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By electronic submission to regs.comments@federalreserve.gov

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

Re: Comment Letter on the Notice of Proposed Rulemaking on Internal TLAC, LTD, and Related Requirements Applicable to MUFG Americas Holding Corp., the U.S. Intermediate Holding Company of MUFG

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

Ladies and Gentlemen:

Mitsubishi UFJ Financial Group, Inc. ("MUFG" or "we") welcomes the opportunity to comment on the proposed rule (the "Proposed Rule") issued by the Board of Governors of the Federal Reserve System (the "Federal Reserve") that would impose internal total loss-absorbing capacity ("TLAC"), long-term debt ("LTD"), and related requirements on MUFG Americas Holdings Corporation ("MUAH"), the U.S. intermediate holding company of MUFG.[1]

MUFG strongly supports the public policy goal behind the implementation of TLAC, LTD, and related requirements on global systemically important banking groups ("G-SIBs"): ending the perception that certain institutions are too big to fail and will receive extraordinary public support in times of financial stress. We believe, however, that this policy goal can be accomplished through the implementation of the Financial Stability Board's ("FSB") *Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution, Total Loss-absorbing Capacity (TLAC) Term Sheet* (the "FSB Standards") by our home country regulators in Japan (*i.e.*, the Financial Services Agency) and, as necessary, through home-host cooperation between the Federal Reserve and the Financial Services Agency.[2]

We also believe, however, that the potential failure of MUAH -- which has not been independently classified as a G-SIB -- poses a minimal threat to the U.S. financial system and that this minimal threat is adequately addressed by the range of U.S. regulatory requirements, controls, and mechanisms currently in place. As a result, MUFG believes that if the Federal Reserve elects to apply any aspect of the Proposed Rule to MUAH then it should allow for

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

[2] *Principles on Loss-absorbing Recapitalisation Capacity of G-SIBs in Resolution, Total Loss-absorbing Capacity (TLAC) Term Sheet* (November 9, 2015), available at http://www.fsb.org/2015/11/total-loss-absorbing-capacity-tlac-principles-and-term-sheet/ (the "FSB Standards").

several sensible alterations that will achieve the goals of the Proposed Rule while alleviating the substantial funding burdens it imposes.

MUFG is the financial holding company for one of the world's largest financial groups, with consolidated assets of approximately $2.45 trillion as of December 31, 2015.[3] MUFG has offices in over 40 countries and employs more than 140,000 persons worldwide. Headquartered in Tokyo, Japan, MUFG is listed on the Tokyo and Osaka stock exchanges, and is also listed on the NYSE as MTU. MUFG is the global holding company for its primary banking subsidiaries, The Bank of Tokyo-Mitsubishi UFJ, Ltd. ("BTMU") and Mitsubishi UFJ Trust and Banking Corp. ("MUTB"), and for its primary non-banking subsidiary Mitsubishi UFJ Securities Holdings Co., Ltd. ("MUSHD"), a holding company for MUFG's global securities and investment banking operations. MUFG had U.S. consolidated assets of approximately $313 billion as of December 31, 2015 across its two foreign banking subsidiaries, BTMU and MUTB, and its non-banking subsidiary MUSHD, which operates in the U.S. through its wholly-owned broker-dealer subsidiary Mitsubishi UFJ Securities (USA), Inc. ("MUS(USA)"). MUS(USA) employs more than 300 persons in its New York office, and had consolidated assets of $34.2 billion as of December 31, 2015. MUS(USA) concentrates its activities in investment grade debt and equity underwriting and private placements, and also in equity and debt sales and trading. MUFG provides oversight and strategic guidance to all of the entities within its global network, and is the indirect sole shareholder of MUS(USA) and of MUAH and its subsidiaries.

MUAH is currently 100% owned by BTMU. Its principal subsidiary is MUFG Union Bank, N.A. ("MUB"), a regional bank based in California with main banking offices in San Francisco and corporate offices in New York. MUB is an FDIC-insured depository institution concentrating its activities on residential mortgage loans, and commercial and industrial loans. MUAH has more than 12,000 employees and had total consolidated assets of $116 billion as of December 31, 2015. On July 1, 2016, MUAH is expected to become MUFG's intermediate holding company in conformity with Enhanced Prudential Standards ("EPS") requirements established pursuant to Section 165 of the Dodd-Frank Act. In addition, MUAH is expected to assume direct ownership of MUS(USA).

