January 16, 2024

Via Electronic Mail

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, D.C. 20551
Attention: Ann E. Misback, Secretary

Federal Deposit Insurance Corporation
550 17th Street NW
Washington, D.C. 20429
Attention: James P. Sheesley, Assistant Executive Secretary, Comments/Legal OES

Office of the Comptroller of the Currency
400 7th Street, SW, Suite 3E-218
Washington, D.C. 20219
Attention: Chief Counsel's Office, Comment Processing

Re: Long-Term Debt Requirements for Large Bank Holding Companies, Certain Intermediate Holding Companies of Foreign Banking Organizations, and Large Insured Depository Institutions (Federal Reserve Docket No. R-1815, RIN 7100-AG66; FDIC RIN 3064-AF86; Docket ID OCC-2023-0011)

Ladies and Gentlemen:

The Bank Policy Institute[1] appreciates the opportunity to comment on the joint notice of proposed rulemaking issued by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency (the "Agencies") that would require certain large depository institution holding companies ("Covered Holding Companies"), certain U.S. intermediate holding companies ("Covered IHCs") of foreign banking organizations ("FBOs"), and certain insured depository institutions ("Covered IDIs" and, together with Covered Holding Companies and Covered IHCs,

[1] BPI is a nonpartisan public policy, research, and advocacy group, representing the nation's leading banks and their customers. BPI's members include universal banks, regional banks, and major foreign banks doing business in the United States. Collectively, they employ almost two million Americans, make nearly half of the nation's small business loans, and are an engine for financial innovation and economic growth.

"Covered Entities") to issue and maintain outstanding a minimum amount of long-term debt ("LTD").[2]

I. Executive Summary

As proposed, the LTD requirements would be much costlier than the Agencies estimate. To adjust for these costs, the Agencies should fundamentally reconsider the structure of the proposed requirements, including the proposal's calibration and the internal LTD requirement. As explained throughout this letter, it is unclear whether the LTD requirements, as proposed, are necessary to achieve the proposal's intended objectives, but there is no question that they would impose sizable costs on Covered Entities and the broader economy. Therefore, we urge the Agencies to reconsider the design, application, calibration, and other aspects of the proposed LTD requirements as recommended in this letter. The recommended changes are necessary to mitigate the significant actual costs of the proposed LTD requirements.

Our comments proceed as follows:

- **Section II** recommends that the Agencies finalize any new LTD requirement only after any Basel III Endgame rule has been implemented. The Agencies should thoroughly consider the effects of any capital changes on the calibration of an additional loss-absorbing capacity requirement among Covered Entities.

- **Section III** demonstrates that the costs of the LTD proposal are significantly underestimated and describes the adverse impact the proposed requirements would have. BPI estimates that the costs of the proposed LTD requirements would be **three times** the estimate in the proposal.

- **Section IV** recommends that the Agencies: (i) adopt an alternative calibration of two percent of risk-weighted assets ("RWAs") (and revise any leverage-based LTD requirements commensurately); (ii) differentiate the proposed requirements based on the statutory tailoring framework; and (iii) eliminate or significantly revise the proposed internal LTD requirement. These recommended changes would help to correct for the higher cost estimates described in Section III.

- **Section V** shows that the minimum denomination requirement for LTD is unsupported, would negatively affect market depth and liquidity, and would be inconsistent with the disclosure-based framework of the federal securities laws and long-standing aspects of the bank capital framework.

- **Section VI** recommends the Federal Reserve provide additional exemptions to the general prohibition on top-tier holding companies entering into qualified financial contracts ("QFCs") with third parties, both in the current LTD proposal and in the existing TLAC rule and recommends that the clean holding company requirements not apply to banking organizations that do not have single point of entry ("SPOE") resolution strategies.

- **Section VII** recommends other adjustments and clarifications related to the existing TLAC

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[2] *See* Long-Term Debt Requirements for Large Bank Holding Companies, Certain Intermediate Holding Companies of Foreign Banking Organizations, and Large Insured Depository Institutions, 88 Fed. Reg. 64,524 (Sept. 19, 2023).

rule.

- **Section VIII** makes several additional technical recommendations and clarifications on the proposed LTD requirements.

II. The Agencies should not finalize any new LTD requirements until they finalize a rule to implement the Basel III Endgame and thoroughly consider the effects of those changes on the calibration of an additional loss-absorbing capacity requirement among Covered Entities.

As an initial matter, it is impossible to assess properly the impact of the proposed LTD requirements without knowing whether and how the Basel III Endgame proposal will be implemented.[3] The Basel III Endgame proposal would significantly increase RWAs for Category I through IV banking organizations. Specifically, the Agencies estimate that, under the proposed Expanded Risk-Based Approach, RWAs for these banking organizations would be approximately $2.2 trillion higher than under the U.S. Standardized Approach.[4] The Agencies acknowledge that they did not consider the potential effect of these enormous changes in their impact analysis under the LTD proposal, but merely state that, if adopted, the RWA increases would "lead mechanically to increased requirements for LTD under the LTD proposal."[5]

The LTD proposal is silent on whether the proposed LTD requirements were calibrated based on the existing calculation of RWAs under the U.S. Standardized Approach or the meaningfully higher calculation of RWAs under the Expanded Risk-Based Approach. If the latter, by the Agencies' own estimate, the cost and market impacts are unknown but significantly higher than under current standards. If the former, then the LTD requirement should be recalibrated given the proposed increases under the Expanded Risk-Based Approach. In addition, the Agencies did not analyze the interrelationship between the two proposals in terms of overall costs, whether and how either proposal should factor into the design or calibration of the other, or otherwise.[6] Until the Agencies fully understand and explain the effects of the Basel III Endgame on RWAs, capital requirements, and overall loss-absorbing capacity of large banking organizations, it is premature to propose any new LTD requirements, let alone finalize them. For this reason, implementation of any LTD requirements should be phased in to occur *after* implementation of any new Basel III Endgame requirements. Any other approach would prevent the Agencies and Covered Entities from having a complete picture of the overall loss-absorbency requirements applicable to larger banks.

The Agencies extended the comment period on the Basel III Endgame proposal from November 30,

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[3] *See* Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity, 88 Fed. Reg. 64,028 (Sept. 18, 2023).

[4] *See id.* at 64,168. RWAs would increase by approximately $1.8 trillion for Category I and II banking organizations and approximately $400 billion for Category III and IV banking organizations.

[5] 88 Fed. Reg. at 64,551, n. 97. The Agencies also assert, without any attendant analysis, that the Basel III Endgame revisions "could also reduce the cost of various forms of debt for impacted firms due to the increased resilience that accompanies additional capital." *Id.*

[6] In fact, the Basel III Endgame proposal does not even mention the LTD proposal, as it had not yet been released when the Agencies issued the Basel III Endgame proposal.

2023 to January 16, 2024.[7] With the extension, the Federal Reserve also announced that it would conduct a quantitative impact study with respect to that proposal, the results of which would be made public.[8] This development only begins to address the significant procedural problems with that proposal, which we have discussed elsewhere.[9] Only after a rule to implement the Basel III Endgame has been finalized, based on sound empirical analysis and a thorough process that adheres to the letter and spirit of the Administrative Procedure Act ("APA"), should the Agencies turn to LTD requirements for Covered Entities, where a robust cost-benefit analysis, accounting for the final rule to implement the Basel III Endgame, should likewise factor into the Agencies' rulemaking.

III. The Agencies should recalibrate the LTD proposal to capture the actual costs of LTD more accurately.

The Agencies' economic impact assessment significantly understates both the LTD shortfall and the overall costs of the LTD proposal. BPI estimates a shortfall 2.7 times higher and costs three times higher than estimated in the proposal.[10] BPI has estimated the impact of the LTD proposal on bank funding costs,

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7 *See* Joint Press Release, Agencies extend comment period on proposed rules to strengthen large bank capital requirements (Oct. 20, 2023), *available at* https://www.federalreserve.gov/newsevents/pressreleases/bcreg20231020a.htm.

8 *See* Press Release, Federal Reserve Board launches data collection to gather more information from the banks affected by the large bank capital proposal it announced earlier this year (Oct. 20, 2023), *available at* https://www.federalreserve.gov/newsevents/pressreleases/bcreg20231020b.htm.

9 *See, e.g.*, Letter from the Bank Policy Institute, Financial Services Forum, Securities Industry and Financial Markets Association, and U.S. Chamber of Commerce to the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency (Jan. 12, 2024), *available at* https://bpi.com/wp-content/uploads/2024/01/Joint-Trades-Legal-Comment-on-Basel-III-Endgame-Proposal-FINAL.pdf; Request for Re-Proposal of Regulatory Capital Rule to Remedy Administrative Procedure Act Violations (Sept. 12, 2023), *available at* https://www.federalreserve.gov/SECRS/2023/October/20231003/R-1813/R-1813_091223_154704_493500277597_1.pdf; Quantitative Impact Study of the Potential Effects of Proposed Regulatory Capital Rules (Oct. 13, 2023), *available at* https://www.federalreserve.gov/SECRS/2023/October/20231013/R-1813/R-1813_101323_154734_486154207979_1.pdf.

10 The Agencies' economic impact analysis includes two approaches for analyzing the costs for the banking organizations that would become newly subject to LTD requirements: (i) a lower-end estimate ("incremental shortfall approach"), which assumes the current reported principal amounts of LTD issuance at Covered Entities are a "reasonable proxy for the levels of such debt that would be maintained in future periods in the absence of the [LTD proposal]," and (ii) a higher-end estimate ("zero baseline approach"), which assumes that Covered Entities would, in the absence of the LTD proposal, "choose to maintain no instruments that satisfy the [LTD proposal's] requirements in future periods." 88 Fed. Reg. at 64,549. The Agencies state that "the funding cost impact of the proposal is likely between the lower-end estimate from the incremental shortfall approach and the higher-end estimate from the zero baseline approach," while adding that "the incremental shortfall approach may provide a more accurate near-term perspective on funding cost impact." *Id.* at 64,553. Under the incremental shortfall approach, the Agencies estimate that the aggregate LTD shortfall would be approximately $70 billion, and pre-tax annual funding costs would increase by approximately $1.5 billion, which would represent a three-basis-point decline in net interest margins ("NIMs"). *See id.* at 64,552. Under the zero baseline approach, the Agencies estimate that the total principal value of external LTD required of these banking organizations, irrespective of existing LTD, would be approximately $250 billion, and pre-tax annual funding costs would increase by approximately $5.6 billion, which would represent an 11-basis-point decline in NIMs. *See id.* at 64,551; 64,553. As shown in Figure 2, BPI's zero baseline approach estimate is that pre-tax

considering factors overlooked in the Agencies' economic impact analysis. BPI estimates that the actual LTD shortfall under the LTD proposal requirements would be $186.6 billion ($83 billion for Category II and III banking organizations and $103.6 billion for Category IV banking organizations), or 2.7 times the Agencies' estimate under the incremental shortfall approach.[11] Based on these shortfalls, BPI estimates the LTD requirement would raise pre-tax annual funding costs by $4.9 billion ($1.8 billion for Category II and III banking organizations and $3.1 billion for Category IV banking organizations), which would represent a nine-basis-point decline in net interest margins ("NIMs") (a seven-basis-point decline for Category II and III banking organizations and a 13-basis-point decline for Category IV banking organizations).[12] As explained further below, these cost estimates are three times higher than the Agencies' comparable estimate. Last, the Agencies did not include in their economic analysis a standard measure utilized by investors to evaluate the profitability of banks: the impact on the return on tangible common equity ("ROTCE"). By this measure, the proposal would lead to an 80 basis point decline in ROTCE for Covered Entities, a material reduction in bank profitability.[13]

The Agencies should revise and recalibrate the LTD requirements to account for these higher expected costs. As described further in this section, we estimate significantly higher costs due to the following factors: (i) the impact of any LTD requirements on holding company liquidity requirements; (ii) the LTD shortfall at Covered IDIs under the proposed requirements; (iii) the significant projected increase in RWAs under the Basel III Endgame proposal's Expanded Risk-Based Approach; (iv) the need for banks to maintain management buffers to avoid dipping below minimum requirements; and (v) the consideration of individual bond spreads instead of credit default swap ("CDS") spreads. The Agencies should incorporate these factors into their cost estimates. The Agencies should *also* consider the difference in credit spreads between Covered Entities and U.S. global systemically important banks ("GSIBs"), the impact of the actual market capacity for LTD of Covered Entities, and fluctuations in funding costs over business cycles. For instance, some banks may choose to maintain an LTD buffer significantly exceeding six months in order to more effectively manage refinancing risk.

In finalizing an LTD requirement and related cost estimates, the Agencies should account for the foregoing factors and disclose the data sources they considered. Designing and finalizing any LTD requirement on the basis of an inaccurate economic impact analysis—including one that ignores the actual shortfall, costs, and the actual market capacity for LTD issuances by Covered Entities—would not be consistent with the requirements of the APA.

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annual funding costs would increase by approximately $9.4 billion, which would represent a 19-basis-point decline in NIMs.

[11] *See* Haelim Anderson, Francisco Covas, and Felipe Rosa, *The Long-Term Debt Proposal and Bank Profitability* (Dec. 7, 2023), *available at* https://bpi.com/the-long-term-debt-proposal-and-bank-profitability/. Although this estimated shortfall is lower than the estimated shortfall by the Agencies under the zero baseline approach, the incremental shortfall approach is the more relevant point of reference given the proposal to allow legacy external LTD to count toward minimum LTD requirements. As shown in Figure 2, BPI estimates significantly higher costs than the Agencies under a zero baseline approach.

[12] *See id*. Using the assumptions under the zero baseline approach yields an even greater disparity in pre-tax annual funding costs and declines in NIMs. *See id*.

[13] *See id.*

A. Covered Entities will need to issue significantly more LTD than estimated by the Agencies.

Figure 1 shows the waterfall of the LTD shortfall for Category II through IV banking organizations. This figure expands the cost analysis in the proposal after accounting for the IDI-level shortfall (described in Section III.D), the impact of the proposal on holding company Liquidity Coverage Ratio ("LCR")[14] (described in Section III.C), the rise in RWAs due to the Basel III Endgame proposal, and the need to maintain management buffers to avoid breaching minimum requirements. As shown in Figure 1, the shortfall for Category II through IV banking organizations rises by an additional $18.1 billion due to shortfalls at the IDI level, as discussed in Section III.D. This shortfall is further increased by $59.8 billion to restore the level of the LCR at the holding company level, as discussed in Section III.C. Moreover, a 10 percent increase in RWAs due to the Basel III Endgame proposal would increase the shortfall by an additional $20.5 billion. If banks also establish a buffer of LTD over the minimum requirements to manage day-to-day balance sheet fluctuations and refinancing risk, this buffer would translate into a further increase in LTD by $19.7 billion.[15] When these factors are taken into account in the cost estimates for the LTD proposal, the total shortfall for Category II through IV banking organizations is projected to reach $186.6 billion—approximately 2.7 times the proposal's estimated $70 billion shortfall under the incremental shortfall approach. Even though the market is expected to be able to absorb the newly issued debt, bond spreads are likely to widen, as discussed in more detail below. Together these factors contribute to a more comprehensive and accurate cost analysis, which should inform the proposal's calibration and other proposed requirements. Specifically, in light of these significantly higher estimated costs, the Agencies should recalibrate the proposal, tailor its application, and eliminate or significantly revise the internal LTD issuance requirement, each as discussed further in Section IV.

