

FEDERAL RESERVE SYSTEM

12 CFR 252

[Regulations YY; Docket No. R-1523]

RIN 7100-AE37

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

AGENCY: Board of Governors of the Federal Reserve System (Board).

ACTION: Final rule.

SUMMARY: The Board is adopting a final rule to require a U.S. top-tier bank holding company identified under the Board’s rules as a global systemically important bank holding company (covered BHC) to maintain outstanding a minimum amount of loss-absorbing instruments, including a minimum amount of unsecured long-term debt. In addition, the final rule prescribes certain additional buffers, the breach of which would result in limitations on the capital distributions and discretionary bonus payments of a covered BHC. The final rule applies similar requirements to the top-tier U.S. intermediate holding company of a global systemically important foreign banking organization with \$50 billion or more in U.S. non-branch assets (covered IHC). The final rule also imposes restrictions on other liabilities that a covered BHC or covered IHC may have outstanding in order to improve their resolvability and resiliency; these restrictions are referred to in the final rule as “clean holding company requirements.”

DATES: The final rule is effective on [insert date 60 days after publication in the Federal Register].

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SUPPLEMENTARY INFORMATION:

Table of Contents

I. Introduction

- A. Background
- B. Notice of Proposed Rulemaking and General Summary of Comments
- C. Overview of the Final Rule
- D. Consultation with the Federal Deposit Insurance Corporation, the Financial Stability Oversight Council, and Foreign Authorities

II. External TLAC and LTD Requirements for U.S. GSIBs

- A. Scope of Application
- B. Calibration of the External TLAC and LTD Requirements

- C. Core Features of Eligible External TLAC
- D. External TLAC Buffer
- E. Core Features of Eligible External LTD
- F. Costs and Benefits

III. TLAC and LTD Requirements for U.S. Intermediate Holding Companies of Global Systemically Important Foreign Banking Organizations

- A. Eligible External and Internal Issuance of TLAC and LTD by covered IHCs
- B. Scope of Application
- C. Resolution and Non-Resolution IHCs
- D. Calibration of the TLAC and LTD Requirements
- E. Core Features of Eligible TLAC
- F. TLAC Buffer for Covered IHCs
- G. Core Features of Eligible Internal and External LTD for Covered IHCs

IV. Clean Holding Company Requirements

- A. Third-Party Short-Term Debt Instruments
- B. Qualified Financial Contracts with Third Parties
- C. Guarantees that Are Subject to Cross-Defaults
- D. Upstream Guarantees and Offset Rights
- E. Cap on Certain Liabilities
- F. Disclosure Requirements

V. Regulatory Capital Deduction for Investments in the Unsecured Debt of Covered BHCs

VI. Transition Periods

VII. Consideration of Domestic Internal TLAC Requirements and Public Reporting Requirements for Eligible Internal TLAC and LTD

VIII. Regulatory Analysis

- A. Paperwork Reduction Act
- B. Regulatory Flexibility Act
- C. Invitation for Comments on Use of Plain Language

I. Introduction

A. Background

In October 2015, the Board invited public comment on a notice of proposed rulemaking (proposal) to require the largest domestic and foreign banks operating in the United States to maintain a minimum amount of total loss-absorbing capacity (TLAC), consisting of a minimum amount of long-term debt (LTD) and tier 1 capital.¹ In addition, the proposed rule prescribed certain buffers, the breach of which would result in limitations on the capital distributions and discretionary bonus payments of the firm. The proposal also included a separate requirement that these companies maintain a minimum amount of LTD. The TLAC and LTD requirements in the proposal had two overall objectives: improving the resiliency of these companies and improving their resolvability in the event of their failure or material financial distress. Both objectives help to reduce risks to financial stability, as provided in section 165 of the Dodd-Frank Act.²

¹ See 80 FR 74926 (November 30, 2015).

² Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111– 203, 124 Stat. 1376. (2010); 12 U.S.C. 5365.

Improving the resiliency of banking organizations, and in particular large banking organizations, has long been a goal of the Board. The Board has had a long-standing practice of requiring large bank holding companies to maintain minimum amounts of regulatory capital in order to absorb losses.³ Banking organizations subject to the Board's regulatory capital rules (Regulation Q) must maintain a minimum amount of regulatory capital and maintain a capital buffer above the minimum capital requirements in order to avoid restrictions on capital distributions and discretionary bonus payments.⁴ The largest and most complex banking organizations are subject to additional capital buffers because of their greater systemic risk.⁵

The minimum capital requirements in Regulation Q take the form of minimum ratios of different forms of regulatory capital to risk-based and total-leverage-based measures of assets.⁶ The risk-based ratios are the common equity tier 1 ratio (common equity tier 1 capital to risk-weighted assets), the tier 1 risk-based capital ratio (tier 1 capital to risk-weighted assets), and the total risk-based capital ratio (tier 1 capital plus tier 2 capital to risk-weighted assets).⁷ Regulation Q also includes a leverage ratio that relates a company's tier 1 capital to its total assets.⁸

³ See 12 CFR part 225, Appendix A (superseded as of January 1, 2015, by 12 CFR part 217).

⁴ 12 CFR 217.11(a). The capital conservation buffer is composed entirely of common equity tier 1 capital

⁵ These are the countercyclical capital buffer and the buffer in the Board's risk-based capital surcharge for global systemically important bank holding companies.

⁶ See 12 CFR 217.10.

⁷ See 12 CFR 217.10(a)(1) through (3).

⁸ See 12 CFR 217.10(a)(4). In addition, certain internationally active banking organizations are subject to a supplementary leverage ratio, which incorporates certain off-balance sheet exposures into the measure of total assets. 12 CFR 217.10(a)(5).

The TLAC and LTD requirements in the final rule build on, and serve as a complement to, the regulatory capital requirements in Regulation Q. While regulatory capital requirements are intended to ensure that a banking organization has sufficient capital to remain a going concern, the objective of the TLAC and LTD requirements in the final rule is to reduce the financial stability impact of a failure by requiring companies to have sufficient loss-absorbing capacity on both a going concern and a gone-concern basis.

A company's gone-concern loss-absorbing capacity is different from the company's going-concern capacity in a few fundamental respects. Although regulatory capital theoretically can absorb losses after a firm has entered resolution, the firm's regulatory capital, and especially its equity capital, is likely to be significantly or completely depleted in the lead up to a bankruptcy or resolution. Thus, if the ultimate goal is to have a failed firm re-emerge from resolution with sufficient capital to successfully operate as a going concern, there will need to be a new source of capital for the firm. In this regard, debt instruments, which count in regulatory capital in limited amounts and are subject to restrictions on their terms, are capable of absorbing losses in resolution. This is because the debt holders' claim on a company's assets may be reduced in a resolution or bankruptcy proceeding. This would increase the size of a company's assets relative to the size of its liabilities and thereby increase the company's equity. Certain debt instruments are better able to absorb losses in a resolution proceeding and only these eligible debt instruments count toward the TLAC and LTD requirement in the final rule.

As in the proposal, the TLAC and LTD requirements in the final rule focus on the largest and most systemic U.S. banking organizations and the U.S. operations of the largest and most systemic foreign banking organizations, because, as shown in the recent financial crisis, the failure or material financial distress of these companies has the greatest potential to disrupt U.S. financial stability.

The TLAC requirements in the final rule are based on many of the same measures as those that are in Regulation Q. For example, the TLAC requirements include both risk-based and leverage-based measures and include buffer requirements on top of the minimum TLAC requirements that function in a manner similar to the capital conservation buffer in Regulation Q. The risk-based measures of TLAC help to ensure that the amount of TLAC held by a company would be commensurate with its overall risks, while the leverage-based measures of TLAC act as a backstop to the risk-based measures. Companies that do not meet a TLAC buffer face limitations on capital distributions and discretionary bonus payments (in a manner similar to the restrictions in Regulation Q).

Improving resolvability was also an important goal of the proposal, and remains an important goal of the final rule. Efforts to ensure the orderly resolution of firms subject to the rule enhances financial stability. To further this objective, the largest domestic and foreign banks operating in the United States will be required to maintain a minimum amount of outstanding LTD instruments. This LTD also will count toward the TLAC requirements in the final rule. In the event that a company had significant losses such that it was experiencing significant financial distress or had depleted its equity capital, the LTD that the company had outstanding could be used to replenish the

company's equity. This could occur in a resolution proceeding, or, in the case of the U.S. operations of certain foreign banks, by order of the Board.⁹ Like the minimum TLAC requirements and for the same reasons as noted above, the minimum LTD requirements include both risk-based and leverage-based measures.

If a company subject to the final rule experiences losses, the losses would be passed on first to shareholders of the parent company and, if the losses exceed the parent company's equity, to the holders of the parent company's debt. In this way, the TLAC and LTD requirements would increase market discipline for banking organizations subject to the requirements by making them bear the costs of issuing a minimum amount of LTD instruments that are capable of absorbing losses in a manner that would enhance the resiliency and resolvability of the organization.

Foreign jurisdictions have been pursuing similar approaches to the approach adopted by the Board in the final rule since the 2007-2009 financial crisis.¹⁰ In November 2015, the Financial Stability Board (FSB) finalized an internationally negotiated minimum standard for the total loss-absorbing capacity of global systemically important banks (GSIBs) (the FSB standard).¹¹

⁹ *See, e.g.*, 80 FR 74928-30.

¹⁰ These efforts have been coordinated through the Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB), at the direction of the Heads of State of the Group of Twenty (G20 Leaders). Representatives of the United States have taken an active role in these efforts.

¹¹ Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution, Total Loss-absorbing Capacity (TLAC) Term Sheet, November 9, 2015 (hereinafter "FSB Standard"), available at <http://www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf>.

The final rule also is generally consistent with the FSB standard, although the final rule adopts a minimum LTD requirement, unlike the FSB standard.¹² Several commenters noted that the proposed rule deviated from the FSB standard in various respects. These comments are addressed in greater detail below in the description of the requirements of the final rule, including those aspects of the final rule that were modified in response to issues raised by commenters. As described further below, the final rule requires full compliance by January 1, 2019.

The Board is issuing the final rule under section 165 of the Dodd-Frank Act. Section 165 authorizes the Board to impose enhanced prudential standards on bank holding companies with total consolidated assets of \$50 billion or more “[i]n order to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected financial institutions.”¹³ These enhanced prudential standards must increase in stringency based on the systemic footprint and risk characteristics of individual covered firms.¹⁴ In addition, section 165 authorizes the Board to establish

¹² Under the FSB standard, GSIBs would be subject to a minimum TLAC requirement equal to 16 percent of the banking organization’s risk weighted assets (risk-weighted assets) as of January 1, 2019 and 18 percent as of January 1, 2022 plus any applicable regulatory capital (Basel III) buffers, which must be met in addition to the TLAC risk-weighted assets minimum. Minimum TLAC must also be at least 6 percent of the Basel III leverage ratio denominator as of January 1, 2019, and at least 6.75 percent as of January 1, 2022. The FSB standard also contains an expectation that a GSIB would meet at least one-third of its TLAC requirement with eligible LTD rather than equity.

¹³ 12 U.S.C. 5365(a)(1).

¹⁴ 12 U.S.C. 5365(a)(1)(B), (b)(3).

such other prudential standards as the Board of Governors, on its own or pursuant to a recommendation made by the Council, determines are appropriate.¹⁵

In implementing other portions of the Dodd-Frank Act, the Board has taken important steps to protect U.S. financial stability by making major financial companies more resolvable – that is, to take measures so that a failed firm could be dealt with in an orderly manner, without the destructive effects on other important financial firms that were caused by the failures and near-failures of major financial firms in 2008. These steps include heightened regulatory capital and capital planning requirements for large, systemically important banks holding companies and resolution planning requirements.¹⁶ In addition, Title II of the Dodd-Frank Act established a new statutory resolution framework for major financial companies as an alternative to bankruptcy.¹⁷

The enhanced prudential standards in the final rule are intended to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress, failure, or ongoing activities of a covered BHC or covered IHC. In particular, the final rule would improve the resolvability of a covered BHC under either the U.S. Bankruptcy Code or Title II of the Dodd-Frank Act and improve their resiliency.

Similarly, the final rule would improve the resiliency of covered IHCs and their subsidiaries, and thereby increase the likelihood that a failed foreign bank with significant U.S. operations could be successfully resolved without the failure of the U.S.

¹⁵ 12 U.S.C. 5365(b)(1)(B)(iv).

¹⁶ *See, e.g.*, 12 CFR part 217, subpart H; 12 CFR 225.8; and 12 CFR part 243.

¹⁷ *See* 12 U.S.C. 5381-5394.

subsidiaries or, failing that, that the U.S. operations could be separately resolved in an orderly manner.

In addition to the authority identified above, section 165 of the Dodd-Frank Act authorizes the Board to establish “enhanced public disclosures” and “short-term debt limits.”¹⁸ The final rule includes disclosure requirements and limits on the ability of covered BHCs and covered IHCs to issue short-term debt.

Finally, as noted, the Board has tailored the final rule to apply to companies that, if resolved in a disorderly manner, would likely pose the greatest risk to the financial stability of the United States.¹⁹

B. Notice of Proposed Rulemaking and General Summary of Comments

As noted, the proposal contained requirements regarding LTD and TLAC for large, interconnected U.S. bank holding companies and the U.S. operations of large, interconnected foreign banking organizations.²⁰ The proposal included four interrelated requirements for these organizations.

First, the top-tier parent holding companies of U.S. GSIBs (covered BHCs) would be required to maintain outstanding minimum levels of total loss-absorbing capacity (external TLAC) and long-term unsecured debt (external LTD). In addition, the proposal included a related buffer on top of the risk-weighted asset component of external TLAC, the breach of which would result in limitations on a covered BHC’s capital distributions and discretionary bonus payments. The proposal defined external LTD as unsecured debt

¹⁸ 12 U.S.C. 5365(b)(1)(B)(ii) and (iii).

¹⁹ 12 U.S.C. 5365(a)(1)(B).

²⁰ 80 FR 74926 (November 30, 2015).

that is issued directly by a covered BHC, is “plain vanilla” (that is, the debt instrument has no features that would interfere with a smooth resolution proceeding),²¹ and is governed by U.S. law. External TLAC, under the proposal, was defined as the sum of the tier 1 regulatory capital issued directly by the covered BHC (excluding minority interests) and the external LTD of the covered BHC.

Second, under the proposal, the top-tier U.S. intermediate holding companies of foreign GSIBs (covered IHCs) would have been required to maintain outstanding minimum levels of total loss-absorbing capacity (internal TLAC) and long-term unsecured debt instruments (internal LTD) issued to their foreign parent company. In addition, the proposal included a related buffer on top of the risk-weighted asset component of internal TLAC, the breach of which would result in limitations on a covered IHC’s capital distributions and discretionary bonus payments. The proposal defined internal TLAC and LTD for covered IHCs similarly to external TLAC and LTD for covered BHCs, with a few key differences for internal LTD. These included the requirements that internal LTD had to be issued to a parent foreign entity that controls the covered IHC, be contractually subordinated to all third-party liabilities of the covered IHC, and contain a contractual conversion trigger pursuant to which the Board could require the covered IHC to cancel the eligible internal LTD or convert or exchange it into common equity tier 1 capital under certain circumstances. In addition, the minimum amount of internal TLAC required under the proposal varied based on whether the

²¹ “Plain vanilla” is described in detail in section II.E.3 and generally excludes exotic features that could impact the loss absorbing capacity of the LTD and thereby diminish the prospects for an orderly resolution of a covered BHC, such as structured notes and most instruments that contain derivative-linked features.

covered IHC was expected to adopt either an SPOE or MPOE resolution strategy, though both types of firms were required to issue the same amounts of internal LTD.

Third, the operations of the covered BHCs and covered IHCs would have been subject to “clean holding company” limitations to further improve their resolvability and the resiliency of their operating subsidiaries. In particular, the proposal would have prohibited covered BHCs from issuing short-term debt instruments to third parties (including deposits); entering into “qualified financial contracts” (QFCs) with third parties; having liabilities that are subject to “upstream guarantees” from the covered BHC’s subsidiaries or that are subject to contractual offset rights for its subsidiaries’ creditors; or issuing guarantees of its subsidiaries’ liabilities, if the guarantee provided that the covered BHC’s insolvency or entry into resolution was an event of default on the part of the subsidiary. The proposal applied a similar prohibition to covered IHCs. Additionally, the proposal capped the value of a covered BHC’s liabilities (other than those related to external TLAC and external LTD) that can be pari passu with or junior to its external LTD at 5 percent of the value of its external TLAC. This cap on liabilities was not relevant to covered IHCs under the proposal because the proposal required that a covered IHC’s eligible internal LTD be contractually subordinated to all of the covered IHC’s third-party liabilities.

Fourth and finally, banking organizations subject to the Board’s capital requirements would have been required to make certain deductions from capital for holding of unsecured debt issued by covered BHCs to limit the potential for financial sector contagion in the event of the failure of a covered BHC.

The Board received approximately 50 comments on the proposed rule from

banking organizations, trade associations, public interest advocacy groups, members of Congress, and private individuals. Board staff also met with some commenters at their request to discuss their comments on the proposal and summaries of these meetings may be found on the Board's public Web site.

Commenters generally supported the proposal, including the proposed minimum TLAC and LTD requirements. Certain commenters, however, argued that the calibration of the proposed TLAC and LTD requirements under the proposal was too high for both covered BHCs and covered IHCs. A number of these commenters encouraged the Board to reduce or eliminate certain proposed requirements. In particular, a number of commenters urged the Board to eliminate the separate LTD requirement and allow covered BHCs and covered IHCs the option to meet the proposed TLAC requirements with equity or debt.

Commenters also expressed concerns about the eligibility requirements for LTD. These commenters urged the Board to permit a broader set of instruments to qualify as eligible long-term debt, including debt with various types of acceleration clauses, debt issued under foreign law, principal-protected structured notes, and trust preferred securities ("TruPS"). In the alternative, to mitigate the impact of the requirements, commenters urged the Board to grandfather as eligible LTD existing outstanding long-term debt, which often contains features that would cause disqualification as eligible LTD under the proposal. The Board also received comment requesting that the leverage component of external TLAC be reduced and include a buffer similar to that placed on the risk-weighted asset component.

Foreign bank commenters raised a number of concerns related to the proposed

internal TLAC and LTD requirements. These commenters expressed general concerns about national treatment and competitive equality.²² In particular, some commenters argued that, given their relative size, covered IHCs should not be subject to TLAC and LTD requirements under the proposed rule considering that similarly-sized U.S. institutions would not be subject to these requirements. Commenters also urged the Board to permit covered IHCs to issue debt externally on the same terms as covered BHCs. Commenters expressed particular concerns about additional costs resulting from certain features of internal LTD that the proposal would not require for external LTD. According to the commenters, these features would make internal LTD relatively more costly than external LTD. In particular, foreign bank commenters requested the removal of the acceleration clause prohibition, the contractual subordination requirement, and the contractual conversion trigger requirement. Commenters argued that these requirements for internal LTD could cause eligible LTD to be characterized as equity, rather than debt, for U.S. income tax purposes.

While commenters generally supported the proposed clean holding company requirements, certain commenters urged the Board to modify the proposal to allow certain types of guarantees that are subject to cross-default rights. Commenters also requested that the Board include a market-making exception from the proposed capital deduction and provide additional time for companies to come into compliance with the requirements of the final rule. Comments on the proposal and the changes in the final rule are described in more detail throughout the remainder of this SUPPLEMENTARY

²² The Board is required to give due regard to the principle of national treatment and equality of competitive opportunity in developing enhanced prudential standards under the Dodd-Frank Act. 12 U.S.C. 5365(b)(2).

INFORMATION.

C. Overview of the Final Rule

The Board is adopting this final rule to improve the resiliency and resolvability of GSIBs and thereby reduce threats to financial stability. The Board has made a number of changes to the proposal in response to concerns raised by commenters, as further described below.

The final rule is intended to improve the resolvability of the most systemically important banking firms – global systemically important banking organizations (GSIBs) without extraordinary government support or taxpayer assistance by establishing “total loss-absorbing capacity” standards for the GSIBs and requiring them to issue a minimum amount of LTD.²³ The final rule requires the top-tier holding companies of U.S. GSIBs to maintain outstanding minimum levels of TLAC and eligible LTD. In addition, the final rule establishes a buffer on top of both the risk-weighted asset and leverage components of the external TLAC requirements, the breach of which would result in limitations on a covered BHC’s capital distributions and discretionary bonus payments.

The final rule requires the top-tier U.S. intermediate holding companies of foreign GSIBs to maintain outstanding minimum levels of total loss-absorbing capacity and long-term unsecured debt. In addition, the final rule establishes a buffer on top of the risk-weighted asset component of the internal TLAC requirements, the breach of which would

²³ Separately, the Board is continuing to work with the OCC and FDIC to mitigate the resolvability risks related to potential disorderly unwinds of financial contracts.

result in limitations on a covered IHC's capital distributions and discretionary bonus payments.

The final rule applies "clean holding company" limitations to the operations of the top-tier holding companies of U.S. GSIBs and the top-tier U.S. intermediate holding companies of foreign GSIBs to further improve their resolvability and the resiliency of their operating subsidiaries. The Board has decided to defer adoption of capital deduction requirements for Board-regulation institutions that hold unsecured LTD. The Board will work with the other federal banking agencies to adopt the deduction requirements on a coordinated basis as further described below.

After analyzing the expected impact of the final rule with the modifications adopted to address concerns of commenters, the Board has determined to establish an effective date of January 1, 2019, for the rule. While this provides a shorter transition period than originally proposed, the changes adopted by the Board, including grandfathering outstanding LTD and other changes discussed below, mitigate the actions firms must take to comply with the final rule.

1. External Total Loss-Absorbing Capacity and Long-Term Debt Requirements for Covered U.S. Bank Holding Companies

Under the final rule, a "covered BHC" is defined to mean a U.S. GSIB identified under the Board's rule establishing risk-based capital surcharges for global systemically important bank holding companies (GSIB surcharge rule).²⁴ A covered BHC will be required to maintain outstanding minimum levels of eligible TLAC and eligible external LTD beginning on January 1, 2019. Consistent with the proposal, a covered BHC's

²⁴ 12 CFR 217.402; 80 FR 49106 (August 14, 2015).

eligible external TLAC is defined to be the sum of the tier 1 regulatory capital issued directly by the covered BHC and the amount of the covered BHC's eligible external LTD that is due to be paid after one year or more.²⁵

Also consistent with the proposal, eligible external LTD is defined under the final rule as debt that is issued directly by the covered BHC, is unsecured, is "plain vanilla," and is governed by U.S. law. Only 50 percent of the amount of eligible external LTD that is due to be paid between one and two years can be used for purposes of the external LTD requirement (though such debt would count in full for purposes of the external TLAC requirement). The amount of eligible external LTD due to be paid in less than one year will not count toward the external TLAC requirement or the external LTD requirement.

In response to comments and to mitigate the impact of the requirements, the final rule differs from the proposal by providing a grandfather for certain outstanding LTD of covered BHCs issued prior to December 31, 2016, to count towards the external LTD and external TLAC requirements in the final rule. The final rule also includes a provision that would allow the Board, after notice and an opportunity to respond, to order a global systemically important BHC to exclude from its outstanding eligible long-term debt amount any debt securities with features that would significantly impair the ability of such debt securities to take losses.

Under the external TLAC requirement of the final rule, a covered BHC is required to maintain outstanding eligible external total loss-absorbing capacity ("eligible

²⁵ The proposal was based on the "remaining maturity" of the debt, while the final rule is based on the unpaid principal amount "due to be paid" for reasons discussed below.

external TLAC”) in an amount not less than the greater of 18 percent of the covered BHC’s total risk-weighted assets and 7.5 percent of the covered BHC’s total leverage exposure.²⁶ In addition, external TLAC buffers that are similar to the capital buffers in the Board’s Regulation Q²⁷ will apply in addition to the risk-weighted asset component and leverage component of the external TLAC requirement. These requirements generally are the same as under the proposal, except the leverage component of the external TLAC requirement has been reduced from 9.5 percent under the proposal to 7.5 percent in the final rule, and the Board has adopted a 2 percent buffer on top of the leverage component of the external TLAC requirement to better align with the risk-weighted asset component and the Board’s regulatory capital rules.

Under the external LTD requirement of the final rule, a covered BHC is required to maintain outstanding eligible external long-term debt instruments (eligible external LTD) in an amount not less than the greater of 6 percent plus the surcharge applicable under the GSIB surcharge rule (expressed as a percentage) of total risk-weighted assets and 4.5 percent of total leverage exposure. These requirements are the same as under the proposal. The external LTD requirement is calibrated by reference to a “capital refill” framework that helps to ensure that the covered BHC could be effectively recapitalized to the individual capital levels expected of each covered BHC to be sufficiently capitalized in the event that all or most of its capital were depleted. Because the capital requirements that apply to covered BHCs depend, in part, on idiosyncratic measures of a covered BHC’s risks and, in part, on standardized measures of risk that are common across all

²⁶ Total leverage exposure is defined in 12 CFR 217.10(c)(4)(ii).

²⁷ 12 CFR part 217.

bank holding companies, the LTD requirements that apply to a particular covered BHC will vary. To the extent that these capital requirements are updated over time, the Board would also expect to consider updating the associated external LTD requirement in an effort to preserve the general alignment between the Board's capital rules and the external LTD requirements.

2. Total Loss-Absorbing Capacity and Long-Term Debt Requirements for Covered U.S. Intermediate Holding Companies

The term "covered IHC" is defined in the final rule to include any U.S. IHC that (a) is required to be formed under the Board's enhanced prudential standards rule, and (b) is controlled by a foreign banking organization that has been designated as a GSIB or would be designated as a GSIB under the Board's capital rules.²⁸ Under the final rule, a "covered IHC" is required to maintain outstanding minimum levels of eligible total loss-absorbing capacity and eligible long-term debt beginning on January 1, 2019. A covered IHC's eligible TLAC generally is defined to be the sum of (a) the tier 1 regulatory capital issued from the covered IHC to a foreign parent entity that controls the covered IHC and (b) the covered IHC's eligible LTD, as defined below.

Under the final rule, the amount of eligible total loss-absorbing capacity ("eligible TLAC") and long-term debt that a covered IHC is required to maintain outstanding, as well as whether the eligible long-term debt component may be issued externally, depends on whether the covered IHC (or any of its subsidiaries) is expected to enter resolution

²⁸ The Board's enhanced prudential standards rule generally requires any foreign banking organization with total consolidated non-branch U.S. assets of \$50 billion or more to form a single U.S. intermediate holding company over its U.S. subsidiaries. 12 CFR 252.153; 79 FR 17329 (May 27, 2014).

(resolution covered IHC) in a multiple-point-of-entry (MPOE) resolution strategy, or to continue to operate outside of resolution proceedings (non-resolution covered IHC) while a foreign parent entity is resolved under a single-point-of-entry (SPOE) resolution strategy.²⁹ A key modification to the proposal is that, under the final rule, a resolution covered IHC that adopts an MPOE resolution strategy would have the option to issue capital and LTD externally to third parties in a fashion similar to covered BHCs (and consistent with their resolution strategy) as described below. Non-resolution covered IHCs continue to be required under the final rule to issue LTD internally.

²⁹ In developing the TLAC and LTD requirements in the proposal and final rule, the Board considered the two scenarios under which large financial firms are likely to be resolved following failure. In one scenario, an SPOE resolution, only the top-tier holding company would enter a resolution proceeding. An SPOE resolution thus would avoid the need for separate proceedings for separate legal entities run by separate authorities across multiple jurisdictions and the associated destabilizing complexity. The losses that caused the banking organization to fail would be passed up from the subsidiaries that incurred the losses using one of several potential mechanisms and would then be imposed on the equity holders and unsecured creditors of the holding company, which would have the effect of recapitalizing the subsidiaries of the banking organization. An SPOE resolution could avoid losses to the third-party creditors of the subsidiaries and could thereby allow the subsidiaries to continue normal operations, without entering resolution or taking actions (such as asset fire sales) that could pose a risk to the financial stability of the United States. The expectation that the holding company's equity holders and unsecured creditors would absorb the banking organization's losses in the event of its failure would also help to maintain the confidence of the operating subsidiaries' creditors and counterparties, reducing their incentive to engage in potentially destabilizing funding runs. Most of the U.S. GSIBs, as well as most foreign GSIBs, are developing plans that facilitate an SPOE approach, including in their most recent resolution plans.

The other likely resolution scenario is an MPOE resolution. An MPOE resolution involves separate resolutions of different legal entities within a financial firm and could potentially be executed by multiple resolution authorities across multiple jurisdictions. The final rule would improve the prospects for a successful MPOE resolution of a GSIB by requiring U.S. GSIBs and the intermediate holding company of a foreign GSIBs to maintain substantially more loss-absorbing capacity. The final rule also includes certain features that would facilitate the resolution of a foreign GSIB under an MPOE resolution. Moreover, an MPOE resolution strategy involving the resolution of a covered IHC may often effectively be an SPOE resolution strategy of their U.S. operations.

In particular, under the final rule, the capital and long-term debt of a non-resolution covered IHC will be required to be issued either to a foreign company that controls the covered IHC (a “foreign parent”) or to a directly or indirectly wholly-owned foreign subsidiary of the top-tier foreign parent (internal TLAC and LTD) consistent with the SPOE resolution strategy. The proposal, by contrast, required a foreign parent to hold internal TLAC and LTD issued by covered IHCs. In response to comments, the final rule was changed from the proposal to allow any directly or indirectly wholly owned subsidiary of the top-tier foreign parent to hold eligible internal TLAC an LTD issued by covered IHCs. This change is consistent with the overall objectives of the proposal that a non-resolution covered IHC upstream any losses outside of the United States to a parent foreign banking organization. By contrast, under the final rule, a resolution covered IHC will have the option to issue its LTD internally to its foreign affiliates or externally to third-party investors consistent with an MPOE resolution strategy.

Under the final rule, beginning on January 1, 2019, non-resolution covered IHCs are required to maintain eligible internal TLAC in an amount not less than the greater of: (a) 16 percent of the covered IHC’s total risk-weighted assets; (b) 6 percent of the covered IHC’s total leverage exposure (for covered IHCs that are subject to the supplementary leverage ratio)³⁰; and (c) 8 percent of the covered IHC’s average total consolidated assets, as computed for purposes of the U.S. tier 1 leverage ratio.³¹ For all

³⁰ Under the IHC rule, U.S. intermediate holding companies with total consolidated assets of \$250 billion or more or on-balance sheet foreign exposure equal to \$10 billion or more are required to meet a minimum supplementary leverage ratio of 3 percent. 12 CFR 252.153(e)(2); 79 FR 17329 (March 27, 2014).

³¹ The final rule imposes the same leverage capital requirements on U.S. intermediate holding companies as it does on U.S. bank holding companies. 12 CFR 252.153(e)(2);

covered IHCs, a buffer that is similar to the capital conservation buffer in the Board's Regulation Q will apply in addition to the risk-weighted assets component of the TLAC requirement. These requirements for non-resolution covered IHCs are the same as under the proposal. In addition, under the final rule and as explained above, a non-resolution covered IHC is required to issue internal LTD to a foreign parent that controls the IHC as under the proposal, or to a directly or indirectly wholly owned foreign subsidiary of the top-tier foreign parent.

Under the final rule, beginning on January 1, 2019, resolution covered IHCs are required to maintain outstanding eligible TLAC in an amount not less than the greater of (a) 18 percent of the covered IHC's total risk-weighted assets; (b) 6.75 percent of the covered IHC's total leverage exposure (if applicable); and (c) 9 percent of the covered IHC's average total consolidated assets, as computed for purposes of the U.S. tier 1 leverage ratio. As noted above, for all covered IHCs, a TLAC buffer that is similar to the capital conservation buffer in the Board's Regulation Q applies in addition to the risk-weighted assets component of the TLAC requirement. These requirements are generally the same as under the proposal.

In response to comments, the minimum eligible LTD requirements have been adjusted downward to reflect the same balance-sheet depletion assumption afforded to the calibration of the eligible external LTD requirements of U.S. bank holding companies. Accordingly, all covered IHCs (whether or not a resolution entity) will be required under the final rule to maintain outstanding eligible LTD in an amount not less

79 FR 17329 (March 27, 2014). These leverage capital requirements include the generally applicable leverage ratio and the supplementary leverage ratio for U.S. intermediate holding companies that meet the scope of application for that ratio.

than the greater of (a) 6 percent of total risk-weighted assets; (b) 2.5 percent of the total leverage exposure (if applicable); and (c) 3.5 percent of average total consolidated assets, as computed for purposes of the U.S. tier 1 leverage ratio. As discussed in more detail below, the final rule also includes a provision that would allow the Board, after notice and an opportunity to respond, to order a covered IHC to exclude from its outstanding long-term debt amount any debt securities with features that would significantly impair the ability of such debt securities to take losses.

A covered IHC's eligible LTD generally is subject to the same requirements as the requirements that apply to eligible external LTD for U.S. GSIBs: the eligible LTD must be issued directly from the covered IHC, be unsecured, have only "plain vanilla" features, and be governed by U.S. law. The amount of eligible LTD that is due to be paid between one and two years is subject to a 50 percent haircut for purposes of the LTD requirement, and eligible LTD amounts due to be paid in less than one year will not count toward the LTD requirement.

In addition, the final rule has been modified to allow eligible LTD issued by covered IHCs, whether external or internal LTD, to have the same acceleration clauses that are permitted for eligible external LTD issued by covered BHCs. Moreover, under the final rule, covered IHCs will have the option to adopt contractual subordination or structural subordination for their eligible long-term debt; under the proposal covered IHCs were required to contractually subordinate their long-term debt. These modifications will allow covered IHCs to issue eligible long-term debt, whether internal or external, on similar terms as covered BHCs under the final rule and therefore reduce burden on covered IHCs and help ensure national treatment and competitive equality. In

response to comments and to mitigate the impact of the requirements, the final rule differs from the proposal by providing a grandfather for certain outstanding eligible external LTD of resolution covered IHCs issued prior to December 31, 2016.

However, one key feature will continue to distinguish eligible internal LTD from eligible external LTD for covered IHC's (both for non-resolution covered IHCs and for resolution covered IHCs that exercise their option to issue their LTD internally). Eligible internal LTD must include a contractual trigger pursuant to which the Board could require the covered IHC to convert or exchange the LTD into common equity tier 1 capital without the covered IHC's entry into a resolution proceeding in certain circumstances. These circumstances are (a) the Board determines that the covered IHC is "in default or in danger of default"; and (b) any of the following situations apply (i) the top-tier foreign banking organization or any subsidiary outside the United States is placed into resolution proceedings, (ii) the home country supervisory authority consents to the conversion, or does not object to the conversion following 24 hours' notice, or (iii) the Board makes a written recommendation to the Secretary of the Treasury that the Federal Deposit Insurance Corporation (FDIC) should be appointed as receiver of the covered IHC.

