Office of the Comptroller of the Currency
400 7th Street, SW_ Suite 3E-218,
Washington, DC 20219
Attention: Chief Counsel's Office - Comment Processing
Docket ID OCC–2023–0011

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
Attention: Ann E. Misback, Secretary
Docket No. R– 1815 and RIN 7100–AG66

Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
RIN 3064–AF86

Re: **Long-term Debt Requirements for Large Bank Holding Companies, Certain Intermediate Holding Companies of Foreign Banking Organizations, and Large Insured Depository Institutions**

Submitted Via: *https://www.regulations.gov/*.

December 10, 2023

➢ ***Executive Summary***

The Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (FRB), and the Federal Deposit Insurance Corporation (FDIC) (together, the "agencies") have proposed the above referenced proposed rulemaking ("proposed rule") for public comment summarized as follows:

The multi-agency rulemaking is seeking comment on proposed rules that would require certain large depository institution holding companies, U.S. intermediate holding companies of foreign banking organizations, and certain insured depository institutions, to issue and maintain outstanding a minimum amount of long-term debt. The proposed rule would improve the resolvability of these banking organizations in case of failure, may reduce costs to the Deposit Insurance Fund, and mitigate financial stability and contagion risks by reducing the risk of loss to uninsured depositors.

The agencies stated that the proposed rule represents another key step in their collective efforts to impose enhanced prudential standards on banking organizations with $100 billion or more in total consolidated assets and align those enhanced prudential standards with those currently applicable to largest global banking institutions, commonly referred to as global systemically important banks (GSIBs).

The CFA Institute Systemic Risk Council (SRC) appreciates the opportunity to comment on these important new Proposals and their potential to improve systemic risk protections and economic stability.

- ***Summary of the Proposals.***

Specifically, the proposed rule would require Categories II, III and IV bank holding companies (BHC), savings and loan holding companies (SLHC) and U.S. intermediate holding companies (IHC) of foreign banking organizations that are not GSIBs to issue and maintain minimum amounts of long-term debt (LTD) that satisfies various thresholds.

The proposed rule would also require four categories of insured depository institutions (IDI) that are not consolidated subsidiaries of U.S. GSIBs to issue and maintain minimum amounts of LTD. These categories include:

> i. IDIs that have at least $100 billion in total consolidated assets and that are a consolidated subsidiary of a covered entity or a U.S. IHC of a foreign GSIB;
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> ii. IDIs that have at least $100 billion in total consolidated assets and are not controlled by a parent entity;
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> iii. IDIs that have at least $100 billion in total consolidated assets and are either a consolidated subsidiary of a company that is not subject to FRB total loss-absorbing capacity (TLAC) rules or controlled but not consolidated by another company; and
>
> iv. IDIs of any size that are affiliated with an IDI in one of the three previous categories.

IDIs that are consolidated subsidiaries of U.S. GSIBs would not be subject to the Proposed Rule because their parent holding companies are subject to LTD requirements under the FRB 's TLAC rule and the most stringent capital, liquidity and other enhanced prudential standards. Meanwhile, covered IDIs that are consolidated subsidiaries of U.S. IHCs controlled by foreign GSIBs would be subject to the Proposals and would be required to issue and maintain minimum amounts of LTD.

- ***General Comments***

Minimum Levels of LTD. The Systemic Risk Council supports the agencies' proposed requirement that large regional banks must hold a minimum level of long-term debt to aid in their resolvability in the case of failure. We agree with the agencies that long-term debt promotes the resolvability of regional banks as unsecured creditors absorb losses prior to the Deposit Insurance Fund, uninsured depositors, and other senior creditors in the event of failure.

Under the agencies' proposed rule, long-term debt must be in the form of unsecured debt with a remaining maturity of more than one year from the date of issuance. In addition, to better ensure that the unsecured debt is loss absorbing, the agencies do not permit the inclusion of exotic features; for example, the unsecured debt may not be in the form of a structured note or include embedded derivatives, credit-sensitive features or be convertible into equity. We agree with the premise that these features will help ensure that long-term debt will be unencumbered by multiple claims and able to absorb the losses of a regional bank once the regulatory capital of the bank has been fully exhausted.

When a bank fails, losses are first absorbed by the owners of the common equity and then by the owners of the bank's preferred equity, if any. Together, common equity and preferred equity comprise the bulk of the bank's Tier 1 capital. Unless there is some form of unsecured debt issued by the bank, any

additional losses beyond the amount of Tier 1 capital would then be taken by senior creditors, which include uninsured depositors and the FDIC – who takes all losses in the place of insured depositors. If unsecured debt has been issued by the bank, the owners of unsecured debt would absorb any losses beyond the amount of Tier 1 capital outstanding; and, senior creditors would not absorb any losses unless the total losses of institution exceeded the total amount of Tier 1 capital plus unsecured debt outstanding.

