of the LTD requirement; the TLAC part of the rule is entirely sufficient;
- Elimination of the U.S. Tier 1 leverage test for firms that calculate an SLR basis; the SLR provides a more complete estimate of unweighted exposure[49];
- Inclusion of preferred stock as an eligible instrument, for both the TLAC rule and the LTD rule if retained;
- Reduced calibration of the TLAC requirement to the lower end of the FSB's intended range (75%) for non-resolution entities; and
- The ability to use non-cash instruments, such as CCAs, guarantees or keepwell agreements to qualify for a portion of the TLAC and LTD. Such instruments can provide a high degree of assurance of foreign support, and provide other benefits. They enhance and clarify existing economic interests of FBOs to support their US operations with an additional and clear legal duty. Such non-cash instruments would reduce brittleness and misallocation risks mentioned elsewhere in our letter, but still provide strong assurance to US authorities. If the allocation of funds under such agreement is subject to an "early" trigger (i.e. very soon after the incurrence of loss), the quality of this support will be high.

Question 29: The Board invites comment on its proposed method for identifying covered IHCs that are non-resolution entities.

The certification method suggested in the rule is well designed and can help to create clear understandings between supervisors in different jurisdictions. Our only concern is whether there are legal or policy difficulties that may prevent foreign resolution entities from providing a certification. Assuming that any such legal concerns can be addressed, we support this element of the proposed rule.

Question 30: The Board invites comment on whether, instead of being subject to differing internal TLAC requirements on the basis of whether or not they are non-resolution entities, all covered IHCs should be subject to either the lower proposed internal TLAC requirement or to the higher proposed internal TLAC requirement.

[49] The text of the rule indicates that the U.S. Tier 1 leverage test is necessary for competitive equity with smaller IHCs that don't calculate an SLR. This is a strange argument for fairness, as it ignores the majority of the competitive landscape. U.S. owned firms are not subject to this test at all (covered BHCs are subject only to SLR and non-covered BHCs are not subject to any such limit). Since U.S. owned firms are the dominant competitive element in the market, any argument from "fairness" would therefore exclude the imposition of an additional leverage test. The issue of fairness within the IHC category can be addressed easily by offering non-SLR firms the opportunity to calculate an SLR if they wish to opt out of the leverage requirement.

There is a fundamental difference between MPOE (i.e. a resolution entity) and SPOE (i.e. a non-resolution entity) IHCs. We believe that this difference justifies a greater differential between the two methods – a larger discount to reflect the benefits of stated support by the parent. As noted previously, significant FBO entities have an exceptional credit record in the United States, and have contributed meaningfully to broader financial stability. In the recent crisis, no significant foreign firms failed; in fact, many provided an important island of stability in a turbulent storm. Firms that have a non-resolution IHC explicitly accept responsibility to continue this record of support; they should be given a bigger discount to recognize this factor and this historic track record. Such a discount will also reduce certain risks noted in the body of our letter and in Question 28, and work to improve overall stability.

Question 31: The Board invites comment on whether to eliminate the proposed internal TLAC requirement and subject covered IHCs to the proposed internal LTD requirement only.

As noted in our letter (pp 16-17), we recommend the Board take the opposite approach. The internal TLAC requirement, together with existing supervisory powers, is fully sufficient to achieve the aims of the proposed rule. The internal LTD requirement is unnecessary and can result in strange outcomes: for example, is it appropriate to sanction an IHC that meets both its capital and its internal TLAC requirement in full, but happens to do so with an internal TLAC mix that is a bit too equity-orientated? We do not see the benefit of such a scenario for financial stability purposes.

One key benefit of an LTD requirement for external LTD is that it ensures a significant and liquid pool of securities that provide a "monitoring function." External LTD subject to bail-in will price primarily on the analysis of downside risks.[50] The market pricing of external LTD will provide an important disciplinary tool for management, and will also provide an important, independent assessment of firm health to supervisors. We believe these provide important benefits of some external LTD for BHCs, and for resolution-entity IHCs, (though at a more moderated level than in the existing rule).