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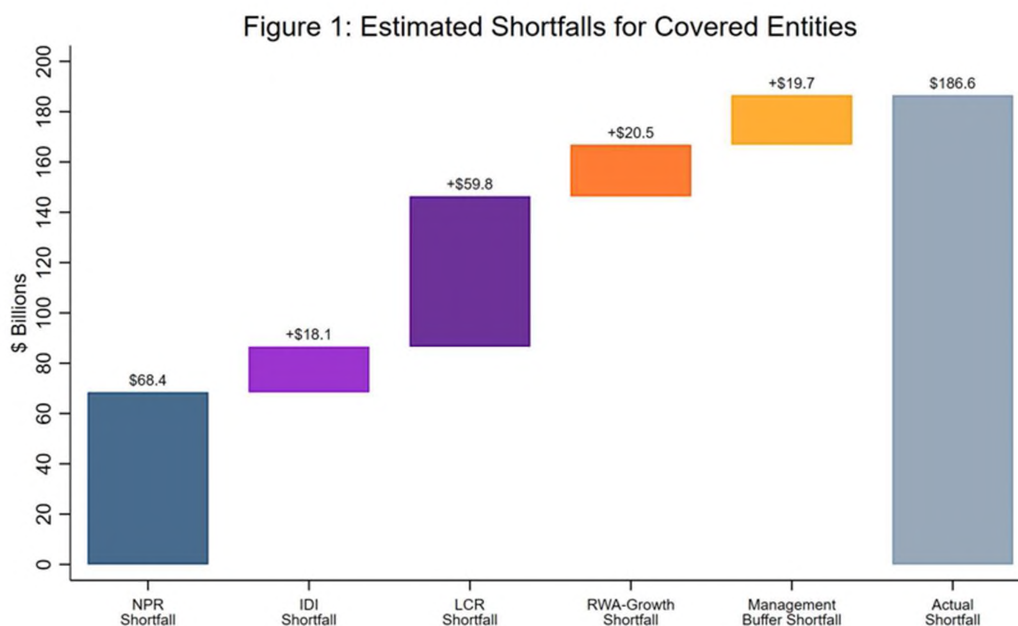
[14] *See* 12 C.F.R. Parts 50 (OCC), 249 (Federal Reserve), and 329 (FDIC).

[15] The buffer is estimated by assuming what each bank will need to maintain to comfortably navigate a six-month period in compliance, without the necessity to issue new LTD. Specifically, the estimation is calculated as the ratio of the individual bank's amount of outstanding LTD to the bank's weighted average maturity (the denominator is also multiplied by four to account for entire maturity of the debt and the six-month period).



B. The cost of the LTD proposal is likely at least three times higher than the Agencies' estimate.

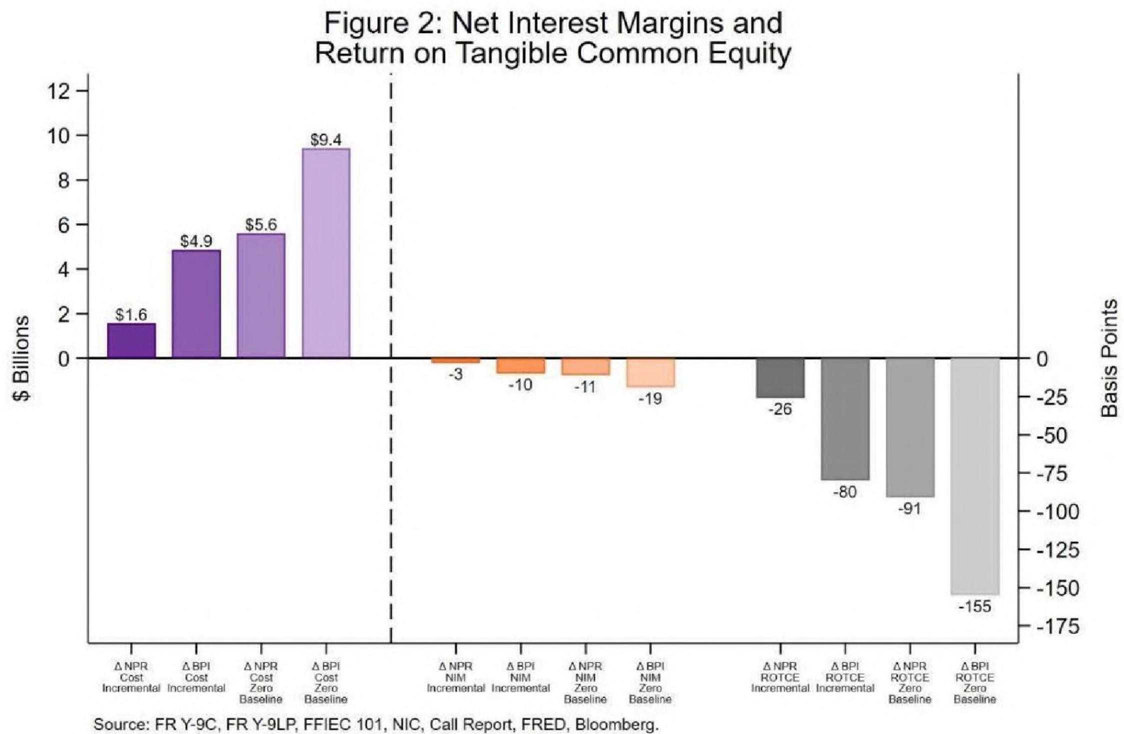
The Agencies estimate the funding cost spread as the difference between yields on five-year debt and the post-2008 average of the national non-jumbo three-month certificate of deposit rate.[16] To calculate yields on five-year debt for each firm, the Agencies add the post-2008 averages of the five-year senior CDS spread referencing the individual bank and the five-year Treasury yield.[17] However, CDS pricing data is available for only six entities among the 20 consolidated entities covered in the proposal. As a result, the Agencies use the average of a basket that includes six single-name CDS spreads and the single-name CDS spreads for GSIBs for the remaining 14 entities that do not have individual CDS pricing data. In contrast, our analysis relies on more comprehensive data consisting of credit spreads for individual bonds, improving the accuracy and granularity of credit-cost estimates. We estimate the funding credit cost for individual banks by constructing a covered-entity-specific bond credit spread index covering the post-2008 period for 17 of the 20 covered entities in the scope of applicability of the proposal. For the three banks lacking a sufficient time-series history of long-term debt outstanding, we utilize the arithmetic average of credit spread indices corresponding to the relevant bank category. These indices include bonds with a remaining tenor between four and six years for both the holding company and IDI subject to the proposal, if available.[18]

16 *See* 88 Fed. Reg. at 64,552.

17 *See id.*

18 For calculating the remaining maturity of each individual bond, we use the earliest of (1) the bond's scheduled maturity date and (2) the earliest date on which the bond is callable at its par value, if any. In addition, we remove a bond from the set of index constituent bonds on the earliest date on which the issuer expresses interest in the bond, through mechanisms such as an exchange, tender offer, consent solicitation, or open market purchase, among others.

Based on estimates for LTD requirements, shortfalls, and bond spreads, the total bank funding costs for Category II through IV banks are projected to reach $4.9 billion, which is three times the proposal's estimated costs of $1.5 billion under the incremental shortfall approach. Moreover, the higher funding costs translate into a significantly larger decrease in NIMs—10 basis points under the incremental shortfall approach versus three basis points in the proposal and an 80 basis point reduction in ROTCE.



As described further in Section IV, the Agencies should recalibrate and tailor the proposed LTD requirements to reflect these higher cost estimates, which are based on more comprehensive and accurate assumptions.

C. The Agencies should consider the impact of the LTD proposal on holding company liquidity.

The Agencies estimate that, under the incremental shortfall approach, the aggregate LTD shortfall would be approximately $70 billion. The Agencies acknowledge that the analysis under the incremental shortfall approach "may underestimate the costs," noting that the proxy for eligible external LTD used in the analysis may not satisfy all the eligibility requirements in the proposal, and that the Agencies did not consider management buffers.[19] Our impact analysis takes management buffers into account. And in this section we explain how the assumption that it "will be costless to . . . downstream resources from holding companies to IDIs through eligible internal debt securities, to fulfill the requirements of the [LTD proposal]

[19] 88 Fed. Reg. at 64,553, n. 109 and accompanying text.

and general funding needs"[20] results in a significant underestimate of the costs of the proposal.

This assumption renders the impact analysis inaccurate because it does not account for the actual effects of downstreaming resources from holding companies to IDI subsidiaries as an extension of credit in the form of eligible internal LTD, including the effect on the LCR at the holding company or the use of proceeds from holding company debt to fund the operations of broker-dealer or other non-bank subsidiaries. BPI's analysis shows that accounting for the need to restore the LCR at the holding company level at Category II through IV banking organizations would increase the LTD shortfall by approximately $59.8 billion.[21]

The LCR framework caps the amount of an IDI subsidiary's high-quality liquid assets ("HQLA") that can count toward its parent holding company's LCR at the value of the IDI's projected net cash outflows ("NCO") plus additional amounts of HQLA that are available to be transferred to the parent during times of stress without statutory, regulatory, contractual, or supervisory restrictions.[22] Currently, for purposes of the LCR, some banking organizations seek to minimize the amount of "trapped liquidity" (*i.e.*, HQLA held by a subsidiary that cannot be counted toward the parent's liquidity requirements) at their IDI subsidiaries arising from intercompany funding arrangements by having the holding company provide funding to the IDI through demand deposits.[23] Effectively, demand deposits increase the NCO of the IDI subsidiary, which, in turn, increase the amount of HQLA at the IDI subsidiary that can be counted as HQLA by the holding company.[24] To count toward any LTD requirement applicable to an IDI under the LTD proposal, extensions of credit from the holding company to an IDI subsidiary would need to be in the form of internal LTD (*i.e.*, internal demand deposits or any other short-term deposits would not qualify). Exchanging deposits, such as demand deposits, for LTD (*i.e.*, extending the term and changing the structure of the funding the IDI subsidiary receives from the holding company) would reduce NCO at the IDI subsidiary. This would, in turn, increase the amount of "trapped liquidity" at the IDI and reduce the amount of HQLA at the IDI subsidiary that can be counted as HQLA by the holding company. The increase in trapped liquidity would decrease the holding company's HQLA for purposes of the LCR.

To maintain the holding company LCR at current levels while satisfying any new internal LTD requirements, the holding company could not simply restructure internal demand deposits as LTD. Rather, a holding company would need to do one of two things. First, the holding company could issue incremental external LTD, beyond what is needed to satisfy its own external LTD requirements, to raise proceeds that could be lent to the IDI in the form of internal LTD. Alternatively, if the holding company restructured existing internal demand deposits as LTD, the holding company would need to issue securities

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[20] 88 Fed. Reg. at 64,551–52.

[21] *See* Anderson, Covas, and Rosa, *supra* note 11. *See also* Haelim Anderson, Francisco Covas, and Felipe Rosa, *The Long-Term Debt Shortfall and the Liquidity Coverage Ratio* (Oct. 23, 2023), *available at* https://bpi.com/the-long-term-debt-shortfall-and-the-liquidity-coverage-ratio/ [hereinafter *Liquidity Coverage Ratio*].

[22] *See* Section 22(b)(3)(i) of the LCR rule, 12 C.F.R. Parts 50 (OCC), 249 (Federal Reserve), and 329 (FDIC). The shortfall estimates reflect an assumption that the amount of IDI-level HQLA that counts toward the parent's LCR is limited to the IDI's NCOs—that is, that the parent does not count additional amounts of IDI-level HQLA toward its LCR on the ground that those amounts could be transferred during times of stress without restriction.

[23] See generally *Liquidity Coverage Ratio*, *supra* note 21, for additional details on the foregoing analysis.

[24] *See id*. The demand deposits would not affect the holding companies' NCO because the demand deposits are eliminated in consolidation.

that do not increase NCO at the holding company level (*e.g.*, LTD, preferred stock, or common stock) and use the proceeds to increase HQLA at the holding company by either acquiring HQLA directly or lending the proceeds to the IDI in the form of internal demand deposits. In either case, to maintain its current LCR and satisfy LTD requirements at both the IDI and holding company levels, the holding company would, in effect, be required to issue substantially more external LTD than would be necessary to satisfy the external LTD requirement applicable to the holding company.

The proposed internal LTD requirement could also have an impact on parent company internal liquidity stress tests ("ILST") under Regulation YY, which could affect parent company cash management. The proposal would require the parent to downstream funds to the IDI in the form of term funding. This would require the funds to stay in the IDI for 24 months, which would affect the parent's ILST by locking up access to the cash for 24 months—a much longer period than most companies' stress coverage under the ILST.

Although Category IV banking organizations are, appropriately, generally not subject to LCR requirements, the assumption of "costless" downstreaming is likewise inaccurate for them. Category IV banking organizations maintain deposits, including internal demand deposits, with their IDI subsidiaries in light of the ILST, parent company liquidity, rating agency, Regulation W, and other considerations. They too could not restructure internal demand deposits as internal LTD in a "costless" manner.

In addition, absent clarification by the Agencies, LTD issued to satisfy a loss-absorbency requirement promulgated under statutory authorities in the Federal banking laws allowing the Agencies to establish capital requirements could be treated differently from deposits, including internal demand deposits, for purposes of Regulation W.[25] Specifically, Regulation W permits certain deposit accounts to qualify as collateral,[26] but provides that debt securities that "represent regulatory capital" are not eligible collateral.[27] Eligible senior LTD would *not* be "regulatory capital" because it would not be issued to satisfy the requirements in the regulatory capital rules,[28] but the Agencies would need to confirm that it would not be treated as regulatory capital for purposes of Regulation W because they appear to rely, in part, on the statutory authority to promulgate regulations on regulatory capital for the proposed LTD requirement for Covered IDIs.[29] Accordingly, the Agencies should confirm that LTD issued pursuant to any LTD requirement would qualify as eligible collateral for purposes of Regulation W.

To avoid undue costs relating to trapped liquidity and other potential consequences of the internal LTD requirement, the Agencies should eliminate the separate internal LTD requirement for Covered IDIs. Instead, the Agencies should permit a Covered Holding Company or Covered IHC to comply with any LTD requirement at either the holding company level or the IDI level, as discussed further in Section IV.D

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[25] *Compare* 12 C.F.R. 223.14(b)(1)(i)(D) *with* 12 C.F.R. 223.14(c)(3).

[26] *See* 12 C.F.R. 223.14(b)(1)(i)(D).

[27] 12 C.F.R. 223.14(c)(3).

[28] *See* 12 C.F.R. Parts 3 (OCC), 217 (Federal Reserve), and 324 (FDIC).