LTD Effects on Resiliency. Under existing regulatory capital rules, to be considered adequately capitalized from a Tier 1 capital perspective, a regional bank must maintain a minimum amount of Tier 1 capital equal to the greater of 6 percent of total risk-weighted assets (Tier 1 risk-based capital ratio), 4 percent of average total assets (Tier 1 leverage ratio), or 3 percent of leverage exposures (supplemental leverage ratio). The long-term debt proposal would nearly double the minimum amount of required loss absorbency by requiring regional banks to also hold a minimum amount of long-term debt equal to the greater of 6 percent of total risk-weighted assets, 3.5 percent of average total assets, or 2.5 percent of leverage exposures.

Using the Tier 1 leverage ratio as a clear example, under today's requirements, a regional bank with $100 billion in total consolidated assets would be required to hold $4 billion in Tier 1 capital to absorb losses. If the same financial institution had no long-term debt outstanding, once the institution recognized more than $4 billion in losses, senior creditors (including uninsured depositors and the FDIC) could begin to take a loss.

However, the proposed rule would require a regional bank with $100 billion in total consolidated assets to hold $3.5 billion in unsecured debt in addition to the $4 billion in Tier 1 capital required under the regulatory capital rules. As such, the institution would now have $7.5 billion in loss absorbency, and almost twice as many losses would have to be recognized before senior creditors (including uninsured depositors and the FDIC) would begin to take a loss.

As a result, long-term debt requirements significantly increase the ability of the FDIC to resolve a large regional bank without resorting to the use of the Deposit Insurance Fund or extraordinary support measures. Indeed, the ability of long-term debt to protect the Deposit Insurance Fund is well demonstrated by the 2008 failure of Washington Mutual, where unsecured debt holders absorbed all remaining losses, uninsured depositors were protected, and the Deposit Insurance Fund was able to emerge from the Washinton Mutual bankruptcy without suffering a loss.[1]

Systemic Risk Mitigation. Increasing the resolvability of regional banks should reduce overall systemic risks in the financial system by creating additional "gone-concern" loss-absorbing capacity that can absorb additional losses once the failed bank's equity is fully exhausted. This additional loss-absorbing capacity provides a meaningful measure of protection to not only the Deposit Insurance Fund but also to senior creditors such as uninsured depositors, which could reduce the probability of a run on those deposits. If a run on deposits were to occur, the loss-absorbing support that long-term debt provides to depositors could reduce the speed of the deposit run, allowing the FDIC to resolve the failed institution in a more orderly fashion. Taken together, the additional protection to uninsured depositors and the more orderly resolution process should bolster confidence in the banking system, reducing contagion as well as the

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[1] Financial Crisis Inquiry Commission (2011). Panic and Crisis. In *The Financial Crisis Inquiry Report* (pp. 353–386). U.S. Government Printing Office. Available at https://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_chapter20.pdf

likelihood that systemwide support mechanisms, such as the use of the systemic risk exception, will be needed.

The use of systemwide mechanisms in the event of the failure, or potential failure, of an individual bank erodes public confidence in the banking system and exacerbates contagion risks. Unfortunately, the use of the systemic risk exception was viewed by regulators as necessary in the case of the failures of Silicon Valley Bank and Signature Bank.[2] While it is difficult to say whether the long-term debt requirements proposed by the regulators would have prevented the need to invoke the systemic risk exception, the issuance of long-term debt would have provided additional loss-absorbing capacity to protect the uninsured depositors. The issuance of long-term debt could have slowed the deposit runs experienced by those banks and, at the very least, would have reduced the ultimate loss to the Deposit Insurance Fund.

Beyond the benefits to the Deposit Insurance Fund, long-term debt can diversify the funding structure of regional banks and increase their financial resiliency. Long-term debt is a stable source of funding that can be used by regional banks to supplement their funding reliance on uninsured deposits and other forms of short-term wholesale funding that exhibit the tendency to run in times of financial stress.

The issuance of long-term debt also provides regulators and market participants with additional sources of data and external signals regarding changes in the risk profile of a regional bank. Debt investors may be attuned to the overall change in a bank's risk profile and the effect that the change in its risk profile has on its ability to service debt. In the case of Silicon Valley Bank and Signature Bank, it is plausible that, had meaningful amounts of long-term debt been issued by those banks, the yield requirements for their long-term debt would have risen contemporaneously with both the level of unrealized losses on their investment securities and the degree to which the banks relied upon uninsured deposits for funding. Such an increase in long-term debt yields could have increased the banks' overall funding pressure, resulting in a natural economic brake to the buildup of risk.