MUFG supports the comment letters submitted by The Clearing House and the Institute of International Bankers regarding the Proposed Rule, and is submitting this letter because we believe it is also important to present our views directly to the Federal Reserve.

Executive Summary

We believe the Proposed Rule unnecessarily departs from the FSB Standards. This departure imposes substantial additional funding costs on MUAH, prejudicing MUAH against its competitors in the marketplace. MUAH's size, business model, and risk profile are akin to that of a regional bank, and as the Federal Reserve is well aware the Proposed Rule does not apply to regional banks. A number of regulatory measures already in place, including EPS, resolution planning, and the 2015 ISDA Resolution Stay Protocol, are adequate to address both the likelihood of failure and the negative consequences of failure. As a result, the additional funding costs the Proposed Rule imposes -- which we estimate to be as much as $81 to $109 million per

[3] Figure based on USD-JPY exchange rate for December 31, 2015.

year for bank holding companies roughly the same size as MUAH -- are not necessary to achieve the goals of the Proposed Rule. In addition, the Proposed Rule departs from the Federal Reserve's own liquidity management principles; those principles direct banks to diversify their funding in the marketplace, but the Proposed Rule will force MUAH to substantially concentrate its funding with a foreign parent. To mitigate the burden of the Proposed Rule, while also achieving its purposes, MUFG respectfully proposes three alterations to the rule. First, in accordance with the FSB Standards, we urge the Federal Reserve to work with the Financial Services Agency in calibrating the TLAC and LTD requirements to the specifics of MUFG. MUFG is extremely well capitalized and well managed, and MUFG's performance during the 2007-2009 financial crisis was exemplary. Moreover, MUFG exists in a home country with no political or legal impediments to assisting MUAH; the Federal Reserve can have no doubts about the ability of MUFG to come to the aid of MUAH in time of financial stress. Second, in accordance with the FSB Standards, we urge the Federal Reserve to use collateralized guarantees in place of LTD. Third, the Federal Reserve should permit MUAH to issue at least a portion of its LTD to third-party investors in a way that avoids change of control issues.

I. APPLYING THE PROPOSED RULE AS IS IN THE U.S. IS EXCESSIVE, PREJUDICES MUAH AGAINST ITS COMPETITION, AND CONTRADICTS EXISTING FEDERAL RESERVE PRINCIPLES

The Proposed Rule is the latest regulatory measure designed to eliminate the possibility and negative effects of a bank failure. In view of existing regulatory measures, however, the Proposed Rule is not needed for a bank with MUAH's comparatively small footprint, and will impose substantial, unnecessary funding costs on MUAH while contradicting existing Federal Reserve principles about maintaining diverse funding sources.

A. Existing Regulatory Measures Eliminate the Need to Apply the Proposed Rule As Is in the U.S.

Irrespective of the application of the Proposed Rule to MUAH, the version of the FSB Standards adopted by Japan's Financial Services Agency will apply to MUFG in Japan because MUFG is a G-SIB. MUFG strongly supports the public policy goals of imposing TLAC, LTD, and related requirements on G-SIBs. As the Federal Reserve notes, the Proposed Rule aims to improve the resiliency and resolvability of G-SIBs and thereby "end[] market perceptions that certain financial companies are 'too big to fail' and would therefore receive extraordinary government support to prevent their failure."[4] The FSB Standards echo these stated goals.[5] MUFG believes that G-SIBs owe to themselves, their investors, their customers, and the broader financial markets a high degree of watchfulness regarding the risks they pose to the stability of the global financial system and, further, that G-SIBs should therefore be required to take steps to mitigate the effects of a potential failure on global financial stability. Accordingly, MUFG fully supports the implementation of the FSB Standards in Japan at the top-tier parent company level of MUFG.[6]

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[4] 80 Fed. Reg. at 74928, 74926.

[5] FSB Standards at 3.

[6] Under the FSB Standards, "[t]he Minimum TLAC requirement for each resolution entity will be set in relation to the consolidated balance sheet of each resolution group." FSB Standards at 9.