[29] *See* 88 Fed. Reg. at 64,561, 64,562, 64,578 (citing 12 U.S.C. 5371 and 12 U.S.C. 3907 as statutory authorities). In addition, the FDIC staff memo states that the LTD proposal "would be adopted under the authority that allows the Agencies to issue capital rules." Memorandum from James L. McGraw, Acting Director, Division of Complex Institution Supervision & Resolution, to FDIC Board of Directors 10 (Aug. 29, 2023), *available at* https://www.fdic.gov/news/board-matters/2023/2023-08-29-notice-dis-a-mem.pdf.

below. In any case, the Agencies should lower the calibration of any LTD requirement, as discussed further in Section IV.B below. The recommended calibration of two percent of RWAs would also reduce any trapped liquidity issue resulting from an internal LTD requirement, should the Agencies decide to maintain an internal LTD requirement.

D. The Agencies should consider the LTD shortfall at Covered IDIs.

The Agencies do not address the potential impact on a banking organization if a Covered IDI that is a subsidiary of a Covered Holding Company or Covered IHC has less outstanding debt than the Covered Holding Company or Covered IHC, such that the shortfall at the holding company level does not reflect the overall shortfall for the banking organization. As explained above in Section III.C, for a variety of regulatory and liquidity management reasons, holding companies today do not downstream all the proceeds of outstanding LTD through the issuance of subsidiary-level term debt. As a consequence, the amount of outstanding LTD at a holding company and its IDI subsidiary typically differs. For example, if a holding company and an IDI each have an LTD requirement of $10 billion, and the holding company has $4 billion LTD outstanding and the IDI only has $1 billion LTD outstanding, the shortfall at the holding company would be $6 billion, but the shortfall at the IDI would be $9 billion, or 1.5 times greater. Because the proposal would permit the IDI only to issue eligible LTD internally, the holding company would need to issue at least $9 billion, rather than $6 billion, because it would need to generate proceeds to be able to downstream at least $9 billion to the IDI. A failure to consider such a scenario and the actual funding structures of Covered Entities renders the impact assessment inaccurate, especially with respect to Covered IDIs. BPI's analysis shows that accounting for the IDI-level shortfall at Category II through IV banking organizations would increase the LTD shortfall by approximately $18.1 billion.[30] The Agencies should account for IDI-level shortfalls as part of an updated impact analysis and revise the LTD proposal accordingly—specifically, by recalibrating the proposed LTD requirements and eliminating the internal LTD requirement as described in Section IV.

E. The Agencies should consider the impact of the actual market capacity for LTD of Covered Entities.

The Agencies estimate that the LTD proposal could increase the amount of annual LTD issuance by non-GSIBs by 16 to 24 percent.[31] The LTD proposal acknowledges the "risk that efforts by [Covered Entities] to issue a large volume of LTD over a limited period could strain the market capacity to absorb the full amount of such issuance if issuance volume exceeds debt market appetite for LTD instruments."[32] However, the LTD proposal does not quantify the potential costs of insufficient market capacity and appears to dismiss these concerns because the "estimated eligible external LTD shortfall is a small to moderate fraction of the average total annual LTD issuance."[33] It is unclear whether the Agencies considered the potential effect of a nearly 25 percent increase in annual issuance levels by Covered Entities on investor demand, pricing, or credit spreads. It is also unclear whether the Agencies considered the high interest rate environment in reaching their conclusions. Nor does it appear that the Agencies considered the actual experience of GSIBs as part of their economic impact analysis. Specifically, the cost of GSIB debt

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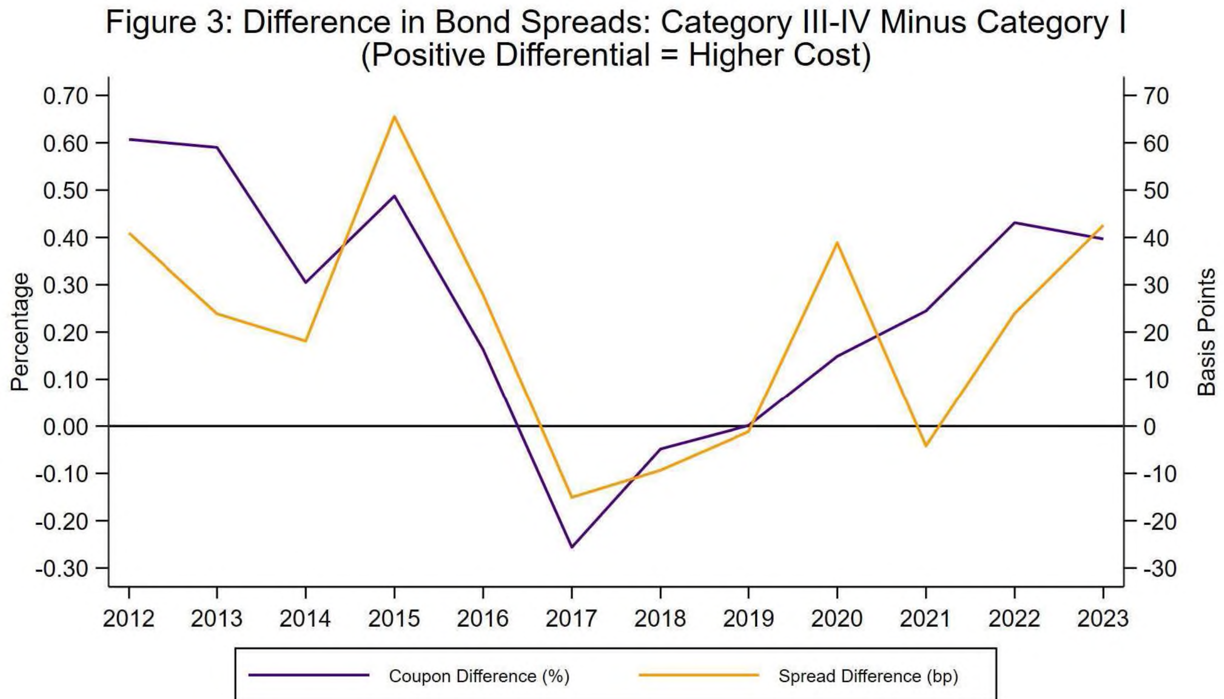
30 *See* Anderson, Covas, and Rosa, *supra* note 11.

31 88 Fed. Reg. at 64,552.

32 *Id.* at 64,553.

33 *Id.* at 64,553, n. 111.

increased significantly following the adoption of the Federal Reserve's total loss-absorbing capacity ("TLAC") rule in 2016, such that the debt of domestic Category III and IV banking organizations temporarily traded more favorably than the debt of U.S. GSIBs.



Forcing Category II through IV banking organizations to significantly increase issuance volumes to satisfy any new requirement would create, at a minimum, significant temporary cost increases. Market participants would demand pricing concessions, as they know the banking organizations have no choice but to issue the debt.

Even if the Agencies had correctly estimated the eligible external LTD shortfall,[34] that estimate would not address what the cost implications might be of forcing this amount of LTD into the market. Finally, as discussed in more detail below,[35] the proposed minimum denomination requirement, which should not be adopted in connection with any LTD requirement, would reduce the secondary market liquidity and the investor base for LTD. As a consequence, this proposed requirement would increase the cost of issuing LTD. It does not appear that the Agencies considered the effect of the proposed minimum denomination requirement on secondary market liquidity, market capacity, pricing, or credit spreads as part of their economic impact analysis. The Agencies should address these issues as part of an updated

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[34] As noted above, the fact that the Agencies did not consider the LTD shortfall at Covered IDIs or the actual funding structures of Covered Entities makes this assumption inherently inaccurate.

[35] *See* Section V.A.

economic impact analysis and revise the proposed LTD requirements accordingly.

The cost analysis of the LTD proposal incorporates the historical credit spreads of U.S. GSIBs. But the credit spreads of Covered Entities have not tracked those for GSIBs, and the Agencies do not provide any rationale for why that might change in the future. In recent years, the debt issued by GSIBs has generally had tighter (*i.e.*, more favorable) credit spreads than other banking organizations, and the exceptions serve only to underscore how the Agencies undercounted the potential costs of the proposal. In the past decade, debt of regional banking organizations traded more favorably than the debt of GSIBs after the Federal Reserve's TLAC rule was finalized and at the early stages of the pandemic when GSIBs issued significant amounts of LTD to satisfy TLAC and LTD requirements in light of growth in their balance sheets—that is, after developments that effectively required the GSIBs to go to the debt capital markets. If regulatory requirements to issue LTD caused the generally more favorable credit spreads of GSIBs to fall behind those of regional banking organizations, requiring materially higher issuance volumes by regional banking organizations would likely drive even less favorable credit spreads than is currently the case. Indeed, recent experience indicates that the finalization of an LTD requirement that mandates the issuance of additional LTD, over a short transition period, would make accessing the debt capital markets only more expensive for Covered Entities.[36]

F. The Agencies should consider fluctuations in funding costs over business cycles for the issuance of LTD of Covered Entities to meet any LTD requirement.

The Agencies did not consider potential variations in bank funding costs due to fluctuations in credit spreads, as evidenced by the use of the average of CDS spreads since 2008. When fluctuations in bond spreads are considered, bank funding costs vary significantly over time. The analysis below utilizes individual bond credit spreads in lieu of CDS spreads to enhance the precision and detail in calculating the rise in bank funding costs resulting from the proposal. Figure 4 illustrates that an index of bond spreads—which is weighted by the volume of outstanding bonds with a remaining tenor of four to six years—has displayed considerable variability over the past 14 years. Following the financial crisis, this index peaked at 900 basis points. It also registered sharp increases during the European sovereign debt crisis, the COVID-19 pandemic, and the bank failures in the spring of 2023.

[36] The Agencies are incorrect to assume that, if the LTD proposal is phased in gradually, the "transition-related costs and risks of the proposal's adoption are likely to be small relative to long-run effects." 88 Fed. Reg. at 64,553. That assumption is predicated on (i) investors not demanding wider credit spreads when Covered Entities increase their issuance volumes in response to an LTD requirement, which is inconsistent with historical experience, and (ii) spreads decreasing during the phase-in period, which is overly speculative, especially in the current interest rate environment. That assumption also presupposes that banking organizations can issue LTD at the optimal time, including with issuance entirely at the end of the phase-in period, which is impractical. Finally, the market would price the full LTD issuance into banking organizations' equity prices immediately and would not wait until the end of the phase-in period, further exacerbating the problem and leading to far higher spreads than those assumed by the Agencies' economic impact analysis.

In light of the current macroeconomic uncertainty, bond spreads could widen again. Hence, it is important to incorporate bond spread variability into the cost analysis for the proposal. This variability influences not just the funding cost per dollar of issuance but also the aggregate funding costs. It is crucial to acknowledge this variability, especially since credit spreads for regional banks are expected to remain high in the near future. This anticipation stems from the persistently high interest rate environment and the possibility of future downgrades in the credit ratings of regional banks.

G. The Agencies should recalibrate the proposal in light of the impact on bank funding costs, especially for Category IV banks.

The application of the LTD proposal would significantly raise bank funding costs, particularly for Category IV banks. This is primarily due to the higher costs per dollar of debt issued. According to BPI's estimates, Category II and III banks face an LTD shortfall of $82 billion, while Category IV banks face an LTD shortfall of $93 billion. As shown in Figure 5, data from 2009 to 2022 indicate that investors demanded 81 basis point higher spreads from Category IV banks compared to Category II and III banks. Furthermore, during market stress, Category IV banks' bond spreads tend to increase more than those of Category II and III banks, leading to significantly higher costs when these banks access the bond markets during such periods. Overall, the proposed LTD requirement would raise pre-tax annual funding costs by $2.7 billion for Category IV banks, which is more pronounced than the $1.8 billion increase for Category II and III banks, using the incremental shortfall approach.

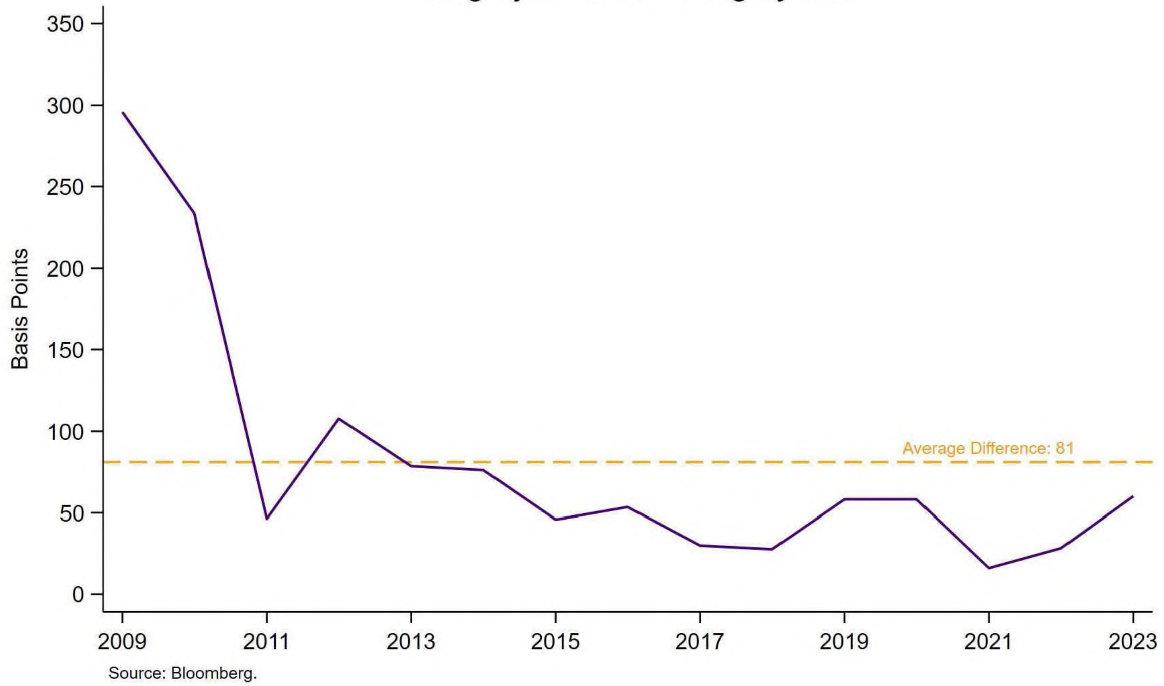
Figure 5: Yearly Average Difference in Bond Spreads
Category IV Minus Category II-III
Basis Points
350
300
250
200
150
100
50
0
Average Difference: 81
2009
2011
2013
2015
2017
2019
2021
2023
Source: Bloomberg.