In response to comments, the final rule includes certain changes to the requirement that the Board must be able to cause a covered IHC to convert its LTD to equity. Under the proposed rule, the contractual conversion trigger would have allowed the Board to cancel or convert the covered IHC's LTD. The final rule includes only the requirement that LTD be convertible into equity and does not include the requirement that LTD be subject to cancellation. Thus, under the final rule, a covered IHC must

include a contractual conversion provision in its LTD that would allow the Board to order the conversion of the long-term debt into equity. In addition, the final rule has been modified to allow the Board to convert all or part of a covered IHC's LTD into equity. The intended purpose of these changes, along with allowing certain acceleration clauses and structural subordination, is to provide flexibility consistent with the purposes of the rule and to respond to concerns raised by commenters regarding the contractual conversion trigger as further discussed below. The Board believes that these changes respond to comments on the proposed rule and serve to mitigate the costs of the conversion feature on covered IHCs.

3. Clean Holding Company Requirements

The final rule prohibits or limits covered BHCs and covered IHCs from directly entering into certain financial arrangements that could impede an entity's orderly resolution. These prohibitions and limitations will enhance resiliency by reducing complexity and reliance on short-term funding and are intended to support the orderly resolution of a covered BHC and covered IHC.

Under the final rule, a covered BHC and covered IHC are prohibited from issuing short-term debt instruments to third parties (including deposits); entering into "qualified financial contracts" (QFCs) with third parties; having liabilities that are guaranteed by the covered BHC's subsidiaries or subject to contractual offset rights for its subsidiaries' creditors; or issuing certain guarantees of its subsidiaries' liabilities if the liability provides default rights based on the resolution of the covered BHC or covered IHC. This last prohibition has been revised from the proposal to exempt guarantees of liabilities that

are subject to any future rule of the Board or another Federal banking agency restricting default rights.

Additionally, the final rule caps the amount of a covered BHC's third-party liabilities (other than those related to eligible external TLAC and eligible external LTD) that can be pari passu with or junior to its eligible external LTD at 5 percent of the value of its eligible external TLAC. The final rule includes a similar cap for covered IHCs that choose structural subordination of their long-term debt though with certain differences for non-resolution covered IHCs and resolution covered IHCs described further below. In each case, under the final rule, both covered BHCs and covered IHCs have the option under the final rule to contractually subordinate their eligible long-term debt to other third-party liabilities without the need for the 5 percent cap. Finally, the final rule requires covered BHCs and covered IHCs that issue long-term debt externally to make certain public disclosures.

4. Capital deduction

The final rule does not adopt the requirement in the proposal that state member banks, bank holding companies, and savings and loan holding companies and IHCs formed to comply with the Board's enhanced prudential standards for foreign banking organizations deduct investments in the unsecured debt of covered BHCs that exceed certain thresholds from regulatory capital. The Board intends to address these elements of the proposal jointly with the Office of the Comptroller of the Currency (OCC) and FDIC at a later time, in order to apply these requirements consistently to all entities subject to the regulatory capital requirements of the federal banking agencies.

E. Consultation with the FDIC, the Council, and Foreign Authorities

In developing this final rule, the Board consulted with the FDIC, the Financial Stability Oversight Council (Council), and other U.S. financial regulatory agencies. The final rule reflects input that the Board received during this consultation process. Furthermore, the Board has consulted with foreign financial regulatory authorities regarding this final rule and the establishment of other standards that would maximize the prospects for the cooperative and orderly cross-border resolution of failed GSIBs.

II. External TLAC and LTD Requirements for U.S. GSIBs

A. Scope of Application (section 252.60 of the final rule)

The final rule, like the proposal, applies to all “covered BHCs.” The term “covered BHC” is defined in the final rule in the same manner as the proposal to include any U.S. top-tier bank holding company identified as a global systemically important BHC under the Board’s GSIB surcharge rule.³² Under the GSIB surcharge rule, a U.S. top-tier bank holding company subject to the advanced approaches rule must determine whether it is a global systemically important BHC by applying a multifactor methodology established under the Board’s regulatory capital rules.³³ This methodology evaluates a banking organization’s systemic importance on the basis of its attributes in five broad categories: size, interconnectedness, cross-jurisdictional activity, substitutability, and complexity. Accordingly, the methodology provides a tool for identifying as global systemically important BHCs those banking organizations that pose elevated risks. The final rule’s focus on global systemically important BHCs is in keeping with the Dodd-

³² 12 CFR 217.402; 80 FR 49106 (August 14, 2015).

³³ 12 CFR part 217, subpart H.

Frank Act's mandate that more stringent prudential standards be applied to the most systemically important bank holding companies.³⁴

Under the methodology in the GSIB surcharge rule, eight U.S. bank holding companies are currently identified as GSIBs. Those eight top-tier bank holding companies will therefore be covered BHCs subject to this final rule.³⁵ In addition, because the GSIB surcharge methodology is dynamic, other banking organizations could become subject to the final rule in the future. As under the proposal, a covered BHC will become subject to the requirements of the final rule on the later of January 1, 2019, or three years after the date on which the firm becomes a covered BHC.

The Board did not receive any comments on the proposed methodology for identifying those U.S. BHCs subject to the rule. Accordingly, the Board is adopting this methodology in the final rule without modification.

B. Calibration of the External TLAC and LTD Requirements (sections 252.62 and 252.63 of the final rule)

Under the proposal, a covered BHC would have been required to maintain outstanding eligible external TLAC in an amount not less than the greater of 18 percent of its total risk-weighted assets and 9.5 percent of its total leverage exposure under the supplementary leverage ratio rule.³⁶ Under the final rule's external TLAC requirement, a

³⁴ 12 U.S.C. 5365(a)(1)(B).

³⁵ The eight firms currently identified as U.S. GSIBs are Bank of America Corporation, The Bank of New York Mellon Corporation, Citigroup Inc., Goldman Sachs Group, Inc., JP Morgan Chase & Co., Morgan Stanley, State Street Corporation, and Wells Fargo & Company.

³⁶ *See* 12 CFR 217.10(c)(4)(ii). Under the proposal, the risk-weighted assets component of the external TLAC requirement would have been phased in as follows: It would be equal to 16 percent of the covered BHC's risk-weighted assets beginning on January 1,

covered BHC is required to maintain outstanding eligible external TLAC in an amount not less than the greater of 18 percent of the covered BHC's total risk-weighted assets³⁷ and 7.5 percent of the covered BHC's total leverage exposure.

As described below, the reduction of the leverage component of the external TLAC requirement is intended to account for revisions to the proposal. As revised, the final rule includes a buffer over the minimum external TLAC leverage exposure requirement that is being added in the final rule for parallelism with the buffer over the risk-weighted asset measure of external TLAC and with the Board's Regulation Q. As a result, two separate external TLAC buffers apply in addition to both the risk-weighted assets component and leverage component of the external TLAC requirement under the final rule.

Under the final rule's external LTD requirement, as under the proposal, a covered BHC is required to maintain outstanding eligible external LTD in an amount not less than the greater of 6 percent plus the surcharge applicable under the GSIB surcharge rule (expressed as a percentage) of total risk-weighted assets and 4.5 percent of total leverage exposure. Covered BHCs are prohibited from redeeming or repurchasing eligible

2019, and would be equal to 18 percent of the covered BHC's risk-weighted assets beginning on January 1, 2022.

³⁷ A covered BHC would calculate risk-weighted assets for purposes of the external TLAC requirement using the same methodology it uses to calculate risk-weighted assets under the Board's regulatory capital rules. *See* 12 CFR part 217, subparts D and E. The Board's regulatory capital rules require an advanced approaches banking organization (generally, a banking organization with \$250 billion or more in total consolidated assets or \$10 billion or more in total on-balance sheet foreign exposure) that has successfully completed its parallel run to calculate each of its risk-based capital ratios using the standardized approach and the advanced approaches, and directs the banking organization to use the lower of each ratio as its governing ratio. *See* 12 CFR 217.10.

external LTD prior to its stated maturity date without obtaining prior approval from the Board where the redemption or repurchase would cause the covered BHC’s eligible external LTD to fall below its external LTD requirement. A summary table of the final rule’s calibrations for eligible external TLAC and LTD appears below.

Table 1: Eligible External TLAC and LTD Calibrations under the Final Rule for Covered BHCs

		Risk-weighted assets	Leverage
Covered BHCs	External TLAC	18 percent plus buffer	7.5 percent plus buffer
	External LTD	6 percent plus GSIB surcharge	4.5 percent

In developing the final rule, the Board considered comments on the calibration of the proposed external TLAC and LTD requirements. A number of commenters supported the external TLAC and LTD requirements in the proposed rule, and some commenters suggested that the requirements were appropriately calibrated to support U.S. financial stability. A few commenters, however, suggested that higher minimum TLAC requirements would provide additional financial stability benefits. Certain commenters argued that the external TLAC requirement should be calibrated using a more severe set of loss assumptions than the historical loss experience of major financial institutions during past financial crises, or set at a significantly higher percentage of a covered BHC’s risk-weighted assets. For example, one commenter argued that the requirements should be well above a requirement informed by the most recent financial

crisis and recommended a minimum TLAC requirement of 30 percent of risk-weighted assets.

A few commenters argued that the calibration of the external TLAC and external LTD requirements in the proposed rule was higher than necessary to support a successful resolution, did not take into account other regulatory efforts to address financial stability, and would impede economic growth and access to capital. These commenters generally supported adjusting the calibration of the external TLAC and LTD requirements by lowering the minimum external TLAC and LTD percentages levels. For example, certain commenters suggested reducing the risk-weighted asset component of the TLAC requirement from 18 percent to 14 percent and reducing the supplementary leverage ratio component of the TLAC requirement from 9.5 percent to 6.75, 7.5 or 8 percent. Similarly, one commenter suggested reducing the leverage component of LTD from 4.5 percent to 2.5 percent.

In addition, some commenters urged the Board to eliminate or significantly reduce the component of the external TLAC and external LTD requirement calculated as a percentage of the covered BHC's total leverage exposure in light of the lack of risk sensitivity of this measure. The commenters that objected to the calibrations as too high argued that superequivalent external TLAC and LTD requirements of the proposal relative to the FSB standard would put U.S. firms at a competitive disadvantage. Other commenters, however, expressed the view that superequivalence relative to the FSB requirements would enhance the competitive position of U.S. institutions and U.S. financial stability.

Certain commenters urged that the separate long-term debt requirement in the proposed rule be eliminated and that covered BHCs should be permitted to meet TLAC requirements with either equity or debt. These commenters argued that equity capital is the best way to ensure that firms are well capitalized and can absorb losses and that equity can act as a going-concern or gone-concern form of capital. These commenters further argued that if a separate LTD requirement were retained in the final rule, the final rule should include a one-year cure period for any breaches of the LTD requirement. Other commenters, however, including a member of Congress, expressed support for a separate long-term debt requirement to strengthen the resilience of covered firms and support recapitalization in a resolution, which would likely only occur after equity capital is depleted.

With regard to the calibration in the final rule, the Board balanced the need to help ensure the orderly resolution of a GSIB without imposing unduly high costs on the economy, against the need to ensure that firms can manage their overall liability structure in a cost effective manner that fits with their overall mix of business lines and funding needs. The final rule retains the overall calibration of the external TLAC and external LTD requirements set forth in the proposal but with certain modifications, discussed below, including a buffer for the leverage component of the external TLAC requirement.

As suggested by some commenters, the Board considered whether to structure the final rule solely around a minimum TLAC requirement—that is, as a single minimum requirement that could be satisfied by any mixture of capital and eligible LTD—without a specific minimum LTD requirement. In the absence of an LTD requirement, a TLAC requirement would permit each covered firm to reduce its expected systemic impact by

striking its own balance between reducing its probability of default (by issuing additional going-concern equity capital above regulatory capital minimum requirements) or by reducing the harm it would cause if it were to fail (by issuing additional gone-concern LTD above regulatory capital minimum requirements).³⁸

The Board has determined that it is appropriate for the final rule to include both a minimum LTD requirement and a minimum TLAC requirement. Unlike existing equity, LTD can be “bailed-in” to create additional equity capital subsequent to a firm’s failure. Imposing an LTD requirement would help to ensure that a covered firm would have a known and observable quantity of loss-absorbing capacity in excess of its going-concern equity capital. Unlike common equity, that loss-absorbing capacity would not be at substantial risk of volatility or depletion before the covered BHC fails or enters a resolution proceeding. Thus, the LTD requirements of the final rule would enhance the prospects for the successful resolution of a failed GSIB and thereby better address the too-big-to-fail problem, as compared with an approach that relied solely on a minimum TLAC requirement.

The availability of long-term debt that can serve as a fresh source of capital is vital to ensure a successful recapitalization of a failing firm experiencing stress without relying on government or taxpayer support to provide additional equity capital. The calibration of the TLAC and LTD requirements in the final rule takes into account the various statutory and regulatory requirements applicable to covered BHCs and other financial institutions, including those designed to enhance the stability of the United

³⁸ See “Calibrating the GSIB Surcharge” at 3 (July 20, 2015), available at www.federalreserve.gov/aboutthefed/boardmeetings/gsib-methodology-paper-20150720.pdf.

States financial system and support a successful resolution. In addition, the empirical analysis underlying the final rule's calibration described below suggests it would be sufficient to support the viability of a covered BHC during a period of severe economic stress.

The final rule also retains the proposed leverage-related TLAC and LTD requirements. Capital requirements based on simple measures of equity to total assets and capital requirements based on risk are complementary tools. Risk-based capital requirements reflect the different risk characteristics of different assets, while leverage capital requirements act as a backstop and act as a counterweight to potential arbitrage of risk-based capital requirements. For these reasons, the required TLAC and LTD requirements in the final rule include both risk-weighted and leverage-related components to ensure a robust set of requirements that are not overly dependent on a single risk measurement framework.

The calibration of the external TLAC requirement in the final rule is based in part on an analysis of the historical loss experience of major financial institutions during financial crises. First, a targeted analysis of losses of U.S. financial firms during the 2007-2009 financial crisis was performed. The analysis considered the loss experiences of the 19 bank holding companies that participated in the Supervisory Capital Assessment Program (SCAP).³⁹ This analysis combined the losses actually sustained by those firms

³⁹ See Press Release, "Federal Reserve, OCC, and FDIC release results of the Supervisory Capital Assessment Program" (May 7, 2009), available at <http://www.federalreserve.gov/newsevents/press/bcreg/20090507a.htm>.

during the 2007-2008 period with their 2009 SCAP loss projections⁴⁰ and the government recapitalization support that they received. This provided an estimate of the level of losses that would have been sustained in the absence of extraordinary government intervention in the financial system, which likely prevented substantial losses that each firm would otherwise have incurred as a result of the material financial distress or failure of major counterparties. The purpose of a TLAC requirement is to ensure that GSIBs have sufficient loss-absorbing capacity to absorb significant losses and then be recapitalized to the level necessary for them to face the market on a going-concern basis without public-sector support. Therefore, the sum of losses and public-sector recapitalization provides a good measure for the approximate level of TLAC necessary to achieve this purpose.

The analysis found that the bank holding company with the most severe loss experience incurred estimated losses and recapitalization needs of roughly 19 percent of risk-weighted assets. The risk-weighted assets component of the external TLAC requirement is consistent with this high-water mark from the global financial crisis. This historical analysis confirms the appropriateness of the calibration under the final rule.

Additionally, a separate quantitative study of the experiences of 13 U.S. and foreign GSIBs and other major financial firms that incurred substantial losses during the 2007-2009 financial crisis and the Japanese financial crisis of the 1990s was conducted.

⁴⁰ See “The Supervisory Capital Assessment Program: Overview of Results” (May 7, 2009), available at <http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20090507a1.pdf>. One commenter indicated that it conducted a similar internal analysis and determined that the calibration for external TLAC under the proposed rule is well-sized and would be more than sufficient to restore firms to solvency based on last financial crisis.

With respect to each firm, the study considered both the peak losses incurred by the firm (measured in terms of total comprehensive income) over the loss period and public-sector capital support, incorporating both direct capital injections and asset relief transactions.

The study examined losses and recapitalization needs in terms of both risk-weighted assets and total assets, which is relevant to the total leverage exposure component of the external TLAC requirement. The calibration of the external TLAC requirement in the final rule is consistent with the findings of this historical survey. The risk-weighted assets component of the final rule exceeds a substantial majority of the loss-and-recapitalization experiences surveyed, while the total leverage exposure requirement is slightly higher than the most severe experience surveyed. These are appropriate results in light of the Dodd-Frank Act's focus on the mitigation of risks that could arise from the material financial distress or failure of the largest, most systemic financial institutions, and further supports the calibration of the final rule.⁴¹

The calibration of the external LTD requirement in the final rule was also informed by an analysis of the extreme loss tail of the distribution of income for large U.S. bank holding companies over the past several decades. This analysis closely resembled the analysis that informed the calibration of the minimum risk-based capital requirements in the revised capital framework, but it involved looking further into the loss tail of the income distribution.

Like the proposal, 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

⁴¹ See 12 U.S.C. 5365.

BHC 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. Thus, even if a covered BHC were unable to identify outside sources of funding, the company would be capitalized at a level sufficient to support all of the operations that had been in place before resolution proceedings were initiated. This enhanced level of resiliency is appropriate because of the size, interconnectedness, and complexity of covered BHCs. Fulfilling this objective is vital to the use of eligible external LTD to facilitate the orderly resolution of a covered BHC, because an orderly SPOE resolution requires that a firm exiting from resolution have sufficient going-concern capital to maintain market confidence in its solvency so that other market participants will do business with it.

The external LTD requirement was calibrated in accordance with this framework. Under the Board's regulatory capital requirements, a covered BHC must maintain a minimum ratio of common equity tier 1 capital to risk-weighted assets of 4.5 percent. In addition, a covered BHC is subject to a capital conservation buffer of 2.5 percent of risk-weighted assets plus a firm-specific surcharge determined under the GSIB surcharge rule (expressed as a percentage) of risk-weighted assets.⁴² Thus, a covered BHC with a GSIB

⁴² See 12 CFR 217.10(a)(1); 217.11. Under the Board's capital rules, the capital conservation buffer can be increased by an additional 2.5 percent of risk-weighted assets through the activation of a countercyclical capital buffer. The external LTD requirement

surcharge of 2 percent would be subject to a combined common equity tier 1 capital minimum plus buffers of 9 percent.

Since the calibration of the external LTD requirement is based on the capital refill framework, and the capital refill framework depends on the precise structure and calibration of bank capital requirements, the Board expects to consider updating the external LTD requirement in the event that the Board updates bank capital requirements in a way that materially changes their precise structure or calibration.

Under the final rule, a covered BHC is subject to an external LTD requirement equal to 7 percent of risk-weighted assets, plus the applicable GSIB surcharge, minus a 1 percentage point allowance for balance-sheet depletion. This results in a requirement of 6 percent plus the applicable GSIB surcharge (expressed as a percentage) of risk-weighted assets. Without the 1 percentage point allowance for balance-sheet depletion, the risk-weighted assets component of a covered BHC's external LTD requirement would require it to maintain outstanding an amount of eligible external LTD equal to the full amount of its minimum common equity tier 1 capital ratio plus buffer. The 1 percentage point allowance for balance-sheet depletion is appropriate under the capital refill theory because the losses that the covered BHC incurs leading to its failure will deplete its risk-weighted assets as well as its capital. Accordingly, the pre-failure losses would result in a smaller balance sheet for the covered BHC at the point of failure, meaning that a smaller dollar amount of capital would be required to restore the covered BHC's pre-stress capital level. Although the specific amount of eligible external LTD necessary to

does not incorporate any countercyclical capital buffer because it is likely that no such buffer would be active under the economic circumstances most likely to be associated with the failure and resolution of a covered BHC.

restore a covered BHC's pre-stress capital level in light of the diminished size of its post-failure balance sheet will vary in light of the firm-specific GSIB surcharges applicable to the covered BHCs, the Board is applying a uniform 1 percentage point allowance for balance-sheet depletion so as to avoid undue regulatory complexity.

The application of the capital refill framework to the leverage component of the external LTD requirement is analogous. The supplementary leverage ratio requires that bank holding companies maintain a ratio of tier 1 capital to total leverage exposure of at least 3 percent.⁴³ The enhanced supplementary leverage standards applicable to global systemically important BHCs add to a covered BHC's supplementary leverage ratio minimum a buffer of 2 percent of its total leverage exposure for a total tier 1 capital to total leverage exposure requirement plus buffer of 5 percent.⁴⁴ Under the final rule, a covered BHC is subject to an external LTD requirement equal to 4.5 percent of its total leverage exposure. This requirement, which incorporates a balance-sheet depletion allowance of 0.5 percent, is appropriate to ensure that a covered BHC that has depleted its tier 1 capital and failed would be able to refill its capital to meet the minimum leverage ratio requirement and buffer through the exchange or conversion of its eligible external LTD into equity.

The proposed rule would have prohibited a covered BHC from redeeming or repurchasing any outstanding eligible external LTD without the prior approval of the Board, if after the redemption the covered BHC would not meet its external LTD requirement or its external TLAC requirement. One commenter generally supported the

⁴³ 12 CFR 217.10(a)(5).

⁴⁴ The supplementary leverage ratio requirement and buffer become effective January 1, 2018. *See* 12 CFR 217.1(f)(1)(iii)(B).

proposed prior approval requirement, and, in particular, its limited application to cases where a BHC would fail to meet its external LTD requirement or its external TLAC requirement following redemption or repurchase.

The final rule adopts as proposed the prior approval requirement for redemptions and repurchases of a covered BHC's outstanding eligible external LTD. Allowing a covered BHC to redeem or repurchase its eligible external LTD without prior Board approval, where such redemption or repurchase would not result in the covered BHC failing to comply with the external TLAC and LTD requirements of the final rule, gives the covered BHC flexibility to manage its outstanding debt levels without interfering with the underlying purpose of the rule. In addition and as discussed below, the final rule includes a provision that would allow the Board, after notice and an opportunity to respond, to order a global systemically important BHC to exclude from its outstanding eligible long-term debt amount any debt securities with features that would significantly impair the ability of such debt securities to take losses.⁴⁵

In addition, the final rule does not include a grace period during which a covered BHC that breaches its external LTD requirement could take voluntary actions to come into compliance with such requirement without being subject to any other regulatory

⁴⁵ Section 263.83 of the Board's rules of procedures describes the notice and response procedures that apply if the Board determines that a company's capital levels are not adequate. *See* 12 CFR 263.83. The Board would follow the same procedures under the final rule to determine that a covered BHC must exclude from its eligible LTD amount securities with features that would significantly impair the ability of such debt securities to take losses. For example, the Board would provide notice to a company of its intention to require the company to exclude certain securities from its eligible LTD amount and up to 14 days to respond before the Board would issue a final notice requiring that company exclude the securities from its eligible LTD amount, unless the Board determines that a shorter period is necessary.

consequences, such as an enforcement action, as suggested by certain commenters. The Board expects covered BHCs subject to the final rule to comply with applicable minimum external LTD requirements at all times. The key purpose of the eligible external LTD requirement is to have debt available to absorb losses; a one-year cure period would defeat this purpose by providing a period of time during which covered BHCs would not be required to meet the minimum requirements of the final rule.

C. Core Features of Eligible External TLAC (section 252.63(b) of the final rule)

The core features of eligible external TLAC under the final rule are the same as under the proposal. Under the final rule, a covered BHC's eligible external TLAC would be defined to be the sum of (a) the tier 1 regulatory capital (common equity tier 1 capital and additional tier 1 capital) issued directly by the covered BHC (excluding any tier 1 minority interests), and (b) the covered BHC's eligible external LTD, as defined below.⁴⁶ Tier 2 capital that meets the definition of eligible external LTD would continue to count toward the external LTD and TLAC requirements.

Certain commenters urged the Board to harmonize the proposed TLAC requirement with the Basel III Capital framework by not disqualifying minority interests in consolidated subsidiaries from counting as TLAC. These commenters argued that the qualifying criteria imposed on minority interests in consolidated subsidiaries in the U.S.

⁴⁶ Although eligible external LTD due to be paid between one and two years would be subject to a 50 percent haircut for purposes of the external LTD requirement, such eligible external LTD would continue to count at full value for purposes of the external TLAC requirement in the same manner as under the proposal. As discussed below, eligible external LTD due to be paid in less than one year would not count toward either the external TLAC requirement or the external LTD requirement.

capital rules and Basel capital framework significantly haircut the amount of minority interest in a consolidated subsidiary that may be included in a parent organization's regulatory capital, thus mitigating any concern that the subsidiary's loss absorbing capacity would be unavailable to absorb losses anywhere in an banking organization.

Like the proposal, the final rule does not permit minority interests in consolidated subsidiaries to count as TLAC. The requirement that regulatory capital be issued out of the covered BHC itself (rather than by a subsidiary) is intended to ensure that the total required amount of loss-absorbing capacity would be available to absorb losses incurred anywhere in the banking organization (through downstreaming of resources from the BHC to the subsidiary that has incurred the losses, if necessary).

D. External TLAC Buffers (section 252.63(c) of the final rule)

The proposal would have imposed a buffer over the external TLAC requirement measured as a percentage of risk-weighted assets, but did not include a buffer over the external TLAC requirement measured as a percentage of total leverage exposure. The final rule retains the proposed buffer for the risk-weighted assets component of the external TLAC requirement and adds a buffer for the leverage component of the external TLAC requirement to address concerns raised by commenters regarding burden of the proposal's total leverage exposure requirement and for better parallelism with the regulatory capital framework in Regulation Q.

The Board received several comments on the proposed external TLAC buffer. The Board received comment arguing that the buffer should be broadened to apply to the leverage component of the external TLAC requirement, as well as the external LTD requirement, so that similar limitations on capital distributions and discretionary bonus

payments would apply to each of the minimum requirements under the rule. A commenter also urged the Board to align the leverage component of the external TLAC requirement with the enhanced supplementary leverage ratio standard in Regulation Q by reducing the leverage component of the external TLAC requirement by 2 percent and adding a 2 percent buffer over this component. Commenters noted that, where the leverage component of the external TLAC requirement was binding, a buffer over this component of the external TLAC requirement would impose progressively more stringent limits on a firm's ability to make capital distribution and discretionary bonus payments as its capital was depleted, in parallel with the proposed buffer over the risk-weighted assets component of the external TLAC requirement. Another commenter suggested that breaches of the TLAC buffer should bar any capital distributions and discretionary bonus payments until the firm has refilled its TLAC buffer, rather than only resulting in the incremental limits to the firm's ability to make such payments. A commenter further urged the Board to study how the proposed TLAC buffer would interact with any incentive-based compensation rules issued by the Board and whether the rules were duplicative.

In response to comments received on the proposal, the final rule reduces the minimum amount of the leverage component of the external TLAC requirement and adds, in an equal amount, a TLAC buffer to the leverage component of the external TLAC requirement. Specifically, under the final rule, the leverage component of the external TLAC requirement has been reduced to 7.5 percent from 9.5 percent and a 2 percent buffer has been added over the leverage component of the external TLAC requirement. These changes should address the major concern raised by commenters to

create a buffer for the leverage component of external TLAC to better parallel the buffer for the risk-weighted asset component of external TLAC and the Board's regulatory capital rules.

The purpose of the external TLAC buffers is to reduce the risk of insolvency by limiting the ability of a covered bank holding company to make capital distributions and discretionary bonus payments as its capital levels decline in the same manner as capital buffers in the Board's regulatory capital framework limits capital distributions and discretionary bonus payments. The buffer over the leverage component of the external TLAC requirement is designed to operate in a similar manner to the buffer in the enhanced supplementary leverage ratio standards, which functions similarly to the capital conservation buffer by limiting the ability of a company to make capital distributions and discretionary bonus payments as its capital levels decline.

Since the TLAC buffers are intended to be analogous to the capital buffers in Regulation Q, the final rule does not prohibit all discretionary bonus payments and dividends for breach of the applicable buffer, as suggested by one commenter, or include separate buffers on top of the long-term debt requirements. The Board notes that a covered BHC subject to this final rule may also be subject to future rules related to incentive compensation and that covered BHCs must comply with all applicable regulatory requirements.⁴⁷

A covered BHC's external TLAC buffer for the risk-weighted asset component (TLAC risk-weighted assets buffer) is equal to the sum of 2.5 percent plus the GSIB

⁴⁷ See 12 U.S.C. § 956; 81 FR 37670 (June 10, 2016).

surcharge applicable to the covered BHC under method 1 of the GSIB surcharge rule⁴⁸ plus any applicable countercyclical capital buffer. The external TLAC risk-weighted assets buffer must be filled solely with common equity tier 1 capital, and a covered BHC's breach of its external TLAC risk-weighted assets buffer would subject it to limits on capital distributions and discretionary bonus payments in accordance with Table 1 to section 252.63 of the final rule. Thus, the external TLAC risk-weighted asset buffer is analogous to the capital conservation buffer applicable under the Board's Regulation Q, except that it applies in addition to the external TLAC requirement rather than in addition to minimum risk-based capital requirements under Regulation Q and incorporates only the applicable GSIB surcharge amount required under method 1 of the GSIB surcharge rule (rather than the greater of the applicable GSIB surcharge under method 1 and method 2).⁴⁹

A covered BHC's external TLAC buffer for the total leverage exposure component of the external TLAC requirement (TLAC leverage buffer) is equal to 2 percent of total leverage exposure, the same as the buffer set by the enhanced supplementary leverage ratio standards. The TLAC leverage buffer must be filled solely with tier 1 capital, and a covered BHC's breach of its TLAC leverage buffer also subjects it to similar limits on capital distributions and discretionary bonus payments, as described in Table 2 to section 252.63 of the final rule. Accordingly, the TLAC leverage buffer is

⁴⁸ 80 FR 49082 (Aug. 14, 2015); 12 CFR Part 217, Subpart H.

⁴⁹ See 12 CFR 217, subpart H.

analogous to the buffer established under the enhanced supplementary leverage ratio standards except that it would apply in addition to the external TLAC requirement.⁵⁰

Finally, since under the final rule a covered BHC is subject to both the TLAC risk-weighted assets and TLAC leverage buffers, any limitations on distributions and discretionary bonus payments would be based on the more restrictive of the buffers. As an example, if a covered BHC had an amount of TLAC in excess of the TLAC risk-weighted asset requirement and in excess of the TLAC risk-weighted assets buffer but had an amount of TLAC in excess of the TLAC leverage requirement but less than the TLAC leverage buffer, the covered BHC’s distributions and discretionary bonus payments would be limited by the level of its TLAC leverage buffer.

Table 2: Calculation of Maximum External TLAC Risk-Weighted Asset Payout Amount

External TLAC risk-weighted buffer level	Maximum External TLAC risk-weighted payout ratio (as a percentage of eligible retained income)
Greater than the external TLAC risk-weighted buffer	No payout ratio limitation applies
Less than or equal to the external TLAC risk-weighted buffer, <u>and</u> greater than	60 percent

⁵⁰ See 79 FR 24528 (May 1, 2014); 80 FR 49082 (August 14, 2015).

75 percent of the external TLAC risk-weighted buffer	
Less than or equal to 75 percent of the external TLAC risk-weighted buffer, <u>and</u> greater than 50 percent of the external TLAC risk-weighted buffer	40 percent
Less than or equal to 50 percent of the external TLAC risk-weighted buffer, <u>and</u> greater 25 percent of the external TLAC risk-weighted buffer	20 percent
Less than or equal to 25 percent of the external TLAC risk-weighted buffer	0 percent

Table 3: Calculation of Maximum External TLAC Leverage Payout Amount

External TLAC leverage buffer level	Maximum External TLAC leverage payout ratio (as a percentage of eligible retained income)
Greater than 2.0 percent	No payout ratio limitation applies

Less than or equal to 2.0 percent, and greater than 1.5 percent	60 percent
Less than or equal to 1.5 percent, and greater than 1.0 percent	40 percent
Less than or equal to 1.0 percent, and greater than 0.5 percent	20 percent
Less than or equal to 0.5 percent	0 percent

A covered BHC’s external TLAC risk-weighted asset buffer level will be equal to its common equity tier 1 capital ratio minus that portion (if any) of its common equity tier 1 capital ratio (expressed as a percentage) that could be used to meet the risk-weighted assets component of the external TLAC requirement. To calculate its external TLAC risk-weighted assets buffer level, a covered BHC will subtract from its common equity tier 1 capital ratio the greater of 0 percent and the following figure: the risk-weighted assets component of the covered BHC’s external TLAC requirement minus the ratio of its additional tier 1 capital (excluding tier 1 minority interest) to its risk-weighted assets and minus the ratio of its outstanding eligible external LTD to its risk-weighted assets.

For example, suppose that a covered BHC called “BHC A” has a common equity tier 1 capital ratio of 10 percent, an additional tier 1 capital ratio of 2 percent, an outstanding eligible external LTD amount equal to 8 percent of its risk-weighted assets, and no tier 1 minority interest. Suppose further that BHC A is subject to an external risk-weighted asset TLAC requirement of 18 percent and an external risk-weighted assets TLAC buffer of 5 percent of risk-weighted assets. BHC A would meet its external risk-

weighted asset TLAC requirement because the sum of its common equity tier 1 capital ratio, its additional tier 1 capital ratio, and the ratio of its eligible external LTD to risk-weighted assets would be equal to 20, which is greater than 18. Moreover, BHC A would have an external TLAC risk-weighted assets buffer level equal to $10 - (18 - 2 - 8) = 2$ percent. Because 2 percent is less than 50 percent and more than 25 percent of the applicable 5 percent external TLAC buffer, BHC A would be subject to a maximum external TLAC risk-weighted payout ratio of 20 percent of eligible retained income.

The covered BHC's external TLAC leverage buffer level would be equal to its supplementary leverage ratio minus that portion (if any) of its supplementary leverage ratio (expressed as a percentage) that is used to meet the leverage component of the external TLAC requirement. To calculate its external TLAC leverage buffer level, a covered BHC would subtract from its supplementary leverage ratio the greater of 0 percent and the following figure: 7.5 percent (the leverage component of the covered BHC's external TLAC requirement) minus the ratio of its outstanding eligible external LTD amount to its total leverage exposure.