MUFG understands that MUAH would qualify as a "material subgroup" under the FSB Standards and would therefore be eligible for the imposition of an internal TLAC requirement within the U.S. Nevertheless, MUFG and MUAH are already subject to, or have already implemented, a wide range of measures that greatly reduce the likelihood of failure and any harmful knock-on effects of failure on the broader financial system.

EPS have already imposed enhanced capital and liquidity requirements and stress-testing measures that will result in increased resiliency against failure and reduce the likelihood of actual failure. In addition, MUFG and MUB have developed detailed resolution strategies -- in collaboration with the Federal Reserve and the FDIC -- that are designed to mitigate the potential harm to the markets that could be caused by the failure of any of the MUFG material entities in the U.S.[7] Indeed, in the Proposed Rule the Federal Reserve calls attention to this collaborative effort as a means of reducing the systemic risk posed by an institution's resolution: "The [Federal Reserve] and the FDIC review the resolution plans, provide feedback on their shortcomings, and set expectations for subsequent iterations of the plans that are intended to improve the organizations' resolvability."[8] As noted below, this same spirit of regulatory collaboration ought to inform the implementation of TLAC, LTD, and related requirements that are tailored to the specifics of each institution, especially in the case of MUFG and MUAH. Finally, MUFG subsidiaries including BTMU are signatories to the ISDA 2015 Resolution Stay Protocol; the Protocol is designed to override cross-defaults in certain financial contracts, further removing any impediments to an orderly resolution and reducing the risk of systemic contagion flowing from failure.[9] In this context, and as further explained below, applying the Proposed Rule to MUAH, a regional bank holding company that is not itself a G-SIB, seems excessive and inconsistent with the goal of ending too big to fail.

B. The Proposed Rule Unfairly Prejudices MUAH Because Regional Banks That Are Not Owned by G-SIBs Will Not Be Subject to the Added Funding Costs of the LTD Requirement

MUFG is deeply concerned that the Proposed Rule unfairly prejudices MUAH against its competitors in the U.S.: while regional banks owned by foreign G-SIBs must comply with the Proposed Rule, those regional banks not owned by foreign G-SIBs escape compliance. As noted, MUAH had assets of $116 billion and MUS(USA) had assets of $34.2 billion as of December 31, 2015. MUAH's peer institutions in the U.S. are other regional bank holding companies, some of which are also owned by foreign G-SIBs. This peer group set will not change with the expected integration of MUS(USA) under MUAH on July 1, 2016 pursuant to EPS: the combined assets of MUAH (pro forma, based on data from December 31, 2015) would equal $150.2 billion, an amount far below that of several institutions that are not subject to the rule. Indeed, banking institutions with far more assets than MUAH, including institutions with assets greater than $225 billion -- some of which have substantially larger footprints in the U.S.

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[7] MUFG 165(d) Resolution Plan (December 2015) and MUB IDI Resolution Plan (December 2015), available at: https://www.fdic.gov/regulations/reform/resplans/.

[8] 80 Fed. Reg. at 74928.

[9] Other signatories are Mitsubishi UFJ Securities International plc, the London-based subsidiary of MUSHD, and Mitsubishi UFJ Morgan Stanley Securities Co., Ltd., a Tokyo-based joint venture with Morgan Stanley.

than MUAH and engage in significant non-banking activities -- escape application of the Proposed Rule, further underscoring how unnecessary it is to apply the rule to a regional bank holding company such as MUAH.[10] The only material difference, then, between MUAH/MUB and its peer institutions is that MUAH is owned by a G-SIB, a distinction the Proposed Rule does not address.

Applying the Proposed Rule to MUAH will impose additional costs that regional banks not owned by G-SIBs will not have to bear. According to the Proposed Rule, the internal LTD MUAH is required to issue to MUFG must be subordinated to all other MUAH obligations. Because of arm's length pricing rules that apply to all transactions between an intermediate holding company and its parent organization, this debt must be priced at market rates. To illustrate the increased costs the Proposed Rule imposes, MUFG offers the following outline of how MUAH would likely fund the required LTD. In the absence of TLAC, most regional banks would issue senior unsecured term debt from their operating bank entities due to funding needs within that particular entity. The additional cost of issuing internal LTD compared to issuing senior unsecured bank-level term debt is comprised of five factors detailed below: (i) issuer difference (bank-level vs. holding company level), (ii) subordination premium, (iii) cancelation / conversion premium, (iv) longer average maturity, and (v) likely tax deductibility of LTD. These factors and their related funding premiums are as follows:

(i) The premium for a U.S. regional bank to issue debt from its holding company compared to its operating bank is approximately 10-15 basis points.