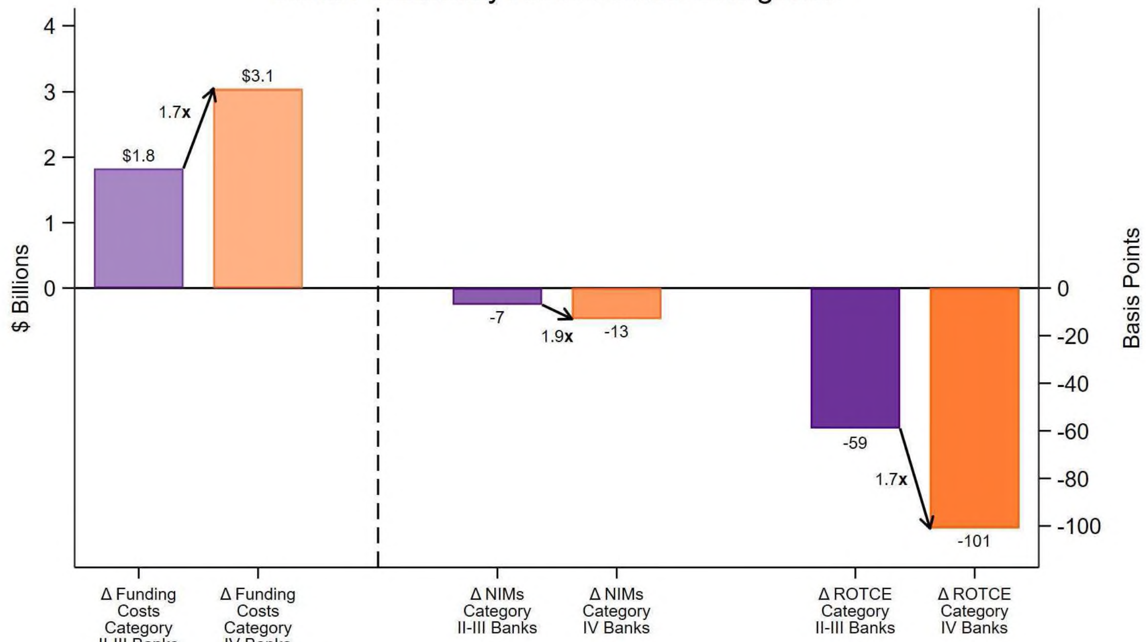
Figure 6: Effect of Proposal on Bank Funding Costs and
Bank Profitability Across Bank Categories
$ Billions
4
3
2
1
0
$1.8
1.7x
$3.1
-7
1.9x
-13
-59
1.7x
-101
Basis Points
0
-20
-40
-60
-80
-100
Δ Funding Costs Category II-III Banks
Δ Funding Costs Category IV Banks
Δ NIMs Category II-III Banks
Δ NIMs Category IV Banks
Δ ROTCE Category II-III Banks
Δ ROTCE Category IV Banks
Source: FR Y-9C, FR Y-9LP, FFIEC 101, NIC, Call Report, FRED, Bloomberg.

The projected increase in pre-tax annual funding costs would reduce the profitability of Category IV banks considerably more than those of Category II and III banks. BPI has analyzed the effect of higher funding costs on NIMs and ROTCE to assess the effect of the proposed LTD requirements. As shown in Figure 6, BPI's analysis indicates that the implementation of LTD requirements would reduce NIMs by approximately seven basis points for Category II and III banks and by 12 basis points for Category IV banks. Furthermore, ROTCE is expected to fall by 59 basis points for Category II and III banks and by a substantial 101 basis points for Category IV banks. To mitigate the adverse financial impact of the LTD proposal on Category IV banks, the Agencies should recalibrate and tailor the LTD requirement for Category IV firms as described in Section IV.

H. Failing to update the economic impact analysis and revise any LTD requirement accordingly would raise concerns under the APA.

The APA authorizes reviewing courts to "hold unlawful and set aside agency action, findings, and conclusions" found to be, among other things, arbitrary and capricious.[37] Although a court may not substitute its judgment for that of the agency, the agency must "examine the relevant data and articulate a satisfactory explanation for its action."[38] Further, an agency rule would generally be arbitrary and capricious if the agency "entirely failed to consider an important aspect of the problem."[39]

The foregoing data and analyses bear directly on an "important aspect of the problem" (*i.e.*, the ability of banking organizations to issue LTD and the attendant costs of doing so). In addition, the fact that the Basel III Endgame proposal, if adopted, would "lead mechanically to increased requirements for LTD under the LTD proposal" is directly relevant to the calibration of any LTD requirement.[40] A final LTD rule that fails to consider these issues may not satisfy the requirements of the APA.

IV. The Agencies should revise the design, application, and calibration of the proposed LTD requirements.

This section recommends revisions to the proposed requirements that would reduce expected costs while continuing to promote the Agencies' stated policy objectives. The Agencies describe the principal objectives of an LTD requirement as: (i) increasing the likelihood that some or all uninsured deposits are protected from losses, even under the FDIC's least-cost resolution test;[41] (ii) providing the FDIC with more flexibility to transfer all deposits to an acquirer or bridge depository institution;[42] (iii) lowering the risk that multiple concurrent failures of Covered Entities might occur and impose high costs on the Deposit Insurance Fund ("DIF");[43] and (iv) enhancing market discipline and incentivizing prudent

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[37] 5 U.S.C. 706(2).

[38] *Motor Vehicle Mfrs. Ass'n of U.S., Inc.* v. *State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 30 (1983).

[39] *Id*. at 43; *see also Michigan* v. *EPA*, 576 U.S. 743, 753 (2015) (holding that a statutory requirement that an agency determine whether "regulation is appropriate and necessary" is not "an invitation to ignore cost").

[40] 88 Fed. Reg. at 64,551, n. 97. Because the Agencies have not issued a final rule to implement the Basel III Endgame, it may not be possible to estimate accurately the costs of any LTD requirement.

[41] *See id*. at 64,550; *see also* 12 U.S.C. 1823(c)(4).

[42] 88 Fed. Reg. at 64,527.

[43] *See id*. at 64,550.

behavior by Covered Entities.[44] The Agencies have not explained why an LTD requirement equal to the greater of six percent of RWAs, 3.5 percent of average total consolidated assets, and 2.5 percent of total leverage exposure[45] (if a banking organization is subject to the supplementary leverage ratio)—which is based on a capital refill framework— is necessary to support these policy objectives.

As described below, the Agencies should adopt an alternative calibration of two percent of RWAs,[46] which is more appropriate for Covered Holding Companies and Covered IHCs and aligns with the Agencies' own policy objectives. In addition, the requirements should be tailored for Category II through IV banking organizations and the Agencies should eliminate the proposed internal LTD requirement and permit a Covered Holding Company or Covered IHC to comply with any LTD requirement at either the holding company level or the IDI level.

We also note that the LTD proposal broadly states that increased reliance on uninsured deposit funding has given rise to vulnerabilities at banking organizations.[47] Here, as in any action to address the risks presented by uninsured deposits, we urge the Agencies to recognize the distinctions among types of uninsured deposits and to acknowledge the important reasons customers hold deposits at a bank above the federal deposit insurance limit. For example, businesses and investors maintain operational deposit accounts at banks to meet their day-to-day payment, settlement, payroll administration, cash management, and other needs. These types of deposits are generally more stable and must meet requisite criteria under liquidity regulations, which recognize their deposit stability. Failure to recognize important differences—both in terms of function and stability—between types of deposits could discourage banks from accepting those deposits and prevent banks from conducting critical operational business activities, both when markets are stable and in times of stress.

A. A capital refill calibration is unnecessary to support the proposal's stated objectives.

The Agencies note that the proposed requirement was calibrated on the basis of the "capital refill" framework. The objective of the capital refill framework is to ensure that a banking organization has a minimum amount of eligible LTD such that, if the banking organization's going-concern capital is fully

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44 *See id.* at 64,551.

45 *See id.* at 64,529–30.

46 Any leverage-based LTD requirements would need to be revised commensurately, reflecting the fact that leverage capital requirements are intended to be a backstop and not a binding requirement. *See, e.g.*, Jerome H. Powell, "Central Clearing and Liquidity" (June 23, 2017), *available at* https://www.federalreserve.gov/newsevents/speech/powell20170623a.htm ("A risk-insensitive leverage ratio can be a useful backstop to risk-based capital requirements. But such a ratio can have perverse incentives if it is the binding capital requirement because it treats relatively safe activities, such as central clearing, as equivalent to the most risky activities.").

47 *See* 88 Fed. Reg. at 64,525 ("In recent years, certain banking organizations that are not [GSIBs] have grown in size and complexity, and new vulnerabilities have emerged, such as increased reliance on uninsured deposits."). Similarly, recent comments by FDIC Chairman Gruenberg suggest that reducing uninsured deposits is among the benefits of the LTD proposal. *See* 2023 European Systemic Risk Board Annual Conference – Panel Discussion: Banking Sector Turbulences (Nov. 16, 2023), *available at* https://www.youtube.com/watch?v=M5naHjaV2Fw ("On the relationship between [LTD] and uninsured deposits . . . we don't want more uninsured deposits, we want less uninsured deposits, quite frankly, in terms of concentrations . . . And also the expectation is, assuming we move forward with the [LTD] rule, [LTD] will take the place of some of the uninsured deposits on the balance sheet of some of these institutions, which would have multiple, multiple benefits.").

depleted, the LTD would be sufficient to fully recapitalize the going-concern capital of the banking organization to at least the amount required to meet minimum leverage capital requirements and a minimum common equity tier 1 ("CET1") risk-based capital requirement of 4.5 percent plus the capital conservation buffer ("CCB") of 2.5 percent.[48] The Agencies originally developed this framework for a banking organization with a resolution strategy contemplating that, when the top-tier parent fails and enters resolution proceedings, the going-concern capital of the top-tier parent's material subsidiaries would be fully recapitalized so those subsidiaries could continue to operate as going concerns outside resolution proceedings. Yet, the Agencies offer no explanation of why the proposed calibration is necessary to achieve their stated objectives in the case of banking organizations with different resolution strategies. The stated objectives of protecting uninsured depositors from losses in the event of a banking organization's failure, providing the FDIC with more flexibility to transfer all deposits, meeting the least-cost resolution test without imposing losses on uninsured depositors, minimizing losses to the DIF, and enhancing market discipline may all be served by an LTD requirement calibrated well below the capital refill level. Any LTD requirement for Category II through IV banking organizations should reflect the policy objectives of the proposal, as well as the actual resolution strategies for those banking organizations, which generally do not contemplate the full recapitalization of their material subsidiaries such that they can remain going concerns outside their own resolution proceedings.

B. The calibration of any LTD requirement for Covered Entities should be substantially revised.

1. The capital refill framework is inconsistent with the typical resolution strategies of Category II through IV banking organizations.

Category II through IV banking organizations generally conduct the vast majority of their operations through IDI or retail brokerage subsidiaries. To reflect these organizational structures, Category II through IV banking organizations subject to resolution planning requirements have generally not adopted resolution strategies under which material subsidiaries would be recapitalized and continue operations or be wound down in an orderly manner outside their own resolution proceedings. By contrast, the IDIs of Category II through IV banking organizations would likely be resolved under a Federal Deposit Insurance Act ("FDIA") proceeding.[49] For these banking organizations, the purpose of an LTD requirement would be to ensure that they can be recapitalized at a level that is sufficient to give the FDIC enough time to execute their resolution strategy successfully, minimize losses to the DIF, and otherwise provide the FDIC, as receiver, with incremental flexibility in resolving the failed IDI.[50] There would be no need to recapitalize the IDI to the level necessary for the IDI to remain a going concern operating outside its own FDIC resolution proceeding.

The Agencies should revise the calibration of any LTD requirement for Covered Entities to reflect

[48] *See* 88 Fed. Reg. at 64,530.

[49] A retail broker-dealer subsidiary could be sold or wound down under a proceeding pursuant to the Securities Investor Protection Act, which is designed to protect retail investors. *See* 15 U.S.C. §§ 78aaa *et seq.* The main insolvency imperative would be to transfer customer accounts to another broker-dealer, and the Securities Investor Protection Corporation has a well-established and proven process for executing such a resolution.

[50] *See* 88 Fed. Reg. at 64,526 ("In the resolution of a failed IDI, the availability of an outstanding amount of LTD may increase the likelihood of an orderly and cost-effective resolution for the IDI and may help minimize costs to the DIF.").

that, in the context of an FDIA receivership for an IDI, it is not necessary to recapitalize an IDI from a starting point of zero capital to a level of capital sufficient to operate as a going concern outside a receivership proceeding. These revisions would recognize that an LTD requirement equal to the greater of six percent of RWAs, 3.5 percent of average total consolidated assets, and 2.5 percent of total leverage exposure, based on the capital refill framework, was specifically designed for strategies that contemplate the material subsidiaries of a banking organization continuing as going concerns outside of their own resolution proceedings. A capital refill calibration is unnecessary for banking organizations whose resolution strategies do not contemplate their material subsidiaries continuing to operate as going concerns outside of their own resolution proceedings. The Federal Reserve clearly described the connection between the capital refill calibration and going concern capital in the final rule adopting LTD requirements for GSIBs.[51]

Revising the LTD calibration to reflect the resolution strategies of Covered Entities would align with and reinforce the statement that the Federal Reserve and the FDIC "do not prescribe a specific resolution strategy for any covered company" or "identify a preferred strategy," and the commitment that the related proposed resolution planning guidance is "not intended to favor one strategy or another."[52] Without revisions to the design, application, and calibration of any LTD requirement, these commitments may be merely theoretical, insofar as banking organizations are effectively pushed to adopt a resolution strategy involving the recapitalization of material subsidiaries such that they can continue to operate outside their own resolution strategies.[53] Adoption of this strategy would be an unnecessarily costly and operationally complex endeavor for the banking organizations subject to the proposal.

2. *The proposal should adopt more justifiable capital starting and ending points.*

The capital refill framework makes two assumptions that are not reasonable for a Covered Entity: (i) the going concern capital of the Covered Entity will be fully depleted by the time it files a Chapter 11 petition or the time it is put into an FDIA receivership, and (ii) the Covered Entity's bridge-bank, purchase and assumption ("P&A") agreement, or other non-SPOE resolution strategy requires enough LTD to fully

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[51] *See* 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, 82 Fed. Reg. 8,266, 8,274 (Jan. 24, 2017) ("… the final rule's external LTD requirement was calibrated primarily on the basis of a 'capital refill' framework. According to the capital refill framework, the objective of the external LTD requirement is to ensure that each covered BHC [bank holding company] has a minimum amount of eligible external LTD such that, if the covered BHC's going-concern capital is depleted and the covered BHC fails and enters resolution, the eligible external LTD will be sufficient to absorb losses and fully recapitalize the covered BHC by replenishing its going-concern capital. The amount of eligible external LTD required by the final rule is the amount estimated to be necessary for a covered BHC that has depleted all of its equity capital to return to a sufficient level of going concern capital level without any government assistance or outside investment.").

[52] Guidance for Resolution Plan Submissions of Domestic Triennial Full Filers, 88 Fed. Reg. 64,626, 64,627 (Sept. 19, 2023); Guidance for Resolution Plan Submissions of Foreign Triennial Full Filers, 88 Fed. Reg. 64,641, 64,643 (Sept. 19, 2023).