For example, suppose that a covered BHC called "BHC B" has a ratio of common equity tier 1 capital to total leverage exposure of 5 percent, a ratio of additional tier 1 capital to total leverage exposure of 1 percent, a ratio of outstanding eligible external LTD amount to total leverage exposure of 3 percent, and no tier 1 minority interest. BHC B will be subject to an external TLAC leverage requirement of 7.5 percent and a TLAC leverage buffer of 2 percent. BHC B would meet its external TLAC leverage requirement because the ratio of its common equity tier 1 capital and additional tier 1 capital plus outstanding eligible external LTD amount to total leverage exposure would

be equal to 9 percent. Moreover, BHC B would have a TLAC leverage buffer level equal to $5 - (7.5 - 1 - 3) = 1.5$ percent. Because 1.5 percent is less than or equal to 1.5 percent and greater than 1.0 percent, BHC B would be subject to a 40 percent maximum external TLAC leverage payout ratio for making distributions or discretionary bonus payments.

Finally, it is important to note that if the two examples provided above described a single BHC's TLAC risk-weighted assets buffer level and TLAC leverage buffer level then the BHC would be bound by the TLAC risk-weighted assets buffer because it would be more restrictive.

In order to comply with the external TLAC requirement and satisfy the TLAC risk-weighted assets buffer and TLAC leverage buffer, a covered BHC would need to have an outstanding TLAC amount sufficient to satisfy both the risk-weighted assets component and the total leverage exposure component of the TLAC requirement, as well as additional capital sufficient to satisfy both buffers. A covered BHC generally may use the same regulatory capital to satisfy its external TLAC requirement and the minimum ratios under Regulation Q. Therefore, a covered BHC that satisfies the minimum requirements and buffers under Regulation Q, and complies with the external LTD requirement, generally will satisfy the external TLAC requirement and the TLAC risk-weighted assets buffer and TLAC leverage buffer.

The rationale for the external TLAC buffers is similar to the rationale for the capital conservation buffer established by the Board's Regulation Q. During the 2007-2009 financial crisis, some banking organizations continued to pay dividends and substantial discretionary bonuses even as their financial condition weakened. These capital distributions weakened the financial system and exacerbated the crisis. The

external TLAC buffers are intended to encourage covered BHCs to practice sound capital conservation and thus to enhance the resilience of covered BHCs and of the financial system as a whole. The external TLAC buffers pursue this goal by providing covered BHCs with incentives to hold sufficient capital to reduce the risk that their eligible external TLAC would fall below the minimum external TLAC requirement during a period of financial stress.

E. Core Features of Eligible External LTD (section 252.61 of the final rule)

Under the final rule, a covered BHC's eligible external LTD is defined to be debt that is paid in and issued directly by the covered BHC, is unsecured, has a maturity of greater than one year from the date of issuance, has "plain vanilla" features, and is governed by U.S. law. While the core features of eligible external LTD are generally the same under the final rule as under the proposal, eligible external LTD under the final rule also includes certain debt instruments issued prior to December 31, 2016 that do not meet all the same requirements of eligible external LTD as described further below. Principal due to be paid on eligible external LTD in one year or more and less than two years is subject to a 50 percent haircut for purposes of the external LTD requirement, and principal due to be paid on eligible external LTD in less than one year would not count toward the external LTD requirement.

Commenters expressed general concerns about the criteria that long-term debt would be required to meet in order to count towards a firm's external long-term debt requirement. Some commenters suggested that the definition of eligible external LTD should be expanded to include a broader set of debt securities that may be available to

absorb losses and recapitalize the covered BHC in a Title II resolution or bankruptcy. Several commenters suggested that the definition of eligible external LTD should include all capital structure liabilities, which would include all debt instruments available to absorb losses that have a reasonably determinable claim in bankruptcy, including instruments with standard acceleration clauses, instruments issued under foreign law, and principal-protected structured notes. Certain commenters, for example, urged the Board to permit all instruments that satisfy the Board's tier 2 regulatory capital requirements to qualify as eligible LTD, including preferred stock.⁵¹ Commenters also noted that the criteria proposed for eligible external LTD would disqualify a significant amount of the existing, outstanding long-term debt issued by covered BHCs.

Several commenters suggested that the existing, outstanding long-term debt issued by covered BHCs should qualify as eligible external LTD, even if such debt does not meet all of the requirements for eligible external LTD. Some of these commenters noted that other actions covered BHCs would need to take to conform outstanding debt to the requirements for eligible external LTD in lieu of grandfathering—such as tendering and replacing outstanding debt, exchanging outstanding debt, or acquiring bondholder consent to amend the terms of outstanding debt—would impose significant costs on covered BHCs, costs that would be significantly reduced if the Board permitted such debt to qualify as eligible external LTD for even a short transitional period after the effective date of the final rule. Many of these commenters proposed that all external debt issued by covered BHCs before the effective date of the final rule should be permanently

⁵¹ Commenters requested that preferred stock be allowed as eligible external LTD and eligible internal LTD. The Board is declining to allow preferred stock for either form of LTD for the same reasons as described below.

grandfathered to qualify as eligible external LTD. Other commenters proposed permitting outstanding long-term debt to qualify as eligible external LTD if such debt would be ineligible only due to one of the following features: the inclusion of otherwise impermissible acceleration clauses, such debt being subject to foreign law, or debt that was ineligible due to inclusion of a market-based redemption feature (e.g., a security with a survivor put provision). Certain commenters noted that nearly all outstanding long-term debt issued by covered BHCs includes standard market acceleration clauses that would be impermissible under the proposal absent an explicit grandfathering provision in the final rule and that a significant fraction of currently outstanding long-term debt issued by covered IHCs has been issued under foreign law.

As discussed below, the general purpose of the proposed limitations on eligible long-term debt was to ensure the adequacy of the instruments to absorb losses in a resolution of the covered BHC. As a consequence, the final rule largely retains the eligibility criteria for eligible external LTD set forth in the proposal, with important modifications to address concerns raised by commenters. The modifications provided in the final rule to the eligibility criteria for eligible external LTD should mitigate the impact on covered BHCs and preserve the marketability of such debt, without adversely impacting its loss-absorbing capacity in resolution.

In response to concerns raised by comments, and to mitigate the impact of the requirements, the final rule includes as eligible external LTD those long-term debt instruments that are issued by a covered BHC prior to December 31, 2016 even if these instruments contain otherwise impermissible acceleration clauses or are subject to foreign law as described below. This grandfathering provision would largely eliminate the costs

of modifying the terms of existing, outstanding debt or issuing new debt to meet the minimum requirements as cited by commenters. Over time, debt that is grandfathered will mature and be replaced by long-term debt that meets the eligibility criteria of the final rule. As noted above, the final rule also contains a provision that would allow the Board, after notice and an opportunity to respond, to exclude from a covered BHC's outstanding long-term debt, the amount of any debt securities with features that would impair the ability of the debt to absorb losses.

1. Issuance by the Covered BHC and Prohibition on Own Holdings

Consistent with the proposal, eligible external LTD would be required to be paid in and issued directly by the covered BHC itself—that is, by the banking organization's top-tier holding company. Thus, debt instruments issued by a subsidiary would not qualify as eligible external LTD, even if they would qualify as regulatory capital.

Two commenters requested that the final rule make explicit whether TruPS would be classified as eligible external LTD in the final rule. In a typical TruPS structure, a trust holds assets consisting solely of junior subordinated notes issued by the bank holding company to the trust, and the trust issues the TruPS to investors. Therefore, TruPS, as typically structured, would not meet the requirement in the final rule that the debt be issued externally by the covered BHC. In addition, TruPS do not meet the criteria that such debt be “plain vanilla,” given the somewhat complex structure used to issue TruPS to the market, and the fact that TruPS are hybrid equity-debt instruments.

One commenter, who argued that TruPS should count as LTD, noted that its existing TruPS had impermissible acceleration clauses, another feature that would disqualify the securities from counting as eligible external LTD. In addition, information

provided by commenters and the Board's review of available information regarding outstanding TruPS issued by U.S. covered BHCs suggests that the effect of not counting TruPS as eligible long-term debt would have a relatively minor impact on covered BHCs.

The requirement that eligible external LTD be issued by the covered BHC itself serves two purposes. First, as with the requirement that regulatory capital be issued directly by the covered BHC in order to count as eligible external TLAC, this requirement allows eligible external LTD to be used to absorb losses incurred anywhere in the banking organization. By contrast, loss-absorbing debt issued by a subsidiary would lack this flexibility and would generally be available only to absorb losses incurred by that particular subsidiary.

Second, issuance directly from a covered BHC would enable the use of the eligible external LTD in an SPOE resolution of the covered BHC. Under the SPOE approach, only the covered BHC itself would enter resolution. The covered BHC's eligible external LTD would be used to absorb losses incurred throughout the banking organization, enabling the recapitalization of operating subsidiaries that had incurred losses and enabling those subsidiaries to continue operating on a going-concern basis. For this approach to be implemented successfully, the eligible external LTD must be issued directly by the covered BHC. Debt issued by a subsidiary generally cannot be used to absorb losses, even at the issuing subsidiary itself, unless that subsidiary enters a resolution proceeding. Therefore, permitting debt issued by a subsidiary to qualify as eligible external LTD would be contrary to the SPOE approach and potentially would create risks to the orderly resolution of a covered BHC.

2. Unsecured

Eligible external LTD is required to be unsecured, not guaranteed by the covered BHC or a subsidiary of the covered BHC, and not subject to any other arrangement that legally or economically enhances the seniority of the instrument (such as a credit enhancement provided by an affiliate). As no commenters raised issues regarding the requirement that eligible LTD must be unsecured, the final rule retains this requirement with no changes from the proposal.

The primary rationale for this restriction is to ensure that eligible external LTD can serve its intended purpose of absorbing losses incurred by the banking organization in resolution. To the extent that a creditor is secured, it can avoid suffering losses by seizing the collateral that secures the debt. This would thwart the purpose of eligible external LTD by leaving losses with the covered BHC (which would lose the collateral) rather than imposing them on the eligible external LTD creditor (which could take the collateral).

A secondary purpose of the restriction is to prevent eligible external LTD from contributing to the asset fire sales that can occur when a financial institution fails and its secured creditors seize and liquidate collateral. Asset fire sales can drive down the value of the assets being sold, which can undermine financial stability by transmitting financial stress from the failed firm to other entities that hold similar assets.

Finally, the requirement that eligible external LTD be unsecured ensures that losses can be imposed on that debt in resolution in accordance with the standard creditor hierarchy in bankruptcy, under which secured creditors are paid ahead of unsecured creditors.

3. “Plain vanilla”

As under the proposal, eligible external LTD instruments are required to be “plain-vanilla” instruments under the final rule. Exotic features could create complexity and thereby diminish the prospects for an orderly resolution of a covered BHC. These limitations would help to ensure that a covered BHC’s eligible external LTD represents loss-absorbing capacity with a definite value that can be quickly determined in resolution. In a resolution proceeding, claims represented by such “plain-vanilla” debt instruments are more easily ascertainable and relatively certain compared to more complex and volatile instruments. Permitting these features could engender uncertainty as to the level of the covered BHC’s loss-absorbing capacity and could increase the complexity of the resolution proceeding, both of which could undermine market participants’ confidence in an SPOE resolution and potentially result in a disorderly resolution. This could occur, for instance, if creditors and counterparties of the covered BHC’s subsidiaries decided to reduce their exposures to the subsidiaries of the failed covered BHC by severing business relationships and refusing to provide additional funding to such subsidiaries.

Under the final rule, eligible external LTD instruments are prohibited from (1) being structured notes; (2) having a credit-sensitive feature; (3) including a contractual provision for conversion into or exchange for equity in the covered BHC; or (4) including a provision that gives the holder a contractual right to accelerate payment (including automatic acceleration), other than a right that is exercisable on a one or more dates specified in the instrument, in the event of the insolvency of the covered BHC, or

the covered BHC's failure to make a payment on the instrument when due that continues for 30 days or more.⁵²

In response to comments requesting that the Board permit all tier 2 capital to count as eligible LTD, the Board has determined not to include as eligible LTD any instrument that qualifies as tier 2 capital. Certain of these instruments (e.g., certain forms of preferred stock and convertible debt) would not meet the requirement to be "plain vanilla" or other aspects of the requirements of eligible LTD (e.g., the prohibition on convertibility features described below). An instrument that qualifies as tier 2 capital will only qualify as eligible LTD under the final rule if it meets the applicable qualification requirements.

a. Structured Notes

The final rule retains the prohibition on counting structured notes, including principal-protected structured notes, as eligible external LTD. Structured notes contain features that could make their valuation uncertain, volatile, or unduly complex. In addition, they are often liabilities of retail customers (as opposed to investor liabilities). To promote resiliency and market discipline, it is important that covered BHCs have a minimum amount of loss-absorbing capacity whose value is easily ascertainable at any given time. Moreover, in an orderly resolution of a covered BHC, debt instruments that will be subjected to losses must be able to be valued accurately and with minimal risk of

⁵² As under the proposal, this restriction would be subject to an exception that would permit eligible external LTD instruments to give the holder a future put right as of a date certain, subject to the provisions discussed below regarding when the debt is due to be paid.

dispute. The requirement that eligible external LTD not contain the features associated with structured notes advances these goals.

For purposes of the final rule, a “structured note” is defined a debt instrument that (a) has a principal amount, redemption amount, or stated maturity that is subject to reduction based on the performance of any asset,⁵³ entity, index, or embedded derivative or similar embedded feature; (b) has an embedded derivative or similar embedded feature that is linked to one or more equity securities, commodities, assets, or entities; (c) does not have a minimum principal amount that becomes due and payable upon acceleration or early termination; or (d) is not classified as debt under U.S. generally accepted accounting principles. The definition of a structured note does not include a non-dollar-denominated instrument or an instrument whose interest payments are based on an interest rate index (for example, a floating-rate note linked to the federal funds rate or to LIBOR) that satisfies the proposed requirements in all other respects.⁵⁴

Several commenters proposed modifying the “plain vanilla” requirement for eligible external LTD to include a broader array of long-term debt securities issued by covered BHCs. In particular, certain commenters suggested that the final rule expand the definition of eligible external LTD to include structured notes that are principal-protected at par, as these notes by their terms require the issuer to pay 100 percent of the stated

⁵³ Assets would include loans, debt securities, and other financial instruments.

⁵⁴ One commenter recommended that the final rule clarify that instruments denominated in a currency other than U.S. dollars would not constitute “structured notes” and therefore may qualify as eligible external LTD. The same commenter noted that the final rule should clarify that an instrument whose interest payments are linked to an interest rate index would not be a structured note merely due to inclusion of this feature. The preamble to the proposed rule addressed these points and changes to provide further clarity are reflected in the final rule.

principal amount of the structured note upon early termination or acceleration and at maturity. As a result, these commenters argued that principal-protected structured notes do not present the same type of valuation issues as other structured notes whose value may be more volatile or uncertain since the minimum amount of any claim in a bankruptcy or Title II proceeding for a principal-protected structured note will always be the stated principal amount of the structured note.

Structured notes with principal protection often combine a zero-coupon bond, which pays no interest until the bond matures, with an option or other derivative product, whose payoff is linked to an underlying asset, index, or benchmark.⁵⁵ The derivative feature violates the intent of the clean holding company requirements (described below), which prohibits derivatives entered into by the covered bank holding company with third parties. Moreover, investors in structured notes tend to pay less attention to issuer credit risk than investors in other long-term debt, because structured note investors use structured notes to gain exposure unrelated to the covered BHC. As a result, these investors are less likely to contribute to the market discipline objective of the minimum LTD requirements.

For these same reasons, the final rule does not grandfather existing outstanding structured notes as eligible external TLAC. These products may not serve in a loss absorbing capacity consistent with the intended purposes of the final rule's long-term debt requirement. Moreover, based on figures provided by commenters and the Board's review of available information, the impact of not counting principal-protected structured notes as eligible external LTD is likely to be limited, especially in light of the

⁵⁵ <https://www.sec.gov/investor/alerts/structurednotes.htm>

grandfathering provided in the final rule for other outstanding long-term debt instruments.

b. Contractual provision for conversion into or exchange for equity

Consistent with the proposal, the final rule retains the requirement that eligible external LTD be prohibited from including contractual provisions for conversion into or exchange for equity. Some commenters supported the requirement that the eligible external LTD not exclude debt that is convertible or exchangeable into equity of the covered BHC, arguing that such a conversion feature would reduce the financial stability benefits of the debt and increase risks to investors. By contrast, other commenters pointed out that tier 2 capital includes debt that may convert into tier 1 capital, but under the proposed rule would not count towards a firm's LTD or TLAC requirements even though such securities would be "loss-absorbing" either on an as-converted basis, or as outstanding debt. Consequently, these commenters contended that such securities should count as eligible external LTD (or, at a minimum, count towards a covered BHC's TLAC requirement). These commenters also stated that, while covered BHCs currently do not have long-term debt with such convertibility features outstanding, covered BHCs may wish to issue debt securities with such convertibility features in the future, particularly in times of stress when issuing other forms of capital could be difficult.

The fundamental objective of the external LTD requirement is to ensure that covered BHCs will have a minimum amount of loss-absorbing capacity available to absorb losses upon the covered BHC's entry into resolution. Debt instruments that could convert into equity prior to resolution may not serve this goal, since by doing so they would reduce the amount of debt that will be available to absorb losses in resolution. In

addition, debt with features to allow conversion into equity are often complex and thus may not be characterized as “plain vanilla.” Convertible debt instruments may be viewed as debt instruments with an embedded stock call option. The embedded stock call option introduces a derivative-linked feature to the debt instrument that is inconsistent with the purpose of the clean holding company requirements (described below) and introduces uncertainty and complexity into the value of such securities. For these reasons, under the final rule, eligible external LTD may not include contractual provisions allowing for the conversion into or exchange for equity prior to the covered BHC’s resolution. Moreover, in light of the fact that commenters indicate that existing outstanding debt generally does not contain such convertibility features, the impact of such a prohibition is likely to be immaterial.

c. Credit-sensitive features and acceleration clauses

Under the proposal, eligible external LTD was prohibited from having a credit-sensitive feature or giving the holder of the instrument a contractual right to the acceleration of payment of principal or interest at any time prior to the instrument’s stated maturity (an acceleration clause), other than upon the occurrence of either an insolvency event or a payment default event, except that eligible external LTD instruments would be permitted to give the holder a put right as of a future date certain, subject to the remaining maturity provisions discussed below.

Several commenters expressed concerns with the proposed limitations on acceleration clauses. These commenters contended that the Board’s final rule should permit more classes of acceleration clauses. In particular, these commenters argued that a covered BHC is unlikely to breach any traditional covenants that result in acceleration

unless it were on the brink of insolvency. Traditional covenants range from covenants that are impossible to breach inadvertently, such as those not to enter a merger transaction or sell all or substantially all of their assets unless the successor assumes the debt securities subject to the covenant or to pledge the stock of material subsidiaries, to those that are administrative in nature and easy to comply with or cure breaches of, such as maintaining paying agents in certain locations. Commenters also argued that some classes of acceleration clauses that would be barred by the proposal would be unlikely to frustrate the purposes of the rule, and should therefore be permitted, including, for example, clauses permitting acceleration upon the event of non-payment of principal or interest (subject to a period during which the covered BHC could “cure” the failure to pay), restrictions on mergers or asset transfers, limits on the sale of principal subsidiaries, and other procedural covenants intended to facilitate payments on, and registration and transfer of, the debt securities. Moreover, commenters argued that these traditional covenants and related acceleration rights are important to investors and have traditionally been demanded and given in the markets for investment-grade senior long-term debt securities issued by covered BHCs.

Commenters contended that nearly all currently outstanding long-term debt of covered BHCs includes standard acceleration clauses, which would not qualify as eligible external LTD under the proposed rule, and that it would be impossible or very expensive to conform or redeem. For these reasons, commenters argued that the impact of this requirement was significant. The commenters asserted that, to the extent such debt is not grandfathered, covered BHCs would have a projected shortfall, as of January 1, 2019, of almost three times the estimated shortfall projected in the proposal. A number of

commenters suggested that grandfathering outstanding debt would be helpful to mitigate the impact of the requirements.

A few commenters expressed the view that the final rule should prohibit all acceleration clauses in eligible external LTD, including the insolvency or payment default acceleration clauses permitted under the proposal. These commenters argued that because acceleration clauses related to payment default or insolvency are highly unlikely to protect creditors from losses upon insolvency of a covered BHC, their inclusion could be deceptive for investors.

Under the final rule, eligible external LTD is prohibited from having a credit-sensitive feature or an acceleration clause—a contractual right to the acceleration of payment of principal or interest at any time prior to the instrument’s stated maturity, other than upon the occurrence of either an insolvency event or a payment default event that continues for 30 days or more—except that eligible external LTD instruments would be permitted to give the holder a put right as of a future date certain, subject to the provisions discussed below related to when the debt is due to be paid.⁵⁶

The final rule does not broaden the list of acceleration clauses that are permissible for long-term debt (and limits the permissibility of payment default acceleration clauses to those that include a cure period as described below). This restriction on acceleration clauses serves the same purpose as several of the other restrictions discussed above: to ensure that the required amount of loss-absorbing capacity will indeed be available to

⁵⁶ This final rule’s prohibition is similar to but moderately less stringent than the analogous restriction on tier 2 regulatory capital. The main difference between eligible external LTD and tier 2 capital in this regard is that tier 2 capital is also prohibited from containing payment default event acceleration clauses. *See* 12 CFR 217.20(d)(1)(vi).

absorb losses in resolution if the covered BHC fails. Early acceleration clauses, including cross-acceleration clauses, could undermine an orderly resolution by forcing a covered BHC to make payment on the full value of the debt prior to the entry of the covered BHC into resolution, potentially depleting the covered BHC's eligible external LTD immediately prior to resolution. This concern does not apply to acceleration clauses that are triggered by an insolvency event, however, because the insolvency that triggers the clause would generally occur concurrently with the covered BHC's entry into a resolution proceeding.

Senior debt instruments issued by covered BHCs commonly also include payment default event clauses. These clauses provide the holder with a contractual right to accelerate payment upon the occurrence of a "payment default event"—that is, a failure by the covered BHC to make a required payment when due. Payment default event clauses, which are not permitted in tier 2 regulatory capital, raise more concerns than insolvency event clauses because a payment default event may occur (triggering acceleration) before the institution has entered a resolution proceeding and a stay has been imposed. Such a pre-resolution payment default event could cause a decline in the covered BHC's loss-absorbing capacity.

Nonetheless, the final rule permits eligible external LTD to be subject to payment default event acceleration rights for two reasons. First, default or acceleration rights upon a borrower's default on its direct payment obligations are a standard feature of senior debt instruments, such that a prohibition on such rights could be unduly disruptive to the potential market for eligible external LTD. Second, the payment default of a covered BHC on an eligible external LTD instrument would likely be a credit event of

such significance that whatever diminished capacity led to the payment default event would also be a sufficient trigger for an insolvency event acceleration clause, in which case a prohibition on payment default event acceleration clauses would have little or no practical effect.

In addition, the final rule revises this aspect of the proposal to provide that an acceleration clause relating to a failure to pay principal or interest must include a “cure period” of at least 30 days. During this cure period, the covered BHC could make payment on the eligible external LTD before such debt could be accelerated and if the covered BHC satisfies its obligations on the eligible external LTD within the cure period, the instrument could not be accelerated. The purpose of this modification is to ensure that an accidental or temporary failure to pay principal or interest does not trigger immediate acceleration. Moreover, this cure period for interest payments is found in many existing debt instruments and is consistent with current market practice.

As discussed, the final rule’s definition of “eligible debt security” has been modified to allow debt instruments issued prior to December 31, 2016 that contain otherwise impermissible acceleration clauses to count as eligible long-term debt. This change significantly mitigates the impact of the requirements, because, based on information provided by commenters, nearly all existing outstanding long-term debt issued by covered BHCs contains acceleration clauses that would otherwise be prohibited under the final rule.

Certain commenters argued that the inclusion of acceleration causes could be misleading to investors that hold long-term debt. The disclosure requirements (described below) require a covered BHC to publicly disclose a description of the financial

consequences to unsecured debtholders of the covered IHC entering into a resolution proceeding. Accordingly, the disclosure requirements should address the concerns raised by commenters regarding transparency.

Commenters also noted that the proposal does not impose limits on the rights of holders of internal LTD to file suit in the event of non-payment or that such holders would have to waive those rights. However, because of the limitations on acceleration provisions, commenters requested that the Board clarify that the rule does not also limit such rights. The final rule does not require the holder of an eligible debt security to waive the holder's rights to file suit to enforce their ordinary creditor remedies. However, if a covenant involves a redemption or repurchase by the covered BHC (e.g., upon sale of a principal subsidiary), any such covenant would be subject to the restrictions on repurchase described elsewhere in this SUPPLEMENTARY INFORMATION, including prior approval from the Board where the redemption or repurchase would cause the covered BHC's eligible external LTD to fall below its external LTD requirement.

4. Minimum Remaining Maturity and Amortization (section 252.62(b) of the final rule)

Under the proposal, eligible external LTD with a remaining maturity of between one and two years would be subject to a 50 percent haircut for purposes of the external LTD requirement, and eligible external LTD with a remaining maturity of less than one year would not count toward the external LTD requirement.

Some commenters recommended that debt with a remaining maturity of at least one year, but less than two years, should not be subject to a haircut for purposes of the

external LTD requirement. These commenters argued that this haircut incorrectly assumes that a covered BHC could be cut off from capital markets for a period of up to two years. One commenter noted, for example, that this proposed haircut would depart from the FSB standard, and would thus contribute to unequal treatment of covered BHCs subject to the U.S. requirements and foreign GSIBs subject to rules of foreign jurisdictions that adhere to the FSB standard. Another commenter, however, expressed the view that the proposed haircut is appropriately conservative, and would help to ensure that loss-absorbing resources will likely always exceed a covered BHC's total loss-absorbing capacity needs. One commenter urged the Board to require that LTD have a maturity of considerably longer than one year.

In addition, some commenters suggested that the Board should take into consideration maturity date concentrations in the issuances of covered BHCs. One commenter suggested that the Board should establish a mandatory minimum maturity to which all eligible external LTD would have to comply at issuance. Other commenters, however, urged the Board not to mandate a particular issuance schedule for external LTD of covered BHCs.

The final rule adopts the proposed amortization haircut requirements applicable to eligible external LTD. However, the final rule modifies the terminology from the remaining maturity of the unpaid principal amount to the amount due to be paid. The purpose of this intended change is to clarify that it is the amount of debt due to be paid that counts as eligible LTD under the final rule.⁵⁷ Under the final rule, the amount of

⁵⁷ The final rule makes clear that when principal payments are due, rather than the remaining maturity, governs the amount of LTD that counts toward the minimum requirements under the final rule. A covered BHC may only count the unpaid principal

eligible external LTD that is due to be paid between one and two years would be subject to a 50 percent haircut for purposes of the external LTD requirement, and the amount of eligible external LTD that is due to be paid in less than one year would not count toward the external LTD requirement. The amount of eligible external LTD that is due to be paid in more than two years would count at 100 percent of the unpaid principal amount.

The purpose of these restrictions is to limit the debt that would fill the external LTD requirement to debt that will be reliably available to absorb losses in the event that the covered BHC fails and enters resolution. Debt that is due to be paid in less than one year does not adequately serve this purpose because of the relatively high likelihood that the debt will mature during the period between the time when the covered BHC begins to experience extreme stress and the time when it enters a resolution proceeding. If the debt matures during that period, then it is likely that the creditors would be unwilling to maintain their exposure to the covered BHC and will therefore refuse to roll over the debt or extend new credit, and the distressed covered BHC will likely be unable to replace the debt with new long-term debt that would be available to absorb losses in resolution. This run-off dynamic could result in a case where the covered BHC enters resolution with materially less loss-absorbing capacity than would be required to recapitalize its subsidiaries, potentially resulting in a disorderly resolution. To protect against this outcome, eligible external LTD would cease to count toward the external LTD requirement upon being due to be paid in less than one year, so that the full required

amount that is due to be paid as eligible external LTD. For amortizing debt, when the covered BHC pays back principal, that amount would not count toward the minimum LTD requirements in the final rule.

amount of loss-absorbing capacity would be available in resolution even if the resolution period were preceded by a year-long stress period.⁵⁸

For the same reasons, eligible external LTD that is due to be paid in less than two years but greater than or equal to one year is subject to a 50 percent haircut under the final rule for purposes of the external LTD requirement, meaning that only 50 percent of the value of its principal amount would count toward the external LTD requirement.⁵⁹ This amortization provision is intended to protect a covered BHC's 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) in two ways. First, it requires covered BHCs that rely on eligible external LTD that is vulnerable to such a run-off period (because it due to be paid in less than two years) to maintain additional loss-absorbing capacity. Second, it incentivizes covered BHCs to reduce or eliminate their reliance on loss-absorbing capacity that is due to be paid less than two years, since by doing so they avoid being required to issue additional eligible external LTD in order to account for the haircut. A covered BHC could reduce its reliance on eligible external LTD that is due to be paid in less than two years by staggering its issuance, by issuing eligible external LTD that is due to be paid after a longer period, or by redeeming and replacing eligible external LTD once the amount due to be paid falls below two years.

⁵⁸ This requirement also accords with market convention, which generally defines "long-term debt" as debt with maturity in excess of one year.

⁵⁹ As discussed above, the proposed amortization would apply only to eligible external LTD, not to eligible external TLAC. Thus, an eligible external LTD instrument that counts for only half value toward the external LTD requirement because of the 50 percent amortization provision would continue to count for full value toward the external TLAC requirement, although debt with a remaining maturity of less than one year would not count toward either requirement.

The final rule also provides similar treatment for eligible external LTD that could become subject to a “put” right—that is, a right of the holder to require the issuer to redeem the debt on demand—prior to reaching its stated maturity. As under the proposal, such an instrument would be treated as if it were due to be paid on the day on which it first became subject to the put right, since on that day the creditor would be capable of demanding payment and thereby subtracting the value of the instrument from the covered BHC’s loss-absorbing capacity.⁶⁰

One commenter also recommended that the Board permit or grandfather long-term debt with a “survivor put” feature—that is, a provision that says that, on the death of the holder, the named holder’s representative may require the issuer to repay the security within a designated period after the primary holder’s death—to count as eligible external LTD. Under the final rule, the date on which debt is due to be paid of an outstanding eligible debt security is the date that the holder first has a contractual right to request or require payment of principal, provided that, with respect to a right that is exercisable on one or more dates that are specified in the instrument only on the occurrence of an event, the date will be calculated as if the event has occurred. Therefore, under the final rule, debt with a survivor put right would be treated as having matured on the first day it became subject to a put right, which would be the day of issuance. Because eligible external LTD must have a maturity of greater than one year, debt with a survivor put would therefore not qualify as eligible external LTD. For similar reasons, the final rule

⁶⁰ The date on which principal is due to be paid would be calculated from the date the put right would first be exercisable regardless of whether the put right would only be exercisable on that date if another event occurred (e.g., a credit rating downgrade).

does not grandfather as eligible LTD outstanding long-term debt with such survivor put features.

5. Governing Law

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, the proposal would have required eligible external LTD to be governed by the laws of the United States or any State, which would include the U.S. Bankruptcy Code and Title II.

Several commenters argued that long-term debt subject to foreign law should not be excluded from the definition of eligible external LTD. These commenters contended that a significant fraction (over 10 percent) of existing, outstanding long-term debt securities would be ineligible due to the restriction on foreign governing law. These commenters expressed the view that there is no material risk that any actions taken in a U.S. bankruptcy or Title II proceeding to impose losses on long-term debt securities governed by foreign law would be subject to a successful legal challenge or not upheld by a court in foreign jurisdictions. These commenters pointed out that the United Kingdom, Japan and Australia, which commenters said account for 98 percent of the foreign-law governed LTD outstanding as of September 30, 2015, all have statutes that provide a judicial mechanism for recognizing and giving effect to actions taken in a U.S. bankruptcy or Title II proceeding. Certain commenters recommended that any material risk of a successful legal challenge could be eliminated by including clauses in eligible long-term debt securities that result in investors consenting to any actions taken in U.S.

bankruptcy or Title II proceedings in the event of a covered BHC's failure as suggested by the FSB standard which provides that eligible external TLAC may be made subject to the laws of a foreign jurisdiction if the application of the home country's resolution tools is made "enforceable on the basis of binding statutory provisions or legally enforceable contractual provisions for recognition of resolution actions."⁶¹

The final rule retains the requirement that long-term debt subject to foreign law does not qualify as eligible external LTD. Long-term debt that is subject to foreign law would potentially be subject to legal challenge in a foreign jurisdiction, which could jeopardize the orderly resolution of a covered BHC. Foreign courts might not defer to actions of U.S. courts or U.S. resolution authorities requiring the debt be converted into equity, for example, where the conversion negatively impacts foreign bondholders or foreign shareholders. While the presence of recognition regimes abroad does improve the likelihood that these actions would be enforced, it does not guarantee it.

However, to mitigate the impact of this requirement, the final rule's definition of "eligible debt security" has been modified to allow debt instruments issued prior to December 31, 2016 that are governed by foreign law to count as eligible long-term debt. Thus, long-term debt that is governed by foreign law and issued before December 31, 2016, may count toward the minimum LTD and TLAC requirements in the final rule.

6. Contractual Subordination

The final rule, like the proposal, does not include a requirement that eligible LTD instruments be contractually subordinated. Covered BHCs would have the option of contractual subordination or structural subordination.

⁶¹ FSB Standard at 17.

A number of commenters expressed support for the approach taken in the proposal to not require contractual subordination of eligible external LTD. Some commenters expressed concern that if the final rule required eligible external LTD to be either contractually or structurally subordinated to other liabilities of a covered BHC, long-term debt that failed to meet this criteria would not be available to absorb losses in the event of a resolution of a covered BHC. These commenters expressed the view that structural subordination would sufficiently ensure that eligible external LTD would absorb losses ahead of the liabilities of subsidiaries in an SPOE resolution. These commenters further argued that giving covered BHC's flexibility to comply with the external LTD requirement by either contractual or structural subordination allows for efficient compliance and adaptation to investor risk preferences, and limits the need to re-issue LTD that would otherwise be outstanding and available to absorb losses. By contrast, other comments expressed the view that the failure to include a contractual subordination provision might improve marketability but could be deceptive to investors. One commenter recommended that the Board should prohibit such debt from being called "senior debt," which commenter argued was a title that could further mislead unsophisticated investors.

After reviewing the comments, the Board again considered whether to require eligible external LTD instruments to be contractually subordinated to the claims of general creditors of a covered BHC. A contractual subordination requirement could improve the market discipline imposed on a covered BHC by increasing the clarity of treatment for eligible external LTD holders relative to other creditors as suggested by certain commenters.