(ii) The premium for a U.S. regional bank holding company to issue subordinated debt compared to senior debt is approximately 40-50 basis points.

(iii) The cost of the Federal Reserve's cancelation or equity conversion option is uncertain because it does not currently exist in any other securities. Similar features in bonds issued by foreign banks in other markets have cost anywhere from 40-60 basis points.

(iv) Due to the proportionally lower TLAC content of shorter maturity debt (phase out beginning with two years left to maturity), it is likely that most affected banks will issue 5- or 10-year instruments to comply with LTD requirements. In the absence of LTD, most banks typically issue 3- and 5-year unsecured debt, which is closer to the expected life of typical bank loan assets. These banks would likely extend liability duration to comply with the LTD requirements of the Proposed Rule. For U.S. banks, the spread curve from 3-year to 5-year debt is currently 10-15 basis points and the spread curve from 5-year to 10-year debt is currently 40-45 basis points. If maturity extension is accomplished evenly across these two changes, the average additional cost is 25-30 basis points.

(v) Several observers have identified the cancelation or equity conversion feature required of LTD as causing a change in the tax characterization of LTD compared

[10] See *Federal Reserve Statistical Release: Insured U.S.-Chartered Commercial Banks That Have Consolidated Assets of $300 Million or More, Ranked by Consolidated Assets As of June 30, 2015*, available at: http://www.federalreserve.gov/releases/lbr/current/.

to more typical long term unsecured debt. These observers have advised that the Internal Revenue Service could view an instrument with such a feature as being more equity-like than debt-like and therefore not eligible for the tax deduction applicable to interest expense. If this view is correct, the after-tax cost of LTD for Covered IHCs would be affected by the inability to deduct interest expense at the bank's 39% marginal tax rate.

The total cost of internal LTD issuance would be the sum of (i) through (iv), which ranges from 115-155 basis points per annum on the entire amount of internal LTD, plus a gross-up to reflect the disparate tax treatment. For a regional bank with $100 billion in risk-weighted assets, LTD causes an additional ***$81mm to $109mm per year*** in interest expense (based on an LTD requirement equal to 7% of risk-weighted assets) on an after-tax basis due to the unavailability of the tax deduction.

This additional cost is significant for a regional bank such as MUB, which could otherwise use these funds to strengthen its safety and soundness by bolstering its capital or enhancing critical infrastructure (MUAH has not paid a dividend since being fully privatized by BTMU in November 2008). In fact, this cost would represent 14-19% of MUAH's net income of $573 million for the 12 months ending December 31, 2015. In this context, MUFG notes that a special concern of the Federal Reserve, as expressed in the Proposed Rule, is that the market perception surrounding too big to fail generates a competitive distortion in the marketplace: because the market perceives certain G-SIBs as too big to fail and thus always able to obtain public capital support in times of stress, those G-SIBs are able to fund themselves more cheaply than other banks.[11] According to the Federal Reserve, these "distortions are unfair to smaller companies and detrimental to competition."[12] It seems paradoxical and unfortunate that the Proposed Rule, while professing to be concerned with competitive distortions, should substitute one competitive distortion for another.

C. The Proposed Rule Contradicts Federal Reserve Principles by Imposing Reduced Financial Flexibility on MUAH

The internal LTD requirement of the Proposed Rule requires covered intermediate holding companies ("Covered IHCs"), many of which independently fund themselves in the debt capital markets, to concentrate their term funding with their foreign parent. This concentration of funding is antithetical to liquidity risk management principles espoused by the Federal Reserve and other federal regulators in the 2010 *Interagency Policy Statement on Funding and Liquidity Risk Management*.[13] A key tenet of the Interagency Statement is that adequate diversification of funding sources is necessary to preserve access to funding in the event one or more funding sources becomes unavailable. Specifically, the Interagency Statement encourages financial institutions to:

- "Establish a funding strategy that provides effective diversification in the sources and tenor of funding,"

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[11] 80 Fed. Reg. at 74926-74927.
[12] 80 Fed. Reg. at 74927.
[13] *Interagency Policy Statement on Funding and Liquidity Risk Management*, 75 Fed. Reg. 13656 (Mar. 22, 2010), ("Interagency Statement").