[53] *See* Statement by Governor Michelle W. Bowman on the Proposed Long-term Debt Requirements and Proposed Guidance for Resolution Plan Submissions of Domestic Triennial Full Filers (Aug. 29, 2023), *available at* https://www.federalreserve.gov/newsevents/pressreleases/bowman-statement-20230829.htm ("Although the guidance suggests that it is not intended to favor either the 'single point of entry' or 'multiple point of entry' resolution strategy, ongoing regulatory reform efforts could effectively eliminate this optionality.").

recapitalize the business of the Covered Entity in order for that strategy to be credible. As a result, the framework results in a calibration for the proposed LTD requirement of six percent of RWAs, which corresponds to a minimum CET1 capital ratio of 4.5 percent plus a CCB of 2.5 percent, for a total of seven percent, less a balance-sheet depletion allowance of one percent. But neither of these assumptions is realistic. Correcting these assumptions results in an alternative calibration of two percent, which is a more appropriate level that would still support the Agencies' stated goal of facilitating the transfer of all deposits to an acquirer or bridge bank.

A Covered Entity is almost certain to have going concern leverage capital of at least two percent of its average total assets at the time it reaches its point of non-viability, as contemplated by the prompt corrective action ("PCA") framework under section 38 of the FDIA.[54] In addition, unlike a resolution strategy involving the recapitalization of material subsidiaries so they can continue to operate as going concerns outside their own resolution proceedings, a bridge-bank, P&A, or other alternative resolution strategy does not require enough LTD to fully recapitalize the IDI subsidiary. It is not reasonable for the Agencies to assume that the Covered Holding Company or Covered IHC needs to have enough LTD to recapitalize its IDI subsidiary at the minimum CET1 capital level, plus the CCB.[55] The minimum CET1 capital level of 4.5 percent of RWAs,[56] without the CCB of 2.5 percent of RWAs, should be a sufficient recapitalization target. Indeed, the FDIA expressly provides that a bridge bank is not subject to capital requirements.[57] It is unclear why, especially in light of the statutory exemption, the Agencies would believe that a bridge bank must be recapitalized at the same level as the failed IDI prior to experiencing financial distress—that is, at a level able to satisfy both the minimum CET1 capital and CCB requirements.[58]

The Agencies should revise these unrealistic and overly conservative assumptions by (i) assuming a starting point of two percent of RWAs, as contemplated by the PCA framework, instead of zero capital as a result of full depletion; (ii) using an ending point of 4.5 percent of RWAs, reflecting the CET1 capital requirement necessary to be considered adequately capitalized under the Agencies' regulations without the CCB of an additional 2.5 percent;[59] and (iii) in light of the revised assumptions, providing for a balance

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54 *See* 12 U.S.C. 1831o; *see also* 12 C.F.R. 6.4(b)(5); 12 C.F.R. 208.43(b)(5); 12 C.F.R. 324.403(b)(5). The PCA framework generally requires the appropriate Federal banking agency to promptly close a critically undercapitalized IDI and appoint a receiver or conservator. *See* 12 U.S.C. 1831o(h).

55 The Agencies should explicitly state, as part of any final rule, that they are not requiring Category II through IV banking organizations to adopt an SPOE resolution strategy, but that these banking organizations may adopt an SPOE resolution strategy in the future.

56 *See* 12 C.F.R. 3.10(a)(1)(i); 12 C.F.R. 217.10(a)(1)(i); 12 C.F.R. 324.10(a)(1)(i). This also corresponds to the threshold for adequately capitalized status. *See* 12 C.F.R. 6.4(b)(2)(iii); 12 C.F.R. 208.43(b)(2)(iii); 12 C.F.R. 324.403(b)(2)(iii).

57 *See* 12 U.S.C. 1821(n)(5).

58 *See* 88 Fed. Reg. at 64,530 ("In terms of [RWAs], a covered entity's [CET1] capital level is subject to a minimum requirement of 4.5 percent of [RWAs] plus a [CCB] equal to at least 2.5 percent. Accordingly, a covered entity would be subject to an external LTD requirement equal to 7 percent of [RWAs] minus a 1 percentage point allowance for balance sheet depletion. This results in a proposed LTD requirement equal to 6 percent of [RWAs].").

59 Notably, the full capital refill framework appears predicated on recapitalizing an IDI subsidiary beyond the 6.5 percent CET1 requirement for well capitalized status, as the framework uses the higher threshold of the minimum requirement plus the 2.5 percent CCB requirement. *See* 12 C.F.R. 6.4(b)(1)(i); 12 C.F.R. 208.43(b)(1)(i); 12 C.F.R. 324.403(b)(1)(i); 12 C.F.R. 3.10(a)(1)(i); 12 C.F.R. 217.10(a)(1)(i); 12 C.F.R. 324.10(a)(1)(i); 12 C.F.R. 3.11(a); 12 C.F.R. 217.11(a); 12 C.F.R. 324.11(a).

sheet depletion allowance of 0.5 percentage point (versus the allowance of one percentage point used to arrive at the Agencies' proposed six percent calibration). These revised assumptions would result in an LTD requirement equal to two percent of RWAs rather than the proposed six percent of RWAs. These revised assumptions should carry through to any leverage-based LTD requirements, especially as leverage capital requirements are intended to be a backstop and not a binding constraint.

3. *The proposal should recognize that FBOs' regulatory context already achieves the purposes of an LTD requirement.*

The capital refill framework is not appropriate for the IHCs of FBOs because FBOs are already subject to significant resolution-related requirements, including gone-concern loss-absorbing capacity ("GLAC") requirements, and have developed resolution strategies designed to achieve the same objectives as the proposal: the orderly resolution of their U.S. subsidiaries. The Agencies should recognize these existing requirements under any final rule and recalibrate the LTD requirements applicable to Covered IHCs and Covered IDI subsidiaries of Covered IHCs accordingly. The Federal Reserve should also recalibrate the existing requirements for IHCs of non-U.S. GSIBs to be at the low end of the range of 75–90 percent of applicable requirements contained in the Financial Stability Board's international TLAC standard.[60] This would increase the likelihood that non-U.S. jurisdictions would calibrate internal TLAC requirements for the non-U.S. subsidiaries of U.S. GSIBs at the lower end of that range.

C. The Federal Reserve should tailor the LTD requirements for Category II through IV banking organizations, as required by statute.

The LTD proposal would apply the LTD requirements to Category II through IV banks without any differentiation. In this manner, the proposal—like the Basel III Endgame proposal—ignores the statutory requirements to tailor the application of prudential standards and, in the case of Category IV banks, to make a determination regarding the application of these standards.

Section 165 of the Dodd-Frank Act includes three core, yet simple, requirements: the Federal Reserve shall (i) establish enhanced prudential standards for bank holding companies with $250 billion or more in total consolidated assets;[61] (ii) differentiate the application of enhanced prudential standards (either on an individual basis or by category) based on a bank holding company's capital structure, riskiness, complexity, financial activities, size, or other risk-related factors;[62] and (iii) make a determination in order to apply enhanced prudential standards to any bank holding company or bank holding companies

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[60] *See* FSB, *Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution: Total Loss-absorbing Capacity (TLAC) Term Sheet* 19–20 (Nov. 9, 2015), *available at* https://www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf. In requiring each material sub-group of a GSIB to maintain internal TLAC of 75–90 percent of the external minimum TLAC requirement that would apply to the material subgroup if it were a resolution group, the Financial Stability Board's international TLAC standard rightfully acknowledged the need to strike an appropriate balance between the value of pre-positioning internal loss-absorbing capacity and the value of maximizing the amount of available loss-absorbing capacity at the parent holding company, which can be used to recapitalize material subsidiaries when, as, and where needed at the time of material financial distress.

[61] *See* 12 U.S.C. 5365(a)(1).

[62] *See* 12 U.S.C. 5365(a)(2)(A).

with total consolidated assets between $100 billion and $250 billion.[63] The Federal Reserve has previously recognized its TLAC rule as an enhanced prudential standard satisfying the requirements of Section 165.[64] Therefore, with respect to bank holding companies, Section 165 requires the Federal Reserve to differentiate the application of the LTD proposal based on the enumerated statutory factors and, with respect to bank holding companies with total assets between $100 billion and $250 billion, make a determination that the application of these standards is appropriate to prevent or mitigate risks to the financial stability of the United States or to promote the safety and soundness of the bank holding company or bank holding companies.

The Federal Reserve has not proposed to differentiate the application of the LTD proposal among Category II through IV banking organizations or publicly made the requisite determination. Consistent with the letter and spirit of the statute,[65] the Federal Reserve must do so before finalizing any LTD requirements, as Chair Powell recently recognized in testimony before Congress.[66] The Agencies should differentiate LTD requirements for large banking organizations, and this differentiation should recognize the actual cost of an LTD requirement for a given category of banking organizations.[67]

D. Covered IDIs should not be subject to a separate internal LTD requirement, and, at a minimum, Covered Entities should be subject to a more flexible GLAC requirement.

The Agencies should eliminate the separate internal LTD requirement for Covered IDIs. A Covered Holding Company or Covered IHC should be able to satisfy its LTD requirement either with external debt issued at the holding company level or with debt issued at the IDI level. A banking organization should not be required to issue LTD at both levels in the highly prescriptive manner contemplated in the proposal.

If the Agencies believe that it is necessary to require Covered IDIs to have internal loss-absorbing capacity, the Agencies should replace the proposed internal LTD requirement with a more general GLAC requirement and permit that requirement to be satisfied by any combination of (i) eligible internal LTD; (ii) any internal demand deposit or other short-term extensions of credit to a Covered IDI or any Level 1 HQLA of a Covered Holding Company, Covered IHC, or funding affiliate, if pledged by the holding company to secure its obligation to use those financial assets to recapitalize its Covered IDI subsidiaries, without any such internal deposit or other short-term extension of credit being required to satisfy the conditions of eligible internal debt securities; or (iii) any other means jointly approved by the Federal Reserve and the

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[63] *See* 12 U.S.C. 5365(a)(2)(C).

[64] *See* 82 Fed. Reg. at 8,267 ("The Board is issuing the final rule under section 165 of the Dodd-Frank Act.").

[65] *See* 12 U.S.C. 5365(a)(2)(A) (requiring differentiation in the application of prudential standards based on capital structure, riskiness, complexity, financial activities, size, and any other risk-related factors).

[66] *See The Federal Reserve's Semi-Annual Monetary Policy Report: Hearing Before the H. Comm. on Fin. Servs.*, 118th Cong. (Mar. 8, 2023), *available at* https://www.youtube.com/watch?v=5hrcZJTLfCE (testimony of Chair Powell in response to a question regarding a potential LTD requirement for Category II through IV banking organizations) ("We believe strongly and always have in tailoring to address the different size and risk characteristics of financial institutions and certainly nothing like that for the regionals. They won't have anything like what the very large, most systemically important banks have in terms of overall regulation . . . We're required by the law now and we're doing this [tailoring]. Dodd-Frank actually required us, suggested that we should tailor, and then S. 2155 required it. And anything that we do will reflect appropriate tailoring.").

[67] *See* Anderson, Covas, and Rosa, *supra* note 11.

FDIC under the 165(d) resolution planning process or otherwise.

This approach would recognize that banking organizations have a variety of funding models and, without increasing the aggregate amount of debt funding, it would often not be feasible for a banking organization to revise its funding structure to change the issuing entity or restructure intercompany funding. Perhaps most importantly, it would mitigate the trapped liquidity problem discussed in Section III.C above.

If the Agencies retain an LTD requirement for IDI subsidiaries of Covered Entities, the IDI should be permitted to issue internally or externally. This requirement would align with the requirement for IHCs of non-U.S. GSIBs that are "resolution covered IHCs" under the Federal Reserve's TLAC rule[68] and the Agencies' policy objectives.

E. The proposed internal LTD requirements should not be extended to IDI subsidiaries of U.S. GSIBs.

The LTD proposal would correctly not apply the internal LTD requirements to IDI subsidiaries of U.S. GSIBs but seeks comment on the "advantages and disadvantages of requiring IDI subsidiaries of U.S. GSIBs to issue specified minimum amounts internal LTD."[69] The Agencies should not extend internal LTD requirements to IDI subsidiaries of U.S. GSIBs because they are already subject to sufficient GLAC requirements under the 165(d) resolution planning process. Specifically, as the Agencies recognize, U.S. GSIBs (i) are "subject to the most stringent capital, liquidity, and other prudential standards in the United States" and (ii) have adopted resolution plans reflecting guidance from the Federal Reserve and the FDIC that establishes a capital and liquidity framework for resolution.[70] This guidance includes Resolution Capital Adequacy and Positioning ("RCAP"), which is designed to provide adequate maintenance of loss-absorbing resources either at the parent of material subsidiaries such that all material subsidiaries, including IDIs, could be recapitalized in the event of resolution under the SPOE resolution strategies adopted by the U.S. GSIBs.[71] Accordingly, the Agencies should not extend the internal LTD requirements to IDI subsidiaries of U.S. GSIBs, but should continue to implement GLAC requirements through the 165(d) resolution planning process.

A corollary recommendation, reflected in our comments on the FDIC and Federal Reserve's proposed 165(d) guidance for domestic and foreign triennial full filers is that, should the Agencies maintain an internal LTD requirement in a final rule, Covered Entities should not be subject to the RCAP and Resolution Liquidity Adequacy and Positioning ("RLAP") requirements contemplated in the proposed 165(d) guidance,[72] as these requirements are duplicative. In particular, a Covered Entity that becomes

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[68] *See* 82 Fed. Reg. at 8,289 ("[U]nder the final rule a resolution covered IHC has the option to issue TLAC and LTD externally to third-parties").

[69] 88 Fed. Reg. at 64,532–33.

[70] *Id.* at 64,526, n. 2.

[71] *See id.*; *see also* Guidance for Section 165(d) Resolution Plan Submissions by Domestic Covered Companies applicable to the Eight Largest, Complex U.S. Banking Organizations, 84 Fed. Reg. 1,438 (Feb. 4, 2019).

[72] Guidance for Resolution Plan Submissions of Domestic Triennial Full Filers, 88 Fed. Reg. 64,626, 64,627 (Sept. 19, 2023); Guidance for Resolution Plan Submissions of Foreign Triennial Full Filers, 88 Fed. Reg. 64,641, 64,643 (Sept. 19, 2023).

subject to an SPOE resolution strategy should not be subject to an internal LTD requirement if it is also subject to RCAP requirements.

F. The proposed internal LTD requirements should be eliminated for IDI subsidiaries of non-U.S. GSIBs.

As discussed in Section IV.D above, the Agencies should eliminate the separate internal LTD requirement for Covered IDIs. With respect to the IDI subsidiaries of non-U.S. GSIBs, the Agencies should recognize that the U.S. operations of these GSIBs are already subject to sufficient loss-absorbing capacity requirements under the Federal Reserve's TLAC rule, as the Agencies recognize,[73] as well as home-country loss-absorbing capacity and stringent capital, liquidity, and resolution planning requirements under both U.S. and home country regulation. The Agencies offer no analysis for why an IDI-level requirement for IDI subsidiaries of non-U.S. GSIBs is necessary in light of these existing requirements.

G. The LTD proposal should be revised to permit banking organizations to satisfy any LTD requirements with an equivalent amount of CET1 or additional Tier 1 ("AT1") capital.