There continue to be several reasons to not require eligible LTD be contractually subordinated to the claims of third-party creditor. First, as discussed above, the structural subordination of a covered BHC's creditors to the creditors and counterparties of the covered BHC's subsidiaries already generally ensures that the covered BHC's creditors would absorb losses ahead of the creditors of the covered BHC's subsidiaries in an SPOE resolution of the covered BHC.⁶² Second, the final rule includes clean holding company requirements that limit the amount of non-TLAC instruments that could be pari passu with or junior to eligible external LTD, which will further address any concerns with covered BHCs' unsecured creditor hierarchies. In order to provide additional flexibility, the final rule provides that a covered BHC that chooses to issue all of its external LTD with a contractual subordination provision would not be subject to such a cap as described further below.

By limiting the criteria for eligible external LTD to those necessary to achieve the objectives of the final rule, the final rule seeks to retain the broadest possible market for eligible external LTD instruments. Allowing covered BHCs to retain the flexibility to satisfy the external LTD requirement with either senior or subordinated debt instruments should allow covered BHCs to comply with the requirement efficiently, to adapt to debt investors' risk preferences, and to avoid re-issuances of outstanding long-term senior debt instruments that would otherwise meet the criteria for eligible external LTD.

7. Explicit Bail-In Mechanisms

⁶² As discussed above, in an insolvency proceeding, direct third-party claims on a parent holding company's subsidiaries would be superior to the parent holding company's equity claims on the subsidiaries.

Several commenters recommended that the final rule include an express mechanism by which a covered BHC's eligible external LTD would be "bailed in" in the event of the covered BHC's bankruptcy or resolution. These commenters argued that additional detail would facilitate the orderly resolution of a covered BHC and reduce investor uncertainty. For example, such commenters sought clarification that the "bail in" of eligible external LTD would wipe out existing equity holders of a covered BHC in a resolution scenario. Other commenters encouraged the Board to mandate that a covered BHC's eligible external LTD could not be bailed in prior to the failure of the firm. One commenter suggested that a covered BHC emerging from bankruptcy or resolution should be required to be significantly simpler.

Under the final rule, eligible external LTD would be "bailed in" to absorb losses of the covered BHC only in bankruptcy or resolution proceedings of the firm. In contrast to the debt conversion mechanism that applies to the internal LTD of covered IHCs, as discussed below, the final rule does not require that a covered BHC's eligible external LTD include a specific conversion mechanism that could be triggered outside of bankruptcy or resolution. The requirements in the final rule are written under the assumptions that a covered BHC would recapitalize its subsidiaries in the event of distress so that the subsidiaries could remain operational outside of a bankruptcy or resolution proceedings and that losses the covered BHC sustained by such recapitalization could be imposed on holders of TLAC through a bankruptcy or resolution proceeding. However, the final rule does not prescribe any specific requirements for how a covered BHC would enter into bankruptcy or resolution, as any resolution would be dependent on the specific facts and circumstances of a covered BHC at the time of

failure, and would be within the purview of the bankruptcy court (in a proceeding under the U.S. Bankruptcy Code) or the FDIC (in a Title II resolution).

8. Other comments

Certain commenters argued that a covered BHC's eligible external LTD should be a required component of its executive compensation program. These commenters argued that requiring executives of a covered BHC to be compensated with such debt would help align the incentives of a covered BHC's management with the incentives of other holders of eligible external LTD.

The final rule does not include a requirement that a covered BHC compensate management with eligible external LTD. The intended purpose of this final rule is to improve the resolvability of covered BHCs by requiring them to issue long-term debt. Achieving this policy objective does not, as a general matter, require certain parties to hold the long-term debt of covered BHCs. Moreover, other rules may apply to the incentive compensation practices of covered BHCs.⁶³

F. Costs and Benefits

An analysis of the potential costs and benefits of the external TLAC and external LTD requirements was conducted at the time of the release of the proposal. To evaluate the costs attributable to the proposed requirements, this analysis estimated (a) the extent by which each covered BHCs' required capital and currently outstanding long-term debt fell short of the proposed requirements, (b) the increase in each U.S. GSIB's ongoing cost

⁶³ Recently, the Board jointly issued with the OCC, the FDIC, the National Credit Union Administration, the Securities and Exchange Commission, and the Federal Housing Finance Agency, joint proposed rules that would implement the incentive compensation requirements of the Dodd-Frank Act. *See* 12 U.S.C. 956; 81 FR 37670 (June 10, 2016).

of funding that would result from meeting the proposed requirements, (c) the expected increase in the interest rates that the U.S. GSIBs would charge to borrowers to make up for their higher funding costs, and (d) any decline in the gross domestic product (GDP) of the United States that would result from these increased lending rates.

The following components relevant to the benefits of the proposed requirements were evaluated: (a) the probability of a financial crisis occurring in a given year, (b) the cumulative economic cost that a financial crisis would impose if it were to occur, and (c) the extent to which the proposed requirements would decrease the likelihood and cost of a financial crisis.

The analysis concluded that the estimated benefits would outweigh the estimated costs and that the proposed external TLAC and LTD requirements would yield a substantial net benefit for the U.S. economy. In evaluating the costs and benefits of the final rule it is important to consider the state of covered BHC's at the time of the proposal. Importantly, while covered BHC's have closed some of the shortfall in their TLAC requirements since the time of the proposal, this activity does not reduce the costs of complying with the requirements. In particular, information reviewed by the Board suggests that covered BHC's aggregate TLAC shortfall has fallen from roughly \$120 billion at the time of the proposal to roughly \$70 billion as of the third quarter of 2016.⁶⁴ This reduction in shortfall, however, does not reduce the overall cost of the requirements but rather demonstrates that covered BHCs have already begun to bear the cost of the requirements of the final rule. Moreover, since the requirements of the final rule have

⁶⁴ The TLAC proposal reported a total shortfall of \$120BN as of year-end 2014 that was based on different data and assumptions than the estimates presented above.

been finalized largely as proposed, the overall estimated costs and benefits of the requirements as described in the final rule have not materially changed from the proposal. Several features of the final rule that differ from the proposal have impacted overall costs and we discuss these below.

A few commenters suggested that the Board underestimated the cost of the rule in the proposal because the proposal's analysis assumed that covered firms' existing long-term debt is eligible under the rule even though much of the existing long-term debt would not have met the eligibility requirements under the proposal. Existing debt containing impermissible acceleration clauses was identified by certain commenters to be present in nearly all of the covered BHC's outstanding traditional long-term debt as of September 30, 2015. Similarly, commenters argued that a significant portion (over 10 percent) of the covered BHC's outstanding LTD would be ineligible under the proposal because it had been issued under foreign law. Commenters estimated that absent any grandfathering of this debt to satisfy the LTD requirements, the resulting shortfall would be in the range of \$500 to \$700 billion rather than the Board's estimated shortfall of \$120 billion under the proposal. The Board believes that these comments on impact have been addressed and the costs of the final rule mitigated in large part by the fact that, as described above, eligible LTD in the final rule includes debt issued prior to December 31, 2016, that contains impermissible acceleration clauses or that is governed by foreign law. As a result the estimated shortfall of \$120 billion that was reported in the original proposal is appropriate for considering the economic costs of the final rule.

1. Shortfall Analysis

An analysis of information collected and reviewed by the Board suggested that the total TLAC shortfall of U.S. GSIBs at the time of the proposal was roughly \$120 billion.⁶⁵ This estimate includes debt with impermissible acceleration clauses and debt that is issued under foreign law but that is included in eligible LTD due to grandfathering of these features under the final rule. In addition, U.S. GSIBs have taken steps to reduce their overall shortfall since the release of the proposal. Information received and reviewed by the Board suggests that the aggregate TLAC shortfall has declined to roughly \$70 billion as of the second quarter of 2016. This reduction in the shortfall indicates that the TLAC requirements are manageable as firms have made considerable progress in reducing their shortfalls in the relatively short period of time since the proposal. However, this also indicates that firms have already begun bearing the costs of the final rule by beginning to alter their capital structures after the proposal. The Board estimates that \$120 billion is the relevant amount for purposes of considering the cost of the final rule because this is the shortfall that existed at the time of the proposal before covered entities had an opportunity to adjust their capital structure in response to the proposal.

2. Cost-of-Funding Analysis

The analysis also considered the effect that filling the \$120 billion shortfall through the issuance of additional eligible external LTD would have on the covered BHCs' cost of funding. This analysis relied on additional information about the amounts and costs of funding of the debt that the covered BHCs and their subsidiaries have outstanding. For the same reasons that were discussed above, the estimated cost of filling

⁶⁵ See 80 FR 74926 at 74938.

the \$120 billion shortfall that was described in the proposal is appropriate for estimating the costs of the final rule: it captures the cost that covered entities will bear to fill the shortfall that existed at the time the proposal was released and before covered entities made any changes to their capital structure in response to the proposal's requirements.

One reason that would cause the proposal's cost estimate to be inaccurate would be if the cost of long term debt relative to short term debt changed markedly between the time of the proposal and the final rule. Such a change would indicate that the current costs of filling the shortfall at the time of the release of the final rule would be significantly different from the costs that prevailed at the time of the proposal. One simple measure of the cost of long term versus short term financing is the spread between five-year and three-month U.S. Treasury debt. At the time of the proposal, this yield spread was roughly 1.45 percent and as of November 2016 this spread is roughly 1.1 percent. Accordingly, the cost of exchanging short term debt for long term debt has declined somewhat, which suggests that the estimates provided in the proposal represent a somewhat conservative estimate of filling the estimated shortfall. Accordingly, the estimated cost of filling the shortfall has not been decreased to reflect the modest narrowing in funding spreads.

Several additional assumptions were made to estimate the cost of filling the \$120 billion shortfall. First, it was assumed that covered BHCs would fill their shortfalls by replacing existing, ineligible debt with eligible external LTD during the period prior to the effective date of the proposed requirements, rather than by expanding their balance sheets by issuing the new debt while maintaining existing liabilities outstanding. Second, it was assumed that covered BHCs would minimize the cost associated with meeting the

proposed external TLAC and LTD requirements by first replacing with eligible external LTD their “near-eligible debt”—that is, their outstanding debt that comes closest to meeting all requirements for eligible external LTD (and that therefore entails a cost of funding almost as high as that associated with eligible external LTD)—and by proceeding in this cost-minimizing fashion until the proposed requirements were met. Thus, the marginal cost of each additional dollar of eligible external LTD was assumed to be the surplus of the funding cost associated with eligible external LTD over the funding cost of the covered BHC’s highest-cost remaining ineligible debt. Finally, if total near-eligible liabilities were insufficient to fill the shortfall, it was assumed that the covered BHC proceeded to replace more senior, short-term liabilities, such as deposits, with eligible external LTD.

Roughly \$65 billion of the aggregate \$120 billion shortfall could be filled through the issuance of eligible external LTD in the place of existing near-eligible debt, most of which would be the form of long-term bonds issued by the covered BHCs’ bank subsidiaries.⁶⁶ Based on market data, it was estimated that the spread between this near-eligible debt and eligible external LTD is between 20 and 30 basis points. Some commenters provided independent estimates of the cost of replacing this near-eligible

⁶⁶ For purposes of this analysis, structured notes were not treated as near-eligible debt. Structured notes could be viewed as near-eligible debt, but in many cases structured notes serve different purposes than debt that was treated as near-eligible (such as “plain-vanilla” bonds issued by covered BHCs’ bank subsidiaries). As a result, the analysis assumed that covered BHCs would not replace their outstanding structured notes with eligible external LTD. On the assumption that covered BHCs would indeed replace their outstanding structured notes with eligible external LTD, covered BHCs would be able to meet roughly \$100 billion of the aggregate \$120 billion shortfall by replacing near-eligible debt with eligible external LTD, which would result in a lower estimated cost impact from the proposed requirements.

debt with eligible debt. In particular, a group of commenters estimated that the cost of subordinating near-eligible debt would range from 25 to 100 basis points.⁶⁷ The remaining \$55 billion shortfall could then be filled through the issuance of eligible external LTD in the place of existing deposits or other lower-cost liabilities. It was estimated that the spread between these liabilities and eligible external LTD would be approximately equal to the spread between the risk-free interest rate and the eligible external LTD rate, which is estimated to be between 100 and 150 basis points. One commenter provided independent estimates of the cost of lengthening the duration of a bank's funding profile, but these estimates compared the costs of three to five year debt versus debt with a ten year maturity, rather than the relative costs of short term, deposit-like funding with longer-term debt.

The funding cost estimates at the low ends of the ranges described above—20 basis points for replacing near-eligible debt and 100 basis points for replacing lower-cost liabilities such as deposits—result in an aggregate increased cost of funding for the covered BHCs of \$680 million per year.

A more conservative estimate can be produced using figures at the high ends of these ranges and then further adjusting them upward to reflect a potential supply effect of 30 basis points.⁶⁸ Using the resulting, higher figures—130 basis points for replacing

⁶⁷ This particular estimate was provided by foreign bank commenters that were required under the proposal to contractually subordinate their debt. They indicated these costs reflected arm's length market terms for these transactions and, accordingly, the Board has considered these costs in evaluating the total cost of subordinating the debt.

⁶⁸ This accounts for an increase in the interest rate on eligible external LTD caused by the increase in the supply of eligible external LTD as a result of the external LTD requirement. The aggregate shortfall in eligible LTD amounts to approximately 20 percent of the covered BHCs' current eligible LTD, implying that the covered BHCs in

near-eligible debt and 200 basis points for replacing lower-cost liabilities—resulted in an estimated aggregate increased cost of funding for the covered BHCs of approximately \$2.0 billion per year. The Board notes that this amount is roughly \$500 million larger than the estimate that was provided in the proposal since the high estimate of the cost of replacing near-eligible debt with eligible debt has been taken from the higher estimate provided by one group of commenters which was 100 basis points rather than the 30 basis points that was cited in the proposal.

Thus, the aggregate increased cost of funding attributable to the proposed external TLAC and LTD requirement are estimated to be in the range of \$680 million to \$2.0 billion annually.

3. Increased Lending Rate Analysis

The Board conducted an analysis of increased lending rates using the updated values described previously that was similar to the analysis conducted under the proposal. To arrive at a conservative estimate of the effect of the final rule's external TLAC and LTD requirements on lending rates, it was next assumed that the U.S. GSIBs would maintain their current return-on-equity levels by passing all of their increased funding costs on to borrowers, holding constant their level of lending activity. The increased lending rates that the U.S. GSIBs would charge to borrowers were calculated by dividing both the low-end and the high-end estimated cost-of-funding increases by the U.S.

the aggregate would need to increase their outstanding eligible external LTD by 3 to 4 percent each year through 2022, when the proposed requirements would be fully phased in. On the basis of both internal analysis and an international survey of market participants in which Board staff participated, it is estimated that this increase in supply would increase spreads of covered BHCs' eligible external LTD by approximately 30 basis points.

GSIBs' aggregate outstanding loans of roughly \$3.2 trillion. Under this analysis, covered BHCs would employ an increased lending rate of 1.3 to 6.3 basis points as a result of the external TLAC and LTD requirements of the final rule. The total dollar value of this increase in funding rates is between \$4.2 and \$20.2 billion per year in increased lending costs across the entire U.S. economy.

4. Macroeconomic Costs Analysis

The Board also conducted the analysis of macroeconomic costs similar to that conducted for the proposal using the updated values described previously. In prior assessments of the economic impact of regulations on banking organizations, increases in lending rates have been assumed to produce a drag on GDP growth. However, the very modest lending rate increases estimated above—from 1.3 to 6.3 basis points—do not rise to the level of increase that could be expected to meaningfully affect GDP. Thus, from the standpoint of the economy as a whole and consistent with the analysis in the proposal, it appears that the costs associated with the external TLAC and LTD requirements would be minimal.

5. Macroeconomic Benefits Analysis

To estimate the benefits of the final rule's requirements, the analysis built on the framework considered in a recent study titled "An assessment of the long-term economic impact of stronger capital and liquidity requirements" (LEI report).⁶⁹ The LEI report estimated that, prior to the regulatory reforms undertaken since 2009, the probability of a financial crisis occurring in a given year was between 3.5 percent and 5.2 percent and the

⁶⁹ Basel Committee on Banking Supervision, "An assessment of the long-term economic impact of stronger capital and liquidity requirements" (August 2010), available at <http://www.bis.org/publ/bcbs173.pdf>.

cumulative cost was between 20 percent and 100 percent of annual economic output. Even assuming that the lower ends of these ranges are accurate, these estimates reflect the well-understood fact that financial crises impose very substantial costs on the real economy. And the disorderly failures of major financial institutions play a major role in causing and deepening financial crises, as Congress recognized in enacting section 165 of the Dodd-Frank Act.

This final rule will materially reduce the risk that the failure of a covered BHC would pose to the financial stability of the United States by enhancing the prospects for the orderly resolution of such a firm. Moreover, by ensuring that the losses caused by the failure of such a firm are borne by private-sector investors and creditors (the holders of a covered BHC's eligible external TLAC), the final rule will materially reduce the probability that a covered BHC would fail in the first place by giving the firm's shareholders and creditors stronger incentives to discipline its excessive risk-taking. Both of these reductions will promote financial stability and materially reduce the probability that a financial crisis would occur in any given year. The final rule will therefore advance a key objective of the Dodd-Frank Act and help protect the American economy from the substantial potential losses associated with a higher probability of financial crises.

III. TLAC and LTD Requirements for U.S. Intermediate Holding Companies of Global Systemically Important Foreign Banking Organizations

A. Eligible External and Internal Issuance of TLAC and LTD by covered IHCs

One of the key elements of the proposed rule was that it would have required a covered IHC, regardless of its resolution strategy, to issue internal TLAC and LTD— i.e., to issue TLAC and LTD, directly or indirectly, to its foreign parent. A U.S. covered BHC, by contrast, would have been required to issue its TLAC and LTD externally to third-party investors. A number of commenters, particularly foreign banks with MPOE resolution strategies, urged the Board, consistent with the FSB standard, to permit a covered IHC the flexibility to satisfy its TLAC and LTD requirements with instruments issued either to unaffiliated third parties or to foreign parents. These commenters argued that requiring covered IHCs that intend to serve as a point of entry for resolution to maintain internal TLAC issued solely to a parent entity is inconsistent with an MPOE resolution strategy and, in fact, makes it impossible to pursue an MPOE resolution strategy by creating dependencies between the U.S. operations and the larger foreign banking organization.

One commenter urged the Board to allow any covered IHC, regardless of its resolution strategy, to issue LTD externally to third-party investors in the same manner as U.S. GSIBs. This commenter suggested that an IHC with an SPOE resolution strategy should be permitted to issue LTD externally, provided that a cap is established to ensure that less than a majority of the covered IHC's LTD is issued to third parties. The purpose of the cap would be to ensure that, in the event that the long-term debt is converted to equity, the foreign parent would remain the controlling owner, thereby preserving alignment of interests between the covered IHC and its parent. Certain commenters also noted that the requirement to issue internally under the proposal limited the funding options available to covered IHCs.

In response to these comments, the proposed rule has been modified to allow a resolution covered IHC, which expects to enter into resolution in the U.S. based on its FBO parent's MPOE resolution strategy, to have the option to issue its capital and debt internally to the FBO parent or to a foreign wholly owned subsidiary of the FBO parent,⁷⁰ or externally to third-party investors. The purpose of this change is to ensure that covered IHCs can issue TLAC and LTD in a manner that best fits their adopted resolution strategy. For the same reason, the final rule, like the proposed rule, requires non-resolution covered IHCs that are not expected to enter resolution proceedings in the U.S. (because their foreign parent has adopted an SPOE resolution strategy) to issue debt internally to the FBO parent or to a wholly owned subsidiary of the FBO parent. Requiring internal issuance by these covered IHCs is consistent with their resolution strategy to upstream losses to their home country FBO parent or a wholly owned subsidiary of the FBO parent.

B. Scope of Application (Sections 252.153 and 252.160 of the final rule)

The proposed rule would have applied to "covered IHCs," defined to include any U.S. intermediate holding company that is (a) required to be formed under the Board's enhanced prudential standards rule (IHC rule) and (b) controlled by a foreign GSIB.

The proposed rule would have established three methods by which the top-tier foreign banking organization that controls a covered IHC would be deemed a foreign GSIB. First, the proposed rule would have required foreign banking organizations that already provide the information used for the BCBS assessment methodology to use such

⁷⁰ While the proposed rule required the internal debt to be issued, directly or indirectly, to the parent FBO, the final rule also allows covered IHCs the option to issue internal debt to other foreign affiliates that are wholly owned by the parent FBO, as described below.

information to determine whether they have the characteristics of a GSIB under that methodology. Accordingly, the proposed rule would have required a foreign banking organization that controls a U.S. intermediate holding company to notify the Board each year whether its home country regulatory authority has adopted standards consistent with the BCBS assessment methodology; whether the organization, for any reason, prepares or reports the information required for the BCBS assessment methodology; and whether, after using such information, the organization has determined that it is a GSIB under the BCBS assessment methodology.⁷¹ Any foreign banking organization that determined it is a GSIB under the BCBS assessment methodology would have been a foreign GSIB under the proposed rule.

Second, a foreign banking organization would have been deemed a foreign GSIB under the proposed rule if the Board determined that the organization either was a GSIB under the BCBS assessment methodology, or would be a GSIB under the Board's capital rules if the foreign banking organization were a domestic, top-tier bank holding company.

Third, a foreign banking organization would have been deemed a foreign GSIB under the proposed rule if the Board determined that the organization's intermediate holding company, formed pursuant to the IHC rule, would be a GSIB under the Board's capital rules if the intermediate holding company were a top-tier bank holding company.

⁷¹ As discussed in the supplementary information section to the proposed rule, these notice and determination requirements would have applied to the "top-tier foreign banking organization," which would have been defined as, with respect to a foreign bank, the top-tier entity that controls the foreign bank (if any) unless the Board specifies a subsidiary of such entity as the "top-tier foreign banking organization." Thus, the definition would have included the top-tier entity that controls a foreign bank, which would be the foreign bank if no entity controls the foreign bank, or the entity specified by the Board that is a subsidiary of the top-tier entity.

Several commenters expressed concern with the proposal's method of identifying whether a covered IHC is controlled by a foreign GSIB. In particular, commenters argued that the TLAC requirements should apply only to covered IHCs of foreign banking organizations that have been identified as GSIBs by the FSB. These commenters argued that the additional requirement for covered IHCs to conduct their own assessment using both the Board's methodology and the global methodology and report to the Federal Reserve is overly complex and burdensome, especially where the covered IHC and its top-tier FBO are not close to the GSIB threshold. One commenter requested that the Board confirm it will determine which FBOs are subject to the final rule's requirements by relying exclusively on the method 1 GSIB surcharge calculation and not the method 2 GSIB surcharge calculation.

The final rule adopts the same methodology as the proposal for determining whether a covered IHC is controlled by a foreign GSIB. The methodology in the GSIB surcharge rule identifies the most systemically important U.S. banking organizations. As discussed above with respect to covered BHCs, this methodology evaluates a banking organization's systemic importance on the basis of its size, interconnectedness, cross-jurisdictional activity, substitutability, and complexity. The firms that score the highest on these attributes are classified as GSIBs. While the GSIB surcharge rule itself applies only to U.S. BHCs, its methodology is equally well-suited to evaluating the systemic importance of foreign banking organizations. The method 1 methodology in the GSIB surcharge rule for identifying GSIBs is consistent with the methodology developed by the BCBS to identify GSIBs. Moreover, foreign jurisdictions collect information from

banking organizations in connection with that framework that parallels the information collected by the Board for purposes of the Board's GSIB surcharge rule.

Given that the global methodology and the method 1 methodology in the GSIB surcharge rule to identify GSIBs are virtually identical, the two methodologies should lead to the same outcomes, and the requirements in the final rule to identify whether a foreign banking organization is a GSIB should entail minimal additional burden for foreign banking organizations.

The Board received a number of comments arguing that covered IHCs should not be subject to the requirements of the final rule. Commenters contended that the U.S. operations of covered IHCs are not significant enough to justify applying the proposed rule to them and that the Board did not explain its basis for subjecting covered IHCs to the proposal. In particular, certain commenters argued that the proposed internal TLAC and LTD requirements have no relationship to the systemic risk to the U.S. financial system posed by covered IHCs and discriminated against covered IHCs compared to covered BHCs with similar systemic significance based solely on ownership of the covered IHC by a global systemically important FBO. These commenters generally recommended that covered IHCs should be treated more like non-GSIB, similarly sized, domestic bank holding companies, which are not subject to TLAC or LTD requirements under the final rule. These commenters argued that the proposed rules conflicted with the statutory requirements to give due regard to the principle of national treatment and equality of competitive opportunity and take into account the extent to

which the financial company is subject on a consolidated basis to home country standards that are comparable to those applied to financial institutions in the United States.⁷²

The Dodd-Frank Act requires the Board to give due regard to national treatment and equality of competitive opportunity. This generally means that the Board must, in establishing standards applicable to foreign banking organizations operating in the United States, consider the standards applicable to similarly situated U.S. banking organizations and explain any differences in treatment between the two. The purpose of this requirement is to encourage competition in the U.S. banking market so that neither U.S. banking organizations nor the U.S. operations of foreign banking organizations are unfairly disadvantaged. The requirement does not mean, however, that the same standards must always apply to U.S. banking organizations and foreign banking organizations of a similar size and complexity.

For example, in the context of resolution, covered IHCs are not similarly situated to U.S. banking organizations of a similar size and complexity. Unlike U.S. banking organizations, covered IHCs are connected to foreign GSIBs, which affects the potential impact of their resolution, the contexts under which they will be resolved, and how their resolution will be conducted. Foreign GSIBs, whose failure would impact the financial stability of the global financial system, also pose risks to the financial stability of the United States. Therefore, covered IHCs are more similarly situated to the U.S. GSIBs, and the final rule treats the two groups similarly, with appropriate adjustments to reflect their differences.

⁷² 12 U.S.C. 5635(b)(2).

The Board's enhanced prudential standards rules identify foreign banking organizations with a substantial U.S. presence and require each of them to form a single U.S. intermediate holding company over their respective U.S. subsidiaries.⁷³ Thus, whether a foreign banking organization is required to form a U.S. intermediate holding company is an indicator of whether its U.S. presence is substantial. As with the application of the requirements in the final rule to covered BHCs, which are the largest, most systemically important U.S. banking organizations, the final rule's focus on IHCs held by foreign GSIBs is in keeping with the Dodd-Frank Act's mandate that more stringent prudential standards be applied to the most systemically important bank holding companies.⁷⁴ Furthermore, as discussed in more detail below, the use of the methodology in the GSIB surcharge rule to identify both foreign and U.S. GSIBs (and to identify both covered BHCs and covered IHCs) promotes a level playing field between U.S. and foreign banking organizations. Thus, the final rule applies to the U.S. operations of those foreign banking organizations that would be considered GSIBs under the Board's GSIB surcharge rule and that have substantial operations in the United States.

Additionally, while some covered IHCs may be subject to comparable TLAC standards in their home jurisdiction, the final rule is tailored to the potential risks presented by the U.S. operations of foreign GSIBs to the U.S. financial system. In this regard, the final rule mandates that a covered IHC have sufficient loss absorbing capacity

⁷³ The IHC rule generally requires any foreign banking organization with total consolidated non-branch U.S. assets of \$50 billion or more to form a single U.S. intermediate holding company over its U.S. subsidiaries. 12 CFR 252.153; 79 FR 17329 (May 27, 2014).

⁷⁴ 12 U.S.C. 5365(a)(1)(B).

present in the United States to support a successful recapitalization or resolution of the covered IHC.

C. Resolution and non-resolution IHCs (section 12 CFR 252.164 of the final rule)

Under the final rule, as explained above, whether or not a covered IHC has the option to issue debt externally to third-party investors depends on whether the covered IHC (or any of its subsidiaries) is expected to enter resolution if a foreign parent entity fails (an MPOE strategy), rather than continuing to operate outside of resolution proceedings while a foreign parent entity is resolved (an SPOE strategy). In addition, under the final rule like under the proposal, the amount of eligible total loss-absorbing capacity that a covered IHC would be required to maintain outstanding would depend on whether the covered IHC (or any of its subsidiaries) is expected to enter resolution if a foreign parent entity fails, rather than the covered IHC continuing to operate outside of resolution proceedings.

Under the proposal, the home country resolution authority for the parent foreign banking organization of the covered IHC would have been required to provide a certification to the Board indicating that the authority's planned resolution strategy for the foreign banking organization did not involve the covered IHC or any subsidiary of the covered IHC entering a resolution proceeding in the United States for the covered IHC to have been considered a "non-resolution entity." A few commenters objected to the requirement in the proposal that this determination require the home country resolution authority to provide such a certification to the Board. These commenters generally argued that this requirement created an unnecessary administrative burden that home

country resolution authorities may not be able to satisfy—for example, due to internal policies or requirements that would not permit them to make an official certification. These commenters also pointed out that the Board already has enough information to make such a determination. In particular, these commenters noted the Board reviews FBO resolution plans that specify whether their resolution strategy is SPOE or MPOE, and participates in Crisis Management Groups for all covered IHCs of FBOs.

To address these concerns, the final rule modifies the proposal to require the top-tier foreign banking organization with U.S. non-branch assets equal to or greater than \$50 billion, rather than the home country resolution authority, to certify to the Board whether the planned resolution strategy of the top-tier foreign banking organization involves the covered IHC or its subsidiaries entering resolution, receivership, insolvency, or similar proceedings in the United States. The certification must be provided by the top-tier foreign banking organization to the Board on the later of June 30, 2017 or one year prior to the date on which the covered IHC is required to comply with the covered IHC TLAC and LTD requirements of the final rule.⁷⁵ In addition, the top-tier foreign banking organization with U.S. non-branch assets equal to or greater than \$50 billion must provide an updated certification to the Board upon a change in resolution strategy.

A covered IHC is a “resolution covered IHC” under the final rule if the certification provided indicates that the top-tier foreign banking organization’s planned resolution strategy involves the covered IHC or its subsidiaries entering into resolution,

⁷⁵ Under the final rule, a covered IHC is required to comply with the rule’s requirements by the later of three years after the date on which the U.S. non-branch assets of the foreign banking organization that controls the covered IHC equal or exceed \$50 billion, and the date on which the foreign banking organization that controls the covered IHC first became a GSIB.

receivership, insolvency or similar proceeding. A covered IHC is a “non-resolution covered IHC” under the final rule if the certification provided to the Board indicates that the top-tier foreign banking organization’s planned resolution strategy does not involve the covered IHC or its subsidiaries entering into resolution, receivership, insolvency, or similar proceedings in the United States.

In addition, under the final rule, the Board may determine in its discretion that an entity that is certified to be a non-resolution covered IHC is a resolution covered IHC, or that an entity that is certified to be a resolution covered IHC is a non-resolution covered IHC.

In reviewing certifications provided with respect to covered IHCs, the Board would expect to review all the information available to it regarding a firm’s resolution strategy, including information provided to it by the firm. The Board would also expect to consult with the firm’s home country resolution authority in connection with this review. In addition, the Board may consider a number of factors suggested by commenters including but not limited to whether a foreign banking organization conducts substantial U.S. activities outside of the IHC chain; whether the group’s capital and liability structure is set up in a way to allow for losses to be upstreamed to the top-tier parent; whether the top-tier parent or foreign affiliates provide substantial financial or other forms of support to the U.S. operations (e.g., guarantees, contingent claims and other exposures between group entities); whether the covered IHC is operationally independent (e.g., costs are undertaken by the IHC itself and whether the IHC is able to fund itself on a stand-alone basis); whether the covered IHC depends on the top-tier parent or foreign affiliates for the provision of critical shared services or access to

infrastructure; whether the covered IHC is dependent on the risk management or risk-mitigating hedging services provided by the top-tier parent or foreign affiliates; and the location where financial activity that is conducted in the United States is booked.

A covered IHC would have one year or a longer period determined by the Board to comply with the requirements of the final rule if it changes its resolution strategy or if the Board determines that the firm certified to the wrong strategy. For example, if the Board determines that a firm that had certified it is a non-resolution covered IHC, which is subject to a lower TLAC requirement under the final rule, is a resolution covered IHC for purposes of the final rule, the IHC would have up to one year from the date on which the Board notifies the covered IHC in writing of such determination to raise additional capital or long-term debt to comply with the requirements of the final rule. Similarly, a firm that certified it was a resolution covered IHC that is determined to be a non-resolution covered IHC would have one year to comply with the requirements of the final rule. Since under the final rule a resolution covered IHC has the option to issue TLAC and LTD externally to third-parties, the one-year period would provide the covered IHC with time to make any necessary adjustments to the composition of its TLAC and LTD, for example by issuing internal LTD to its foreign parent.

As noted, under the final rule, the Board may extend the one-year period discussed above. In acting on any requests for extensions of this time period, the Board would consider whether the covered IHC had made a good faith effort to comply with the requirements of the final rule.

D. Calibration of the TLAC and LTD Requirements (sections 252.162 and 252.165 of the final rule)

The proposed rule would have imposed different minimum internal loss-absorbing capacity (eligible internal TLAC) requirements for covered IHCs expected to enter into resolution proceedings if their foreign parent entity fails (resolution covered IHCs), and covered IHCs not expected to enter resolution proceedings under the same circumstances (non-resolution covered IHCs). The proposed rule would have treated all covered IHCs as resolution entities unless the home country resolution authority for the foreign GSIB that controls the covered IHC certified to the Board that the authority's resolution plan for the foreign GSIB adopted an SPOE approach.⁷⁶

Under the proposed rule, covered IHCs that were resolution entities would have been required to maintain a minimum amount of outstanding eligible internal TLAC no less than the greatest of (a) 18 percent of the covered IHC's total risk-weighted assets;⁷⁷ (b) 6.75 percent of the covered IHC's total leverage exposure (if applicable); and (c) 9 percent of the covered IHC's average total consolidated assets, as computed for purposes of the U.S. tier 1 leverage ratio. Covered IHCs that were non-resolution entities would have been required to maintain a minimum amount of outstanding eligible internal TLAC no less than the greater of (a) 16 percent of the covered IHC's total risk-weighted assets;⁷⁸ (b) 6 percent of the covered IHC's total leverage exposure (if applicable); and

⁷⁶ As described above, the final rule has modified this aspect of the proposal.

⁷⁷ Under the proposed rule, the risk-weighted assets component of the internal TLAC requirement for covered IHCs of MPOE firms would have been phased in as follows: it would be equal to 16 percent of the covered IHC's risk-weighted assets beginning on January 1, 2019, and would be equal to 18 percent of the covered IHC's risk-weighted assets beginning on January 1, 2022.

⁷⁸ Under the proposed rule, the risk-weighted assets component of the internal TLAC requirement would have been phased in as follows: It would be equal to 14 percent of the

(c) 8 percent of the covered IHC's average total consolidated assets, as computed for purposes of the U.S. tier 1 leverage ratio.⁷⁹ The proposed rule also would have applied an internal TLAC buffer to all covered IHCs in addition to the applicable risk-weighted assets component of the internal TLAC requirement.