- "[M]aintain an ongoing presence in its chosen funding markets and strong relationships with funds providers," and

- "[D]iversify available funding sources in the short-, medium-, and long-term."[14]

In addition, the Interagency Statement notes that "funding diversification should be implemented using limits addressing counterparties, secured versus unsecured market funding, instrument type, securitization vehicle, and geographic market. In general, funding concentrations should be avoided [and] undue over-reliance on any one source of funding is considered an unsafe and unsound practice."[15] Since the Interagency Statement's release, other regulations and guidelines have been adopted by bank regulators, including the Liquidity Coverage Ratio, the Net Stable Funding Ratio, and EPS. These enhancements to bank regulation have strengthened the funding and liquidity profiles of U.S. financial institutions. EPS in particular requires that bank holding companies with total consolidated assets of $50 billion or more establish limits on liquidity risk, including limits on "concentrations in sources of funding by instrument type, single counterparty, counterparty type …."[16]

Maintaining sufficient liquidity and diversified access to funds is paramount to bank safety, as seen during the U.S. financial crisis in 2008 and later in the European banking crisis in 2011. If inadequate liquidity sources are available to a bank, failure is a likely outcome. The Proposed Rule appears to contradict these lessons and the Federal Reserve's own regulatory guidance, forcing Covered IHCs to sacrifice their liquidity risk management principles and weaken their financial flexibility in an effort to facilitate their possible resolution.

Aside from preserving diversified access to funding, there are many other advantages of maintaining external term debt. Recent history shows that well-capitalized U.S. IHCs can have more reliable and less expensive access to funding than troubled foreign parents. In addition, third party Covered IHC stakeholders (*e.g.*, investors and rating agencies) will expect and push for arm's length decision-making, reinforcing regulatory expectations of governance and risk management found in EPS. Further, the yields on Covered IHC debt issuance can be an important lever for market discipline and an additional indicator for regulators to evaluate the market-perceived health and liquidity costs of the Covered IHC.

II. THE PROPOSED RULE SHOULD BE REVISED TO REDUCE THE FUNDING BURDEN ON MUAH BY INCREASING FLEXIBILITY AFFORDED TO COVERED IHCS

MUFG believes the Proposed Rule suffers from a number of defects and should not be implemented as proposed. As a result, we respectfully submit three proposals to amend the rule that would permit MUAH to operate on a more level playing field with respect to funding costs and liquidity management. By implementing any of these proposals the Federal Reserve will not

[14] 75 Fed. Reg. at 13664.
[15] 75 Fed. Reg. at 13664.
[16] 12 CFR 252.34(g)(1)(i).

sacrifice its important public policy objectives, and will succeed in removing some or all of the competitive distortions that will result from implementing the Proposed Rule.

A. In Accordance with FSB Standards, TLAC, LTD, and Related Requirements Should Be Calibrated Individually

If applied, the final rule should take account of the specifics of MUAH's business, risk profile, and footprint in the U.S. The Proposed Rule indicates it is designed to ensure support for U.S. operations in the event of failure at the foreign parent.[17] This concern, however, is best dealt with on an institution-specific basis, a principle which is at the heart of the FSB Standards.[18] The foreign G-SIBs subject to the Proposed Rule have different footprints and operating models, different capital structures and risk profiles, and exist in different home countries with different regulatory and political climates. The Proposed Rule adopts a one-size-fits-all approach to these banks regardless of their many differences; in place of considered, tailored regulation the Proposed Rule adopts inflexible rules regardless of the systemic risk an institution poses to the U.S. financial system.

MUFG is a conservative, well capitalized, and well managed institution with a very strong commitment to the U.S. market and to MUAH; the Federal Reserve's application of TLAC, LTD, and related requirements to MUAH should reflect these existing strengths. Unlike many global banks, MUFG has already met Basel III global capital requirements for 2019.[19] Across its global platform, MUFG's product lines and business activities are not marked by excessive risk, opacity, or complexity. The same is true of MUAH; its main businesses are residential mortgage lending, and commercial and industrial lending. As noted, the Proposed Rule intends to address market perceptions that large financial institutions are "too big to fail" and will obtain government support in times of financial stress.[20] Moreover, as the Proposed Rule explains, subsequent efforts by international bank regulators have attempted to address a number of the problems surrounding the problem of "too-big-to-fail," including orderly resolution.[21] The solid performance of MUFG and MUAH during the 2007-2009 financial crisis, however, is well known to the Federal Reserve, as is the special role MUFG played during the crisis through its $9 billion investment in Morgan Stanley at a critical moment. Far from being part of the problem of too big to fail, therefore, MUFG has been part of the solution.