The Agencies should revise the LTD proposal to permit banking organizations to satisfy any LTD requirements by issuing an equivalent amount of CET1 or AT1 capital. It would be counterintuitive to prohibit a banking organization from meeting minimum loss-absorbing capacity requirements with equity rather than debt because equity can absorb losses both inside and outside of a resolution proceeding and therefore functions as both going-concern and gone-concern loss-absorbing capacity.[74]

Although it is unlikely that a banking organization would choose to satisfy its entire loss-absorbing capacity requirement with equity rather than debt, this change would provide flexibility and enable banking organizations to comply with their regulatory obligations while also reducing leverage. In addition, this change would recognize that a holding company is permitted to file a voluntary Chapter 11 petition before it becomes balance-sheet insolvent and that balance-sheet insolvency is not required to commence an FDIA receivership proceeding for an IDI.[75, 76]

The Agencies should also recognize that the proposed LTD requirements cannot be met simply by converting existing equity to debt at the election of a banking organization. A banking organization cannot force its equity holders to exchange their equity securities for debt. Any "conversion" would need to be effected through either a voluntary exchange of equity securities for debt securities or through a recapitalization, such as the issuance of debt to fund share repurchases or special dividends. It would be

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73 *See* 88 Fed. Reg. at 64,526, n. 2 (citing 12 C.F.R. 252 Subpart P (subjecting IHCs of non-U.S. GSIBs to TLAC and LTD requirements)).

74 *See* The Clearing House et al., Comment Letter on the Notice of Proposed Rulemaking on External TLAC, Long-Term Debt, Clean Holding Company and Other Requirements Applicable to U.S. GSIBs 9 (Feb. 19, 2016), *available at* https://www.federalreserve.gov/SECRS/2016/April/20160422/R-1523/R-1523_032816_130250_545759023734_1.pdf.

75 *See id.* at 10.

76 Finally, permitting a banking organization to satisfy minimum loss-absorbing capacity requirements by CET1 or AT1 would be consistent with the Financial Stability Board's TLAC standard, which generally permits capital to count toward satisfying the minimum TLAC requirement, but is different from the existing TLAC requirements applicable to U.S. GSIBs. *See* FSB, *supra* note 60, at 11.

more efficient, and equally effective for loss-absorbency purposes, to permit CET1 or AT1 equity instruments to count towards the LTD requirements.

V. A minimum denomination requirement for LTD is unsupported, would negatively affect market depth and liquidity, and would be inconsistent with the disclosure-based framework of the federal securities laws and long-standing aspects of the bank capital framework.

The LTD proposal would require that eligible external LTD be issued through instruments with minimum denominations of not less than $400,000.[77] This requirement would apply to Covered Entities as well as U.S. GSIBs and to external LTD issued by resolution IHCs. The Agencies note that this proposed requirement is intended to "limit direct investment in eligible LTD by retail investors" and that significant holdings of LTD by retail investors "may create a disincentive to impose losses on LTD holders."[78] The Agencies also suggest that retail investors would not be as likely as institutional investors to "monitor the performance of the issuer and thus support market discipline" or "appreciate that LTD that satisfies the requirements of the proposed rule may present different risks than other types of debt instruments" issued by Covered Holding Companies, Covered IHCs, or Covered IDIs.[79]

As further explained below, any final rule should not include a minimum denomination requirement—whether at the proposed $400,000 level or the lower or higher levels discussed in question 28[80]—because such a requirement would impose considerable costs without providing commensurate benefits. Specifically, the requirement would reduce liquidity for LTD securities by precluding a wide range of institutional investors from the market. Moreover, the requirement is unnecessary to achieve the Agencies' policy objectives, as direct investments by retail investors in LTD securities of banking organizations in the United States have historically been very limited, unlike in many European jurisdictions. Further, external LTD that would be issued pursuant to any LTD requirement would differ in meaningful respects from the bail-in-able debt issued by many European and other non-U.S. banking organizations. Under a bail-in resolution, holders of debt and equity are "written down to absorb losses," and "debtholders [...] are issued new equity and become shareholders of the institution post-bail-in."[81] In certain European jurisdictions, regulators would have the authority to "convert[] the full amount of all of [the institution's] bail-in bonds into new shares."[82] Unlike that bail-in-able debt, in a resolution context involving a Covered Entity, losses would be imposed on holders of a Covered Entity's LTD through resolution proceedings under otherwise applicable insolvency law: the U.S. Bankruptcy Code, Title II of the Dodd-Frank Act, or the FDIA. In contrast, in the context of a "bail-in" resolution involving a non-U.S. banking organization, a resolution authority determines to trigger a "bail-in," imposing losses on holders of bail-in-able debt, in an effort to resolve the failed banking organization outside proceedings under otherwise applicable insolvency law.

If the Agencies nevertheless believe they should undertake additional steps to maintain the status

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77 *See* 88 Fed. Reg. at 64,534.

78 *Id*. at 64,537.

79 *Id*.

80 *See id.* at 64,538.

81 FSB, *2023 Bank Failures* 7 (Oct. 10, 2023), *available at* https://www.fsb.org/wp-content/uploads/P101023.pdf.

82 *Id*. at 9.

quo of extremely low direct-to-retail issuance of eligible LTD, this should be achieved through alternative approaches that do not establish a minimum denomination amount. Further, the Agencies should engage in continued monitoring of the market for LTD securities to determine if there is a meaningful likelihood of the status quo of extremely low direct-to-retail issuance changing. BPI would welcome the opportunity to continue engaging with the Agencies to discuss any concerns the Agencies may have in this area, and to submit supplementary information after the close of the comment period based on those discussions.

A. The proposed minimum denomination requirement would reduce liquidity for LTD securities, which would increase the cost of issuing these instruments.

The link between a diverse investor base and liquidity has been long established as a key ingredient of market depth.[83] A minimum denomination requirement would result in a less diverse investor base for eligible external LTD, primarily by preventing certain institutional investors from purchasing these securities, which would be especially problematic given that the LTD proposal would significantly increase LTD issuance.[84] For example, a minimum denomination requirement could restrict investment by asset managers starting new funds because it could make it challenging to comply with asset diversification requirements during an initial investment stage. In addition, a minimum denomination requirement would make it difficult for a broad spectrum of institutional investors—including mutual funds, exchange-traded funds, and asset manager separately managed accounts—to invest in banking organizations' LTD. Because LTD represents just a portion of an investor's overall fixed income portfolio, institutional funds and accounts commonly hold hundreds or thousands of CUSIPs for diversification and to target various exposures. Many funds and accounts are not large enough to make a $400,000 allocation to the LTD of a single banking organization, and registered funds are only considered to be diversified if they do not hold more than five percent of the fund's total assets in a single issuer.[85] Even if a fund or account is large enough to make a $400,000 allocation, managing this position on an ongoing basis may not be practical. Over time, managers will seek to rebalance their portfolios, invest proceeds from coupon payments or additional contributions, and meet investor redemptions requests. To maintain the desired overall risk exposure, managers will need to transact in smaller sizes. As a result of these challenges, the investor base for banking organizations' LTD would be diminished, which would increase concentration of LTD securities among the largest institutional investors and reduce liquidity in the secondary market.

To illustrate these concerns, we estimate that a fixed income portfolio with a corporate bond index would need at least $200 million in total assets to be able to make a $400,000 investment in the LTD of a single banking organization. This estimate reflects the fact that U.S. banking organizations represent approximately 15 percent of the corporate bond index, and, within a specific sector, portfolio managers commonly make investments across a number of issuers for diversification and risk management purposes. Although mutual funds and ETFs are among the largest pools of institutional investments, this high threshold would preclude many of them from investing in banking organizations' LTD. Of the 83 mutual funds and ETFs that Morningstar classifies as corporate bond funds, 41 have less than $200 million in assets. Similarly, we estimate that a fixed income portfolio that uses the U.S. Aggregate Bond Index, which

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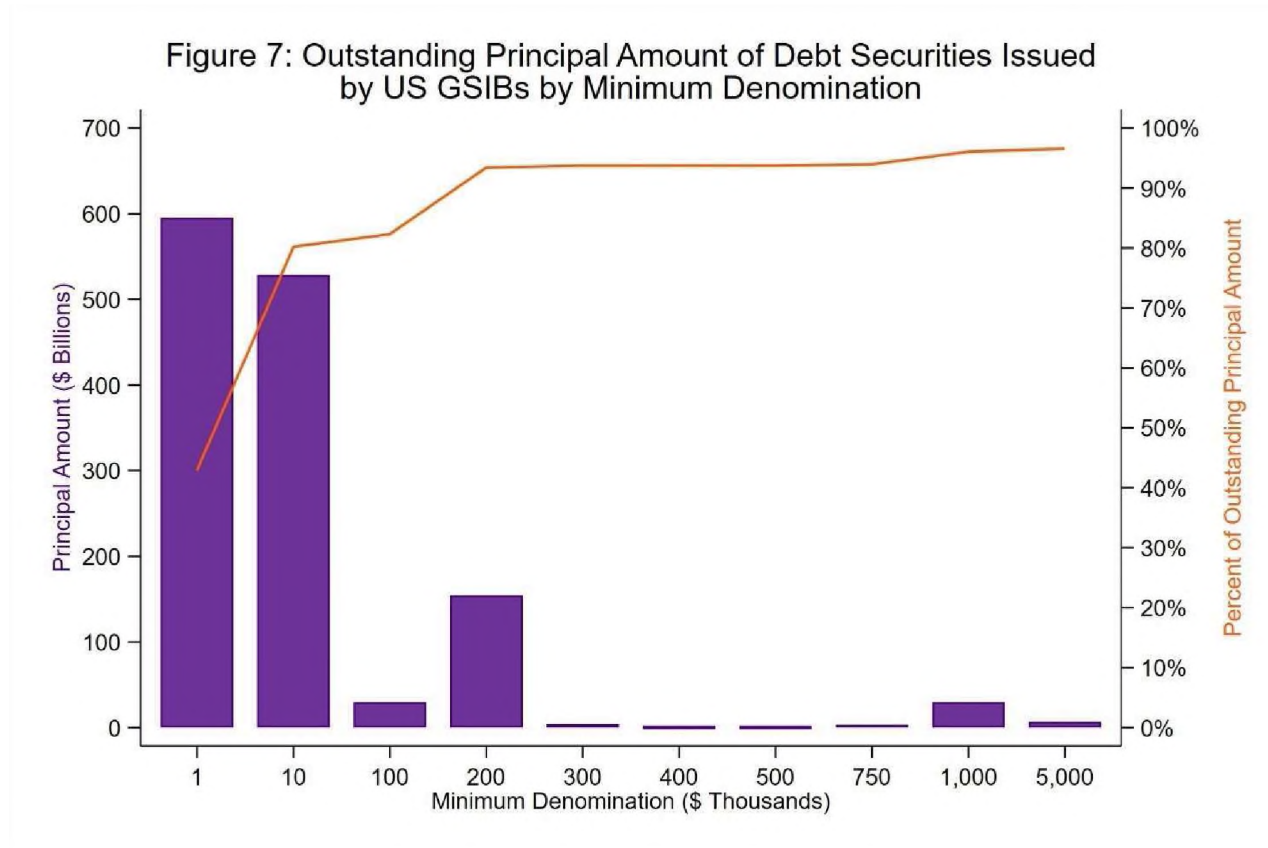
[83] For example, one requirement of the "liquid and readily-marketable" definition under the LCR is that the security is traded in an active secondary market with "[a] large number of non-market maker participants on both the buying and selling sides of transactions." *See* 12 C.F.R. 50.3; 12 C.F.R. 249.3; 12 C.F.R. 329.3.

[84] *See supra*, note 31 and accompanying text.

[85] *See* 15 U.S.C. 80a-5(b)(1).

tracks corporate bonds and a broader spectrum of instruments including U.S. Treasuries, as a benchmark would need at least $800 million in total assets to make a $400,000 investment in the LTD of a single banking organization. According to Morningstar, 355 of 557 mutual funds and ETFs with a U.S. Aggregate Bond Index benchmark have less than $800 million in assets under management. Many other institutional investors have assets lower than these thresholds, effectively removing them from the market for banking organizations' LTD.

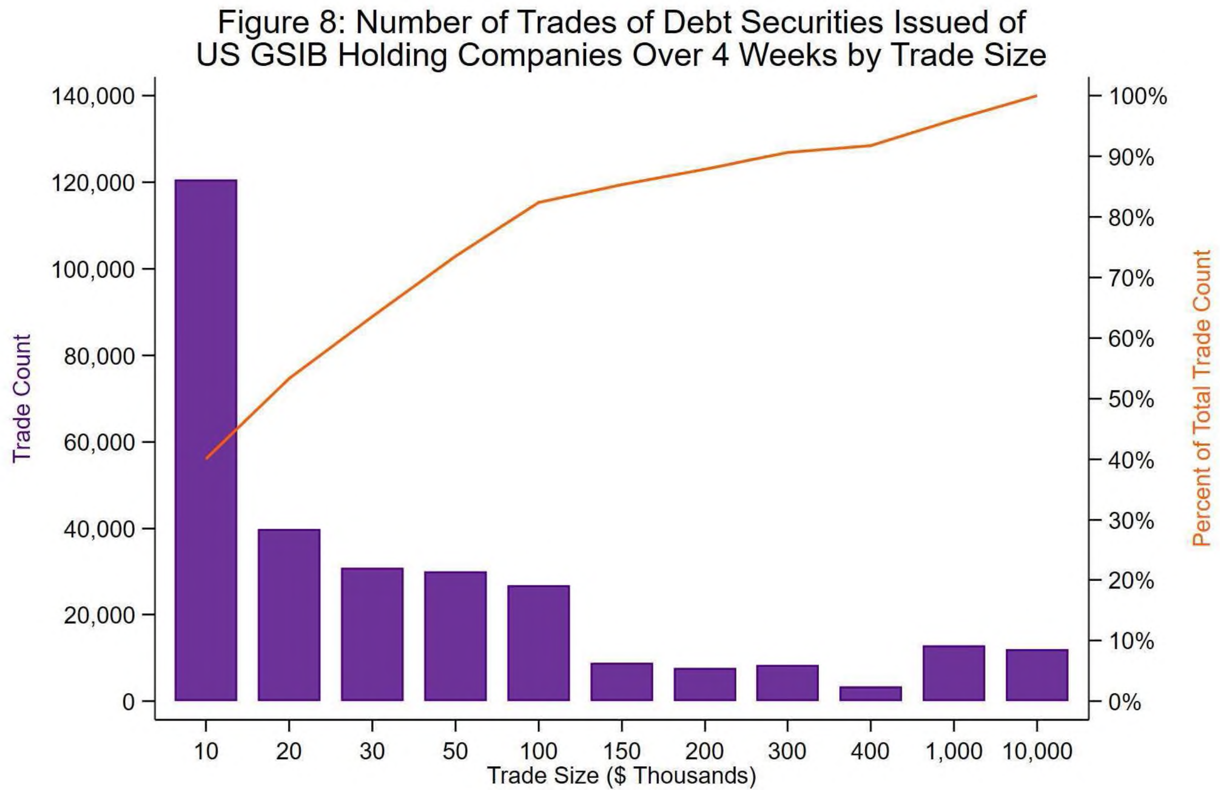
The industry standard minimum denomination is $2,000, although debt is issued at different denominations. For example, an analysis of external LTD issued by the U.S. GSIBs shows that more than 80 percent of the outstanding principal amount of LTD securities have a denomination below the lowest threshold contemplated by the Agencies ($100,000) in the LTD proposal. A threshold of $400,000 would require substantial revisions to the offering structure for substantially all LTD. The Agencies have not conducted any analysis of the potential impact of these revisions on either the issuance market or secondary market liquidity.