Under the proposed internal LTD requirement, a covered IHC would have been required to maintain outstanding eligible internal long-term debt instruments in an amount not less than the greatest of (a) 7 percent of total risk-weighted assets; (b) 3 percent of the total leverage exposure (if applicable); and (c) 4 percent of average total consolidated assets, as computed for purposes of the U.S. tier 1 leverage ratio. A covered IHC would have been prohibited from redeeming eligible internal LTD prior to the stated maturity date without obtaining prior approval from the Board if after such redemption the covered IHC's eligible internal LTD would fall below its internal LTD requirement.

Some commenters argued that, based on the size of their U.S. operations, covered IHCs should be treated like domestic U.S. bank holding companies that are not subject to the requirements of the final rule. These commenters questioned whether TLAC and LTD requirements for covered IHCs are even necessary, particularly where ownership by a major foreign bank parent would add a source of strength for covered IHCs and where other prudential standards, including robust capital, liquidity, stress testing, and risk

covered IHC's risk-weighted assets beginning on January 1, 2019, and would be equal to 16 percent of the covered IHC's risk-weighted assets beginning on January 1, 2022.

⁷⁹ The final rule imposes the same leverage capital requirements on U.S. intermediate holding companies as it does on U.S. bank holding companies. 12 CFR 252.153(e)(2). These leverage capital requirements include the generally applicable leverage ratio and the supplementary leverage ratio for U.S. intermediate holding companies that meet the scope of application for that ratio.

management requirements, already address the risk to U.S. financial stability posed by covered IHCs. A few commenters suggested that the Board reserve the power to alter TLAC and LTD requirements for institutions on a case-by-case basis based on the relative importance of the U.S. operations of a foreign banking organization to U.S. financial stability.

Commenters expressed a number of concerns with the proposal's calibration of internal TLAC and LTD for covered IHCs. In general, commenters requested a reduction in the calibration of internal TLAC and LTD for both resolution covered IHCs and non-resolution covered IHCs. Commenters contended that the levels of internal TLAC and LTD under the proposal were far higher than necessary to promote resolvability and resiliency of covered IHCs. Several commenters expressed concern that prepositioning too much capital and LTD at a covered IHC would prevent a foreign banking group from putting resources to better use, either by providing more services to the market or using the capital to assist the covered IHC's foreign affiliates in times of stress.

Other commenters suggested that the requirements could potentially discourage cooperation between U.S. and foreign banking regulators, and perhaps encourage foreign banking regulators to impose more stringent requirements for foreign affiliates of U.S. banking organizations in retaliation for the proposed rule. Commenters concerned about the reaction of foreign regulators to the proposed rule suggested that the Board set the minimum TLAC requirements applicable to covered IHCs in consultation with foreign regulators. Several commenters also suggested that the requirements were so high that they would negatively impact credit markets and thereby decrease economic activity.

Commenters argued that the calibration for non-resolution covered IHCs, in particular, was too high and that the Board should follow the approach described in the FSB standard and establish internal TLAC calibration levels for non-resolution covered IHCs based only on the need to ensure home-host country cooperation. These commenters urged that the internal TLAC requirements applicable to non-resolution covered IHCs should be reduced from the proposed level of approximately 90 percent of the TLAC requirements applicable to resolution covered IHCs, the top end of the range set by the FSB standard, to not more than 75 percent of such requirements applicable to resolution covered IHCs, representing the low end of the range recommended by the FSB standard, in order to appropriately incentivize SPOE resolution strategy.⁸⁰ These commenters contended that the proposal's higher calibration would not provide enough flexibility to allocate a foreign parent's loss-absorbing capacity wherever necessary within the firm in the case of failure, and that the potential ring-fencing of excessive amounts of capital would reduce, and not enhance, the resilience of the firm. These commenters also argued that non-resolution covered IHCs do not pose the same risks to U.S. financial stability because these firms would receive support from their foreign parents in times of stress.

A number of commenters argued that covered IHCs that are subject to the SLR requirement should not be subject to the additional prong of the covered IHC TLAC and LTD requirements in the proposal that required covered IHCs to maintain TLAC and LTD levels greater than or equal to a percentage of average total consolidated assets, as there is no corresponding requirement imposed on covered BHCs. These commenters

⁸⁰ FSB standard at 19.

urged the Board to remove the average total consolidated assets-based leverage ratio test for covered IHCs subject to the supplemental leverage ratio component of TLAC and LTD.

In addition, commenters urged the Board to allow a portion of internal TLAC to be satisfied through collateralized guarantees, as contemplated in the FSB standard. These commenters suggested that such guarantees would address concerns motivating the proposed internal TLAC requirements in a manner less likely to lead to going-concern ring fencing and “misallocation risk” (i.e., trapping resources that may not be needed in a covered IHC through pre-positioning). To reduce misallocation risk, a few commenters argued that the Board should permit a covered IHC to satisfy minimum TLAC and LTD requirements with capital contribution agreements which would obligate a foreign GSIB parent to contribute an amount of assets up to the minimum amount required in order to recapitalize the covered IHC upon the occurrence of certain events. These commenters also recommended that the Board permit covered IHCs to satisfy a portion of their internal TLAC requirements with other forms of parent support that have similar characteristics to such guarantees and satisfy the Board’s policy objectives, such as keepwell agreements and uncollateralized guarantees.

A number of commenters argued that the Board should eliminate separate long-term debt requirements for covered IHCs. According to the commenters, separate long-term debt requirements are not necessary to ensure that covered IHCs have enough loss-absorbing capacity to be recapitalized. These commenters asserted that equity can absorb losses equally well both inside and outside of a bankruptcy or Title II proceeding, and can function as both going-concern and gone-concern capital. As a result, these commenters

argued that covered IHCs should be able to satisfy their minimum TLAC requirements by freely substituting equity for LTD. A few commenters suggested that, consistent with the FSB standard, LTD for non-resolution IHCs be established as a supervisory expectation, rather than a formal minimum requirement, and that internal LTD be required to comprise no more than 33 percent of internal TLAC. Other commenters, however, noted that requiring covered IHCs to maintain a minimum amount of LTD represents a departure from the FSB standards, which do not require that any portion of internal TLAC consist of long-term debt instruments.

A number of commenters also pointed out that the Board did not apply the “balance sheet” depletion approach to calibrate the proposed internal LTD and TLAC requirements that the Board used for determining the calibration levels for the external LTD and TLAC requirements. These commenters urged the Board, consistent with the principle of national treatment, to include this adjustment to the calibration of LTD and TLAC requirements for covered IHCs.

As noted, covered IHCs are more similarly situated to covered BHCs than to U.S. banking organizations of a similar size, and the LTD and TLAC requirements should therefore apply to covered IHCs. Thus, the rationale for the internal LTD and TLAC requirements in the final rule is generally parallel to the rationale for the TLAC and LTD requirements for covered BHCs, as discussed above. Resolution covered IHCs would be subject to a TLAC requirement with a risk-weighted assets component identical to the risk-weighted assets component of the TLAC requirement applicable to covered BHCs. They would be subject to a supplementary leverage ratio component (if applicable) that is lower than the supplementary leverage ratio component of the proposed TLAC

requirement applicable to covered BHCs, in recognition of the fact that covered IHCs are not U.S. GSIBs and so would not be subject to the enhanced supplementary leverage ratio that applies to U.S. GSIBs. Finally, covered IHCs are also subject to TLAC and LTD requirements that are based on the U.S. tier 1 leverage ratio.⁸¹

The calibrations for TLAC and LTD under the final rule applicable to covered IHCs are reflected below:

Table 4: Covered IHC TLAC and LTD Final Rule Calibrations

		RWA	Leverage: SLR	Leverage: Total Assets
Non- Resolution Covered IHC	Coverd IHC TLAC	16 percent plus buffer	6 percent (if applicable)	8 percent
	Covered IHC LTD	6 percent	2.5 percent (if applicable)	3.5 percent
Resolution Covered IHC	Covered IHC TLAC	18 percent plus buffer	6.75 percent (if applicable)	9 percent
	Covered IHC LTD	6 percent	2.5 percent (if applicable)	3.5 percent

⁸¹ Generally, a bank holding company is subject to a 4 percent on-balance sheet leverage ratio requirement and a 3 percent supplementary leverage ratio requirement (if the supplementary leverage ratio applies to the bank holding company). The final rule's calibration of the on-balance sheet leverage ratio component of the proposed internal TLAC requirement, 8 percent, is twice the 4 percent requirement to be conceptually consistent with the proposed calibration of the supplementary leverage ratio requirement, 6 percent, which is twice the 3 percent requirement.

Other than the adjustment to the LTD calibration to reflect balance sheet depletion, the final rule does not reduce or eliminate the TLAC and LTD requirements in the manner suggested by commenters. However, the final rule does reflect a number of changes intended to address concerns raised by commenters and mitigate the burden of the final rule on covered IHCs. In particular, resolution covered IHCs are permitted under the final rule to issue external debt in the same manner as covered BHCs. Resolution covered IHCs are therefore subject to similar calibrations as covered BHCs under the final rule, because these IHCs are analogous to covered BHCs, which are themselves resolution entities.

The final rule provides that non-resolution covered IHCs are subject to slightly lower TLAC requirements than resolution covered IHCs. However, the final rule does not further reduce the requirement relative to the proposal as requested by commenters. The final rule's calibration of TLAC for non-resolution covered IHCs is the same as under the proposal and within (though toward the higher end) of the recommended range in the FSB standard.

The Board considered comments requesting that the final rule lower the calibration for non-resolution covered IHCs. Most foreign GSIBs are expected to be resolved by their home jurisdiction resolution authorities through an SPOE resolution and are therefore expected to be non-resolution entities under the proposal. Were such an SPOE resolution to succeed, the covered IHC would avoid entering resolution and would continue as a going concern, with its eligible internal TLAC and eligible internal LTD used to transmit the covered IHC's going-concern losses to the parent foreign GSIB, to the extent necessary. However, the final rule recognizes the need to plan for the

contingency in which the covered IHC enters a U.S. resolution proceeding. The proposed calibration for such a covered IHC was based on the desirability of providing support for the preferred SPOE resolution of the foreign GSIB. This approach is most effective when a foreign GSIB parent has internal loss-absorbing capacity that can be freely allocated to whichever subsidiaries have incurred the greatest losses (including non-U.S. subsidiaries). The value of this flexibility must, however, be balanced against the need to maintain sufficient loss-absorbing capacity in the United States so that a covered IHC can be maintained as a going concern or subjected to an orderly resolution in the United States if the foreign GSIB is not successfully resolved in an SPOE resolution or is otherwise unable to provide support to a non-resolution covered IHC.

For these reasons, the final rule retains the proposed calibrations in order to maximize the likelihood that a non-resolution or resolution covered IHC could be resolved in an orderly manner in the United States. For similar reasons, collateralized guarantees and other forms of contingent support do not count toward the minimum TLAC requirements under the final rule as requested by commenters. These forms of contingent support would not be pre-positioned in the United States and available for use during a period of stress without additional actions by the foreign GSIB parent.

To ensure that the LTD requirements are sufficient to replace a covered IHC's capital in a manner consistent with the Board's existing capital requirements, the LTD requirements are based on each of the three regulatory capital measures applicable to covered IHCs. The final rule does not eliminate, as requested by certain commenters, the total consolidated asset measure for covered IHCs that are subject to the total leverage exposure component because covered IHC's are generally subject to U.S. tier 1 leverage

ratio capital requirement and basing the LTD requirements on this capital measure is consistent with the underlying capital refill framework that motivates the requirements.⁸²

The proposal has been modified to reduce the minimum LTD requirement applicable to covered IHCs to reflect the same balance sheet depletion approach that was used to calibrate the requirements in the final rule applicable to the covered bank holding companies. Thus, under the final rule, the risk-weighted asset component of the LTD requirements has been reduced from 7 percent under the proposal to 6 percent (4.5 percent plus a 2.5 percent capital conservation buffer with a 1 percentage point allowance for balance sheet depletion); the SLR component from 3 percent to 2.5 percent; and the total assets component from 4 percent to 3.5 percent.

With respect to the comment that the Board should reserve the power to adjust TLAC and LTD requirements for institutions on a case-by-case basis based on the relative importance of the U.S. operations of a foreign banking organization to U.S.

⁸² Covered BHCs are not subject to a TLAC or LTD requirement that references total average consolidated assets as is the case for covered IHC's. This is because the U.S. tier 1 leverage ratio requirement applicable to covered IHCs is 4 percent, which is lower than the 5 percent enhanced supplementary leverage ratio requirement. Accordingly, adding a total consolidated assets TLAC or LTD requirement in the case of covered BHCs would be superfluous since the enhanced supplementary leverage ratio based requirement would always be larger than the U.S. tier 1 leverage ratio requirement. This is because both the U.S. tier 1 leverage ratio requirement of 4 percent is lower than the enhanced supplementary leverage ratio requirement of 5 percent, and the total consolidated assets amount is always less than the total leverage exposure amount. This reasoning does not apply in the case of covered IHCs. Covered IHCs are not subject to the enhanced supplementary leverage ratio of 5 percent but are subject to the supplementary leverage ratio of 3 percent. Accordingly, there can be cases in which the U.S. tier 1 leverage ratio based requirement would be larger than the supplementary leverage ratio-based requirement. Since covered IHCs are subject to both the U.S. tier 1 leverage ratio and the supplementary leverage ratio and since the U.S. tier 1 based requirement is not redundant, the final rule requires that the TLAC and LTD requirements reference both the U.S. tier 1 and supplementary leverage ratio capital measures.

financial stability, the final rule, like the proposal, establishes a minimum baseline requirement applicable to all covered IHCs. The possibility of adjusting these requirements on a case-by-case basis is something the Board may consider in the future based on the risk of the particular institution in question as the Board gains more experience with the application of the requirements.

The final rule adds a new provision for covered IHCs to describe the treatment of long-term debt subject to a put right—that is, a right of the holder to require the issuer to redeem the debt on demand—that is the same as the applicable provision for covered BHCs under the final rule. In particular, such an instrument would be treated as if it were due to be paid on the day on which it first became subject to the put right, since on that day the creditor would be capable of demanding payment and thereby subtracting the value of the instrument from the covered BHC’s loss-absorbing capacity. Also like the provision applicable to covered BHCs, the Board may order a covered IHC, after notice and an opportunity to respond, to exclude from its outstanding eligible long-term debt amount any debt securities with features that would significantly impair the ability of such debt securities to take losses.

The Board has consulted with, and expects to continue to consult with, foreign financial regulatory authorities regarding the requirements of the final rule. In addition, as noted above, the Board intends to update required TLAC and LTD calibration requirements in light of any future changes to the framework of applicable capital requirements.

E. Core Features of Eligible TLAC (section 252.165 of the final rule)

Under the proposal, a covered IHC's eligible internal TLAC was defined to be the sum of the tier 1 regulatory capital (common equity tier 1 capital and additional tier 1 capital) issued from the covered IHC to a foreign entity that directly or indirectly controls the covered IHC ("foreign parent entity") and the covered IHC's eligible LTD.⁸³ Only those tier 2 capital instruments that meet the definition of eligible LTD would have counted toward the TLAC requirement applicable to covered IHCs.

Requiring that regulatory capital be issued directly by a covered IHC, rather than by a subsidiary of the IHC, in order to count as eligible internal TLAC means that a covered IHC would have loss-absorbing capacity available to absorb losses incurred by any subsidiary of the IHC. In contrast, regulatory capital that is issued by one subsidiary of a covered IHC would not necessarily be available to absorb losses incurred by another subsidiary.

Under the proposal, regulatory capital and long-term debt were also required to be issued to a foreign parent entity of the covered IHC. As noted, a number of commenters urged the Board to permit covered IHCs, particularly resolution covered IHCs, to issue capital and long-term debt externally under the final rule. In addition, a few commenters argued that covered IHCs should be permitted to issue capital or long-term debt to any foreign affiliate (i.e., any foreign entity within the foreign GSIB majority owned by the

⁸³ Although eligible internal LTD with a remaining maturity between one and two years would have been subject to a 50 percent haircut for purposes of the LTD requirement, such eligible LTD would have counted at full value for purposes of the internal TLAC requirement. As discussed below, eligible internal LTD with a remaining maturity of less than one year would not have counted toward either the internal TLAC requirement or the internal LTD requirement. These requirements are the same under the final rule as under the proposal other than the fact that the final rule considers the date debt is due to be paid rather than the remaining maturity of the debt for reasons described above.

same top-tier foreign parent) rather than just a foreign parent as under the proposal. These commenters pointed out that internal TLAC and LTD issued to foreign affiliates would transfer losses outside the U.S. just as well as if the internal TLAC or LTD was issued to a foreign parent. Moreover, these commenters argued that broadening TLAC and LTD eligibility to include instruments held by any non-U.S. affiliate of the covered IHC would provide covered IHCs with greater flexibility to satisfy their TLAC and LTD requirements in a manner consistent with global operations and funding structures.

In response to comments, the final rule makes two changes to the proposed internal TLAC requirements. First, resolution covered IHCs have the option to issue capital and long-term debt externally to third-parties under the final rule or to issue it internally to a foreign parent or foreign wholly owned subsidiary of the foreign parent consistent with their resolution strategy.

Second, covered IHCs may issue internal TLAC and LTD to any foreign affiliate of the covered IHC that is wholly owned, directly or indirectly, by the top-tier parent foreign banking organization, in addition to foreign parent entities of the covered IHC. This modification to the proposal provides additional flexibility to foreign banking organizations without compromising the principle that losses incurred by a covered IHC with an SPOE strategy should be upstreamed to a foreign parent or another foreign affiliate rather than being transferred to other U.S. entities. It will also prevent the conversion of eligible LTD into equity from effecting a change in control over the covered IHC in the case of a non-resolution entity IHC that is required to issue internal LTD. A change in control of a covered IHC could create additional and undesirable

regulatory and management complexity during a failure scenario, and could severely disrupt an SPOE resolution strategy.

F. TLAC Buffer for Covered IHCs

The proposed rule would have required covered IHCs to maintain a buffer of common equity tier 1 capital in addition to the risk-weighted assets component of the minimum internal TLAC requirement. This buffer would have been similar to the buffer in the proposed rule that would have applied to covered BHCs, except that the internal TLAC buffer would not have included a GSIB surcharge component because covered IHCs are not subject to the Board's GSIB surcharge rule. A covered IHC's internal TLAC buffer would thus be equal to the sum of 2.5 percent plus any applicable countercyclical capital buffer. Under the proposed rule, a covered IHC that breached its buffer would be subject to the limits on capital distributions and discretionary bonus payments.

Commenters questioned whether the internal TLAC buffer was necessary for covered IHCs. These commenters argued that the buffer imposed additional burden with no corresponding benefits and encouraged the Board to eliminate the buffer, particularly for covered IHCs that issued TLAC only to their affiliates. Certain commenters recommended that a breach of the buffer should be addressed by the Board as part of the supervisory process rather than through self-executing restrictions on an IHC's capital distributions and discretionary bonus payments. One commenter argued that the 50 percent haircut on long-term debt operates as a de facto buffer, making the internal TLAC buffer duplicative and unnecessary. This commenter also argued that the TLAC buffer would unnecessarily strain liquidity at the covered IHCs.

The covered IHC TLAC buffer serves the same purpose as the TLAC buffer applicable to covered BHCs: it limits capital distributions and discretionary bonus payments as a firm approaches its minimum TLAC requirements, thereby helping to preserve capital. Consistent with this principle and the proposal, the final rule includes a buffer that for covered IHCs that must be satisfied with common equity tier 1 capital.

Also, consistent with the proposal, a covered IHC’s breach of its TLAC buffer would result in limits on capital distributions and discretionary bonus payments in accordance with Table 5. As discussed above with respect to the external TLAC risk-weighted assets buffer, a covered IHC that meets the applicable capital requirements, the existing capital conservation buffer, and the covered IHC LTD requirements generally would not need to increase its common equity tier 1 capital to meet its covered IHC TLAC requirement and its TLAC buffer.

The Board is not adding a buffer over the leverage component of the covered IHC TLAC requirement as described previously for covered BHCs. The buffers in the final rule are designed to be consistent with the buffers in Regulation Q, which only includes a buffer over a leverage requirement for the covered BHCs.

Table 5: Calculation of Maximum Covered IHC TLAC Payout Amount

Covered IHC TLAC buffer level	Maximum Covered IHC TLAC payout ratio (as a percentage of eligible retained income)
Greater than the Covered IHC TLAC buffer	No payout ratio limitation applies

Less than or equal to the Covered IHC TLAC buffer, <u>and</u> greater than 75 percent of the Covered IHC TLAC buffer	60 percent
Less than or equal to 75 percent of the Covered IHC TLAC buffer, <u>and</u> greater than 50 percent of the Covered IHC TLAC buffer	40 percent
Less than or equal to 50 percent of the Covered IHC TLAC buffer, <u>and</u> greater 25 percent of the Covered IHC TLAC buffer	20 percent
Less than or equal to 25 percent of the Covered IHC TLAC buffer	0 percent

G. Core Features of Eligible Internal and External LTD for covered IHCs (section 252.161 of the final rule)

Under the proposal, a covered IHC’s eligible internal LTD would have been defined as debt that is paid in and issued directly from the covered IHC, is unsecured, has a maturity of greater than one year from the date of issuance, is “plain vanilla,” and is governed by U.S. law.⁸⁴ These are generally the same requirements as applied under the proposal to eligible external LTD issued by covered BHCs.

A few additional requirements applied to eligible internal LTD under the proposal. Eligible internal LTD would be required to be issued, directly or indirectly, to

⁸⁴ The proposal required that eligible internal LTD be governed by U.S. law in order to clarify that the conversion and exchange provisions of these instruments, which would be held by foreign companies, are enforceable under U.S. law.

a foreign parent entity of the covered IHC, to be contractually subordinated to all third-party liabilities of the covered IHC, and to include a contractual trigger pursuant to which the Board could require the covered IHC to cancel the eligible internal LTD or convert or exchange it into tier 1 common equity on a going-concern basis under certain specified conditions. Eligible internal LTD was also prohibited from having any acceleration clauses.

In general, commenters argued that the Board should conform the eligibility requirements of internal LTD for covered IHCs with those of external LTD for covered BHCs because the additional features were costly, unnecessary, and thereby placed covered IHCs at a significant competitive disadvantage relative to covered BHCs. In particular, commenters recommended that the Board eliminate the contractual subordination and contractual trigger requirements and to permit eligible internal LTD to contain the same acceleration events as permitted by long-term debt issued by covered BHCs. Commenters argued that covered IHCs transact with foreign parents on an arm's length basis, and that these features would require covered IHCs to pay a significant premiums for these features. Commenters also argued that these features of eligible internal LTD under the proposal would significantly increase the risk that the debt would be characterized as equity for U.S. income tax purposes and therefore significantly increase costs for covered IHCs. Each of these features, relevant comments, and changes to the final rule to address these concerns are discussed in more detail below.

1. Issuance to a Foreign Parent Entity that Controls the Covered IHC

Under the proposal, eligible internal LTD was required to be paid in and issued, directly or indirectly, to a foreign parent entity that controls the covered IHC. As discussed above, a number of commenters urged the Board to allow external issuance for resolution covered IHCs consistent with their resolution strategy. In response to these comments, the final rule permits resolution covered IHCs to issue eligible long-term debt externally to third-party investors as discussed above. The final rule defines a new term “eligible external debt security” with generally the same terms as eligible debt securities issued by covered BHCs.⁸⁵ As it would for eligible external LTD issued by covered BHCs, the final rule would also permit an eligible external debt instrument issued prior to December 31, 2016 by a resolution covered IHC that contains otherwise impermissible acceleration clauses and is issued under foreign law to qualify as an eligible external debt security.

Resolution covered IHCs also have the option to issue debt internally to a foreign parent or foreign wholly owned subsidiary of a global systemically important foreign banking organization that directly or indirectly controls the covered IHC. Non-resolution covered IHCs are required under the final rule to issue debt internally to a foreign parent

⁸⁵ In particular, eligible external debt security is defined as a debt instrument that is paid in, and issued by the covered IHC to and remains held by a company that does not directly or indirectly control the covered IHC and is not a wholly owned subsidiary; is not secured, not guaranteed by the covered IHC or a subsidiary of the covered IHC, and is not subject to any other arrangement that legally or economically enhances the seniority of the instrument; has a maturity of greater than or equal to 365 days (one year) from date of issuance; is governed by the laws of the United States or any State thereof; does not provide the holder of the instrument a contractual right to accelerate payment of principal or interest on the instrument, except for a right that is exercisable on one or more dates that are specified in the instrument or in the event of a receivership, insolvency, liquidation or similar proceeding of the covered IHC or a failure of the covered IHC to pay principal or interest on the instrument when due and payable that continues for 30 days or more; and does not include structured notes.

or foreign wholly owned subsidiary of a global systemically important foreign banking organization that directly or indirectly controls the covered IHC, for the reasons described above. The definition of “eligible internal debt” security is the same for both types of covered IHCs. The requirements for an “eligible internal debt security” are generally the same as the terms for an “eligible external debt security” for a resolution covered IHC and “eligible debt security” for a covered BHC with a few key differences described below.

The proposal prohibited an eligible internal debt security from having any acceleration clauses. Under the final rule, both an eligible external debt security and an eligible internal debt security would be permitted to have the same types of acceleration clauses permitted for an eligible debt security of a covered BHC. However, unlike for eligible external debt securities, the final rule does not allow eligible internal debt of covered IHCs issued prior to December 31, 2016, to have impermissible acceleration clauses or be issued under foreign law. The Board does not believe that covered IHCs have substantial amounts of internal long-term debt outstanding since the requirement to establish a covered IHC became effective on July 1, 2016. Moreover, the Board believes that covered IHCs could modify the terms of existing outstanding internal debt issued to a foreign parent or another foreign affiliate with relative ease and low cost.

Another difference from the proposal is that neither an eligible internal debt security nor an eligible external debt security would be required to be contractually subordinated under the final rule. Under the final rule, a covered IHC like a covered BHC would have the option of structural subordination, subject to a similar cap on unrelated liabilities applicable to covered BHCs described further below.

However, eligible internal debt securities would continue to have two key distinctions from eligible external debt securities under the final rule. First, an “eligible internal debt security” must be issued to and remain held by a company that is incorporated and organized outside of the United States that directly or indirectly controls the covered IHC, or a foreign, wholly owned subsidiary of a global systemically important foreign banking organization that directly or indirectly controls the covered IHC. Second, the internal debt security must have a contractual provision that is approved by the Board that provides for immediate conversion or exchange of the instrument into common equity tier 1 capital of the covered IHC upon issuance by the Board of an internal debt conversion order.

In response to comments by a number of foreign banks, the Board consulted with the U.S. Department of the Treasury on the possibility that internal LTD could be considered equity—rather than debt—for purposes of U.S. tax law, and therefore increase the cost of the debt relative to the external LTD required of covered BHCs.⁸⁶ Four changes to the proposal should mitigate the concerns raised by commenters on the proposal.

First, the final rule removes the ability of the Board to require cancellation of the debt and only retains the ability of the Board to require its conversion or exchange. Second, eligible internal debt securities under the final rule are permitted to have the same acceleration clauses as eligible external LTD. Third, eligible internal debt

⁸⁶ Commenters noted that, regardless of the characterization of internal LTD as equity under U.S. tax law, coupon payments on internal LTD are likely to be treated as debt in an FBO’s home jurisdiction. The commenters argued that the overall result would therefore be the incurrence by FBOs of tax costs in respect of internal LTD substantially in excess of those that would arise from either conventional debt or conventional equity.

securities are not required to be contractually subordinated under the final rule. Fourth, the final rule allows the Board to require the partial conversion or exchange of less than all of the eligible internal debt securities of the IHC, whereas the proposal only contemplated 100 percent conversion. A more detailed explanation of these changes follows.

2. Acceleration Clauses

The proposal would have prohibited an eligible internal debt security issued by a covered IHC from having any contractual provision giving the holder of the instrument a contractual right to accelerate payment of principal or interest on the instrument. Many commenters expressed concern with this aspect of the proposal as being stricter than the requirements for covered BHCs and argued that eligible LTD issued by covered IHCs should be permitted to contain the same acceleration events as permitted for eligible debt securities issued by covered BHCs (i.e., acceleration clauses for insolvency and payment default). These commenters explained that covered IHCs may not have more flexibility than covered BHCs to price internal debt because covered IHCs and their non-U.S. affiliates transact on market terms. These commenters also noted that prohibiting all acceleration clauses further increases the risk that eligible LTD would be characterized as equity rather than debt for U.S. federal income tax purposes, creating uncertainty about the tax deductibility of interest payments on eligible internal LTD and whether these payments are subject to withholding tax. These commenters argued that an instrument is more likely to be considered debt for U.S. tax purposes if its holder has adequate legal remedies, such as acceleration rights or the right to sue (e.g., for breaches of debt covenants).

As explained above, the final rule permits both eligible external debt securities and eligible internal debt securities issued by covered IHCs to have the same acceleration clauses permitted under the final rule for covered BHCs. In particular, the eligible long-term debt issued by covered IHCs would not be permitted to provide the holder of the instrument a contractual right to accelerate payment of principal or interest on the instrument, except a right that is exercisable on one or more dates that are specified in the instrument or in the event of (A) a receivership, insolvency, liquidation, or similar proceeding of the covered IHC or (B) a failure of the covered IHC to pay principal or interest on the instrument when due and payable that continues for 30 days or more. The rationale for these requirements is explained in more detail above in connection with the discussion of requirements for eligible long-term debt for covered BHCs.

As for eligible external LTD issued by covered BHCs, the final rule would also permit an eligible external debt instrument issued prior to December 31, 2016 by a resolution covered IHC that contains otherwise impermissible acceleration clauses or is subject to foreign law to count for eligible external LTD. This allowance should mitigate compliance costs on resolution covered IHCs that have outstanding unsecured debt with acceleration clauses or subject to foreign law. The same treatment does not apply to internal LTD. The Board does not believe that covered IHCs have substantial amounts of internal long-term debt outstanding since the requirement to establish a covered IHC became effective on July 1, 2016. Moreover, the Board believes that covered IHCs could modify the terms of existing outstanding internal debt issued to a foreign parent or another foreign affiliate with relative ease and low cost.

Commenters also noted that the proposal does not impose limits on the rights of holders of internal LTD to file suit in the event of non-payment or that such holders would have to waive those rights. However, because of the limitations on acceleration provisions, commenters requested that the Board clarify that the rule does not also limit such rights. The final rule does not require the holder of an eligible internal debt security, eligible external debt security, or eligible debt security to waive the holder's rights to file suit to enforce their ordinary creditor remedies. However, if a covenant involves a redemption or repurchase by the covered IHC of eligible LTD (e.g., upon sale of a principal subsidiary), any such covenant would be subject to the restrictions on redemption and repurchase described elsewhere in this SUPPLEMENTARY INFORMATION, including prior approval from the Board if after redemption or repurchase of eligible LTD, a covered IHC would not meet its LTD requirement.

3. Contractual Subordination

Under the proposal, eligible internal LTD was required to be contractually subordinated to all third-party liabilities of the covered IHC, with the exception of liabilities that are related to eligible internal TLAC.⁸⁷ A number of commenters objected to the requirement under the proposal that internal LTD was required to be contractually subordinated. These commenters encouraged the Board, consistent with the FSB standard and principles of national treatment and equality of competitive opportunity, to

⁸⁷ The exception for liabilities that are related to eligible internal TLAC applied to instruments that were eligible internal TLAC when issued and have ceased to be eligible solely because their remaining maturity is less than one year, because they have become subject to a put right, or because they could become subject to a put right within one year, as well as to payables (such as dividend- or interest-related payables) that are associated with such liabilities.

permit covered IHCs the flexibility afforded to covered BHCs to rely on either structural or contractual subordination. These commenters suggested that covered IHCs relying on structural subordination should be permitted a similar 5 percent allowance for unrelated liabilities to that permitted for covered BHCs under the proposal.⁸⁸ Commenters argued that these modifications would enable covered IHCs to avoid added costs associated with contractual subordination. One commenter, for example, provided an estimate of the cost of contractual subordination ranging from an additional 25 to 100 basis points with an average of 59 additional basis points. Commenters also indicated that the deep subordination requirements of the proposal would contribute to uncertainty over whether eligible long-term debt would be characterized as debt and not equity for purposes of U.S. federal and state tax laws.

The Board has modified the proposal to permit covered IHCs the option to contractually or structurally subordinate their debt. For the same reasons discussed above with respect to covered BHCs, a covered IHC will have flexibility under the final rule to choose between contractual subordination and structural subordination. This modification also provides parity between covered BHCs and covered IHCs and thus should mitigate the costs of contractual subordination raised by comments under the proposal. If a covered IHC opts to contractually subordinate all of its eligible long-term

⁸⁸ While the Board did not propose to subject covered BHCs to this contractual subordination requirement, it did propose to impose a cap on the value of a covered BHC's non-eligible external LTD-related liabilities that can be pari passu with or junior to its eligible long-term debt. This aspect of the final rule is discussed below.

debt, it will not be required to have a cap on unrelated liabilities.⁸⁹ If a covered IHC has any eligible long-term debt that is structurally subordinated, the long-term debt would be allowed to be senior unsecured debt and to be senior to a capped amount of liabilities of the covered IHC that do not count as eligible external LTD.⁹⁰

4. Contractual Conversion Trigger

Under the proposal, eligible internal LTD was required to include a contractual trigger pursuant to which the Board could require the covered IHC to cancel the eligible internal LTD or convert or exchange it into tier 1 common equity on a going-concern basis (that is, without the covered IHC's entry into a resolution proceeding) under certain circumstances. These were if the Board determines that the covered IHC is "in default or in danger of default" and any of three additional circumstances applied.⁹¹ First, the top-tier foreign banking organization or any of its subsidiaries was placed into resolution proceedings. Second, the home country supervisory authority consented to the

⁸⁹ A covered BHC similarly would have the option under the final rule to contractually subordinate all of its eligible external LTD and not have a cap on unrelated liabilities as described below.

⁹⁰ The applicability of the cap to resolution covered IHCs and non-resolution covered IHCs is described in more detail below.