However, internal TLAC is held privately (for non-resolution IHC entities), and therefore provides none of these market-monitoring benefits. While most IHCs are likely to use some internal LTD to meet their internal TLAC requirements, we do not believe that a limit which requires a fixed amount of internal LTD is a useful feature of the new regime for non-resolution entities. We recommend that this requirement be eliminated (or at least greatly reduced); a rule based solely on internal TLAC is fully sufficient to meet the Board's objectives.

[50] Equity does not perform a clear risk monitoring function, as investors focus both on upside and downside elements.

Question 32: The Board invites comment on all aspects of the proposed definition of eligible internal TLAC.

As noted above, we believe that other forms of support - CCAs, guarantees or keepwells - can provide an important and beneficial alternative to "funded" internal TLAC. We believe that inclusion of such tools would have important policy benefits for US financial stability, as well as global resilience. We do not suggest that all cash capital or other TLAC instruments should be replaced, but a partial substitution of CCAs for the requirements of the proposed rule would provide significant benefits. See pp. 23-24 of our letter.

We discuss subordination and tax elements on pp. 18-21 of our letter.

Question 33: Should eligible internal LTD with a remaining maturity between one and two years be subject to a 50 percent haircut for purposes of the internal TLAC requirement, by analogy to the treatment of such eligible internal LTD for purposes of the internal LTD requirement?

No. This additional discount is cumbersome and unnecessary; it will create discontinuities between US requirements and international requirements. Such discontinuities are especially relevant for a rule that is primarily intended to improve cross-border coordination. The existing discount of all debt inside 1 year is already conservative in our view, and it would be better if the US rule adopted the international standard in this instance.

Question 34: The Board invites comment on the appropriateness of subjecting eligible internal LTD to the same requirements as apply to eligible external LTD.

As noted in both our cover letter and in Part II of the main body of our letter, there is a fundamental difference between internal and external LTD, and we believe the rule needs to be modified to account for this. See answers to question 31 and 32 for further details.

In particular, we believe that CCAs, guarantees and keepwell agreements should qualify for internal LTD for non-resolution entity IHCs, as discussed in Q32 and in the body of our letter. In addition, preferred stock should fully qualify as eligible internal LTD. It is deeply subordinated, and has an easily estimable fixed value. We believe that preferred shares meet all of the important elements that are necessary for this part of the rule to function as intended.

Question 36: The Board invites comment on all aspects of the requirement that eligible internal LTD be issued to a foreign parent entity that controls the covered IHC. In particular, the Board invites comment with respect to whether covered IHCs that are expected to enter resolution themselves in a failure scenario should be permitted to issue eligible internal LTD to third parties, as covered BHCs would. Should internal LTD be required to be issued to the top-tier foreign parent of the covered IHC?

For non-resolution entity IHCs (SPOE firms), it is reasonable to require that all eligible internal LTD be issued to a foreign parent entity. However resolution-entity IHCs are different in this respect, and should be permitted to issue eligible LTD to third parties. The arguments for outright prohibition of third party debt for this group are unconvincing, and the requirement significantly dilutes the benefit of the MPOE strategy for firms that are organized on this basis. We believe that this element of the rule should be redesigned.

Question 37: The Board invites comment on the appropriateness of the proposed contractual subordination requirement for eligible internal LTD.

We support the need for internal TLAC to be subordinated to operating liabilities, as this feature works to preserve critical functions as well as the franchise value of the IHC. However, the specific requirements for subordination set out in the proposed rule are quite severe, and several of these give rise to tax problems. Such tax problems would have a large effect on cost and competitive fairness. We believe that the requirements should be modified so that the subordination is sufficient to achieve the aims of efficient internal recapitalization without these detrimental effects. Please see pp. 18-21 of our letter for more details.

Question 41: The Board invites comment on whether the proposed prohibition would advance SPOE resolution by helping to minimize the run risk and potential negative externalities associated with issuance of short-term debt by covered holding companies. In particular, the Board invites comment on the appropriate scope of the proposed prohibition and whether the prohibition is sufficiently clear.