Source: Bloomberg

In addition, an analysis of trading activity over a four-week period (*i.e.*, the trading weeks beginning on October 10, 2023, October 16, 2023, October 23, 2023, and October 30, 2023) of debt securities issued by the U.S. GSIBs shows that a minimum denomination requirement would significantly

reduce trading activity.[86] Specifically, over 90 percent of trading activity had a size of less than $400,000.[87]



Source: Bloomberg

By reducing the investor base and secondary market liquidity, a minimum denomination requirement would result in greater concentration of LTD securities and make it riskier for investors to hold LTD debt securities, especially during times of stress. Higher risk, in particular liquidity risk, would increase the cost of issuing LTD. Lower liquidity as a result of a minimum denomination requirement could also reduce the diversity of large banking organizations' funding sources, which could affect liquidity stress tests, contingency funding plans and recovery plans of large banking organizations. Accordingly, the Agencies should not include the requirement in a final rule.[88]

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[86] This four-week period should represent normal trading activity given the absence of any extraordinary market shocks or other events that would skew typical trading patterns.

[87] Even when trades are combined at the same price and time, 85 percent of trades with distinct prices had a size of less than $400,000.

[88] If the Agencies retain a minimum denomination requirement and LTD is issued in a currency other than U.S. dollars, the minimum denomination requirement should be assessed only at issuance, based on prevailing exchange rates at the time of issuance.

B. The disclosure-based framework of the federal securities laws and long-standing aspects of the bank capital framework already mitigate the Agencies' concerns without barring investors.

The federal securities laws create a disclosure-based framework. Companies issuing securities to the public are required to provide the detailed disclosures provided by SEC rules, as well as any additional material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made, not misleading.[89] Companies are not restricted in issuing securities to various classes of prospective investors based on the loss-absorbing characteristics of their securities.

There is no reason that retail investors would be prevented from fully understanding the nature of external LTD through disclosure required by the U.S. securities laws or any supplemental disclosure requirements that the Agencies may include in a final rule.[90] In fact, when offering debt securities that qualify as eligible LTD under the existing TLAC rule, a U.S. GSIB is already required to disclose a description of the financial consequences to unsecured debtholders of the U.S. GSIB entering into a resolution proceeding in which the top-tier holding company is the only entity that would be subject to the resolution proceeding.[91] This disclosure-based regime has worked well for regulatory capital instruments, and there is no reason for the Agencies to take a different approach for LTD. Such a disclosure requirement would also be consistent with the general framework of the U.S. capital markets, which is a disclosure-based regime.

Moreover, banking organizations have never been prohibited from issuing CET1 or AT1 capital or Tier 2 subordinated debt securities to retail investors, nor have they been subject to any minimum issuance prices or denomination requirements under the U.S. bank capital rules, and those securities absorb losses before or *pari passu* with any eligible LTD securities. Nor have the U.S. GSIBs been prohibited from issuing plain vanilla LTD securities under the Federal Reserve's existing TLAC rule to retail investors or been subject to any minimum denomination requirements under the U.S. bank capital rules.[92] A minimum denomination requirement for eligible LTD, together with the limit on "unrelated liabilities" in the clean holding company requirements,[93] would, for all practical purposes, function as a severe limitation on the issuance of debt to retail investors by a holding company subject to the proposal (and, depending on the extent of a holding company's other "unrelated liabilities," would function as a virtual prohibition). Congress has never taken any action to severely restrict the rights of retail investors to invest in debt or

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[89] *See generally* Regulation C under the Securities Act of 1933, as amended, 17 C.F.R. 230.400 *et seq.*, including Rule 408, 17 C.F.R. 230.408.

[90] The proposed minimum denomination requirement appears to be something of a solution in search of a problem, as direct investments by retail investors in LTD securities issued by banking organizations, including U.S. GSIBs, have historically been very limited because retail investors tend to invest directly in securities that are listed on a securities exchange, and substantially all LTD securities issued by GSIBs are, like the vast majority of debt securities, not listed. In any event, the retail investors who have purchased LTD securities issued by GSIBs have received disclosure about the resolution-related risks associated with those securities.

[91] *See* 12 C.F.R. 252.65.

[92] Notably, the Financial Stability Board's TLAC standard did not prohibit the issuance of plain vanilla LTD to retail investors or subject them to any minimum denomination requirement. *See* FSB, *supra* note 60.

[93] 88 Fed. Reg. at 64,543–44.

equity securities of large bank holding companies. It would be inappropriate for the Agencies to impose such a restriction on retail investment in banking organization debt and determine which classes of investors can and cannot invest in securities of banking organizations for reasons entirely unrelated to the disclosure provided to investors and based on the Agencies' views as to which classes of investors are appropriate holders of the securities. Existing aspects of the securities laws that address investor eligibility, such as Regulation D and Rule 144A under the Securities Act of 1933,[94] impose eligibility requirements in the context of *exemptions* to registration and disclosure requirements that would otherwise apply.

VI. The Federal Reserve should adopt the proposed changes to the QFC definition and include additional exemptions but should not apply the clean holding company requirements to banking organizations that do not have SPOE resolution strategies.

A. The Federal Reserve should adopt the proposed changes to the QFC definition and include additional exemptions.

Under the LTD proposal, the Federal Reserve would apply clean holding company requirements, which are similar to those applicable to U.S. GSIBs under the TLAC rule, to Covered Holding Companies and Covered IHCs.[95] In addition, the LTD proposal would revise the TLAC rule to align the clean holding company requirements applicable to the top-tier holding companies of U.S. GSIBs and IHCs of non-U.S. GSIBs with the proposed clean holding company requirements for the top-tier holding companies of Covered Holding Companies and Covered IHCs.[96]

The Federal Reserve should provide additional exemptions to the general prohibition on top-tier holding companies entering into QFCs with third parties. Under the TLAC rule, the top-tier holding companies of U.S. GSIBs are generally prohibited from entering into QFCs with a counterparty that is not a subsidiary of the holding company.[97] The definition of QFC includes securities contracts, commodity contracts, forward contracts, repurchase agreements, and swap agreements.[98] The LTD proposal notes that the Federal Reserve "has gained experience with agreements that may constitute QFCs and which the [Federal Reserve] believes may not present the risks intended to be addressed by the clean holding company requirements."[99] Accordingly, the LTD proposal would amend the clean holding company requirements to clarify that the top-tier holding companies of U.S. GSIBs—and Covered Holding Companies and Covered IHCs—are permitted to enter into certain underwriting agreements, fully paid structure share repurchase agreements, employee and director compensation agreements, and other agreements that the Federal Reserve determines would not pose a material risk to orderly resolution of the banking organization or the stability of the U.S. banking or financial system.[100]

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94 *See* 17 C.F.R. 230.144A and 230.500-508.

95 *See* 88 Fed. Reg. at 64,541.

96 *See id.* at 64,546–47.

97 *See* 12 C.F.R. 252.64(a)(3).

98 *See* 12 C.F.R. 252.61; 12 U.S.C. 5390(c)(8)(D)(i).

99 88 Fed. Reg. at 64,547.

100 *See id.* at 64,547-48.

We support this clarification and codification of exemptions that have previously been provided. As the LTD proposal notes, the term QFC includes a "securities contract,"[101] which is broadly defined to include, among other things, "a contract for the purchase, sale or loan of a security."[102] It is common for a holding company, in particular a publicly traded holding company, to engage in a variety of contracts for the purchase and sale of securities that do not implicate the policy concern underlying the prohibition on third-party QFCs. Accordingly, the Federal Reserve should provide additional exemptions for transactions that, given the wide breadth of the term "securities contract" could potentially involve QFCs, including for tender offers; exchange offers; consent solicitations; any open-market or privately negotiated transaction for a holding company to repurchase its own securities; agreements for the spot purchase or sale of securities, including HQLA and other securities; direct stock purchase and dividend reinvestment plans for a holding company's stock; and strategic transactions and investments that involve stock purchase, merger, or similar agreements. Similar to underwriting agreements, fully paid structure share repurchase agreements, and employee and director compensation agreements, these contracts are not the type of contracts that the clean holding company requirements were intended to capture.

Moreover, placing restrictions on the ability of a Covered Holding Company or Covered IHC to repurchase its own securities on the open market or through privately negotiated transactions could have knock-on practical impacts for some banking organizations. One of the most flexible tools that a holding company has to manage capital effectively and to return excess capital to shareholders is the ability to repurchase its securities. The Agencies should avoid introducing unnecessary barriers to this effective tool by excluding these transactions from the QFC prohibition. In addition, many holding companies use third-party broker-dealers to conduct their repurchase activities, while others may use a broker-dealer affiliate. By excluding these share repurchase activities from the QFC prohibition, the Agencies could maintain the status quo and avoid effectively preventing banking organizations that currently use third-party broker-dealers from engaging in share repurchases.

In addition, the Federal Reserve should provide a one-year cure period for inadvertent breaches of the clean holding company requirements and the five percent cap. Otherwise qualifying long-term structured notes (or, at a minimum, otherwise qualifying long-term structured notes that are principal protected at par) should be treated as eligible debt securities or at least excluded from the five percent cap.[103]

Finally, the Federal Reserve should also provide in any final rule that all clean holding company exemptions apply equally to U.S. GSIBs and IHCs of non-U.S. GSIBs.

B. The Federal Reserve should not apply the clean holding company requirements to Covered Holding Companies and Covered IHCs that do not have SPOE resolution strategies.

The Federal Reserve should not apply the clean holding company requirements to Covered Holding Companies and Covered IHCs that do not have SPOE resolution strategies. The preamble to the Federal Reserve's TLAC rule states that the clean holding company requirements applicable to the U.S. GSIBs and IHCs of non-U.S. GSIBs are intended to, among other things, "enhance the credibility of the SPOE

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[101] *Id.* at 64,547.

[102] 12 U.S.C. 5390(c)(8)(D)(ii).

[103] *See* The Clearing House, *supra* note 74, at 15–17.

approach" by reducing the risks associated with short-term debt and other categories of liabilities.[104] The preamble to the TLAC rule notes that, in an SPOE resolution, the creditors of operating subsidiaries would not bear losses incurred by the subsidiaries because such losses would be transferred to the holding company and borne by the external TLAC holders during the bankruptcy or resolution of the holding company.[105] According to the Federal Reserve, to facilitate orderly resolution of a holding company under the SPOE resolution strategy, the clean holding company requirements generally prohibit these holding companies from (i) relying on short-term funding, (ii) entering into QFCs with third parties, (iii) guaranteeing certain liabilities between subsidiaries and external counterparties, and (iv) having outstanding liabilities that are subject to a guarantee from subsidiaries.[106]

Separate and apart from whether the Federal Reserve's policy objectives justify these requirements for banking organizations with SPOE resolution strategies, clean holding company requirements are not equally relevant for banking organizations that do not have SPOE resolution strategies, and in some cases, the requirements are not relevant at all. In a number of cases, clean holding company requirements are not necessary because operating subsidiaries would also be resolved under separate insolvency proceedings.[107] Because all relevant entities would enter their own insolvency proceedings, there is no reason to have a policy preference for certain types of transactions at a holding company or operating subsidiary level, such as qualified financial contracts or debt issued with an original maturity of less than 365 days. The preamble to the TLAC rule implicitly acknowledges that clean holding company requirements are generally ill-suited for banking organizations that do not have SPOE resolution strategies, and there is no reason to impose such requirements on these banking organizations in light of the theoretical possibility one or more may, at some unspecified point in the future, adopt SPOE resolution strategies.[108] In addition, although the proposal would prohibit Covered Entities from having outstanding liabilities that are subject to a guarantee from any direct or indirect subsidiary of the holding company (*i.e.*, upstream guarantees), the proposal acknowledges that "[u]pstream guarantees do not appear to be common among covered entities" and notes that Section 23A of the Federal Reserve Act "already limits the ability of an IDI to issue guarantees on behalf of its parent holding company."[109] In light of the foregoing, the Federal Reserve should recognize the significant differences in banking organizations' resolution strategies by only applying the clean holding company requirements to banking organizations

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[104] 82 Fed. Reg. at 8,299.

[105] *See id.* at 8,298.

[106] *See id.*

[107] Although clean holding company requirements are generally unnecessary for banking organizations with non-SPOE resolution strategies, we acknowledge that certain requirements, such as restrictions on cross-defaults, have benefits even for those banking organizations.

[108] The Agencies appear to justify the proposed application of the clean holding company requirements at least partially on this basis. *See* 88 Fed. Reg. at 64,541 ("… covered entities that currently plan for an MPOE resolution strategy may nevertheless be resolved pursuant to an SPOE resolution strategy or adopt an SPOE resolution strategy in the future. Applying the clean holding company requirements to covered entities that currently plan for an MPOE resolution ensures that the benefits of these requirements that may be more significant for covered entities with an SPOE resolution strategy are readily available to covered entities with an MPOE resolution strategy that ultimately are resolved with an SPOE resolution strategy or eventually change their resolution strategy to an SPOE strategy."). If a banking organization seeks to switch its resolution strategy, it would need to develop its own transition plan for doing so, including complying with the clean holding company requirements.

[109] *Id.* at 64,543.

that have SPOE resolution strategies.[110]

VII. The Federal Reserve should make other adjustments and clarifications related to its existing TLAC rule.

Under the LTD proposal, the Federal Reserve would also make changes to its existing TLAC rule that "generally are technical or intended to improve harmony between provisions within the TLAC rule and address items that have been identified through the [Federal Reserve's] administration of the TLAC rule."[111] The Federal Reserve should make the following adjustments and clarifications to these proposed changes.

A. The Federal Reserve should not include in the TLAC rule a 50 percent haircut to LTD with a maturity between one year and two years.

The LTD proposal would allow only 50 percent of the amount of LTD with a maturity of one year or more—but less than two years—to count towards the TLAC requirement, rather than the current 100 percent.[112] The proposal notes that the purpose of the requirement is to "to protect a TLAC company's LTD loss-absorbing capacity against a run-off period in excess of one year (as might occur during a financial crisis or other protracted stress period)," including by "incentiviz[ing] TLAC companies to reduce or eliminate their reliance on LTD loss-absorbing capacity that is due to be paid in less than two years."[113]

The Federal Reserve should not apply the 50 percent haircut to LTD with a maturity of one year or more—but less than two years—for purposes of the TLAC requirement applicable to GSIBs and certain IHCs of FBOs. The current TLAC rule applies this haircut for purposes of the LTD requirement but not the TLAC requirement.[114] Adding it to the TLAC requirement increases the overall loss-absorbency requirements without any demonstration that such an increase is necessary, particularly in light of the Basel III Endgame proposal. In addition, the existing 50 percent haircut applied to the LTD requirement already prevents banking organizations from relying too heavily on LTD maturing in less than two years.