⁹¹ The phrase "in default or in danger of default" would be defined consistently with the standard provided by section 203(c)(4) of Title II of the Dodd-Frank Act. *See* 12 U.S.C. 5383. Consistent with section 203's definition of the phrase, a covered IHC would be considered to be in default or in danger of default upon a determination by the Board that (A) a case has been, or likely will promptly be, commenced with respect to the covered IHC under the U.S. Bankruptcy Code; (B) the covered IHC has incurred, or is likely to incur, losses that will deplete all or substantially all of its capital, and there is no reasonable prospect for the company to avoid such depletion; (C) the assets of the covered IHC are, or are likely to be, less than its obligations to creditors and others; or (D) the covered IHC is, or is likely to be, unable to pay its obligations (other than those subject to a bona fide dispute) in the normal course of business.

cancellation, exchange, or conversion, or did not object to the cancellation, exchange, or conversion following 48 hours' notice. Third and finally, the Board made a written recommendation to the Secretary of the Treasury that the FDIC should be appointed as receiver of the covered IHC under Title II of the Dodd-Frank Act.⁹²

A number of commenters requested that the Board eliminate the contractual conversion trigger. These commenters argued that the conversion trigger was unnecessary to achieve the Board's objectives, would unfairly increase the funding costs of covered IHCs as compared to covered BHCs and could unfairly increase tax costs of covered IHCs as compared to covered BHCs. In particular, these commenters indicated that this feature posed a substantial risk of the LTD being characterized as equity, rather than debt, for U.S. tax purposes, further increasing the cost of compliance for covered IHCs, especially when combined with the contractual subordination requirement and prohibition on any acceleration clauses under the proposal.

One commenter estimated the cost of the contractual conversion feature would range from a minimum of 20 additional basis points to a maximum of 85 basis points with an average increase in cost of 50 basis points. Another commenter estimated that a covered IHC's pre-tax cost would increase by a range of \$10.5 million to \$105 million as a result of the contractual conversion feature for a hypothetical covered IHC with risk-weighted assets of \$100 billion. These commenters argued that the costs of this feature outweigh its benefits. In particular, certain commenters argued that a conversion trigger is not necessary to ensure an IHC can withstand losses, as the FBO parent would have every incentive to preserve the value of the IHC and recapitalize the IHC to avoid its

⁹² See 12 U.S.C. 5383.

entry into insolvency or resolution. Commenters also argued that the conversion trigger contravenes principles of national treatment and equality of competitive opportunity required under the Dodd-Frank Act.

Commenters recommended that the Board, if it retained the contractual conversion trigger in any final rule, coordinate with the U.S. Treasury to ensure that the long-term debt would be treated as debt for U.S. federal income tax purposes. Commenters also suggested a number of modifications to the conversion trigger to increase the likelihood that the long-term debt would be treated as debt. In particular, commenters urged the Board to remove the ability to cancel the long-term debt, since cancellation is not necessary to ensure that a covered IHC can be recapitalized outside of insolvency (i.e., conversion alone can achieve that end). These commenters argued that the provision providing for the cancellation of the debt instrument would be inconsistent with the principle that debt must retain its priority over equity, because the cancellation of internal LTD would result in the subordination of LTD to existing equity. These commenters also indicated that this same concern arose from the requirement that internal LTD convert into equity while any existing equity remains outstanding. As a result, these commenters urged the Board to clarify in the preamble of the final rule that covered IHCs could adopt “self-help” measures to preserve the priority of internal LTD when it converts into equity (e.g., all classes of a covered IHC’s going concern equity may contain a transfer provision that allows the equity to be transferred for no consideration to the covered IHC, which is able to cancel the equity, prior to conversion of LTD into equity).

Commenters also indicated that allowing internal LTD to have provisions (e.g., acceleration clauses and covenants) on the same terms as external LTD would make it more likely that the internal LTD would be characterized as debt and not equity. Further, commenters argued that not requiring internal LTD to be contractually subordinated, rather allowing it to be structurally subordinated, would further help the characterization of internal LTD as debt and not equity.

As an initial matter, the final rule gives resolution covered IHCs the option to issue debt externally to third-party investors under the final rule on the same terms as covered BHCs. The external debt issued by resolution covered IHCs is not required to contain a contractual conversion trigger.

After considering all of the information provided by commenters, the Board has determined that the benefits of a conversion trigger requirement for internal debt outweigh its potential costs. A conversion trigger will allow covered IHCs that are in default or danger of default to be recapitalized through the conversion of eligible internal LTD to equity upon the occurrence of the trigger conditions in light of the losses that the covered IHC has incurred. Under certain circumstances, entry of a covered IHC into a resolution proceeding could pose a risk to the financial stability of the United States. Recapitalizing such a covered IHC outside of a resolution proceeding, and thereby reducing systemic risk, would advance the Dodd-Frank Act's goal of "mitigat[ing] risks to the financial stability of the United States that could arise from the material financial distress" of the covered IHC without the need for government or taxpayer support.⁹³

⁹³ 12 U.S.C. 5365(a)(1).

The final rule contains certain targeted changes suggested by commenters that are consistent with the policy objectives of the final rule that internal LTD be characterized as debt and not equity and that are intended to mitigate associated potential costs with respect to the proposed conversion feature raised by commenters.

First, the Board has modified the requirement that the internal eligible long-term debt instrument allow the Board to require either the cancellation or conversion of the debt under the proposal. Under the final rule, the Board would only have the ability to require the conversion of the debt into equity. This change does not prejudice the Board's policy objective of transferring the losses suffered by the covered IHC to the holder of the eligible internal LTD through the conversion of eligible internal LTD into equity.

Second, under the proposal, the Board would have had to require conversion of all eligible internal debt. Under the final rule, the Board would have the ability to require the conversion of some or all of the eligible internal debt. This change gives the Board the flexibility to respond to losses or stress at a covered IHC in a more targeted manner.

Third, as noted, the final rule allows all eligible LTD to have acceleration clauses on the same terms as eligible external LTD.

Fourth, also as noted, the final rule allows internal LTD to be structurally subordinated in a similar manner as eligible external LTD. The combination of these changes represent a number of adjustments that commenters indicated would ameliorate the characterization of internal LTD as equity under U.S. tax law. In addition, nothing in this final rule restricts the ability of a covered IHC to build terms that are consistent with applicable law into its equity or debt instruments (e.g., terms that provide that existing

equity would be transferred to the covered IHC and canceled upon transfer if the long-term debt converts to equity or debt covenants on the same terms permissible for covered BHCs described above).

Under the proposal, the Board was required to consider an objection by the home country supervisor to the conversion, exchange or cancellation of eligible internal debt securities if the Board received the objection no later than 48 hours after the Board requested such consent or non-objection from the home country supervisor. A few commenters argued that this period was too short for the home country regulator of a covered IHC's parent FBO to play a meaningful role in the decision to recapitalize or resolve a covered IHC, particularly during a period of market stress.

After giving additional consideration to this issue and consulting with certain foreign regulatory authorities, the Board has determined to reduce the 48-hour-period in the proposal to 24 hours in the final rule. As exhibited during the last financial crisis, a firm can collapse precipitously meaning that time may be of the essence. The Board expects to be in close coordination with regulators in other jurisdictions if a firm with a covered IHC begins to exhibit losses or stress, meaning the 24-hour period should be a sufficient amount of time for the home country regulator to object to the conversion of the covered IHC's LTD into equity. These early communications between the Board and the home country regulators should address the concerns raised by commenters about ensuring that a home country regulator has enough time and notice to be able to play a meaningful role in a decision regarding the covered IHC.

For all these reasons, the final rule requires internal debt, whether issued by resolution covered IHCs or non-resolution covered IHCs, to contain a contractual

conversion feature. As under the proposal, the terms of the contractual conversion provision in the debt instrument would have to be approved by the Board.

The conversion trigger in the final rule represents a compromise between the interests of home and host regulators. From the perspective of a host regulator, it is desirable to have the power to impose losses on eligible internal LTD quickly and easily upon a determination that the hosted subsidiary is in danger of default, in order to remove those losses from the host jurisdiction's financial system and thereby promote financial stability in the host jurisdiction. The conversion trigger advances this interest by giving the Board the power to do so upon a determination that the covered IHC is in danger of default where the home jurisdiction supervisory authority either consents or fails to object within 24 hours or where the home jurisdiction resolution authority has placed the parent foreign banking organization into resolution proceedings.

At the same time, from the perspective of a home regulator, it is desirable that host regulators not impose losses on the top-tier parent entity, except where doing so is appropriate to prevent the failure of the hosted subsidiary, since doing so drains loss-absorbing capacity from the top-tier parent entity that may be needed to support other subsidiaries in the home jurisdiction or in another host jurisdiction. The conversion trigger requirement advances this interest by giving the home jurisdiction supervisory authority the right to object to the triggering decision within 24 hours, except where the home jurisdiction resolution authority has placed the parent foreign banking entity into resolution proceedings. The United States is home to numerous U.S. GSIBs and also hosts substantial operations of numerous foreign GSIBs, thereby making both considerations relevant to the Board's role as both a home and host country supervisor.

5. Haircuts

Under the proposal, eligible internal LTD with a remaining maturity of between one and two years was subject to a 50 percent haircut for purposes of the internal LTD requirement, and eligible internal LTD with a remaining maturity of less than one year would not count toward the internal LTD requirement.

A number of commenters recommended that the Board eliminate the 50 percent haircut applicable to eligible debt securities with a remaining maturity between one and two years, to make the proposed requirements more consistent with the FSB standard. These commenters argued that the haircut is less appropriate in the context of internal LTD for covered IHCs because there would be no refinancing risk – i.e., risk that the covered IHC will lose market risk and be unable to replace the internal LTD as it approaches maturity since it can simply replace internal LTD with a new issuance of internal LTD to a foreign affiliate. These commenters argued that foreign parents and foreign affiliates can be expected to continue to roll over debt or extend credit to a covered IHC in a period of stress so that the covered IHC could continue to meet any applicable LTD requirements. One commenter also recommended that the Board reduce the haircut for internal debt with a remaining maturity of less than one year from 100 percent to 50 percent.

The Board is not modifying the proposed rule in response to these comments. The Board has modified the proposal to change “remaining maturity” of the principal amount to the amount “due to be paid.” Like for covered BHCs, this clarification is intended to make clear that only the remaining principal amount due to be paid counts as eligible LTD. Under the final rule, eligible external LTD or internal LTD issued by

covered IHCs that is due to be paid between one and two years is subject to a 50 percent haircut for purposes of the internal LTD requirement, and eligible LTD that is due to be paid in less than one year would not count toward the internal LTD requirement. These requirements are the same as those applicable to covered BHCs.

The purpose of these requirements is to ensure the ability of LTD instruments to absorb losses. The rationale for the haircut is to incentivize a firm to have enough debt of sufficient maturity to avoid issuing debt in unfavorable market circumstances or in the event that the covered IHC is experiencing financial difficulties. With respect to internal LTD in particular, based on the information provided by commenters it appears covered IHCs should be able to easily roll over their one-year or two-year debt to avoid haircuts if that is the manner in which they choose to fund themselves. Moreover, the argument that foreign parents will always be incentivized to rollover or refinance the debt of covered IHCs, even when a third party would not do so, is inconsistent with other comments provided by foreign GSIBs indicated that covered IHCs generally transact with their FBO parents on an arm's-length terms.

The final rule applies the same treatment as the proposal to an internal debt instrument that could become subject to a put right in the future. Under the final rule, such instruments would be treated as due to be paid on the first day on which the put right could be exercised. The rationale for this approach is the same as the rationale for the identical provisions that apply to eligible external LTD issued by covered BHCs, as discussed above. No comments were received on this aspect of the proposal.

IV. Clean Holding Company Requirements (sections 252.64 and 252.166 of the final rule)

The proposed rule would have prohibited covered BHCs and covered IHCs (together, covered holding companies) from engaging in certain transactions that could impede the orderly resolution of a covered holding company or increase the risk that financial market contagion would result from the resolution of a covered holding company. Specifically, the proposal would have prohibited covered holding companies from having the following categories of outstanding liabilities: third-party debt instruments with an original maturity of less than one year, including deposits (short-term debt); qualified financial contracts with a third party (third-party QFCs); guarantees of a subsidiary's liabilities if the covered holding company's insolvency or entry into a resolution proceeding (other than resolution under Title II of the FDI Act) would create default rights for a counterparty of the subsidiary (subsidiary guarantees with cross-defaults rights); and liabilities that are guaranteed by a subsidiary of the covered holding company (upstream guarantees) or that are subject to rights that would allow a third party to offset its debt to a subsidiary upon the covered holding company's default on an obligation owed to the third party.

Additionally, the proposal would have limited the total value of each covered BHC's non-TLAC-related third-party liabilities that are either pari passu with or subordinated to any eligible external TLAC to 5 percent of the value of the covered BHC's eligible external TLAC (5 percent cap). With respect to covered IHCs, the proposal would have prohibited covered IHCs from having any non-TLAC-related third-party liabilities that are pari passu with or subordinated to eligible internal LTD by requiring that eligible internal LTD be contractually subordinated to all third-party debt

claims. Therefore, the proposed cap was not relevant to covered IHCs under the proposal.

The Board received comments on the proposed prohibitions on short-term debt, third-party QFCs, and subsidiary guarantees with cross-defaults rights. The final rule generally adopts these requirements of the proposal with modifications to address comments received on the proposal.

A. Third-Party Short-term Debt Instruments (sections 252.64(a)(1) and 252.166(a)(1) of the final rule)

Like the proposal, the final rule prohibits covered holding companies from issuing debt instruments with an original maturity of less than one year to a third party.

(Issuances to an affiliate of the covered holding company are permitted under the final rule.) Under the final rule, a liability has an original maturity of less than one year if it would provide the creditor with the option to receive repayment within one year of the creation of the liability, or if it would create such an option or an automatic obligation to pay upon the occurrence of an event that could occur within one year of the creation of the liability (other than an event related to the covered holding company's insolvency). The prohibition of the final rule would also cover short-term and demand deposits at the covered holding company.⁹⁴

One objective of SPOE resolution is to mitigate the risk of destabilizing funding runs. A funding run occurs when the short-term creditors of a financial company observe stress at that institution and seek to minimize their exposures to it by refusing to roll over

⁹⁴ For purposes of the final rule, deposits would include those that are captured in line item 11 of schedule PC of FR Y-9LP.

the debts of the financial company. The resulting liquidity stress can hasten a company's failure, including by forcing the company to engage in asset fire sales to pay obligations due to short-term creditors. Because they reduce the value of similar assets held by other firms, asset fire sales can be a key channel for the propagation of stress throughout the financial system. The short-term creditors of a failing GSIB may also run on counterparties that are similar to a failing firm, thereby weakening those firms and forcing further fire sales. Similarly, certain depositors, who generally have the ability to demand their funds on short notice, present analogous funding issues.

The final rule seeks to mitigate these risks in two complementary ways. First, although the operating subsidiaries of covered holding companies rely on short-term funding, in an SPOE resolution, the short-term creditors of operating subsidiaries would not bear losses incurred by the subsidiaries because those losses would instead be transferred to the covered holding company and therefore borne by the external TLAC holders during the bankruptcy or resolution of the covered holding company. To the extent that market participants view SPOE resolution as workable, the subsidiaries' short-term creditors should have reduced incentives to run because their direct counterparty would not default in such a resolution. Second, the covered holding companies themselves would be prohibited from relying on short-term funding, reducing the run risk associated with the failure of such an entity. This goal is particularly important in light of the likely liquidity needs of a GSIB during SPOE resolution, because a short-term funding run on a covered holding company would drain liquidity that may be needed to support the group's operating subsidiaries.

One commenter argued that the proposal was unnecessarily restrictive and could prevent covered BHCs from obtaining liquidity via temporary secured lending. The prohibition against short-term funding in the final rule applies to both secured and unsecured short-term borrowings. Although secured creditors are less likely to take losses in resolution than unsecured creditors, secured creditors may nonetheless be unwilling to maintain their exposure to a covered holding company that comes under stress. In particular, if the covered holding company were to enter into a resolution proceeding, the collateral used to secure the debt would be subject to a stay, preventing the creditor from liquidating it immediately. (Qualified financial contracts, which are not subject to a stay under the U.S. Bankruptcy Code but which present other potential difficulties for SPOE resolution, are discussed below.) The creditor would therefore face two risks: the risk that the value of the collateral would decline before it could be liquidated and the liquidity risk attributable to the fact that the creditor would be stayed from liquidating the collateral for some time. Knowing this, secured short-term creditors may well decide to withdraw funding from a covered holding company that comes under stress.

Additionally, many short-term lenders to GSIBs are themselves maturity-transforming financial firms that are vulnerable to runs (for instance, money market mutual funds). If such firms incur losses in stressful conditions, then they may be unable to meet their obligations to their own investors and counterparties, which would cause further losses throughout the financial system. Because SPOE resolution relies on imposing losses on the covered holding company's creditors while protecting the creditors and counterparties of its material operating subsidiaries, it is desirable that the

holding company's creditors be limited to those entities that can be exposed to losses without materially affecting financial stability. The final rule would enhance the credibility of the SPOE approach by reducing these risks and simplifying the types of creditors and funding of a covered holding company in resolution.

Finally, the prohibition of the final rule on short-term debt instruments would promote the resiliency of covered holding companies as well as their resolvability. As discussed above, reliance on short-term funding creates the risk of a short-term funding run that could destabilize the covered holding company by draining its liquidity and forcing it to engage in capital-depleting asset fire sales. The increase in covered holding company resiliency yielded by the prohibition provides a secondary justification for the proposal.

One commenter contended that the proposed prohibition on short-term debt might prohibit covered holding companies from obtaining secured liquidity from the FDIC and requested the final rule except from the prohibition secured liquidity provided by the FDIC during periods of market distress or to facilitate an SPOE resolution. The Board would not expect the prohibition under the final rule to interfere with the orderly resolution of covered holding companies under Title II or other forms of governmental liquidity support and therefore is adopting the prohibition as proposed.

B. Qualified Financial Contracts with Third Parties (sections 252.64(a)(3) and 252.166(a) of the final rule)

Under the proposal, covered BHCs could have only entered into qualified financial contracts (QFCs) with their subsidiaries and covered IHCs could have only entered into QFCs with their affiliates. The proposal defined QFCs by reference to

Title II of the Dodd-Frank Act, which defines QFCs to include securities contracts, commodities contracts, forward contracts, repurchase agreements, and swap agreements.⁹⁵

One commenter expressed support for this aspect of the rule arguing that it is best for all holding company swap transactions to be executed with internal entities to minimize the impact of external market disruption and reduce complexity. Other commenters noted that the prohibition on third-party QFCs not only would bar a covered holding company from directly entering into a swap, repurchase agreement, or other QFC but also would prohibit the covered company from guaranteeing or otherwise providing a credit enhancement for such a contract between a subsidiary of the covered holding company and a third party. The proposed third-party QFC prohibition would have prohibited credit enhancements provided by covered holding companies because the definition of QFC in Title II of the Dodd-Frank Act, which the proposal incorporated by reference, includes credit enhancements of swap agreements, repurchase agreements, and the other financial contracts identified in the definition.

Some commenters suggested that the Board permit covered BHCs to enter into QFCs with third parties if the QFCs were cleared through a central counterparty (CCP). This commenter argued that the risk-minimizing requirements in place at CCPs (that is, requirements to post initial and variation margin and the maintenance of a guaranty or default fund) limit concerns over the termination of QFCs and related fire sales as well as

⁹⁵ 12 U.S.C. 5390(c)(8)(D).

any concern that the CCP counterparty would itself become insolvent and contribute to contagion risk.

In response to these comments, the Board notes that, like counterparties to uncleared transactions, a CCP counterparty may respond to an institution's default by immediately liquidating the institution's collateral and seeking replacement trades with other dealers. Even less drastic actions, such as increasing collateral requirements, could have a significant impact on the liquidity of a failing clearing member. Therefore, cleared QFC activities have the potential to complicate the resolution of the covered holding company. Moreover, the potential imposition of losses on CCPs could itself cause contagion and fire sale risk. For these reasons, the final rule prohibits covered holding companies from entering into cleared QFCs with third parties.

Certain commenters requested the final rule permit covered BHCs to enter QFCs for hedging purposes including to engage in risk-management of eligible long-term debt. These commenters pointed out that new margin requirements on swaps and security-based swaps limit the potential build-up of risk from third-party derivatives.

In response, while QFCs entered into for hedging purposes are intended to reduce or mitigate risk of the underlying position being hedged, a material amount of third-party QFCs poses risk to resolution of covered holding companies regardless of the purpose for which they are entered. Moreover, the final rule does not restrict the covered holding company from entering into QFCs with its affiliates for hedging purposes nor does the final rule prohibit other affiliates from engaging in QFCs for hedging purposes and risk management.

The failure of a large financial organization that is a party to a material amount of third-party QFCs could pose a substantial risk to the stability of the U.S. financial system. The restriction on third-party QFCs would mitigate this threat to financial stability in two ways. First, covered holding companies' operating subsidiaries, which are parties to large quantities of QFCs, are expected to remain solvent under an SPOE resolution and not expected fail to meet any ordinary course payment or delivery obligations during a successful SPOE resolution. Therefore, assuming that the cross-default provisions of the QFCs engaged in by the operating subsidiaries of covered holding companies are appropriately structured, their QFC counterparties generally would have no contractual right to terminate or liquidate collateral on the basis of the covered holding company's entry into resolution proceedings.⁹⁶ Second, the covered holding companies themselves would have no QFCs with external counterparties, and so their entry into resolution proceedings would not result in QFC terminations and related fire sales. The restriction on third-party QFCs would therefore materially diminish the fire sale risk and contagion effects associated with the failure of a covered holding company.

For all these reasons, the final rule prohibits third-party QFC, provided that, as requested by commenters, the final rule clarifies that the prohibition on third-party QFCs does not include credit enhancements of QFCs. The clean holding company

⁹⁶ See Restrictions on Qualified Financial Contracts of Systemically Important U.S. Banking Organizations and the U.S. Operations of Systemically Important Foreign Banking Organizations; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions, 81 FR 29169 (May 11, 2016) (Board QFC Stay Proposal).

requirements of the final rule separately address the provision of credit support to QFCs (and other liabilities) by covered holding companies as described below.⁹⁷

C. Guarantees that Are Subject to Cross-Defaults (sections 252.64(a)(4) and 252.166(a)(3) of the final rule)

The proposal would have prohibited a covered holding company from guaranteeing (including by providing credit support) any liability between a direct or indirect subsidiary of the covered holding company and an external counterparty if the covered holding company's insolvency or entry into resolution (other than resolution under Title II of the Dodd-Frank Act) would have directly or indirectly provided the subsidiary's counterparty with a default right.⁹⁸

The proposed prohibition was intended to complement other work that has been done or is underway to facilitate resolution through the stay of cross-defaults, including the International Swaps and Derivatives Association (ISDA) 2014 Resolution Stay Protocol.⁹⁹ Commenters urged the Board to limit the scope of the prohibition on

⁹⁷ The final rule adds a new definition of “credit enhancement” to mean enhancement means a qualified financial contract of the type set forth in section 210(c)(8)(D)(ii)(XII), (iii)(X), (iv)(V), (v)(VI), or (vi)(VI) of Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. § 5390(c)(8)(D)(ii)(XII), (iii)(X), (iv)(V), (v)(VI), or (vi)(VI)) or a credit enhancement that the FDIC determines by regulation is a qualified financial contract pursuant to section 210(c)(8)(D)(i) of Title II of the act (12 U.S.C. § 5390(c)(8)(D)(i)).

⁹⁸ The proposal defined the term “default right” broadly.

⁹⁹ This protocol was subsequently replaced by the ISDA 2015 Universal Resolution Stay Protocol (ISDA Protocol). The ISDA Protocol and its annexes enable parties to amend the terms of their QFCs “to contractually recognize the cross-border application of special resolution regimes applicable to certain financial companies until comprehensive statutory regimes are adopted and to support the resolution of certain financial companies under the United States Bankruptcy Code.” Internal Swaps and Derivatives Association, ISDA 2015 Universal Resolution Stay Protocol *available at* <https://www2.isda.org/functional-areas/protocol-management/protocol/22>.

guarantees with cross defaults to those that are inconsistent with the Board's expected rule restricting default rights in QFCs or the ISDA Protocol. These commenters noted that the ISDA Protocol overrides cross-default rights in instruments subject to the ISDA Protocol with counterparties that have signed the ISDA Protocol if certain conditions are satisfied. These commenters argued that the prohibition in the proposed rule would be overbroad and unnecessary for any guarantees of instruments covered by the ISDA Protocol if the guaranteed subsidiary's counterparty had agreed to the ISDA Protocol. Some commenters argued that the exception to the guarantee prohibition should apply to all liabilities, even if the Board's expected stay rule only applied to QFCs. Some commenters also requested the Board delay imposing prohibitions on covered holding companies until regulations requiring stays of cross-default provisions in QFCs of banking organizations were finalized.

Commenters also argued that, even for instruments not subject to the same conditions as the ISDA Protocol, the prohibition in the proposal would be unnecessary in a resolution proceeding under Title II of the Dodd-Frank Act. Section 210(c)(16) of Title II gives the FDIC authority to override any cross-defaults if they are triggered by a covered BHC's insolvency or entry into resolution under Title II and certain conditions are satisfied.¹⁰⁰

As noted, the proposed prohibition on subsidiary guarantees with cross-defaults rights was intended to complement other efforts to facilitate SPOE resolution through the

¹⁰⁰ These commenters noted that the prohibition may likewise become unnecessary in a U.S. bankruptcy proceed if certain bills pending in both Houses of Congress are passed that would amend the Bankruptcy Code to override such cross-defaults if certain conditions are satisfied.

stay of cross-defaults, including the ISDA Protocol. Since the TLAC proposal was issued, the Board and other banking agencies (OCC and FDIC) have proposed QFC stay rules, which require covered holding companies and their subsidiaries to restrict the default rights of their QFCs that are subject to the rule.¹⁰¹ The QFC stay proposal issued by the Board would permit, under limited circumstances, covered holding companies to provide guarantees of their subsidiaries' covered QFCs with default rights based, directly or indirectly, on the resolution of the covered holding company (or another affiliate). The comment period to the proposed QFC stay rule closed on August 5, 2016, and the Board is considering the comments thereto.

To ensure consistent treatment of financial contracts among the Board's regulations, the final rule prohibits subsidiary guarantees with cross-default rights, but exempts guarantees subject to a rule of the Board restricting such defaults rights or any similar rule of another U.S. federal banking agency.¹⁰² Although the Board has not adopted a rule regarding cross-default provisions of financial contracts (including those regarding the applicability of Title II of the Dodd-Frank Act), this final rule leaves open the possibility that in the future certain guarantees would be permitted to the extent they are authorized under a rule of the Board or another federal banking agency.¹⁰³

¹⁰¹ Board QFC Stay Proposal; Mandatory Contractual Stay Requirements on Qualified Financial Contracts, 81 FR 55381 (Aug. 19, 2016); Restrictions on Qualified Financial Contracts of Certain FDIC-Supervised Institutions; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions, 81 FR 74326 (Oct. 26, 2016).

¹⁰² Liabilities would be considered "subject to" such a rule even if those liabilities were exempted from one or more of the requirements of the rule.

¹⁰³ Because QFCs subject to the final stay rule of the Board or other banking agencies are exempted from the prohibition, these QFCs would be required to conform to the stay rule on the time period specified therein.

Commenters also requested the Board confirm that the prohibition would only apply prospectively. The text of the regulation has been amended to clarify that the prohibition applies only to new agreements.

Finally, the scope of contracts subject to the exception will be co-extensive with the scope of contracts subject to the final stay rule, which the proposed stay rule specifically sought comment on, to align the Board's rulemakings with respect to these requirements. The prohibition under the final rule advances the key SPOE resolution goal of ensuring that a covered holding company's subsidiaries would continue to operate normally upon the covered holding company's entry into resolution. This goal would be jeopardized if the covered holding company's entry into resolution or insolvency operated as a default by the subsidiary and empowered the subsidiary's counterparties to take default-related actions, such as ceasing to perform under the contract or liquidating collateral. Were the counterparty to take such actions, the subsidiary could face liquidity, reputational, or other stress that could undermine its ability to continue operating normally, for instance by prompting a short-term funding run on the subsidiary. As in the proposal, guarantees by covered holding companies of liabilities that are not subject to such cross-default rights are unaffected by the final rule.

D. Upstream Guarantees and Offset Rights (sections 252.64(a)(2), (5) and 252.166(a)(2), (5) of the final rule)

The proposed rule would have prohibited covered holding companies from having outstanding liabilities that are subject to a guarantee from any direct or indirect subsidiary of the holding company. SPOE resolution is premised on the assumption that holders of eligible external TLAC will bear all losses incurred by the issuing covered holding

company on a consolidated basis while ensuring that its operating subsidiaries continue to operate normally. This arrangement could be undermined if a liability of the covered holding company is subject to an upstream guarantee, because the effect of such a guarantee is to expose the guaranteeing subsidiary (and, ultimately, its creditors) to the losses that would otherwise be imposed on the holding company's creditors. A prohibition on upstream guarantees would facilitate the SPOE resolution strategy by increasing the certainty that the covered holding company's eligible external TLAC holders will be exposed to loss ahead of the creditors of its subsidiaries.

Upstream guarantees do not appear to be common among covered holding companies. Section 23A of the Federal Reserve Act already limits the ability of a U.S. insured depository institution to issue guarantees on behalf of its parent holding company.¹⁰⁴ The principal effect of the prohibition would therefore be to prevent the future issuance of such guarantees by material non-bank subsidiaries. For these reasons, the final rule prohibits covered holding companies from having outstanding liabilities that are subject to a guarantee from any direct or indirect subsidiary.¹⁰⁵

For analogous reasons, the final rule prohibits covered holding companies from issuing an instrument if the holder of the instrument has a contractual right to offset its liabilities, or the liabilities of an affiliate of the holder, to the covered holding company's

¹⁰⁴ Transactions subject to the quantitative limits of section 23A of the Federal Reserve Act and Regulation W include guarantees issued by a bank on behalf of an affiliate. See 12 U.S.C. 371c(b)(7); 12 CFR 223.3(h).

¹⁰⁵ In response to comments, the regulatory text of the prohibition has been modified slightly from the proposed to clarify the prohibition only applies prospectively.

subsidiaries against the covered holding company's liability under the instrument.¹⁰⁶ The prohibition includes all such offset rights regardless of whether the right is provided in the instrument itself. Such offset rights are another device by which losses that are expected to flow to the covered holding company's external TLAC holders in an SPOE resolution could instead be imposed on operating subsidiaries and their creditors.

One commenter requested confirmation that this prohibition does not affect the ability of a subsidiary of the covered BHC to provide an offset right to a counterparty where the covered BHC has guaranteed the subsidiary's underlying obligations. In response, the prohibition in the final rule does not extend to offset rights provided by a subsidiary to its counterparties. However, as noted by the commenter, the prohibition does prevent a covered holding company from guaranteeing an obligation of its subsidiary if the guarantee may be offset against obligations of a subsidiary of the covered holding company.

E. Cap on Certain Liabilities (sections 252.64(b)-(c) and 252.166(b)-(c) of the final rule)

Cap on liabilities of Covered BHCs. As noted, the proposed rule would have limited the total value of certain other liabilities of covered BHCs to 5 percent of the value of the covered BHC's eligible external TLAC. The proposed cap would have applied to non-contingent, non-TLAC liabilities (that is, liabilities that were not eligible LTD) to third parties (i.e., persons that are not affiliates of the covered BHC) that would

¹⁰⁶ The prohibition for covered IHCs also includes contractual rights to offset against the covered IHC because the covered IHC itself may not enter resolution or insolvency proceedings.

rank either pari passu with or junior to the covered BHC's eligible LTD in the priority scheme of either the U.S. Bankruptcy Code or Title II.¹⁰⁷

The final rule generally adopts these requirements as proposed. To provide additional flexibility to covered BHCs, and for consistency with the treatment of covered IHCs (described below), the final rule adds a new provision to make clear that in the event the covered bank holding company chooses to contractually subordinate all of its long-term debt, there is no cap on the amount of its non-contingent liabilities.¹⁰⁸

Commenters requested that certain liabilities that could be loss-absorbing in an orderly resolution not count toward the 5 percent cap (i.e., not be "unrelated liabilities" under the proposal). Requests for exclusion included all equity, hybrid and long-term debt securities that can absorb losses without threatening financial stability. In particular, commenters urged that long term debt securities that contain any impermissible acceleration provisions, long-term debt securities governed by foreign law, long-term structured notes, and long term convertible debt securities and hybrid securities should not count as unrelated liabilities under the final rule. One commenter provided figures indicating that without these changes covered BHCs would have outstanding unrelated liabilities nearly 8 times over the 5 percent cap on January 1, 2019. This commenter recommended the Board allow at least a one year cure period for inadvertent breaches of the 5 percent cap.

As noted, debt issued on or before December 31, 2016, with standard acceleration clauses or under foreign law counts as eligible LTD for purposes of the LTD

¹⁰⁷ See 11 U.S.C. 507; 12 U.S.C. 5390(b).

¹⁰⁸ As discussed above, covered BHCs have the option under the final rule to structurally subordinate or contractually subordinate their long-term debt.

requirements and TLAC requirements of the final rule. As such, this outstanding debt is not an “unrelated liability” subject to the 5 percent cap under the final rule. Other forms of debt that do not count as eligible LTD under the final rule would continue to be subject to the cap under the final rule including debt instruments with derivative-linked features (i.e., structured notes); external vendor and operating liabilities, such as for utilities, rent, fees for services, and obligations to employees; and liabilities arising other than through a contract (e.g., liabilities created by a court judgment).¹⁰⁹ Covered BHCs will have until January 1, 2019, to conform these liabilities with the 5 percent cap.

The liabilities subject to the cap fall into two groups: those that could be subjected to losses alongside eligible external TLAC potentially without undermining SPOE resolution or financial stability, and those that potentially could not.

The first group includes structured notes. The final rule defines structured notes so as to avoid capturing debt instruments merely because the debt instrument is non-dollar denominated or pays interest based on the performance of a single index but to otherwise capture all debt instruments that have a principal amount, redemption amount, or stated maturity, that is subject to reduction based on the performance of any asset, entity, index, or embedded derivative or similar embedded feature.¹¹⁰ Such liabilities could be subjected to losses in resolution alongside eligible external TLAC, but the

¹⁰⁹ Commenters requested the Board clarify the scope of judgment liabilities that would be subject to the cap. In general, all administrative penalties and court judgments for which the covered BHC has completed any applicable appeals process would be included. The Board may address other questions regarding these kinds of liabilities based on the facts and circumstances of the liability.

