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Thomas W. Killian
PRINCIPAL

CONFIDENTIAL

June 28, 2016

Mr. Juan Carlos Climent
Board of Governors of the Federal Reserve System
Division of Banking Supervision and Regulation
20th & C Streets, NW
Washington, DC 20551

Dear Juan,

I certainly appreciate the opportunity to catch up with you and your colleague on the TLAC comment letter that we sent earlier this year.

We discussed a number of points from my January 20, 2016 comment letter during the call and I appreciate your willingness to consider these issues. At the conclusion of the call, you suggested that we provide an estimate of the benefit to regional and community banks from pushing back the start date from January 1, 2019 to January 1, 2022 for the capital deduction for excess investment in senior GSIB bank holding company senior debt (Covered Debt).

As discussed on page five of the January 20th comment letter, there is currently no required call report or GAAP disclosure on the amount of investment by banks in Covered Debt. So to develop an estimate of the impact of the potential deduction on the investment portfolios and capital positions of regional and community banks, Sandler O'Neill selected a sample of 200 regional and community banks with total assets of between $1 billion but less than $50 billion and a mean asset size of approximately $4 billion. We discovered that 112 of the 200 banks (about 56%) owned Covered Debt with an average investment amount of approximately $20.7 million. Of the 112 banks that owned Covered Debt, 29 or roughly 26% of the total owned an amount comprising 10% or more of Common Equity Tier 1 Capital (CET1). In aggregate, the amount of investment totaled $1.4 billion.

SANDLER O'NEILL + PARTNERS, L.P.
1251 Avenue of the Americas, 6th Floor, New York, NY 10020
T: (212) 466-7709 / (212) 466-7800
tkillian@sandleroneill.com

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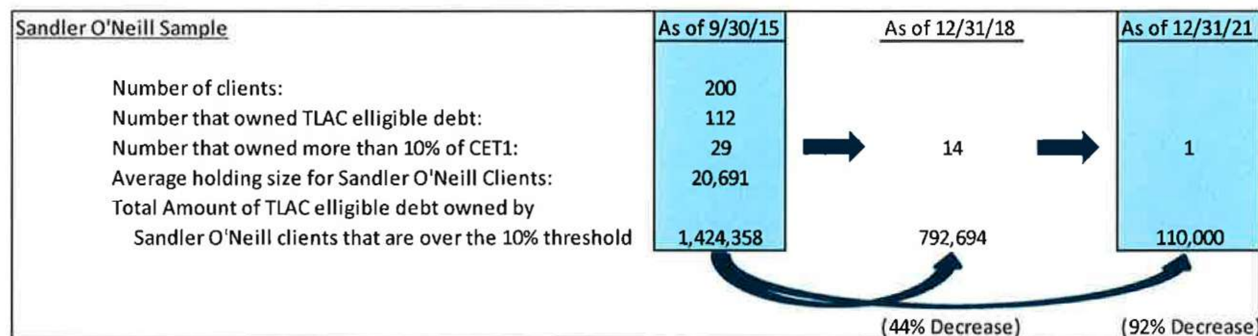
To respond to your request, we reviewed the portfolio of bank holding company debt investments owned by the 29 banks that had more than 10% of their CET1 invested in Covered Debt and rolled those bonds forward to January 1, 2019 to eliminate any debt that would be contractually repaid before that date. We then rolled the debt forward to January 1, 2022 to eliminate the debt that would be contractually repaid before that date. We also conservatively assumed that the CET1 of these 29 banks would be increase each year at a rate of 5% from year-end 2015 through 2021 reflecting a modest level of profitability of these banks.

As shown below in Chart A , the amount of Covered Debt would be reduced dramatically from $1.4 billion at year end 2015, to $.792 billion at year end 2018 and to $.110 billlion at year end 2021 based on the scheduled payments. Only 1 bank would have Covered Debt in excess of 10% of CET1 due to these payments and the addition to retained earnings at 5% per year. This highlights the importance of pushing back the start date for the capital deduction from 2019 to 2022 as the number of effected banks would be reduced from 29 to 1 based on the Sandler O'Neill sample.