Cost / Benefit Assessment. We believe that the costs associated with the proposed rule is modest, especially in comparison to the benefits described. For the 20 top-tier regional bank holding companies covered by this proposal, the agencies have estimated that the aggregate total assets are $5.3 trillion, yet the proposal would only require approximately $250 billion in aggregate long-term debt. After considering the long-term debt already issued by these 20 regional bank holding companies, the agencies expect the aggregate shortfall—that is, the amount of new long-term debt required by this proposal—to be $70 billion. However, regional banks would be allowed to phase in this requirement over a three-year period. To place the $70 billion new long-term debt requirements into context, for calendar year 2022, more than $1.2 trillion of corporate debt was issued in the United States with more than $10.4 trillion outstanding at year end[3]. Given the size of the U.S. corporate bond market, we would not expect this new long-term debt issuance to materially impact pricing or contribute to stress in the bond market.

Statutory Authority. We believe that the agencies have the statutory authority to implement the proposed rule. As previously discussed, the recent failures of Silicon Valley Bank, Signature Bank, and First Republic Bank have clearly demonstrated that the failure of a large regional bank introduces significant contagion risks that can threaten financial stability. Section 165(b) of the Dodd-Frank Act, as amended,

[2] See Joint Statement by the Department of the Treasury, the Federal Reserve, and the FDIC, March 12, 2023. Available at https://www.fdic.gov/news/press-releases/2023/pr23017.html

[3] See SIFMA, Capital Markets Fact Book, 2023 available at https://www.sifma.org/resources/archive/research/

provides the FRB with authority to address financial stability risks.[4] Given that Signature Bank had total assets of slightly more than $110 billion at the quarter end before its failure[5], we support the FRB's assertion that extending the long-term debt requirements to banking organizations with total consolidated assets of $100 billion or more is important for the reduction of contagion risks and the promotion of financial stability.

We also believe that the agencies have the statutory authority to require the issuance of long-term debt by an insured depository institution. As noted, long-term debt provides a meaningful buffer of additional loss absorbency that increases the flexibility of the FDIC to resolve the institution should it fail, reduces potential losses to the Deposit Insurance Fund upon failure, and reduces contagion risk in the banking system by providing additional loss-absorbing protection to senior creditors, including uninsured depositors. As such, the inclusion of long-term debt improves the adequacy of insured depository institution's capital structure to absorb losses and promote financial stability. Further, the inclusion of long-term debt reduces the risk presented by the insured depository institution to the Deposit Insurance Fund. These factors are important considerations in addressing the safety and soundness and the financial stability of the banking system.[6]

➢ ***Additional SRC Comments.***

Who Should Issue Debt? The proposed rule would require the long-term debt to be issued by the regional bank holding company and down streamed to the regional bank. It has been stated that this process is a more efficient mechanism for regional bank holding companies that have more than one banking subsidiary. However, from a resolution perspective, issuance of the debt at the bank level, rather than the holding company level would provide the FDIC with significantly more flexibility.

In general, there are two types of resolution strategies available to the regulators for large banking organizations. The first strategy, referred to as the Single Point of Entry, or SPOE, strategy is designed primarily for larger, more complex banking organizations where the financial activities of larger broker dealer, commodities trading, and insurance affiliates are intertwined with the financial operations of the insured depository institution. In this case, the failure of any holding company subsidiaries – the insured depository institution, the broker dealer, the commodities trading affiliate, or the insurance affiliate – could pose financial stability concerns. To reduce the risk to the financial system, the agencies would only resolve the holding company, allowing the affiliated businesses to continue with their operations. In this type of resolution, having the holding company issue the long-term debt would be beneficial from a resolution perspective as the banking regulators would have control of the resolution process, including the ultimate disposition of the long-term debt.

The second strategy, referred to as the Multiple Point of Entry, or MPOE, strategy is designed primarily for large banking organizations that are not significantly interconnected and the financial operations of the insured depository institution is less impacted the financial activities of its affiliates. In such banking organizations, the FDIC could resolve the insured depository bank and allow the holding company and affiliates to be resolved through normal bankruptcy proceedings. The MPOE strategy was designed primarily for banking organizations such as regional banks, where the predominate activity of the banking

[4] See Public Law 111-203; 124 Stat. 1376 (2010), codified at 12 U.S.C. 5365(b).

[5] See FDIC, "FDIC's Supervision of Signature Bank," April 28, 2023.

[6] **See, for example, 12 U.S.C. 1815, 1816. 1828, 1828a, and 1831o.**

organization is conducted through the insured depository institution. Because the holding company and non-bank affiliates are resolved through normal bankruptcy proceedings, there may be less risk to the financial system as the failure may be viewed as having lower systemic implications and the specter of a "bailout" possibility is lower.

If the long-term debt is issued at the holding company level, the disposition of the long-term debt under an MPOE strategy would be adjudicated through the bankruptcy process rather than through an administrative process under the supervision of the agencies. While a bankruptcy proceeding could result in the holders of long-term debt at the holding company absorbing losses generated at the insured depository institution in the manner intended by the proposed rule, such an outcome cannot be guaranteed. As such, we strongly encourage the agencies to require that the insured depository institution, rather than the holding company, issue the long-term debt.