A clean holding company requirement for covered BHCs is important and necessary to achieve the objectives of the rule. However, we agree with the arguments advanced in the Associations' U.S. G-SIB comment letter on the proposed rule; that is, in short, that the requirements outlined in the proposed rule are somewhat too stringent and unnecessarily burdensome, and should be modified.

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 TLAC rule already provides sufficient incentives for careful management; and the requirements themselves (together with conservative qualification requirements) are more than ample to address redemption risk. Our analysis of prior historical events indicates that the rule would be sufficient to handle the distress of any G-SIB observed in the 2008 crisis, the most severe event in the modern historical record. Further requirements could impair normal treasury optimization functions, and the legitimate supervisory interests are already addressed.

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.

We support this aspect of the rule. We believe it would be best for all holding company swap transactions to be executed with internal entities, in order the minimize the impact of external market disruption and reduce the complexity of communications at a stressful time.

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.

We believe that the current definition is inappropriate. It is somewhat unclear (see especially footnote 85 on p. 74947 of the Federal Register Notice), and will require considerable interpretation. More importantly, several aspects of this are unnecessary, and would prohibit inclusion of otherwise loss-absorbing debt.

The global market for structured notes is approximately $600 billion, and discarding the potential loss absorbency provided by this market is a mistake in our view. We feel that a crisper – and more appropriate - definition of structured notes would restrict it strictly to instruments that are subject to <u>principal</u> reduction based on the performance of a derivative or index calculation. Such instruments can still bear loss (and should not be discouraged in clean holding company calculations) but are difficult to count in a reliable way for TLAC, simply because the amount of recapitalization resources can vary. We believe that principal protected structured notes provide a usable, efficient, and important source of loss bearing capacity and that the rule should be stated clearly to permit them.

More generally, we support the Associations' arguments on this topic in their U.S. G-SIB comment letter on the proposed rule.

Question 56: The Board invites comment regarding whether a grandfather of existing liabilities that would be subject to the proposed cap would be appropriate. In particular, the Board invites comment on the appropriate design of such a grandfather and the likely impact on covered BHCs and debt markets of the failure to include such a grandfather. Please support your response with data.

We believe that the exclusions in the currently proposed rule would invalidate much of the outstanding debt stock of the covered BHCs, and create impacts significantly beyond what was estimated in terms of the estimated gap to compliance. It would substantially increase the difficulty and cost of compliance, and does not justified by a sufficiently substantial policy driver.

We also believe that the existing LTD of most covered BHCs provides a very large amount of usable loss absorption and recapitalization capacity. The investor market has been conditioned to value them and tread them with this expectation. The gradual elimination of the "too big to fail" market uplift is an important policy objective, and our data shows this to have been largely or fully achieved with the effort of many years.[51]

Exclusion of existing BHC LTD could also create confusion over historical communications by the U.S. authorities, who have (rightly) promoted their ability to execute SPOE resolution (for example under Title II) with existing bank securities today. Credibility and consistency in this respect is an important regulatory asset. We believe a retreat from this achievement would be unfortunate in many dimensions. BHCs would likely need to issue a new class of more junior securities (with potential legal or market complications), or buy back/restructure existing debt (or both) to meet the compliance standard in time. Such outcomes would inadvertently reward skeptics who believed their debt holdings would be protected via bail-outs. For many reasons, both policy-based and practical, we recommend that the proposed rule be modified with some combination of changes to debt qualification and permanent grandfathering of otherwise usable debt.

Question 64: The Board invites comment on all aspects of this potential domestic internal TLAC framework. In particular, the Board invites comment on whether the Board should impose domestic internal TLAC requirements on covered holding companies. If so, how should the Board regulate the following key elements: The *definition of "covered subsidiary"; the calibration* of the domestic internal TLAC requirement with respect to each covered subsidiary; the division of domestic internal *TLAC between "contributable resources" and "prepositioned resources"; the definition of "contributable resources," including whether certa*in non-HQLA resources should be *allowed to count toward the requirement; the definition of "prepositioned resources,"* including any minimum maturity and subordination requirements; and the legal risks associated with passing losses from a subsidiary to a holding company by means of the

[51] E.g., see Government Accountability Office, "Large Bank Holding Companies: Expectations of Government Support," July 2014.

mechanisms described above in the context of SPOE resolution, including risks under insolvency law, as well as potential mitigants for these risks.