At the very least, the Federal Reserve should not apply the 50 percent haircut if the LTD was issued prior to the release of a final rule. Existing LTD was not issued with the understanding that it would receive a 50 percent haircut for purposes of the TLAC rule, and an abrupt change could force additional LTD issuance, which could further increase the cost of issuing LTD and exacerbate market capacity challenges. Moreover, the 50 percent haircut would not have any bearing on the contractual terms or loss-absorbing characteristics of existing LTD; rather, it only impacts how much credit a GSIB would receive for purposes of the TLAC requirement.

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[110] The rationale for not applying clean holding company requirements to banking organizations that do not have SPOE resolution strategies also applies to any such holding companies that are currently subject to Subpart G or Subpart P of Regulation YY.

[111] *Id*. at 64,546.

[112] 88 Fed. Reg. at 64,546.

[113] *Id.*

[114] 12 C.F.R. 252.62(b)(1)(ii); 12 C.F.R. 252.63(b)(3).

B. The Federal Reserve should amend the proposed TLAC disclosure requirements.

The Federal Reserve would require U.S. GSIBs to make quantitative and qualitative disclosures—at least every six months—related to the creditor ranking of their liabilities and would require these banking organizations to "comply with the same standards related to internal controls and verification of disclosures, as well as senior officer attestation requirements, as applied to the disclosure requirements of banking organizations under the [Federal Reserve]'s capital rule."[115] These proposed disclosures would impose a significant burden on U.S. GSIBs without providing commensurate benefits. For a banking organization's initial disclosure, it would need to identify and rank all of its outstanding liabilities and instruments. For a banking organization's initial and subsequent disclosures, numerous personnel from various functions would need to spend substantial amounts of time to provide the amounts of its outstanding liabilities and instruments, including the amounts broken out by maturity profile. We are not aware of any existing U.S. requirements to make similar disclosures ranking all creditors in the highly prescriptive manner required by Table 1 ("Creditor ranking for resolution entity").[116] U.S. GSIBs would therefore be required to build systems to generate this information. Given that the priority of LTD is typically clearly and prominently disclosed in the relevant offering documents, the proposed prescriptive and granular disclosure requirements would impose substantial costs without furthering a supervisory, market discipline, or other policy objective.

If the Federal Reserve retains the proposed disclosures in some form, it should amend the proposed requirement related to the creditor ranking of U.S. GSIBs' liabilities such that the liability figures in row 2 of Table 1 and the LTD component of potential TLAC figures in row 5 of Table 1 are both calculated based on unpaid principal amounts.[117] According to proposed § 252.66(b)(5)(i), the total liabilities and equity figures on row 2 are defined as total balance sheet amounts, which we understand to mean carrying values (including fair values), whereas § 252.66(b)(5)(iii) defines the LTD component of potential TLAC on row 5 as 100%, 50%, or 0% of the unpaid principal amounts of that LTD, depending on the remaining maturity.[118] Unpaid principal amounts can differ significantly from carrying values, especially for debt that is carried at fair value. In order to make the liability and LTD figures in these two rows properly comparable, the Federal Reserve should use unpaid principal amounts instead of carrying values for both total liabilities on row 2 and the LTD component of potential TLAC on row 5.

In addition, the Federal Reserve should revise proposed § 252.66(b)(5)(ii)(E) to refer to liabilities that are not governed by the laws of the United States or any State.[119] For purposes of row 3 of Table 1, proposed § 252.66 would exclude liabilities "that, under the laws of the United States or any State applicable to the global systemically important BHC, may not be written down or converted into equity by a resolution authority or bankruptcy court without giving rise to material risk of successful legal challenge or valid compensation claims."[120] However, in the 2015 proposal regarding TLAC and LTD requirements, the Federal Reserve noted that eligible long-term debt instruments are required to be governed by U.S.

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115 *Id.* at 64,548.

116 *Id.* at 64,571 (proposed Table 1 to § 252.66).

117 *See id.* (proposed § 252.66(b)(5)).

118 *See id.* (proposed § 252.66(b)(5)(i); § 252.55(b)(5)(iii)).

119 *See id.* (proposed § 252.66(b)(5)(ii)(E)).

120 *Id.* (proposed § 252.66(b)(5)(ii)(E)).

law to avoid "giving rise to material risk of successful legal challenge."[121] Given that the Federal Reserve has acknowledged that instruments governed by U.S. law are unlikely to present material risk of successful legal challenge, proposed § 252.66(b)(5)(ii)(E) should be revised to refer to instruments that are not governed by U.S. law and that present such risks. This is especially the case given the resources banking organizations would have to expend to review their existing liabilities governed by U.S. law to determine whether they present a material risk of successful legal challenge. This would be a significant burden, given the proportion of liabilities governed by U.S. law, and such an intensive liability-by-liability review would be highly unlikely to provide any useful information, given the features of U.S. law, which the Federal Reserve has previously noted.

The Federal Reserve should also eliminate the board-approved policy and senior management attestation requirements in § 252.66(b)(3) for the figures in Table 1.[122] The proposed disclosure in Table 1 is not extensive enough to warrant a board-approved policy and senior management attestation. Other, more extensive disclosures—such as those related to the LCR and the Net Stable Funding Ratio—do not have similar board-approved policy and senior management attestation requirements.

C. The Federal Reserve should clarify the definition of "eligible internal debt security" for Covered IHCs.

With respect to Covered IHCs, an "eligible internal debt security" would be an instrument that is, among other things, "issued to and remains held by a company that is incorporated or organized outside of the United States, and directly or indirectly controls the Covered IHC or is a wholly owned subsidiary."[123] Further, the term "wholly owned subsidiary" would be defined as an "entity, all of the outstanding ownership interests of which are owned directly or indirectly by a global systemically important foreign banking organization that directly or indirectly controls a covered IHC, except that up to 0.5 percent of the entity's outstanding ownership interests may be held by a third party if the ownership interest is acquired or retained by the third party for the purpose of establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns."[124] The Federal Reserve should delete the words "global systemically important" before "foreign banking organization." This change would clarify that internal LTD issued by IHCs of non-GSIB foreign banking organizations meet the definition of "eligible internal debt security," as intended.

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[121] 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. 74,926, 74,937 (Nov. 30, 2015) ("Eligible long-term debt instruments 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. To this end, eligible external LTD must be governed by U.S. law, including the U.S. Bankruptcy Code and Title II.").

[122] *Id.* (proposed § 252.66(b)(3)).

[123] *Id*. at 64,574.

[124] *Id*.

VIII. Other recommendations

A. The Agencies should eliminate or modify the reservation of authority provisions.

The LTD proposal would authorize (i) the Agencies to require a Covered IDI to maintain an eligible LTD amount "greater than otherwise required" if an Agency determines that the Covered IDI's LTD requirement is "not commensurate with the risk the activities of the [Covered IDI] pose to public and private stakeholders in the event of material distress and failure"[125] and (ii) the Federal Reserve to require a Covered Holding Company, Covered IHC, U.S. GSIB, or IHC of a non-U.S. GSIB to maintain an eligible LTD or TLAC amount "greater than or less than what is otherwise required . . . if the [Federal Reserve] determines that the requirements . . . are not commensurate with the risk the activities of the [banking organization] pose to public and private stakeholders in the event of material distress and failure."[126] The Agencies should not retain the reservation of authority provisions in a final rule because this provision would provide the Agencies undue discretion to increase LTD and TLAC requirements without sufficient procedural safeguards, which would create uncertainty and volatility for banking organizations and affected stakeholders.

If the Agencies decide to retain the reservation of authority provisions in a final rule, the Agencies should include adequate procedural safeguards, including at least 90 days' notice of an Agency's intent to increase LTD or TLAC requirements and a transition period of at least one year to meet increased LTD or TLAC requirements. In addition, the Agencies should be required to publicly disclose any exercise of this authority. Such disclosure would promote transparency regarding the Agencies' regulatory activities and align with the Agencies' practice of publicly disclosing other actions pursuant to reservations of authority under their respective regulations.[127] Finally, if the Agencies decide to retain the reservation of authority provisions in a final rule, the Agencies should clarify that, with respect to the reservation of authority applicable to LTD requirements for Covered IDIs, the Agencies have both the authority to require LTD greater than *or less than* what is otherwise required (*i.e.*, rather than only greater than what is otherwise required). This clarification would align the LTD provisions applicable to Covered IDIs with the LTD and TLAC provisions applicable to Covered Holding Companies and Covered IHCs, as well as the LTD and TLAC provisions applicable to U.S. GSIBs and IHCs of non-U.S. GSIBs.[128]

B. The FDIC should increase the maximum unsecured debt adjustment or reduce the risk-based scorecard to account for any new LTD requirement.

The FDIC calculates assessments for large banks using a risk-based scorecard, which includes a loss severity measure. A bank's base assessment rate under the calculation can be lowered based on its ratio of long-term unsecured debt as a percentage of domestic deposits, up to the lesser of five basis points or

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[125] *Id*. at 64,558.

[126] *Id*. at 64,563; 64,566; 64,572.

[127] *See, e.g.*, Letter from Margaret McCloskey Shanks, Deputy Secretary of the Board, Federal Reserve, to Jiang Liu, Partner, Morrison & Foerster LLP (May 11, 2020), *available at* https://www.federalreserve.gov/supervisionreg/files/citic-regyy-20200511.pdf (relying on a reservation of authority to permit CITIC Group Corporation to comply with capital stress testing requirements and related reporting requirements through its subsidiary foreign banks).

[128] *Compare* 88 Fed. Reg. at 64,558 *with* 88 Fed. Reg. 64,563; 64,566; 64,572.

50 percent of the bank's initial base assessment rate, an "unsecured debt adjustment."

The FDIC should increase the maximum unsecured debt adjustment or provide some reduction in the risk-based scorecard to account for the reduced risk to the DIF provided by any new IDI-level LTD requirement. This change would align with the FDIC's previous recognition that "[a]ll other things equal, greater amounts of long-term unsecured debt can reduce the FDIC's loss in the event of a failure, thus reducing the risk to the DIF."[129]

C. The Agencies should clarify that Covered IDI subsidiaries of FBOs may issue LTD to a mid-tier holding company.

The LTD proposal would require LTD issued by a Covered IDI to be issued and held by a company (i) of which the Covered IDI is a consolidated subsidiary and (ii) domiciled in the United States, if the Covered IDI is a consolidated subsidiary of a U.S. IHC of an FBO. A mid-tier holding company would be an FR Y-9LP filer and may not prepare consolidated financial statements. The Agencies should revise the LTD proposal to make clear that LTD may be issued to a mid-tier holding company for a Covered IDI.

D. The Agencies should coordinate the transition period for any new LTD requirements with the transition period of any final rule to implement the Basel III Endgame proposal.

As the Agencies acknowledge, because LTD is "generally more expensive than the short-term funding banking organizations could otherwise use, the [LTD proposal] is likely to raise funding costs in the long run."[130] This cost would directly reduce the ability of Covered Entities to accrete capital in preparation for any final rule to implement the Basel III Endgame. As a result, banking organizations would need to make more acute changes to their lending activity to comply with the new rules, which would reduce credit availability and raise costs for borrowers.

To facilitate the accretion of CET1 capital and minimize detrimental impacts to borrowers, the Agencies should coordinate the transition period for any new LTD requirements with the transition periods for any final rule to implement the Basel III Endgame. Specifically, the transition periods should run sequentially rather than concurrently to allow banking organizations to prioritize CET1 accretion without the increased funding costs related to the issuance of new LTD. In other words, the first year of the transition period for any new LTD requirements should begin following the end of the transition period for any final rule to implement the Basel III Endgame. This approach would appropriately prioritize the accretion of CET1, given its status as the most loss-absorbing form of capital, while also ensuring that banking organizations meet any new LTD requirements in a timely manner.

E. The Agencies should clarify that the definition of "covered debt instrument" only applies to an IDI that is subject to an LTD requirement.

Any final rule should be revised to provide that, for purposes of the deduction framework under the capital rule, the definition of "covered debt instrument"[131] applies only to an IDI that is subject to an LTD requirement (*i.e.*, unsecured debt issued by an IDI that is not subject to a LTD requirement is not

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[129] Assessments, Large Bank Pricing, 76 Fed. Reg. 10,672, 10,680 (Feb. 25, 2011).

[130] 88 Fed. Reg. at 64,552.

[131] *Id.* at 64,560–61.

included). Specifically, clause (1)(i) of the proposed revised definition of covered debt instrument[132] should refer to a subsidiary subject to an LTD requirement under proposed new Part 54, Part 216, or Part 374, instead of any subsidiary of a depository institution holding company subject to an LTD requirement under Part 238 or Part 252. Otherwise, as currently drafted, the proposed definition of CDI would appear to scope in certain unsecured exposures to subsidiaries of covered companies that do not count as capital or eligible LTD.

F. The Agencies should revise the eligibility requirements for legacy external LTD so such LTD continues to qualify even if a Covered Holding Company becomes a U.S. GSIB.

Under the LTD proposal, there are separate provisions on legacy external LTD for Covered Holding Companies and Covered IDIs, Covered IHCs, and U.S. GSIBs.[133] These provisions have different cutoff dates for legacy debt with otherwise impermissible acceleration clauses: December 31, 2016 for Covered IHCs and U.S. GSIBs, versus publication of a final rule for Covered Holding Companies and Covered IDIs.[134] In addition, the provision for Covered Holding Companies also treats certain debt issued by a consolidated IDI subsidiary as eligible legacy LTD. As a result, if a Covered Holding Company that is not a U.S. GSIB upon publication of a final rule subsequently becomes a U.S. GSIB, legacy debt with otherwise impermissible acceleration clauses issued between December 31, 2016, and the publication of a final rule that would qualify under paragraph (3) of the proposed definition of "eligible debt security" would cease to qualify under paragraph (2) of the definition. Eligible legacy LTD issued by a consolidated IDI subsidiary would likewise become ineligible.

The Agencies should revise the eligibility requirements for legacy external LTD such that legacy external LTD of a Covered Holding Company that is not a U.S. GSIB continues to qualify as LTD even if that company subsequently becomes a U.S. GSIB.

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132 *See id.* (proposed § 3.2(1)(i)).

133 *See id.* at 64,559 (proposed § __.2); 64,564 (proposed § 238.181); 64,567 (proposed § 252.61); 64,573 (proposed § 252.161).

134 *See id.*

The Bank Policy Institute appreciates the opportunity to comment on the LTD proposal. If you have any questions, please contact me by phone at (202) 589-2409 or by email at john.court@bpi.com.

Respectfully submitted,

John Court
Executive Vice President, General Counsel, Head of Regulatory Affairs & COO
Bank Policy Institute