As MUFG's investment in Morgan Stanley demonstrated, MUFG is extremely committed to the U.S. market. With prospects for growth in the Japanese market coming under strain, MUFG understands that the U.S. market represents an important growth opportunity the bank must seize to maintain its prominent position in global finance. MUAH is a well-capitalized institution with parental support of the highest order. Finally, MUFG is headquartered in a country with no apparent political or legal impediments to providing support

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[17] 80 Fed. Reg. at 74929.
[18] "In calibrating the individual requirement for specific firms, authorities will take into account the recovery and resolution plans of individual G-SIBs, their systemic footprint, business model, risk profile and organizational structure." FSB Standards at 5.
[19] *MUFG Report 2015: Integrated Report* (August 2015) at 4, available at: http://www.mufg.jp/english/ir2015/pdf/all.pdf.
[20] 80 Fed. Reg. at 74926.
[21] 80 Fed. Reg. at 74926-27.

to its foreign subsidiaries. Accordingly, the Federal Reserve can have no doubts regarding the ability and willingness of MUFG to come to MUAH's aid in the unlikely event of financial stress. In accordance with the FSB Standards, therefore, MUFG urges the Federal Reserve to consult proactively with Japanese regulatory authorities in tailoring TLAC requirements to the specifics of MUFG and MUAH.[22] The Proposed Rule offers no compelling justification for this departure from the FSB Standards.

B. In Accordance with FSB Standards, Collateralized Guarantees Should be Used in Place of LTD

As contemplated by the FSB Standards, the Proposed Rule should allow a pool of collateral provided by a Covered IHC's foreign parent to satisfy the LTD requirement.[23] Such a pool of collateral would be held within the U.S. and available to the Federal Reserve to liquidate and inject into the Covered IHC in the event of imminent or actual failure. This collateral pool could be comprised of debt issued or guaranteed by the governments of G7 nations, subject to pre-determined valuation haircuts and subject to periodic "mark-to-market" price determination. Through these controls, the Federal Reserve could ensure that the value of the collateral is preserved and able to be liquidated at the time of failure/resolution. MUFG proposes that the collateral pool be sized in a manner consistent with the ultimate LTD requirement as it would serve the same function (*i.e.*, to be liquidated and converted to equity in the Covered IHC). We also propose that a mix of LTD and a collateral pool could be used together to satisfy the "gone-concern" aspect of TLAC.

To the extent a Covered IHC and its foreign parent choose to use a pool of collateral to satisfy the proposed Internal LTD requirements, the Covered IHC would then be able to pursue its funding objectives separately from Internal LTD requirements and therefore would not incur the financial or liquidity costs identified above. In resolution, no change of control event would occur because the collateral that is liquidated and injected into the Covered IHC was originally the property of the Covered IHC's foreign parent. As such, the foreign parent would be given the equity of the Covered IHC in return.

C. The Rule Should Permit MUAH to Issue LTD to Third-party Investors in a Manner That Avoids Change of Control Issues

In addition to issuing LTD to its parent, each covered IHC should also be allowed to issue LTD to third-party investors in the same manner as U.S. G-SIBs. This LTD would be senior unsecured, issued in the debt capital markets, and would implicitly be able to be canceled or converted to equity upon the Federal Reserve's recommendation to the Secretary of the Treasury. This proposal addresses the financial costs imposed by Internal LTD by allowing LTD to take the form of senior unsecured debt with an implicit (as opposed to contractual) "bail-in" feature, similar to covered bank holding companies. This proposal also addresses the liquidity risk management and financial flexibility costs by allowing Covered IHCs the opportunity to

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[22] "The actual Minimum Internal TLAC requirement within that range should be determined by the host authority of the material sub-group in consultation with the home authority of the resolution group." FSB Standards at 19.