Uninsured Deposit Exposures. The agencies' proposed long-term debt requirement does not fully resolve the issues raised by uninsured deposits, especially uninsured operational deposits, as defined by the FDIC. Regional banks play an important role in the main street economy by providing operational deposit services to business organizations, which are used by businesses to meet payroll, accounts payable, tax escrow, and other operating expenses. One of the rationales offered by regulators in support of the exercise of the systemic risk exemption for Silicon Valley Bank and Signature Bank was the negative consequences that a sudden failure of those banks would have on uninsured operational deposits and the ability of affected businesses to meet payroll obligations as the resolution process played out.[7] In addition, large amounts of uninsured deposits were a major contributor to the failure of First Republic Bank.

We recommend that the agencies take the risks associated with large concentrations of uninsured deposits into consideration when sizing the required amount of long-term to be issued by regional banks. The simplest approach would be to require banks that have uninsured deposits that exceed a certain threshold amount, as determined by the agencies, to issue additional long-term debt in the amount by which the uninsured deposits excess the threshold amount. Regional banks could use the proceeds obtained by the additional long-term debt to bolster their liquidity position to protect against the negative liquidity consequences associated with an unexpected run-off of uninsured deposits. The existence of a thick cushion of loss-absorbing capital subordinate to uninsured depositors should also be reassuring to those depositors, ameliorating the risk that they would run an otherwise solvent bank if its financial position weakened, causing an unnecessary liquidity failure.

Systemwide Mechanisms. As previously noted, the use of systemwide mechanisms in the event of failure, or potential failure, of an individual bank erodes public confidence in the banking system. Were the FDIC able to exercise the Transaction Account Guaranty (TAG) authority in an expedient manner, the FDIC could have temporarily extended deposit insurance coverage for uninsured operational deposits, and the exercise of the systemic risk exemption, which protected all uninsured depositors of Silicon Valley Bank and Signature Bank, may not have been necessary. In addition, the exercise of TAG authority might have had a calming effect on the market, as it would have extended the guarantee to the uninsured operational deposits of all banks. The guarantee of all uninsured operational deposits could have reduced the funding pressure exerted on the regional banks caused by the migration of uninsured

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[7] U. S. Government Accountability Office (April 2023). Preliminary Review of Agency Actions Related to March 2023 Bank Failures. Available at https://www.gao.gov/assets/gao-23-106736.pdf

deposits from regional banks to GSIBs. This reduction in funding pressure may have eliminated the need for the Federal Reserve's Bank Term Funding Program.

Restoring TAG Authority. The use of the systemic risk exemption poses significant moral hazard concerns, as it provides a blanket guaranty to all uninsured deposits regardless of depositor purpose and creates a perception that all deposits are effectively insured. As such, we recommend that Congress fully restore the TAG authority to the FDIC. Such legislation would ensure that the FDIC has all the tools necessary to maintain depositor confidence, which should be an important policy goal. It would help maintain the competitive strength of regional and community banks who, because of banking turmoil, are having to pay significantly higher rates to keep their uninsured deposits, while the largest, systemic institutions enjoy lower deposit funding costs because they are perceived as too-big-to-fail. Restoration of TAG would help stem further concentrations of market power in the largest banks. Further, the full restoration of TAG authority would significantly reduce reliance on the Federal Reserve to serve as a source for deposit stability, which we believe is a misuse of its statutory authority. Should TAG authority not be fully restored to the FDIC, we recommend that, at a minimum, Congress modify Section 1105 of the Dodd Frank Act[8] related to the FDIC's debt guarantee authority to provide fast-track consideration in the House of Representatives in a manner similar to the fast-track consideration required by the Senate.

- ***Conclusion***

We appreciate the opportunity to provide these comments and strongly support the agencies' proposal to require large regional banks to hold a minimum level of long-term debt to aid in their resolvability in the case of failure. This requirement will significantly increase the ability of the FDIC to resolve a large regional bank without resorting to the use of taxpayer dollars or extraordinary support measures.

Furthermore, we support other elements of this multi-agency rulemaking as indicated above as it seeks to improve the resolvability of these banking organizations in case of failure, reduce costs to the Deposit Insurance Fund, and decrease the probability that extraordinary support measures may be needed in the future by reducing financial stability and contagion risks associated with the risk of loss to uninsured depositors.

Thank you for the opportunity to comment. We provide these views on behalf of the CFA Institute Systemic Risk Council.

Respectfully submitted,

Simon Johnson, Co-Chair Erkki Liikanen, Co-Chair

Note: The views expressed herein represent the collective views of the SRC and not all members agree with all aspects of this comment letter.

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[8] See 12 USC §5612.

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