¹¹⁰ In addition, the definition captures debt instruments that have more than one embedded derivative (or similar embedded feature) or are not treated as debt under generally accepted accounting principles.

proposal would cap them in light of their greater complexity relative to the plain-vanilla debt that qualifies as external TLAC. In an orderly resolution of a covered BHC, debt instruments that will be subjected to losses should be able to be valued accurately and with minimal risk of dispute. Structured notes contain features that could make their valuation uncertain, volatile, or unduly complex. Additionally, structured notes are often customer products sold to purchasers who are primarily seeking exposure to a particular asset class and not seeking credit exposure to the covered BHC, and the need to impose losses on a financial institution's customers in resolution may create obstacles to orderly resolution. The cap on structured notes promotes the resolvability of covered BHCs by limiting their issuance of instruments that present these issues.¹¹¹ The cap does not limit a covered BHC's ability to issue structured notes out of subsidiaries.

The second group includes, for example, vendor liabilities and obligations to employees. Successful resolution may require that the covered BHC continue to perform on certain of its unsecured liabilities in order to ensure that it is not cut off from vital services and resources. If these liabilities were *pari passu* with eligible external LTD, protecting these liabilities from loss would entail treating these liabilities differently from eligible external LTD of the same priority, which could present both operational and legal risk. The operational risk flows from the need to identify such liabilities quickly in the context of a complex resolution proceeding. The legal risk flows from the no-creditor-worse-off principle, according to which each creditor of a firm that enters resolution is entitled to recover at least as much as it would have if the firm had simply been

¹¹¹ *See also* discussion of structured notes in section II.E.3.a.

liquidated under chapter 7 of the U.S. Bankruptcy Code.¹¹² As creditors of a given priority receive special treatment (that is, as they are paid in full to ensure that the firm maintains access to vital external services and resources), the pool of resources available to other creditors of the same priority shrinks, making it more likely that those creditors will recover less than they would have in liquidation. Thus, imposing a cap on the total value of liabilities that are pari passu with or junior to eligible external TLAC but that might need to receive special treatment in resolution mitigates the no-creditor-worse-off risk.

As indicated in the preamble to the proposal to justify the calibration of the 5 percent cap, the Board collected data from U.S. GSIBs and determined that covered BHCs have outstanding certain third-party operational liabilities that may rank pari passu with eligible LTD and that could not be eliminated without substantial cost and complexity. These liabilities include (among other things) tax payables, compensation payables, and accrued benefit plan obligations. For the eight current U.S. GSIBs, the value of these operating liabilities ranges from 1 percent to 4 percent of the sum of the covered BHC's equity and long-term debt, which provides a reasonable proxy for the amount of eligible external TLAC that a covered BHC would have had under the proposal.

The 5 percent cap was calibrated to allow these existing operational liabilities to continue while limiting the growth of these and other liabilities at the covered BHC so that the problems discussed above may be avoided or mitigated. In particular, several covered BHCs may need to limit the value of structured notes that they have outstanding.

¹¹² See, e.g., 11 U.S.C. 1129(a)(7); 12 U.S.C. 5390(d)(2).

This result would be consistent with the overall rationale for the clean holding company requirements in the final rule because, as noted, such structured notes are not liabilities for the performance of vital services (for example, vendor liabilities) and because their presence at the holding company could create undue complexity during resolution. For these reasons, the rationale for the calibration remains appropriate and the expanded scope of debt that counts as eligible LTD, discussed above, should address the comments regarding calibration.

As in the proposal, the cap under the final rule does not apply to (1) eligible external TLAC; (2) instruments that were eligible external TLAC when issued and have ceased to be eligible (because their remaining maturity is less than one year) as long as the holder of the instrument does not have a currently exercisable put right; or (3) payables (such as dividend- or interest-related payables) that are associated with such liabilities. As described in the proposal, the cap on other third-party liabilities is intended to limit the amount of third party liabilities that should not be subjected to losses as part of an orderly resolution (e.g., vendor liabilities) relative to the amount of liabilities that both could be subjected to losses (e.g., LTD) and is *pari passu* with the liabilities that should not be subjected to losses. Imposing losses only on certain creditors within the same priority shrinks the pool of resources available to other creditors of the same priority and therefore makes it more likely that the distribution would conflict with the no-creditor-worse-off requirements of Title II of the Dodd-Frank Act and Chapter 11 of the U.S. Bankruptcy Code. The final rule also clarifies that if a covered BHC chooses to contractually subordinate all of its long-term debt, the cap on unrelated liabilities does not apply.

Cap on Liabilities of Covered IHCs. The proposal would not have applied the 5 percent cap to covered IHC's because internal LTD would have been contractually subordinated to all third-party liabilities of the covered IHC. Therefore, treating internal LTD differently from vendor liabilities and other third-party liabilities that had the potential to be important to a holding company following resolution would not have violated the no-creditor-worse-off principle. However, as described above, the final rule provides covered IHCs with the option to choose structural subordination or contractual subordination of external and internal long-term debt issued by covered IHCs, as requested by many commenters. The commenters that requested structural subordination generally recognized that covered IHCs that are permitted to adopt structural subordination would need to be subject to a cap in a manner similar to covered BHCs.

The final rule adopts different caps for non-resolution covered IHCs and resolution covered IHCs because resolution covered IHCs are able to issue eligible debt externally to third-parties under the final rule whereas non-resolution covered IHCs must issue eligible long-term debt internally to certain foreign affiliates. For non-resolution covered IHCs, the final rule provides that the aggregate amount of unrelated liabilities that a non-resolution covered IHC owes to persons that are not affiliates of the covered IHC may not exceed 5 percent of the covered IHC's total loss-absorbing capacity amount. The cap for non-resolution covered IHCs thus functions as a cap on unrelated liabilities to non-affiliates like the cap for covered BHCs. Some non-resolution covered IHCs may have external debt outstanding that would not count as eligible LTD (since these firms must issue internal LTD), the amount of which could be well above the 5 percent cap. Non-resolution covered IHCs have two years to conform any external debt

issuance to the requirements of the final rule. Contractual subordination is also available as another possible alternative for non-resolution covered IHCs to conform to the final rule.

The 5 percent cap for non-resolution covered IHCs does not include liabilities owed to foreign affiliates because the eligible long-term debt held by the parent FBO generally should convert to equity, either through actions of the parent or the Board. Therefore, in contrast to resolution covered IHCs (discussed below), concern about the short-term liabilities owed to the FBO parent or other affiliated parties is minimal.

In the case of resolution covered IHCs, the final rule adopts a cap equal to 5 percent of the covered IHC's total loss-absorbing capacity on the aggregate amount of unrelated liabilities that a resolution covered IHC may owe to any person other than a subsidiary of the covered IHC. The cap for resolution covered IHCs applies to unrelated liabilities owed to parents and sister affiliates, as well as third parties, because these IHCs have the option to issue external LTD. Thus, these firms may owe significant amounts of short-term debt or other unrelated liabilities to the FBO parent or another affiliate that would remain outstanding when the IHC enters resolution, because such entities are not anticipated to support the IHC under the resolution plan of the parent FBO.¹¹³ The cap on unrelated liabilities owed to parents and sister affiliates limits the amount of these liabilities that would remain outstanding upon the conversion of long-term debt to equity. Moreover, resolution covered IHCs could choose to issue all eligible LTD, whether internal or external, as contractually subordinated debt to avoid the cap altogether.

¹¹³ This inclusion of liabilities owed to parents of the resolution covered IHC also is on par with the cap on liabilities of covered BHCs, which would include liabilities held by shareholders of the covered BHC.

As with covered BHCs, debt issued prior to December 31, 2016 with standard acceleration clauses or issued under foreign law counts as eligible LTD for purposes of the LTD requirements and TLAC requirements of the final rule. As such, this outstanding debt would not be included as an unrelated liability subject to the cap under the final rule.

F. Disclosure Requirements (sections 252.65 and 252.167 of the final rule)

The final rule, like the proposal, requires each covered BHC to publicly disclose a description of the financial consequences to unsecured debtholders of the covered BHC's entry into a resolution proceeding in which the covered BHC is the only entity that would enter resolution. In addition, the final rule adopts a new section requiring resolution covered IHCs that issue external debt to be subject to the same disclosure requirement applicable to covered BHCs.

Consistent with the disclosure requirements imposed by the Board's capital rules, the covered BHC or covered IHC is permitted to make this disclosure on its website or in more than one public financial report or other public regulatory report, provided that the covered BHC or covered IHC publicly provides a summary table specifically indicating the location(s) of this disclosure.¹¹⁴ Because the disclosure requirement is primarily intended to inform holders of a covered BHC's or covered IHCs' eligible external LTD that they are subject to loss ahead of other creditors of the covered BHC or covered IHC or its subsidiaries, the proposal would also require the covered BHC or covered IHC to disclose the required information in the offering documents for all of its eligible external LTD.

¹¹⁴ See 12 CFR 217.62(a), 12 CFR 217.172(c)(1).

A few commenters argued that comprehensive and clear disclosure is essential to ensure that potential investors are fully informed of the risks of the long-term debt and aware of potential losses. These commenters contended that the risks of misleading investors without such meaningful disclosure could lead to investors grossly underpricing the risk of these new instruments. Certain commenters recommended that the Board prescribe text for a specific warning about the nature of the debt and only allow the debt to be sold to qualified, sophisticated investors. One commenter, for example, urged the Board to mandate comprehensive, plain English disclosures to accompany this new debt with a front page warning in large red lettering to make clear in one sentence “If the bank fails, your full investment is subject to a complete loss.” A few commenters also suggested that the contract should describe expressly how and when the regulators could or would convert the debt, including the possible future scenarios where this debt might become convertible in Title I bankruptcy. One commenter argued that unless the Board specifies the circumstances and mechanism by which this unsecured debt will absorb losses, the mere disclosure of an “expectation” that this debt will absorb losses will be insufficient to force holders of the debt to take this expectation seriously and price for risk accordingly. Another commenter recommended that the required disclosure should include a list of liabilities of both eligible and non-eligible TLAC, and its relative position in the creditor hierarchy.

The Board has long supported meaningful public disclosure by banking organizations, with the objective of improving market discipline and encouraging sound risk-management practices.¹¹⁵ By helping holders of eligible external LTD and other

¹¹⁵ See, e.g., 78 FR 62018, 62128-29 (October 11, 2013).

unsecured debt issued by a covered BHC or covered IHC to understand that they will be allowed to suffer losses in a resolution and generally will absorb losses ahead of the creditors of the covered BHC or covered IHC's subsidiaries, the disclosure requirement of the final rule should encourage potential investors to carefully assess the covered BHC or covered IHC's risk profile when making investment decisions. This careful assessment should lead to an improvement in the market pricing of the unsecured debt of covered BHCs and covered IHCs, including eligible external LTD, providing supervisors and market participants with more accurate market signals about the financial condition and risk profile of the covered BHC or covered IHC. In response to comments, the final rule does not specify the exact circumstances under which eligible LTD will convert to equity—such a provision would be inconsistent with the intent and purpose of the final rule that such debt be available to absorb losses in a flexible manner. However, the final rule states that the Board may order that internal debt be converted into equity only if the Board determines that the covered IHC is in default or danger of default.

V. Regulatory Capital Deduction for Investments in the Unsecured Debt of Covered BHCs

The final rule does not include the proposal's requirement for a Board-regulated institution to deduct from its regulatory capital the amount of any investment in, or exposure to, unsecured debt issued by a covered BHC, including unsecured debt instruments that do not qualify as eligible external LTD. A number of comments urged the Board to, among other things, increase or have separate thresholds for deductions of unsecured debt holdings, allow for deductions of the unsecured debt holdings to be applied to outstanding eligible external LTD instead of regulatory capital, and recognize

an exemption for market-making activity in the debt instruments. Certain commenters recommended that the Board postpone the effective date of these requirements.

The Board is considering these comments, as well as a recent standard related to the regulatory capital treatment of TLAC holdings that was issued by the BCBS.¹¹⁶ The Board intends to work with the OCC and FDIC towards a proposed interagency approach regarding the regulatory capital treatment of debt instruments issued by covered BHCs.

VI. Transition Periods

Under the proposal, the Board generally would have required covered BHCs to achieve compliance with the rule as of January 1, 2019. However, the proposal would have phased in the risk-weighted assets component of the external TLAC requirement in two stages: 16 percent effective January 1, 2019 and 18 percent effective January 1, 2022.

Similarly, under the proposal, the Board generally would have required covered IHCs to achieve compliance as of January 1, 2019. However, the proposal would have phased in the risk-weighted assets component of the internal TLAC requirement applicable to resolution covered IHCs in the same manner as for covered BHCs: 16 percent effective January 1, 2019 and 18 percent effective January 1, 2022.

Certain commenters requested that the leverage component of TLAC be subject to a phase-in until January 1, 2022, like the risk-weighted asset component under the proposal and consistent with the FSB standard. Other commenters urged the Board to adopt a phase-in period for LTD in the final rule or delay other aspects of the proposal.

¹¹⁶ Basel Committee on Banking Supervision, Standard TLAC Holdings Amendments to the Basel III standard on the definition of capital (October 2016), available at: <https://www.bis.org/bcbs/publ/d387.pdf>.

Other than the certification regarding resolution strategy for FBO GSIBs that is due on June 30, 2017, the requirements of the final rule will become effective on January 1, 2019, which will give firms approximately two years from the date of the issuance of the final rule to comply. In this respect, the final rule eliminates the proposed January 1, 2022, phase-in for the risk-weighted asset component of the TLAC requirements. The Board has monitored the shortfalls of covered firms as described above and noted significant declines in the amount of additional capital and long-term debt necessary to meet the requirements of the final rule. Based on available information and given the relatively small estimated shortfalls, requiring full compliance by 2019 should have only a modest incremental impact. In particular, the phase-in period was provided in part to allow firms additional time to adjust their capital structures and issue additional long-term debt. Furthermore, the final rule will grandfather a significant portion of outstanding long-term debt that would not otherwise qualify as eligible internal or external LTD, which significantly reduces the additional time necessary for firms to come into full compliance with the rule.

Consistent with the proposal, firms that become covered BHCs after the date on which the final rule is issued will be required to comply with it on the later of three years after becoming covered BHCs and the effective date applicable to firms that are covered BHCs as of the date on which the final rule is issued.

Also consistent with the proposal, an intermediate holding company controlled by a foreign banking organization becomes subject to the requirements of the final rule on the later of January 1, 2019, and three years from the date on which the foreign banking organization becomes a foreign GSIB and the foreign banking organization is required to

establish an intermediate holding company pursuant to section 252.153 of Regulation YY.

VII. Consideration of Domestic Internal TLAC Requirements and Public Reporting Requirements for Eligible Internal TLAC and LTD

In the proposed rule, the Board indicated that it intends to propose for public comment a requirement that covered BHCs and covered IHCs report publicly their amounts of TLAC and LTD on a regular basis. The Board also indicated its consideration of imposing domestic internal TLAC requirements between certain holding companies and their subsidiaries to ensure firms have in place adequate mechanisms for transferring severe losses up to their operating subsidiaries from the holding company. Such requirements would complement this final rule and enhance the prospects for a successful SPOE resolution of a covered BHC or of the parent foreign GSIB of a covered IHC. The Board received a number of comments on potential public reporting and eligible internal TLAC and LTD requirements. If the Board determines that it would be appropriate to propose public reporting requirements related to TLAC and LTD, or domestic internal TLAC requirements, the Board will invite public comment at that time.

VIII. Regulatory Analysis

A. Paperwork Reduction Act

Certain provisions of the final rule contain “collection of information” requirements within the meaning of the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501 through 3521). The Board reviewed the final rule under the authority delegated to the Board by OMB. The disclosure requirements are found in § 252.65 and § 252.167 and the reporting requirements are found in § 252.153(b)(5) and 252.164.

These information collection requirements would implement section 165 of the Dodd Frank Act, as described in the Abstract below. In accordance with the requirements of the PRA, the Board may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The OMB control number for this collection is 7100–0350.

The final rule would revise the Reporting, Recordkeeping, and Disclosure Requirements Associated with Enhanced Prudential Standards (Regulation YY) (Reg YY; OMB No. 7100-0350). In addition, as permitted by the PRA, the Board is extending for three years, with revision, the Reporting, Recordkeeping, and Disclosure Requirements Associated with Enhanced Prudential Standards (Regulation YY) (Reg YY; OMB No. 7100-0350). The Board received no comments on the PRA.

The Board has a continuing interest in the public’s opinions of collections of information. At any time, commenters may submit comments regarding the burden estimate, or any other aspect of this collection of information, including suggestions for reducing the burden to the ADDRESS section. All comments will become a matter of public record. A copy of the comments may also be submitted to the OMB desk officer: By mail to U.S. Office of Management and Budget, 725 17th Street NW, #10235, Washington, DC 20503 or by facsimile to 202-395-5806, Attention, Federal Reserve Desk Officer.

Revision, with Extension, of the Following Information Collection

Title of Information Collection: Reporting, Recordkeeping, and Disclosure Requirements Associated with Enhanced Prudential Standards (Regulation YY).

Agency Form Number: Reg YY.

OMB Control Number: 7100–0350.

Frequency of Response: Annual, semiannual, quarterly, one-time, and on occasion.

Affected Public: Businesses or other for-profit.

Respondents: State member banks, U.S. bank holding companies, savings and loan holding companies, nonbank financial companies, foreign banking organizations, U.S. intermediate holding companies, foreign saving and loan holding companies, and foreign nonbank financial companies supervised by the Board.

Abstract: Section 165 of the Dodd-Frank Act requires the Board to implement enhanced prudential standards for bank holding companies with total consolidated assets of \$50 billion or more, including global systemically important foreign banking organizations with \$50 billion or more in U.S. non-branch assets. Section 165 of the Dodd-Frank Act also permits the Board to establish such other prudential standards for such banking organizations as the Board determines are appropriate.

Disclosure Requirements

Section 252.65 of the final rule would require a U.S. global systemically important BHC to publicly disclose a description of the financial consequences to unsecured debtholders of the global systemically important BHC entering into a resolution proceeding in which the global systemically important BHC is the only entity that would be subject to the resolution proceeding. A global systemically important BHC must provide the disclosure required of this section: (1) in the offering documents for all of its eligible debt securities; and (2) either on the global systemically important BHC's website, or in more than one public financial report or other regulatory reports, provided

that the global systemically important BHC publicly provides a summary table specifically indicating the location(s) of this disclosure. Section 252.167 of the final rule would impose these requirements on certain intermediate holding companies of non-U.S. global systemically important BHC that issue long term debt to third parties.

Reporting Requirements

Section 252.153(b)(5) of the final rule would require each top-tier foreign banking organization that controls a U.S. intermediate holding company to submit to the Board by January 1 of each calendar year through the U.S. intermediate holding company: (1) notice of whether the home country supervisor (or other appropriate home country regulatory authority) of the top-tier foreign banking organization of the U.S. intermediate holding company has adopted standards consistent with the BCBS assessment methodology for identifying global systemically important banking organizations; and (2) notice of whether the top-tier foreign banking organization prepares or reports the indicators used by the BCBS assessment methodology to identify a banking organization as a global systemically important banking organization and, if it does, whether the top-tier foreign banking organization has determined that it has the characteristics of a global systemically important banking organization under the BCBS assessment methodology.

Section 252.164 of the final rule would require each top-tier global systemically important foreign banking organization with U.S. non-branch assets that equal or exceed \$50 billion to submit to the Board a certification indicating whether the planned resolution strategy of the top-tier foreign banking organization involves the U.S. intermediate holding company or its subsidiaries entering resolution, receivership, insolvency, or similar proceedings in the United States. The rule requires the top-tier

foreign banking organization to update this certification when its resolution strategy changes.

Estimated Paperwork Burden for Proposed Revisions

Estimated Number of Respondents:

Disclosure Burden

Section 252.65 – 8 respondents.

Section 252.167 – 3 respondents.

Reporting Burden

Section 252.153(b)(5) – 15 respondents.

Section 252.164 – 8 respondents.

Estimated Burden per Response

Disclosure Burden

Section 252.65 – 1 hour (annual), 5 hours (one-time burden).

Section 252.167 – 1 hour (annual), 5 hours (one-time burden).

Reporting Burden

Section 252.153(b)(5) – 10 hours (annual).

Section 252.164 – 10 hours.

Total estimated one-time burden: 55 hours.

Current estimated annual burden for Reporting, Recordkeeping, and Disclosure Requirements

Associated with Enhanced Prudential Standards (Regulation YY): 118,546 hours.

Proposed revisions estimated annual burden: 241 hours.

Total estimated annual burden: 118,842 hours.

B. Regulatory Flexibility Act

The Regulatory Flexibility Act, 5 U.S.C. 601 et seq. (RFA), generally requires that an agency prepare and make available an initial regulatory flexibility analysis in connection with a notice of proposed rulemaking.

The Board solicited public comment on this rule in a notice of proposed rulemaking¹¹⁷ and has since considered the potential impact of this rule on small entities in accordance with section 604 of the RFA. Based on the Board's analysis, and for the reasons stated below, the Board believes the final rule will not have a significant economic impact on a substantial number of small entities.

Under regulations issued by the Small Business Administration, a small entity includes a depository institution, bank holding company, or savings and loan holding company with assets of \$550 million or less (small banking organizations).¹¹⁸ As of June 30, 2016, there were approximately 3,203 top-tier small bank holding companies. As the threshold for forming an intermediate holding company in the United States is \$50 billion in total U.S. non-branch assets, there would be no small covered IHCs.

1. *Statement of the need for, and objectives of the final rule.*

As discussed in the supplementary information, the final rule is designed to improve the resolvability of covered BHCs and covered IHCs by requiring such institutions maintain outstanding a minimum amount of loss-absorbing instruments, including a minimum amount of unsecured long-term debt, and imposing restrictions on the corporate practices and liabilities of such organizations. The Board is not finalizing

¹¹⁷ 80 FR 74,926 (Nov. 30, 2015).

¹¹⁸ See 13 CFR 121.201. Effective July 14, 2014, the Small Business Administration revised the size standards for banking organizations to \$550 million in assets from \$500 million in assets. 79 FR 33647 (June 12, 2014).

at this time the provisions of the proposed rule that would have required small state member banks and certain SLHCs and BHCS to make deductions from regulatory capital for investments in eligible external long-term debt of covered BHCs. As such, the final rule will only apply to entities that are not small entities as further explained below.

2. *Summary of the significant issues raised by public comment on the Board's initial analysis, the Board's assessment of any such issues, and a result of such comments.*

The Board did not receive a comments to the initial regulatory flexibility analysis relating to the elements of the proposal that are being finalized at this time. The final rule does not impact small entities as described below.

3. *Small entities affected by the final rule and compliance requirements.*

The provisions of the final rule will apply to a top-tier bank holding company domiciled in the United States with \$50 billion or more in total consolidated assets and has been identified as a GSIB, and to a U.S. intermediate holding company of a foreign GSIB. Bank holding companies and U.S. intermediate holding companies of foreign GSIBs that are subject to the proposed rule therefore substantially exceed the \$550 million asset threshold at which a banking entity would qualify as a small banking organization.

4. *Significant alternatives to the final rule.*

In light of the foregoing, the Board does not believe that this final rule will have a significant negative economic impact on any small entities and therefore believes that there are no significant alternatives to the final rule that would reduce the impact on small entities.

C. Invitation for Comments on Use of Plain Language

Section 722 of the Gramm-Leach Bliley Act of 1999 requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The Board received no comments on these matters and believes that the final rule is written plainly and clearly.

List of Subjects

12 CFR Part 252

12 CFR Chapter II

Administrative practice and procedure, Banks, banking, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities.

Authority and Issuance

For the reasons stated in the SUPPLEMENTARY INFORMATION, the Board amends part 252 of chapter II of title 12 of the Code of Federal Regulations as follows:

PART 252—ENHANCED PRUDENTIAL STANDARDS (REGULATION YY).

1. The authority citation for part 252 is revised to read as follows:

AUTHORITY: 12 U.S.C. 321-338a, 481-486, 1467a(g), 1818, 1828, 1831n, 1831o, 1831p–l, 1831w, 1835, 1844(b), 1844(c), 3904, 3906-3909, 4808, 5361, 5365, 5366, 5367, 5368, 5371.

2. In § 252.2, redesignate paragraphs (i) through (m) as paragraphs (j) through (n), redesignate paragraphs (n) through (s) as (u) through (z), and redesignate (t) through (z) as paragraphs (bb) through (hh); and add new paragraphs (i), (o) through (t), and (aa).

The additions read as follows:

§ 252.2 Definitions.

* * * * *

(i) Credit enhancement means a qualified financial contract of the type set forth in section 210(c)(8)(D)(ii)(XII), (iii)(X), (iv)(V), (v)(VI), or (vi)(VI) of Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. § 5390(c)(8)(D)(ii)(XII), (iii)(X), (iv)(V), (v)(VI), or (vi)(VI)) or a credit enhancement that the Federal Deposit Insurance Corporation determines by regulation is a qualified financial contract pursuant to section 210(c)(8)(D)(i) of Title II of the act (12 U.S.C. § 5390(c)(8)(D)(i)).

* * * * *

(o) Global methodology means the assessment methodology and the higher loss absorbency requirement for global systemically important banks issued by the Basel Committee on Banking Supervision, as updated from time to time.

(p) Global systemically important banking organization means a global systemically important bank, as such term is defined in the global methodology.

(q) Global systemically important foreign banking organization means a top-tier foreign banking organization that is identified as a global systemically important foreign banking organization under § 252.153(b)(4) of this part.

(r) Home country, with respect to a foreign banking organization, means the country in which the foreign banking organization is chartered or incorporated.

(s) Home country resolution authority, with respect to a foreign banking organization, means the governmental entity or entities that under the laws of the foreign

banking organization's home county has responsibility for the resolution of the top-tier foreign banking organization.

(t) Home country supervisor, with respect to a foreign banking organization, means the governmental entity or entities that under the laws of the foreign banking organization's home county has responsibility for the supervision and regulation of the top-tier foreign banking organization.

* * * * *

(aa) Top-tier foreign banking organization, with respect to a foreign bank, means the top-tier foreign banking organization or, alternatively, a subsidiary of the top-tier foreign banking organization designated by the Board.

* * * * *

3. Add subpart G to read as follows:

Subpart G – External Long-term Debt Requirement, External Total Loss-absorbing Capacity Requirement and Buffer, and Restrictions on Corporate Practices for U.S. Global Systemically Important Banking Organizations

Sec.

252.60 Applicability.

252.61 Definitions.

252.62 External long-term debt requirement.

252.63 External total loss-absorbing capacity requirement and buffer.

252.64 Restrictions on corporate practices of U.S. global systemically important banking organizations.

252.65 Disclosure requirements.

§ 252.60 Applicability.

(a) General applicability. This subpart applies to any U.S. bank holding company that is identified as a global systemically important BHC.

(b) Initial applicability. A global systemically important BHC shall be subject to the requirements of this subpart beginning on the later of:

(1) January 1, 2019; or

(2) 1095 days (three years) after the date on which the company becomes a global systemically important BHC.

§ 252.61 Definitions.

For purposes of this subpart:

Additional tier 1 capital has the same meaning as in 12 CFR 217.20(c).

Common equity tier 1 capital has the same meaning as in 12 CFR 217.20(b).

Common equity tier 1 capital ratio has the same meaning as in 12 CFR 217.10(b)(1) and 12 CFR 217.10(c), as applicable.

Common equity tier 1 minority interest has the same meaning as in 12 CFR 217.2.

Default right (1) Means any:

(i) Right of a party, whether contractual or otherwise (including rights incorporated by reference to any other contract, agreement or document, and rights afforded by statute, civil code, regulation and common law), to liquidate, terminate, cancel, rescind, or accelerate the agreement or transactions thereunder, set off or net amounts owing in respect thereto (except rights related to same-day payment netting), exercise remedies in respect of collateral or other credit support or property related

thereto (including the purchase and sale of property), demand payment or delivery thereunder or in respect thereof (other than a right or operation of a contractual provision arising solely from a change in the value of collateral or margin or a change in the amount of an economic exposure), suspend, delay or defer payment or performance thereunder, modify the obligations of a party thereunder or any similar rights; and

(ii) Right or contractual provision that alters the amount of collateral or margin that must be provided with respect to an exposure thereunder, including by altering any initial amount, threshold amount, variation margin, minimum transfer amount, the margin value of collateral or any similar amount, that entitles a party to demand the return of any collateral or margin transferred by it to the other party or a custodian or that modifies a transferee's right to reuse collateral or margin (if such right previously existed), or any similar rights, in each case, other than a right or operation of a contractual provision arising solely from a change in the value of collateral or margin or a change in the amount of an economic exposure; and

(2) Does not include any right under a contract that allows a party to terminate the contract on demand or at its option at a specified time, or from time to time, without the need to show cause.

Discretionary bonus payment has the same meaning as under 12 CFR 217.2.

Distribution has the same meaning as under 12 CFR 217.2.

Global systemically important BHC has the same meaning as in 12 CFR 217.2.

Eligible debt security means, with respect to a global systemically important BHC:

(1) a debt instrument that:

- (i) Is paid in, and issued by the global systemically important BHC;
 - (ii) Is not secured, not guaranteed by the global systemically important BHC or a subsidiary of the global systemically important BHC, and is not subject to any other arrangement that legally or economically enhances the seniority of the instrument;
 - (iii) Has a maturity of greater than or equal to 365 days (one year) from the date of issuance;
 - (iv) Is governed by the laws of the United States or any State thereof;
 - (v) Does not provide the holder of the instrument a contractual right to accelerate payment of principal or interest on the instrument, except a right that is exercisable on one or more dates that are specified in the instrument or in the event of (A) a receivership, insolvency, liquidation, or similar proceeding of the global systemically important BHC or (B) a failure of the global systemically important BHC to pay principal or interest on the instrument when due and payable that continues for 30 days or more;
 - (vi) Does not have a credit-sensitive feature, such as an interest rate that is reset periodically based in whole or in part on the global systemically important BHC's credit quality, but may have an interest rate that is adjusted periodically independent of the global systemically important BHC's credit quality, in relation to general market interest rates or similar adjustments;
 - (vii) Is not a structured note; and
 - (viii) Does not provide that the instrument may be converted into or exchanged for equity of the global systemically important BHC; and
- (2) A debt instrument issued prior to December 31, 2016 that:
- (i) Is paid in, and issued by the global systemically important BHC;

(ii) Is not secured, not guaranteed by the global systemically important BHC or a subsidiary of the global systemically important BHC, and is not subject to any other arrangement that legally or economically enhances the seniority of the instrument;

(iii) Has a maturity of greater than or equal to 365 days (one year) from the date of issuance;

(iv) Does not have a credit-sensitive feature, such as an interest rate that is reset periodically based in whole or in part on the global systemically important BHC's credit quality, but may have an interest rate that is adjusted periodically independent of the global systemically important BHC's credit quality, in relation to general market interest rates or similar adjustments;

(v) Is not a structured note; and

(vi) Does not provide that the instrument may be converted into or exchanged for equity of the global systemically important BHC.

External TLAC buffer means, with respect to a global systemically important BHC, the sum of 2.5 percent, any applicable countercyclical capital buffer under 12 CFR 217.11(b) (expressed as a percentage), and the global systemically important BHC's method 1 capital surcharge.

GAAP means generally accepted accounting principles as used in the United States.

GSIB surcharge has the same meaning as in 12 CFR 217.2.

Method 1 capital surcharge means, with respect to a global systemically important BHC, the most recent method 1 capital surcharge (expressed as a percentage) the global systemically important BHC was required to calculate pursuant to subpart H of Regulation Q (12 CFR 217.400 through 217.406).

Outstanding eligible external long-term debt amount is defined in § 252.62(b).

Person has the same meaning as in 12 CFR 225.2.

Qualified financial contract has the same meaning as in § 210(c)(8)(D) of Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5390(c)(8)(D)).

Structured note means a debt instrument that:

(1) Has a principal amount, redemption amount, or stated maturity that is subject to reduction based on the performance of any asset, entity, index, or embedded derivative or similar embedded feature;

(2) Has an embedded derivative or similar embedded feature that is linked to one or more equity securities, commodities, assets, or entities;

(3) Does not specify a minimum principal amount that becomes due upon acceleration or early termination; or

(4) Is not classified as debt under GAAP, provided that an instrument is not a structured note solely because it is one or both of the following:

(i) An instrument that is not denominated in U.S. dollars; or

(ii) An instrument where interest payments are based on an interest rate index.

Supplementary leverage ratio has the same meaning as in 12 CFR 217.10(c)(4).

Tier 1 minority interest has the same meaning as in 12 CFR 217.2.

Tier 2 capital has the same meaning as in 12 CFR 217.20(d).

Total leverage exposure has the same meaning as in 12 CFR 217.10(c)(4)(ii).

Total risk-weighted assets means the greater of total risk-weighted assets as calculated under 12 CFR 217, subpart D (the standardized approach) or 12 CFR 217, subpart E (the internal ratings-based and advanced measurement approaches).

§ 252.62 External long-term debt requirement.

(a) External long-term debt requirement. Except as provided under paragraph (c) of this section, a global systemically important BHC must maintain an outstanding eligible external long-term debt amount that is no less than the amount equal to the greater of:

(1) The global systemically important BHC's total risk-weighted assets multiplied by the sum of 6 percent plus the global systemically important BHC's GSIB surcharge (expressed as a percentage); and

(2) 4.5 percent of the global systemically important BHC's total leverage exposure.

(b) Outstanding eligible external long-term debt amount. (1) A global systemically important BHC's outstanding eligible external long-term debt amount is the sum of:

(i) One hundred (100) percent of the amount due to be paid of unpaid principal of the outstanding eligible debt securities issued by the global systemically important BHC in greater than or equal to 730 days (two years);

(ii) Fifty (50) percent of the amount due to be paid of unpaid principal of the outstanding eligible debt securities issued by the global systemically important BHC in greater than or equal to 365 days (one year) and less than 730 days (two years); and

(iii) Zero (0) percent of the amount due to be paid of unpaid principal of the outstanding eligible debt securities issued by the global systemically important BHC in less than 365 days (one year).

(2) For purposes of paragraph (b)(1) of this section, the date on which principal is due to be paid on an outstanding eligible debt security is calculated from the earlier of:

(i) The date on which payment of principal is required under the terms governing the instrument, without respect to any right of the holder to accelerate payment of principal; and

(ii) The date the holder of the instrument first has the contractual right to request or require payment of the amount of principal, provided that, with respect to a right that is exercisable on one or more dates that are specified in the instrument only on the occurrence of an event (other than an event of a receivership, insolvency, liquidation, or similar proceeding of the global systemically important BHC, or a failure of the global systemically important BHC to pay principal or interest on the instrument when due), the date for the outstanding eligible debt security under this paragraph (b)(2)(ii) will be calculated as if the event has occurred.

(3) After notice and response proceedings consistent with 12 CFR Part 263, Subpart E, the Board may order a global systemically important BHC to exclude from its outstanding eligible long-term debt amount any debt security with one or more features that would significantly impair the ability of such debt security to take losses.