Sandler O'Neill Sample	As of 9/30/15	As of 12/31/18	As of 12/31/21
Number of clients:	200		
Number that owned TLAC elligible debt:	112		
Number that owned more than 10% of CET1:	29	14	1
Average holding size for Sandler O'Neill Clients:	20,691		
Total Amount of TLAC elligible debt owned by Sandler O'Neill clients that are over the 10% threshold	1,424,358	792,694	110,000
		(44% Decrease)	(92% Decrease)

Source: Sandler O'Neill Analysis, Bloomberg, and SNL Financial

If we extrapolate those numbers to the broader universe of 639 banks in the U.S. between $1 billion and $50 billion in assets, we can estimate that roughly $7.4 billion of senior covered BHC debt is owned by regional and community banks. (i.e., 56% of 639 x $20.7 million average investment amount). By applying the experience from the Sandler O'Neill sample portfolio, we can estimate that this $7.4 billion in Covered Debt would be reduced by 44% at year-end 2018 and by 92% by year-end 2012 and the total amount of investment would approximate $.592 billion. The number of effected banks would be reduced from 358 to roughly 29 substantially reducing if not eliminating the potential problem.

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All Banks 1bln to 50bln in Assets	As of 9/30/15		As of 12/31/18		As of 12/31/21
Number of institutions:	639				
% of Sample that invests in TLAC elligible debt:	56%				
Hypothetical number of institutions 1bln to 50bln that invest in TLAC elligible debt:	358	→	200	→	29
Hypothetical amount invested:	7,403,912		4,146,191		592,313
			(Assuming 44% Decrease)		(Assuming 92% Decrease)

Source: Sandler O'Neill Analysis, Bloomberg, and SNL Financial

To put these numbers in perspective, the amount of bank investment in pooled trust preferred securities at the time of the Volcker Rule announcement in the 4th quarter of 2013 was approximately $5.2 billion but only about $2.8 billion was owned by regional and community banks after excluding the amount owned by GSIBs and USAA.[1] This means that the amount of Covered Debt owned by regional and community banks could be over twice the amount of TPS CDOs owned by such banks.

In 2013, the banking regulators agreed to grandfather investment in pooled trust preferred securities that would otherwise not be permitted under the Volcker Rule to avoid large losses potentially incurred by regional and community banks that owned such securities. The logic was that banks should be permitted to own such investment if the Collins Amendment specifically permitted the issuance of trust preferred as Tier 1 capital for banks less than $15 billion.

The original version of the TLAC rules published by the FSB did not include a capital deduction for investment by non-GSIBs in senior covered BHC debt securities.[2] The NPR does include this deduction and the potential large overhang from additional debt issuance could cause unsuspecting regional and community banks to face losses on the sale of such securities and/or capital deductions. The Board clearly anticipated that this deduction would elicit much comment and devoted Questions 66–70 in the NPR to solicit feedback from impacted banks.[3] Given the somewhat capricious nature of the change in rules and the relatively short remaining life of most of the senior covered BHC debt issues, a reasonable path to compromise may be to push back the start date for the capital deduction for non-GSIB investment in covered BHC senior debt from January 1, 2019 to January 1, 2022, which would substantially lessen any potential negative impact on the regional and community bank investment portfolios and capital levels.

[1] SNL Financial. Based on September 30, 2013 financial information. TRUPs CDO investments by banks totaled $5.2 billion but only $2.8 billion after excluding amounts owned by HSBC, USAA, WFC, BAC, BBVA, Citi, JPM, MS, and GS.

[2] Financial Stability Board. Adequacy of loss-absorbing capacity of global systemically important banks in resolution. Consultative Document, November 10, 2014. Page 18.

[3] Federal Register / Vol. 80. NO. 229 / Monday, November 30, 2015 / Proposed Rules. Pages 74951-52.

With this evidence of the substantial elimination of the capital deduction impacting regional and community banks by pushing back the start date of the deduction to January 1, 2022 and the given the lack of prior notice of this potential deduction, we request that the Federal Reserve Board consider moving the start date for the Covered Debt deduction back to January 1, 2022.