We understand much of the Board's reasoning for a domestic internal TLAC requirement, and acknowledge many of these considerations. While domestic internal TLAC is strictly speaking not necessary – by definition - to avoid cross-border trust issues, some elements of a domestic internal TLAC regime do perform useful functions:

- It helps to ensure a clear pathway by which losses can be upstreamed and capital downstreamed; and
- It helps to establish a clear legal requirement, to mitigate possible legal concerns about director's duties to or any delays due to legal entity valuation elements.

These benefits could be achieved <u>without</u> domestic internal pre-placement of TLAC – for example by CCAs, keepwells or guarantees. These benefits are important, and should be addressed ex ante to reduce uncertainties and delays in the event of resolution.

A more complex consideration is the balance of internal TLAC allocation between domestic and foreign subsidiaries. A domestic internal TLAC requirement could address this issue for entities that have significant foreign requirements, by creating a positive specific requirement for a minimum internal TLAC investment in domestic subsidiaries. However, as noted in a prior section, a fully cash funded strategy has drawbacks, in particular with respect to increased brittleness and misallocation risk. These risks become substantially more binding if domestic internal TLAC is added to the sum of foreign internal TLAC, because the size of domestic subsidiaries is often a large portion of the whole.

We think that a better strategy to accomplish the underlying aims would avoid a specific domestic internal TLAC requirement for covered BHCs, but address the concerns noted above with a different solution. We suggest a constraint by which the Board could assure itself that each covered BHC did not dedicate too high a proportion of its External TLAC to offshore subsidiaries (i.e. to meet the Internal TLAC requirements of other countries), when compared to resources that might be necessary to address domestic stress. If a large portion of a BHC's external TLAC was invested abroad, this could result in misallocation risk, sacrificing potential support for domestic operations. A "negative requirement" - to ensure that a substantial proportion of covered BHC external TLAC remained free for domestic use – would provide a better solution to this issue, because it reduces the largest source of down-streaming pressure that can produce misallocation risk.

One further note: the Board is the first among international regulators to set-out internal TLAC requirements. There is a material likelihood that the relatively "heavy" cash-funded strategies advocated in this proposed rule will be replicated abroad – unless changed in the final rule - for reasons of precedent, or reasons of parity. If other countries do copy the terms of the proposed rule, we believe that there will be significant pressure towards misallocation risk, because of the high cash down-streaming requirement. Another key reason why we advocate for a lower internal TLAC requirement for IHCs in earlier questions is to avoid the misallocation risk that could arise if the proposed rule was copied by other regulators globally.

Question 65: The Board also seeks comment on whether, in a domestic internal TLAC framework, contributable resources and prepositioned debt should be required to be subject to a capital contribution agreement that would impose upon the covered holding company a legal obligation to recapitalize the subsidiary upon the occurrence of a trigger outside the firm's discretion (such as the current or projected insolvency of the subsidiary, or a government order), and on the appropriate design of such a trigger. Finally, the Board invites comment on whether any domestic internal TLAC framework proposed by the Board should treat foreign subsidiaries of covered holding companies differently from their domestic subsidiaries.

We believe CCAs could be an important tool in this respect, and support their use as an important component of internal TLAC, for both domestic and foreign operations. While local subsidiaries are do not face any cross border trust considerations, it is important for SPOE firms to back up their economic structure with a clear legal structure and clear incentives to support the primary mode of resolution. We believe that – for both Bankruptcy Code and Title II procedures – it is critical that the execution of the primary resolution strategy has a clear path to success. Some legal clarification of the holding company's duty to support its key subsidiaries – including non-IDI subsidiaries - would be helpful to establish a clear and simplified path to successful resolution. We believe that it is best for such requirements to be general obligations, rather than specifically collateralized, to ensure clarity without creating other constraints.