[23] "Home and relevant host authorities . . . may jointly agree to substitute on-balance sheet internal TLAC with internal TLAC in the form of collateralised guarantees . . . ." FSB Standards at 20.

issue LTD externally. Importantly, a Covered IHC could issue this form of LTD to its parent without limitation or change in credit towards the LTD requirement. If resolution of the Covered IHC proves necessary, the resolution would occur similarly to the resolution of any U.S. G-SIB with debt issued to capital markets investors. Notably, this form of LTD would be easily issued to debt capital market investors because it is debt that these investors already buy and own. The only difference is a clear message from the Federal Reserve that it intends to use its "bail-in" powers with respect to Covered IHCs (as with G-SIBs) at or prior to the time of failure.

We understand the concerns expressed in the Proposed Rule regarding change of control issues that could arise if Covered IHCs are permitted to issue LTD to third parties.[24] Nevertheless, we encourage the Federal Reserve to consider an alternative that could alleviate those concerns while still permitting Covered IHCs to take advantage of greater funding flexibility by establishing a cap for externally issuing LTD that converts into equity of the IHC without confronting change-of-control issues at the IHC level. We believe that up to but less than 50% of the Internal LTD requirement could be met with senior unsecured debt issued to debt capital market investors (with sufficiently tailored thresholds for individual investors) without causing change of control concerns. The remaining majority (50% or more) of Internal LTD would be satisfied through a combination of senior unsecured debt issued to, or a collateral pool provided by, the Covered IHC's foreign parent. As noted above, to reduce the financial penalty associated with meeting Internal LTD targets, senior unsecured debt should be eligible in place of the subordination requirement in the Proposed Rule (perhaps with a form of liability caps akin to external LTD to preserve proposed Clean Holding Company principles). In respect of LTD that has been issued to the Covered IHC's parent, or a collateral pool provided by the parent, the Federal Reserve could elect to impose losses on those gone-concern instruments prior to applying losses to any LTD issued to capital markets investors. This senior-subordinated status (whether implicit or explicit and contractual) could also mitigate the Federal Reserve's change of control concerns. While this proposal does not fully achieve our liquidity risk management objectives, we intend for it to strike a balance between these objectives and the Federal Reserve's goal to avoid a change of control event upon failure/resolution of the Covered IHC.

III. RESPONSES TO NUMBERED QUESTIONS

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.*

Covered IHCs are subject to U.S. capital rules and stress testing irrespective of the TLAC requirements. They are already held to high capital standards and for many, LTD is the "binding constraint" with respect to TLAC compliance. Due to high levels of "going concern" capital, TLAC only adds a layer of "gone concern" protection in the form of LTD. The Federal Reserve would likely not sacrifice much "going concern" capital by subjecting Covered IHCs to only LTD requirements. However, as stated above, we believe each Covered IHC must be evaluated individually in order to determine what amount of internal TLAC or LTD is appropriate in the first instance.

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[24] 80 Fed. Reg. at 74941-41.

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

As mentioned above, we believe that Internal LTD should be expanded to include an option for a foreign parent to provide a collateral pool to a Covered IHC in order to satisfy the proposed LTD requirements. A collateral pool would allow a Covered IHC to fund itself outside of the requirements of pre-positioned LTD in a manner consistent with its peers and would also allow the Covered IHC to maintain liquidity risk management best practices.

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?*

We recommend that the Federal Reserve eliminate the 50 percent haircut for debt with a remaining maturity of more than one year but less than two years. As articulated in the Proposed Rule, the Federal Reserve's concern underlying the 50 percent haircut is the potential difficulty in refinancing that a financially stressed institution would experience when attempting to refinance its debt.[25] We believe this concern is overstated. To begin with, to the extent that LTD is internally funded by a Covered IHC's foreign parent, the parent can be expected to refinance the debt of a struggling IHC to enable the IHC to maintain the required amount of LTD. Moreover, it is unlikely that the time interval between an institution experiencing such financial stress and ultimately proceeding to resolution would exceed six to twelve months, suggesting that enough readily usable LTD will be available in resolution even after eliminating the 50 percent haircut on debt maturing in more than 12 months.