Question 66: The Board invites comment on the appropriateness of the proposed deduction for investments in a covered BHC's unsecured debt instruments from regulatory capital, including (a) its implementation through amendment of the Board's regulatory capital rules and (b) whether such an approach would impact underwriting and market making for unsecured debt instruments of covered BHCs.

As discussed in Part IV of our letter, we agree that it is important to ensure that TLAC issued under the rule is truly outstanding and held by bona fide third parties. It's important to control the amount of own TLAC that might be temporarily held by the issuer (for example, as part of a market making function). However, we think the Tier 2 deduction approach set out in the proposed rule is misguided, and could result in counterproductive outcomes.

Most G-SIBs make markets in their own debt, and often supply the brunt of the liquidity in this market. Trading liquidity is important for the TLAC market to function properly, and to reach the approximately $4 trillion in global scale necessary to achieve robust loss absorption at the scale required by the FSB and by the United States. A public market of this size will need proper trading support, including robust market making by G-SIBs. We support such market making in own TLAC as an important and valuable element, so long as excessive risk is controlled.

A G-SIB that purchases its own LTD it should be constrained by a corresponding deduction approach (i.e. deducted against the same class of instrument). Deducting LTD against capital can give rise to strange and perverse results. If the Board's rule for a capital deduction were established without modification, this would result in two treatments for market making at many banks. Initially, the rule would require a deduction of long LTD against capital issued (for the market making period). After a defined period[52], the long position would be netted down against issued debt (due to accounting rules) and both would be extinguished; this would reverse the deduction against capital, and shift the deduction to LTD (i.e. a corresponding deduction).

We believe it would is best to avoid such unnecessary volatility in capital calculations, and simply treat long positions consistently, based on a corresponding deduction approach. We see no reason why a short term, market making position should be treated more harshly than a longer term, stale position that happened to become subject to extinguishment. We also recommend that treatment of Question 67 be further applied in this process.

Question 67: The Board invites comment on whether holdings of a covered BHC's debt instruments that result from dealing or market-making activities should be exempt from the proposed deduction, including costs and benefits of such an exemption.

See our answer to question 66 on the importance of market making for the TLAC market. Market making positions in covered BHC own debt instruments are short term in nature (stale positions are typically extinguished). We propose that such short term (market making) investments should be netted first against the short term liabilities that arise from under-one-year issued liabilities that are already eliminated from TLAC (even though they provide good loss absorption at the moment of resolution and otherwise satisfy TLAC criteria). By establishing a safe harbor of this size, the Board would support critical market making, while still assuring itself that there would always be at least the stated TLAC outstanding on a net basis.

[52] Currently, many banks that make markets in their own LTD keep a gross long trading position as an asset for a short period. For accounting policy reasons, if the long position becomes stale, it will then be netted down against the liability (i.e. both the long and the short position would be extinguished).

Questions 69: The Board invites comment on alternatives to the proposed deduction approach, including a stringent risk-weighting approach, integrating eligible long-term debt into the Basel III threshold deduction system as a new class of regulatory capital, or an outright prohibition of bank ownership of covered BHC's unsecured debt instruments.

For smaller banks, we believe that concentration limits are the more appropriate method to control contagion. There are other broadly owned credit classes that can result in similar contagion effects – for example investments in large sectors like energy or technology companies or in real-estate backed debt. It would be strange and unnecessary to subject banking positions to much more severe treatment than these other credit sector risks. Credit sector risk is a natural part of banking (and other portfolio management functions like asset management), and control of these risks should be based within the existing framework of risk-control regulations and supervision (such as large exposure rules).

Question 70: The Board invites comment on whether to expand the proposed capital deduction treatment to cover investments by banking organizations in debt instruments issued by nonbank financial companies supervised by the Board and non-U.S. G-SIBs.

We would recommend expanding capital deduction treatment to TLAC instruments issued by non-U.S. G-SIBs. However, resolution methods and simple systems for identifying TLAC at non-U.S. G-SIBs is still evolving, so we would suggest some deferral of implementation to a later date, when the ability to identify the TLAC relevant loss-absorbing classes will be clearer.