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

As mentioned above, we encourage the Federal Reserve to consider the adverse consequences of the proposed structure of Internal LTD. It imposes several material costs on Covered IHCs and should be restructured to eliminate inconsistencies with external LTD. Further, Internal LTD should allow foreign parents of Covered IHCs to provide collateral pools that satisfy the LTD requirement.

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?*

As noted above, the liquidity risks associated with concentrations of funding are not consistent with regulatory guidance, nor are they consistent with efforts to increase the stability and soundness of U.S. banks. All Covered IHCs, regardless of resolution strategy, should be encouraged to develop robust and diverse funding sources. A bank's resolution strategy should

[25] 80 Fed. Reg. 74936.

not be an input into its funding sources; rather, funding sources should be chosen to minimize the likelihood of resolution in the first place.

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.*

In order to protect operating subsidiaries (likely bank entities) from losses, a Covered IHC that issues LTD should be allowed to directly risk-manage its liability structure and hedge with QFCs. Without this ability, Covered IHCs will likely turn to their operating subsidiaries to intermediate hedges with third parties (*e.g.*, Covered IHC hedges with operating subsidiary, operating subsidiary hedges with a third party).

An illustration will demonstrate how losses could be forced on the operating subsidiary if it assumes an intermediation role. Assume a Covered IHC has entered into a QFC with its operating subsidiary, "Bank A" and Bank A has hedged its exposure by entering into an offsetting QFC with a third party, "Dealer B." In a resolution scenario, creditors to the Covered IHC will take losses in order to preserve Bank A. The Covered IHC might terminate the QFC with a mark to market of $100 in Bank A's favor; however, the Covered IHC may not be able to make a full termination payment. The covered IHC pays $60 instead. In turn, Bank A terminates its offsetting QFC with Dealer B. Bank A likewise owes $100, but only received $60 from the Covered IHC. Bank A has incurred a $40 loss. In order to prevent hedging losses from affecting the operating subsidiary, Covered IHCs must be allowed to engage directly in hedging activities using QFCs with third parties.

63. *The Board invites comment on its plan to propose a reporting requirement for eligible external TLAC and LTD and eligible internal TLAC and LTD.*

We encourage the Federal Reserve to develop a reporting template for TLAC and LTD in order to standardize disclosure across all banks. With a common reporting template, interested stakeholders will be able to evaluate banks' TLAC and LTD compliance more quickly and easily, leading to less confusion in the markets for these banks' debt and equity securities.

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

We believe Domestic Internal TLAC should only apply to G-SIBs and not Covered IHCs. As mentioned previously, Covered IHCs are often domestic regional banks that happen to have a single foreign shareholder and do not have the complexity, interconnectedness or contagion risk of a G-SIB. In order to avoid forcing unnecessary costs and burdens on Covered IHCs that are not also applied to their peer regional banks, the Federal Reserve should limit the scope of Domestic Internal TLAC. Further, to the extent that Domestic Internal TLAC is required to be prepositioned in federally chartered banks and take the form of subordinated debt, the Federal Reserve should be aware of rules governing subordinated debt recently adopted by the Office of the Comptroller of the Currency ("OCC").[26] These rules stipulate certain terms such as minimum original maturity and regulatory approvals for payment of principal and interest in certain circumstances.

71. *The Board invites comments on all aspects of the transition period, including whether the proposed phase-in period for the risk weighted assets components of the proposed external and internal TLAC requirements is appropriate. Would it be appropriate to instead require compliance with those higher requirements as of January 1, 2019?*

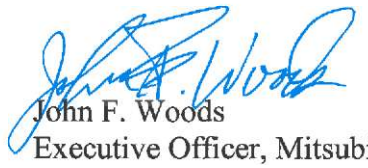
The Proposed Rule conspicuously omits a phase-in period for LTD, both internal and external. For many banks with high levels of Tier 1 Capital, LTD is the binding constraint with respect to TLAC compliance. Therefore, a phase-in period for TLAC without a corresponding phase-in period for LTD is of little use. We encourage the Federal Reserve to apply a phase-in period with respect to LTD that corresponds to the phase-in period for overall TLAC.

[26] "Subordinated Debt: Guidelines and Sample Notes," OCC Bulletin 2015-22 (Apr. 3, 2015).

* * *

We thank the Federal Reserve for its consideration of our comments, and encourage you to contact the undersigned to discuss further.

Sincerely,



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