(c) Redemption and repurchase. A global systemically important BHC may not redeem or repurchase any outstanding eligible debt security without the prior approval of the Board if, immediately after the redemption or repurchase, the global systemically

important BHC would not meet its external long-term debt requirement under paragraph (a) of this section, or its external total loss-absorbing capacity requirement under § 252.63(a).

§ 252.63 External total loss-absorbing capacity requirement and buffer.

(a) External total loss-absorbing capacity requirement. A global systemically important BHC must maintain an outstanding external total loss-absorbing capacity amount that is no less than the amount equal to the greater of:

(1) 18 percent of the global systemically important BHC's total risk-weighted assets; and

(2) 7.5 percent of the global systemically important BHC's total leverage exposure.

(b) Outstanding external total loss-absorbing capacity amount. A global systemically important BHC's outstanding external total loss-absorbing capacity amount is the sum of:

(1) The global systemically important BHC's common equity tier 1 capital (excluding any common equity tier 1 minority interest);

(2) The global systemically important BHC's additional tier 1 capital (excluding any tier 1 minority interest); and

(3) The global systemically important BHC's outstanding eligible external long-term debt amount plus 50 percent of the amount due to be paid of unpaid principal of outstanding eligible debt securities issued by the global systemically important BHC in, as calculated in § 252.62(b)(2), greater than or equal to 365 days (one year) but less than 730 days (two years).

(c) External TLAC buffer—(1) Composition of the External TLAC risk-weighted buffer. The external TLAC risk-weighted buffer is composed solely of common equity tier 1 capital.

(2) Definitions. For purposes of this paragraph, the following definitions apply:

(i) Eligible retained income. The eligible retained income of a global systemically important BHC is the global systemically important BHC's net income for the four calendar quarters preceding the current calendar quarter, based on the global systemically important BHC's FR Y-9C, net of any distributions and associated tax effects not already reflected in net income. Net income, as reported in the FR Y-9C, reflects discretionary bonus payments and certain distributions that are expense items (and their associated tax effects).

(ii) Maximum external TLAC risk-weighted payout ratio. The maximum external TLAC risk-weighted payout ratio is the percentage of eligible retained income that a global systemically important BHC can pay out in the form of distributions and discretionary bonus payments during the current calendar quarter. The maximum external TLAC risk-weighted payout ratio is based on the global systemically important BHC's external TLAC risk-weighted buffer level, calculated as of the last day of the previous calendar quarter, as set forth in Table 1 to § 252.63.

(iii) Maximum external TLAC risk-weighted payout amount. A global systemically important BHC's maximum external TLAC risk-weighted payout amount for the current calendar quarter is equal to the global systemically important BHC's eligible retained income, multiplied by the applicable maximum external TLAC risk-weighted payout ratio, as set forth in Table 1 to § 252.63.

(iv) Maximum external TLAC leverage payout ratio. The maximum external TLAC leverage payout ratio is the percentage of eligible retained income that a global systemically important BHC can pay out in the form of distributions and discretionary bonus payments during the current calendar quarter. The maximum external TLAC leverage payout ratio is based on the global systemically important BHC's external TLAC leverage buffer level, calculated as of the last day of the previous calendar quarter, as set forth in Table 2 to § 252.63.

(v) Maximum external TLAC leverage payout amount. A global systemically important BHC's maximum external TLAC leverage payout amount for the current calendar quarter is equal to the global systemically important BHC's eligible retained income, multiplied by the applicable maximum TLAC leverage payout ratio, as set forth in Table 2 to § 252.63.

(3) Calculation of the external TLAC risk-weighted buffer level. (i) A global systemically important BHC's external TLAC risk-weighted buffer level is equal to the global systemically important BHC's common equity tier 1 capital ratio (expressed as a percentage) minus the greater of zero and the following amount:

(A) 18 percent; minus

(B) The ratio (expressed as a percentage) of the global systemically important BHC's additional tier 1 capital (excluding any tier 1 minority interest) to its total risk-weighted assets; and minus

(C) The ratio (expressed as a percentage) of the global systemically important BHC's outstanding eligible external long-term debt amount to total risk-weighted assets.

(ii) Notwithstanding paragraph (c)(3)(i) of this section, if the ratio (expressed as a percentage) of a global systemically important BHC's external total loss-absorbing capacity amount as calculated under paragraph (b) of this section to its risk-weighted assets is less than or equal to 18 percent, the global systemically important BHC's external TLAC risk-weighted buffer level is zero.

(4) Limits on distributions and discretionary bonus payments. (i) A global systemically important BHC shall not make distributions or discretionary bonus payments or create an obligation to make such distributions or payments during the current calendar quarter that, in the aggregate, exceed the maximum external TLAC risk-weighted payout amount or the maximum external TLAC leverage payout amount.

(ii) A global systemically important BHC with an external TLAC risk-weighted buffer level that is greater than the external TLAC risk-weighted buffer and an external TLAC leverage buffer that is greater than 2.0 percent, in accordance with paragraph (c)(5) of this section, is not subject to a maximum external TLAC risk-weighted payout amount or a maximum external TLAC leverage payout amount.

(iii) Except as provided in paragraph (c)(4)(iv) of this section, a global systemically important BHC may not make distributions or discretionary bonus payments during the current calendar quarter if the global systemically important BHC's:

(A) Eligible retained income is negative; and

(B) External TLAC risk-weighted buffer level was less than the external TLAC risk-weighted buffer as of the end of the previous calendar quarter or external TLAC leverage buffer level was less than 2.0 percent as of the end of the previous calendar quarter.

(iv) Notwithstanding the limitations in paragraphs (c)(4)(i) through (iii) of this section, the Board may permit a global systemically important BHC to make a distribution or discretionary bonus payment upon a request of the global systemically important BHC, if the Board determines that the distribution or discretionary bonus payment would not be contrary to the purposes of this section, or to the safety and soundness of the global systemically important BHC. In making such a determination, the Board will consider the nature and extent of the request and the particular circumstances giving rise to the request.

(v) (A) A global systemically important BHC is subject to the lowest of the maximum payout amounts as determined under 12 CFR 217.11(a)(2), the maximum external TLAC risk-weighted payout amount as determined under this paragraph, and the maximum external TLAC leverage payout amount as determined under this paragraph.

(B) Additional limitations on distributions may apply to a global systemically important BHC under 12 CFR 225.4, 225.8, and 263.202.

(5) External TLAC leverage buffer. (i) General. A global systemically important BHC is subject to the lower of the maximum external TLAC risk-weighted payout amount as determined under paragraph (c)(2)(iii) of this section and the maximum external TLAC leverage payout amount as determined under paragraph (c)(2)(v) of this section.

(ii) Composition of the external TLAC leverage buffer. The external TLAC leverage buffer is composed solely of tier 1 capital.

(iii) Calculation of the external TLAC leverage buffer level. (A) A global systemically important BHC's external TLAC leverage buffer level is equal to the global

systemically important BHC's supplementary leverage ratio (expressed as a percentage) minus the greater of zero and the following amount:

(1) 7.5 percent; minus

(2) The ratio (expressed as a percentage) of the global systemically important BHC's outstanding eligible external long-term debt amount to total leverage exposure.

(B) Notwithstanding paragraph (c)(5)(iii) of this section, if the ratio (expressed as a percentage) of a global systemically important BHC's external total loss-absorbing capacity amount as calculated under paragraph (b) of this section to its total leverage exposure is less than or equal to 7.5 percent, the global systemically important BHC's external TLAC leverage buffer level is zero.

Table 1 to § 252.63: Calculation of Maximum External TLAC Risk-Weighted Payout Amount

External TLAC risk-weighted buffer level	Maximum External TLAC risk-weighted payout ratio (as a percentage of eligible retained income)
Greater than the external TLAC risk-weighted buffer	No payout ratio limitation applies
Less than or equal to the external TLAC risk-weighted buffer, <u>and</u> greater than 75 percent of the external TLAC risk-weighted buffer	60 percent

Less than or equal to 75 percent of the external TLAC risk-weighted buffer, <u>and</u> greater than 50 percent of the external TLAC risk-weighted buffer	40 percent
Less than or equal to 50 percent of the external TLAC risk-weighted buffer, <u>and</u> greater 25 percent of the external TLAC risk-weighted buffer	20 percent
Less than or equal to 25 percent of the external TLAC risk-weighted buffer	0 percent

Table 2 to § 252.63: Calculation of Maximum External TLAC Leverage Payout Amount

External TLAC leverage buffer level	Maximum External TLAC leverage payout ratio (as a percentage of eligible retained income)
Greater than 2.0 percent	No payout ratio limitation applies
Less than or equal to 2.0 percent, and greater than 1.5 percent	60 percent

Less than or equal to 1.5 percent, and greater than 1.0 percent	40 percent
Less than or equal to 1.0 percent, and greater than 0.5 percent	20 percent
Less than or equal to 0.5 percent	0 percent

§ 252.64 Restrictions on corporate practices of U.S. global systemically important banking organizations.

(a) Prohibited corporate practices. A global systemically important BHC may not directly:

(1) Issue any debt instrument with an original maturity of less than 365 days (one year), including short term deposits and demand deposits, to any person, unless the person is a subsidiary of the global systemically important BHC;

(2) Issue any instrument, or enter into any related contract, with respect to which the holder of the instrument has a contractual right to offset debt owed by the holder or its affiliates to a subsidiary of the global systemically important BHC against the amount, or a portion of the amount, owed by the global systemically important BHC under the instrument;

(3) Enter into a qualified financial contract that is not a credit enhancement with a person that is not a subsidiary of the global systemically important BHC;

(4) Enter into an agreement in which the global systemically important BHC guarantees a liability of a subsidiary of the global systemically important BHC if such

liability permits the exercise of a default right that is related, directly or indirectly, to the global systemically important BHC becoming subject to a receivership, insolvency, liquidation, resolution, or similar proceeding other than a receivership proceeding under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5381 through 5394) unless the liability is subject to requirements of the Board restricting such default rights or subject to any similar requirements of another U.S. federal banking agency; or

(5) Enter into, or otherwise begin to benefit from, any agreement that provides for its liabilities to be guaranteed by any of its subsidiaries.

(b) Limit on unrelated liabilities. (1) The aggregate amount, on an unconsolidated basis, of unrelated liabilities of a global systemically important BHC owed to persons that are not affiliates of the global systemically important BHC may not exceed 5 percent of the systemically important BHC's external total loss-absorbing capacity amount, as calculated under § 252.63(b).

(2) For purposes of paragraph (b)(1) of this section, an unrelated liability is any non-contingent liability of the global systemically important BHC owed to a person that is not an affiliate of the global systemically important BHC other than:

(i) The instruments that are used to satisfy the global systemically important BHC's external total loss-absorbing capacity amount, as calculated under § 252.63(b);

(ii) Any dividend or other liability arising from the instruments that are used to satisfy the global systemically important BHC's external total loss-absorbing capacity amount, as calculated under § 252.63(b);

(iii) An eligible debt security that does not provide the holder of the instrument with a currently exercisable right to require immediate payment of the total or remaining principal amount; and

(iv) A secured liability, to the extent that it is secured, or a liability that otherwise represents a claim that would be senior to eligible debt securities in Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5390(b)) and the Bankruptcy Code (11 U.S.C. 507).

(c) A Covered BHC is not subject to paragraph (b) of this section if all of the eligible debt securities issued by the Covered BHC would represent the most subordinated debt claim in a receivership, insolvency, liquidation, or similar proceeding of the Covered BHC.

§ 252.65 Disclosure requirements.

(a) A global systemically important BHC must publicly disclose a description of the financial consequences to unsecured debtholders of the global systemically important BHC entering into a resolution proceeding in which the global systemically important BHC is the only entity that would be subject to the resolution proceeding.

(b) A global systemically important BHC must provide the disclosure required by paragraph (a) of this section:

(1) In the offering documents for all of its eligible debt securities; and

(2) Either:

(i) On the global systemically important BHC's Web site; or

(ii) In more than one public financial report or other public regulatory reports, provided that the global systemically important BHC publicly provides a summary table specifically indicating the location(s) of this disclosure.

4. Add § 252.153(b)(4), (5), and (6) to read as follows:

§ 252.153 U.S. intermediate holding company requirement for foreign banking organizations with U.S. non-branch assets of \$50 billion or more.

* * * * *

(b) * * *

(4) For purposes of this part, a top-tier foreign banking organization with U.S. non-branch assets that equal or exceed \$50 billion is a global systemically important foreign banking organization if any of the following conditions are met:

(i) The top-tier foreign banking organization determines, pursuant to paragraph (b)(6) of this section, that the top-tier foreign banking organization has the characteristics of a global systemically important banking organization under the global methodology; or

(ii) The Board, using information available to the Board, determines:

(A) That the top-tier foreign banking organization would be a global systemically important banking organization under the global methodology;

(B) That the top-tier foreign banking organization, if it were subject to the Board's Regulation Q, would be identified as a global systemically important BHC under § 217.402 of the Board's Regulation Q; or

(C) That the U.S. intermediate holding company, if it were subject to § 217.402 of the Board's Regulation Q, would be identified as a global systemically important BHC.

(5) Each top-tier foreign banking organization that controls a U.S. intermediate holding company shall submit to the Board by January 1 of each calendar year through the U.S. intermediate holding company:

(i) Notice of whether the home country supervisor (or other appropriate home country regulatory authority) of the top-tier foreign banking organization of the U.S. intermediate holding company has adopted standards consistent with the global methodology; and

(ii) Notice of whether the top-tier foreign banking organization prepares or reports the indicators used by the global methodology to identify a banking organization as a global systemically important banking organization and, if it does, whether the top-tier foreign banking organization has determined that it has the characteristics of a global systemically important banking organization under the global methodology pursuant to paragraph (b)(6) of this section.

(6) A top-tier foreign banking organization that controls a U.S. intermediate holding company and prepares or reports for any purpose the indicator amounts necessary to determine whether the top-tier foreign banking organization is a global systemically important banking organization under the global methodology must use the data to determine whether the top-tier foreign banking organization has the characteristics of a global systemically important banking organization under the global methodology.

* * * * *

5. Add subpart P to read as follows:

Subpart P – Covered IHC Long-Term Debt Requirement, Covered IHC Total Loss-absorbing Capacity Requirement and Buffer, and Restrictions on Corporate Practices for Intermediate Holding Companies of Global Systemically Important Foreign Banking Organizations

Sec.

252.160 Applicability.

252.161 Definitions.

252.162 Covered IHC long-term debt requirement.

252.163 Internal debt conversion order.

252.164 Identification as a resolution Covered IHC or a non-resolution Covered IHC

252.165 Covered IHC total loss-absorbing capacity requirement and buffer.

252.166 Restrictions on corporate practices of intermediate holding companies of global systemically important foreign banking organizations.

252.167 Disclosure requirements

§ 252.160 Applicability.

(a) General applicability. This subpart applies to a U.S. intermediate holding company that is required to be established pursuant to § 252.153 and is controlled by a global systemically important foreign banking organization (Covered IHC).

(b) Initial applicability. A Covered IHC is subject to the requirements of sections 252.162, 252.163, 252.165, 252.166, and 252.167 beginning on the later of:

- (1) January 1, 2019; and
- (2) 1095 days (three years) after the earlier of the date on which:
 - (i) The U.S. non-branch assets of the global systemically important foreign banking organization that controls the Covered IHC equaled or exceeded \$50 billion; and
 - (ii) The foreign banking organization that controls the Covered IHC became a global systemically important foreign banking organization.
- (c) Applicability of Section 252.164. Section 252.164 of this subpart applies to a global systemically important foreign banking organization with U.S. non-branch assets that equal or exceed \$50 billion.

§ 252.161 Definitions.

For purposes of this subpart:

Additional tier 1 capital has the same meaning as in 12 CFR 217.20(c).

Average total consolidated assets means the denominator of the leverage ratio as described in 12 CFR 217.10(b)(4).

Common equity tier 1 capital has the same meaning as in 12 CFR 217.20(b).

Common equity tier 1 capital ratio has the same meaning as in 12 CFR 217.10(b)(1) and 12 CFR 217.10(c), as applicable.

Common equity tier 1 minority interest has the same meaning as in 12 CFR 217.2.

Covered IHC is defined in § 252.160.

Covered IHC TLAC buffer means, with respect to a Covered IHC, the sum of 2.5 percent and any applicable countercyclical capital buffer under 12 CFR 217.11(b) (expressed as a percentage).

Covered IHC Total loss-absorbing capacity amount is defined in § 252.165(c).

Default right (1) Means any:

(i) Right of a party, whether contractual or otherwise (including rights incorporated by reference to any other contract, agreement or document, and rights afforded by statute, civil code, regulation and common law), to liquidate, terminate, cancel, rescind, or accelerate such agreement or transactions thereunder, set off or net amounts owing in respect thereto (except rights related to same-day payment netting), exercise remedies in respect of collateral or other credit support or property related thereto (including the purchase and sale of property), demand payment or delivery thereunder or in respect thereof (other than a right or operation of a contractual provision arising solely from a change in the value of collateral or margin or a change in the amount of an economic exposure), suspend, delay or defer payment or performance thereunder, modify the obligations of a party thereunder or any similar rights; and

(ii) Right or contractual provision that alters the amount of collateral or margin that must be provided with respect to an exposure thereunder, including by altering any initial amount, threshold amount, variation margin, minimum transfer amount, the margin value of collateral or any similar amount, that entitles a party to demand the return of any collateral or margin transferred by it to the other party or a custodian or that modifies a transferee's right to reuse collateral or margin (if such right previously existed), or any similar rights, in each case, other than a right or operation of a contractual provision arising solely from a change in the value of collateral or margin or a change in the amount of an economic exposure; and

(2) Does not include any right under a contract that allows a party to terminate the contract on demand or at its option at a specified time, or from time to time, without the need to show cause.

Discretionary bonus payment has the same meaning as under 12 CFR 217.2.

Distribution has the same meaning as under 12 CFR 217.2.

Eligible external debt security means:

(1) a debt instrument that:

(i) Is paid in, and issued by the Covered IHC to, and remains held by, a person that does not directly or indirectly control the Covered IHC and is not a wholly owned subsidiary;

(ii) Is not secured, not guaranteed by the Covered IHC or a subsidiary of the Covered IHC, and is not subject to any other arrangement that legally or economically enhances the seniority of the instrument;

(iii) Has a maturity of greater than or equal to 365 days (one year) from the date of issuance;

(iv) Is governed by the laws of the United States or any State thereof;

(v) Does not provide the holder of the instrument a contractual right to accelerate payment of principal or interest on the instrument, except a right that is exercisable on one or more dates that are specified in the instrument or in the event of (A) a receivership, insolvency, liquidation, or similar proceeding of the Covered IHC or (B) a failure of the Covered IHC to pay principal or interest on the instrument when due and payable that continues for 30 days or more;

(vi) Does not have a credit-sensitive feature, such as an interest rate that is reset periodically based in whole or in part on the Covered IHC's credit quality, but may have an interest rate that is adjusted periodically independent of the Covered IHC's credit quality, in relation to general market interest rates or similar adjustments;

(vii) Is not a structured note; and

(viii) Does not provide that the instrument may be converted into or exchanged for equity of the covered IHC; and

(2) A debt instrument issued prior to December 31, 2016 that

(i) Is paid in, and issued by the Covered IHC to, and remains held by, a person that does not directly or indirectly control the Covered IHC and is not a wholly owned subsidiary;

(ii) Is not secured, not guaranteed by the Covered IHC or a subsidiary of the Covered IHC, and not subject to any other arrangement that legally or economically enhances the seniority of the instrument;

(iii) Has a maturity of greater than or equal to 365 days (one year) from the date of issuance;

(iv) Does not have a credit-sensitive feature, such as an interest rate that is reset periodically based in whole or in part on the Covered IHC's credit quality, but may have an interest rate that is adjusted periodically independent of the Covered IHC's credit quality, in relation to general market interest rates or similar adjustments;

(v) Is not a structured note; and

(vi) Does not provide that the instrument may be converted into or exchanged for equity of the Covered IHC.

Eligible Covered IHC debt security with respect to a non-resolution Covered IHC means eligible internal debt securities issued by the non-resolution Covered IHC, and with respect to a resolution Covered IHC means eligible internal debt securities and eligible external debt securities issued by the resolution Covered IHC.

Eligible internal debt security means a debt instrument that:

- (i) Is paid in, and issued by the Covered IHC;
- (ii) Is not secured, not guaranteed by the Covered IHC or a subsidiary of the Covered IHC, and is not subject to any other arrangement that legally or economically enhances the seniority of the instrument;
- (iii) Has a maturity of greater than or equal to 365 days (one year) from the date of issuance;
- (iv) Is governed by the laws of the United States or any State thereof;
- (v) Does not provide the holder of the instrument a contractual right to accelerate payment of principal or interest on the instrument, except a right that is exercisable on one or more dates that are specified in the instrument or in the event of (A) a receivership, insolvency, liquidation, or similar proceeding of the Covered IHC or (B) a failure of the Covered IHC to pay principal or interest on the instrument when due and payable that continues for 30 days or more;
- (vi) Is not a structured note;
- (vii) Is issued to and remains held by a company that (A) is incorporated or organized outside of the United States, and (B) directly or indirectly controls the Covered IHC or is a wholly owned subsidiary; and

(viii) Has a contractual provision that is approved by the Board that provides for the immediate conversion or exchange of the instrument into common equity tier 1 of the Covered IHC upon issuance by the Board of an internal debt conversion order.

GAAP means generally accepted accounting principles as used in the United States.

Internal debt conversion order means an order by the Board to immediately convert to, or exchange for, common equity tier 1 capital an amount of eligible internal debt securities of the Covered IHC specified by the Board in its discretion, as described in § 252.163.

Non-resolution Covered IHC means a Covered IHC identified as or determined to be a non-resolution Covered IHC pursuant to § 252.164.

Outstanding eligible Covered IHC long-term debt amount is defined in § 252.162(b).

Person has the same meaning as in 12 CFR 225.2.

Qualified financial contract has the same meaning as in section 210(c)(8)(D) of Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5390(c)(8)(D)).

Resolution Covered IHC means a Covered IHC identified as or determined to be a resolution Covered IHC pursuant to § 252.164.

Standardized total risk-weighted assets has the same meaning as in 12 CFR 217.2.

Structured note means a debt instrument that:

(1) Has a principal amount, redemption amount, or stated maturity that is subject to reduction based on the performance of any asset, entity, index, or embedded derivative or similar embedded feature;

(2) Has an embedded derivative or other similar embedded feature that is linked to one or more equity securities, commodities, assets, or entities;

(3) Does not specify a minimum principal amount that becomes due and payable upon acceleration or early termination; or

(4) Is not classified as debt under GAAP, provided that an instrument is not a structured note solely because it is one or both of the following:

(i) a non-dollar-denominated instrument, or

(ii) an instrument whose interest payments are based on an interest rate index.

Supplementary leverage ratio has the same meaning as in 12 CFR 217.10(c)(4).

Tier 1 minority interest has the same meaning as in 12 CFR 217.2.

Tier 2 capital has the same meaning as in 12 CFR 217.20(d).

Total leverage exposure has the same meaning as in 12 CFR 217.10(c)(4)(ii).

Total risk-weighted assets, with respect to a Covered IHC, is equal to the Covered IHC's standardized total risk-weighted assets.

U.S. non-branch assets has the same meaning as in 12 CFR 252.152(b)(2).

Wholly owned subsidiary means 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.

§ 252.162 Covered IHC long-term debt requirement.

(a) Covered IHC long-term debt requirement. A Covered IHC must have an outstanding eligible Covered IHC long-term debt amount that is no less than the amount equal to the greatest of:

- (1) 6 percent of the Covered IHC's total risk-weighted assets;
- (2) If the Covered IHC is required to maintain a minimum supplementary leverage ratio, 2.5 percent of the Covered IHC's total leverage exposure; and
- (3) 3.5 percent of the Covered IHC's average total consolidated assets.

(b) Outstanding eligible Covered IHC long-term debt amount. (1) A Covered IHC's outstanding eligible Covered IHC long-term debt amount is the sum of:

(i) One hundred (100) percent of the amount of the outstanding eligible Covered IHC debt securities issued by the Covered IHC due to be paid in greater than or equal to 730 days (two years); and

(ii) Fifty (50) percent of the amount of the outstanding eligible Covered IHC debt securities issued by the Covered IHC due to be paid in greater than or equal to 365 days (one year) and less than 730 days (two years); and

(iii) Zero (0) percent of the amount of the outstanding eligible Covered IHC debt securities issued by the Covered IHC due to be paid in less than 365 days (one year).

(2) For purposes of paragraph (b)(1) of this section, the date on which principal is due to be paid on an outstanding eligible Covered IHC debt security is calculated from the earlier of:

(i) The date on which payment of principal is required under the terms governing the instrument, without respect to any right of the holder to accelerate payment of principal; and

(ii) The date the holder of the instrument first has the contractual right to request or require payment of the amount of principal, provided that, with respect to a right that is exercisable on one or more dates that are specified in the instrument only on the occurrence of an event (other than an event of a receivership, insolvency, liquidation, or similar proceeding of the Covered IHC, or a failure of the Covered IHC to pay principal or interest on the instrument when due), the date for the outstanding eligible Covered IHC debt security under this paragraph (b)(2)(ii) will be calculated as if the event has occurred.

(3) After notice and response proceedings consistent with 12 CFR Part 263, Subpart E, the Board may order a Covered IHC to exclude from its outstanding eligible Covered IHC long-term debt amount any debt security with one or more features that would significantly impair the ability of such debt security to take losses.

(c) Redemption and repurchase. Without the prior approval of the Board, a Covered IHC may not redeem or repurchase any outstanding eligible Covered IHC debt security if, immediately after the redemption or repurchase, the Covered IHC would not have an outstanding eligible Covered IHC long-term debt amount that is sufficient to meet its Covered IHC long-term debt requirement under paragraph (a) of this section.

§ 252.163 Internal debt conversion order.

(a) The Board may issue an internal debt conversion order if:

- (1) The Board has determined that the Covered IHC is in default or danger of default; and
- (2) Any of the following circumstances apply:
 - (i) A foreign banking organization that directly or indirectly controls the Covered IHC or any subsidiary of the top-tier foreign banking organization has been placed into resolution proceedings (including the application of statutory resolution powers) in its home country;
 - (ii) The home country supervisor of the top-tier foreign banking organization has consented or not promptly objected after notification by the Board to the conversion or exchange of the eligible internal debt securities of the Covered IHC; or
 - (iii) The Board has made a written recommendation to the Secretary of the Treasury pursuant to 12 U.S.C. 5383(a) regarding the Covered IHC.
- (b) For purposes of paragraph (a) of this section, the Board will consider:
 - (1) A Covered IHC in default or danger of default if
 - (i) A case has been, or likely will promptly be, commenced with respect to the Covered IHC under the Bankruptcy Code (11 U.S.C. 101 *et seq.*);
 - (ii) The Covered IHC has incurred, or is likely to incur, losses that will deplete all or substantially all of its capital, and there is no reasonable prospect for the Covered IHC to avoid such depletion;
 - (iii) The assets of the Covered IHC are, or are likely to be, less than its obligations to creditors and others; or
 - (iv) The Covered IHC is, or is likely to be, unable to pay its obligations (other than those subject to a bona fide dispute) in the normal course of business; and

(2) An objection by the home country supervisor to the conversion or exchange of the eligible internal debt securities to be prompt if the Board receives the objection no later than 24 hours after the Board requests such consent or non-objection from the home country supervisor.

§ 252.164 Identification as a resolution Covered IHC or a non-resolution Covered IHC

(a) Initial certification. The top-tier global systemically important foreign banking organization with U.S. non-branch assets that equal or exceed \$50 billion must certify to the Board on the later of (i) June 30, 2017 or (ii) one year prior to the date on which a Covered IHC becomes subject to the requirements of this subpart pursuant to §252.160(b) whether the planned resolution strategy of the top-tier foreign banking organization involves the Covered IHC or the subsidiaries of the Covered IHC entering resolution, receivership, insolvency, or similar proceedings in the United States.

(b) Certification update. The top-tier global systemically important foreign banking organization with U.S. non-branch assets that equal or exceed \$50 billion must provide an updated certification to the Board upon a change in the resolution strategy described in the certification provided pursuant to paragraph (a) of this section.

(c) Identification of a resolution Covered IHC. A Covered IHC is a resolution Covered IHC if the most recent certification provided pursuant to paragraphs (a) and (b) indicates that the top-tier foreign banking organization's planned resolution strategy involves the Covered IHC or the subsidiaries of the Covered IHC entering resolution, receivership, insolvency, or similar proceedings in the United States.

(d) Identification of a non-resolution Covered IHC. A Covered IHC is a non-resolution Covered IHC if the most recent certification provided pursuant to paragraphs (a) and (b) indicates that the top-tier foreign banking organization's planned resolution strategy involves neither the Covered IHC nor the subsidiaries of the Covered IHC entering resolution, receivership, insolvency, or similar proceedings in the United States.

(e) Board determination. The Board may determine in its discretion that a non-resolution Covered IHC identified pursuant to paragraph (d) of this section is a resolution Covered IHC, or that a resolution Covered IHC identified pursuant to paragraph (c) of this section is a non-resolution Covered IHC.

(f) Transition. (1) A Covered IHC identified as a resolution Covered IHC pursuant to paragraph (b) of this section or determined by the Board to be a resolution Covered IHC pursuant to paragraph (e) of this section must comply with the requirements in this subpart applicable to a resolution Covered IHC within 365 days (one year) after such identification or determination, unless such time period is extended by the Board in its discretion.

(2) A Covered IHC identified as a non-resolution Covered IHC pursuant to paragraph (b) or determined by the Board to be a non-resolution Covered IHC pursuant to paragraph (e) must comply with the requirements in this subpart applicable to a non-resolution Covered IHC 365 days (one year) after such identification or determination, unless such time period is extended by the Board in its discretion.

§ 252.165 Covered IHC total loss-absorbing capacity requirement and buffer.

(a) Covered IHC total loss-absorbing capacity requirement for a resolution

Covered IHC. A resolution Covered IHC must have an outstanding Covered IHC total loss-absorbing capacity amount that is no less than the amount equal to the greatest of:

(1) 18 percent of the resolution Covered IHC's total risk-weighted assets;

(2) If the Board requires the resolution Covered IHC to maintain a minimum supplementary leverage ratio, 6.75 percent of the resolution Covered IHC's total leverage exposure; and

(3) Nine (9) percent of the resolution Covered IHC's average total consolidated assets.

(b) Covered IHC total loss-absorbing capacity requirement for a non-resolution

Covered IHC. A non-resolution Covered IHC must have an outstanding Covered IHC total loss-absorbing capacity amount that is no less than the amount equal to the greatest of:

(1) 16 percent of the non-resolution Covered IHC's total risk-weighted assets;

(2) If the Board requires the non-resolution Covered IHC to maintain a minimum supplementary leverage ratio, 6 percent of the non-resolution Covered IHC's total leverage exposure; and

(3) Eight (8) percent of the non-resolution Covered IHC's average total consolidated assets.

(c) Covered IHC Total loss-absorbing capacity amount. (1) A non-resolution

Covered IHC's Covered IHC total loss-absorbing capacity amount is equal to the sum of:

(i) The Covered IHC's common equity tier 1 capital (excluding any common equity tier 1 minority interest) held by a company that is incorporated or organized outside of the United States and that directly or indirectly controls the Covered IHC;

(ii) The Covered IHC's additional tier 1 capital (excluding any tier 1 minority interest) held by a company that is incorporated or organized outside of the United States and that directly or indirectly controls the Covered IHC; and

(iii) The Covered IHC's outstanding eligible Covered IHC long-term debt amount, plus 50 percent of the amount of unpaid principal of outstanding eligible Covered IHC debt securities issued by the Covered IHC due to be paid in greater than or equal to 365 days (one year) but less than 730 days (two years).

(2) A resolution Covered IHC's Covered IHC total loss-absorbing capacity amount is equal to the sum of:

(i) The Covered IHC's common equity tier 1 capital (excluding any common equity tier 1 minority interest);

(ii) The Covered IHC's additional tier 1 capital (excluding any tier 1 minority interest); and

(iii) The Covered IHC's outstanding eligible Covered IHC long-term debt amount, plus 50 percent of the amount of unpaid principal of outstanding eligible Covered IHC debt securities issued by the Covered IHC due to be paid in greater than or equal to 365 days (one year) but less than 730 days (two years).

(d) Covered IHC TLAC buffer.—(1) Composition of the Covered IHC TLAC buffer. The Covered IHC TLAC buffer is composed solely of common equity tier 1 capital.

(2) Definitions. For purposes of this paragraph, the following definitions apply:

(i) Eligible retained income. The eligible retained income of a Covered IHC is its net income for the four calendar quarters preceding the current calendar quarter, based on the Covered IHC's FR Y-9C, or other applicable regulatory report as determined by the Board, net of any distributions and associated tax effects not already reflected in net income. Net income, as reported in the FR Y-9C, reflects discretionary bonus payments and certain distributions that are expense items (and their associated tax effects).

(ii) Maximum Covered IHC TLAC payout ratio. The maximum Covered IHC TLAC payout ratio is the percentage of eligible retained income that a Covered IHC can pay out in the form of distributions and discretionary bonus payments during the current calendar quarter. The maximum Covered IHC TLAC payout ratio is based on the Covered IHC's Covered IHC TLAC buffer level, calculated as of the last day of the previous calendar quarter, as set forth in Table 1 to § 252.165.

(iii) Maximum Covered IHC TLAC payout amount. A Covered IHC's maximum Covered IHC TLAC payout amount for the current calendar quarter is equal to the Covered IHC's eligible retained income, multiplied by the applicable maximum Covered IHC TLAC payout ratio, as set forth in Table 1 to § 252.165.

(3) Calculation of the Covered IHC TLAC buffer level. (i) A Covered IHC's Covered IHC TLAC buffer level is equal to the Covered IHC's common equity tier 1 capital ratio (expressed as a percentage) minus the greater of zero and the following amount:

(A) 16 percent for a non-resolution Covered IHC, and 18 percent for a resolution Covered IHC; minus

(B) (1) For a non-resolution Covered IHC, the ratio (expressed as a percentage) of the Covered IHC's additional tier 1 capital (excluding any tier 1 minority interest) held by a company that is incorporated or organized outside of the United States and that directly or indirectly controls the Covered IHC to the Covered IHC's total risk-weighted assets;

(2) For a resolution Covered IHC, the ratio (expressed as a percentage of the Covered IHC's additional tier 1 capital (excluding any tier 1 minority interest) to the Covered IHC's total-risk weighted assets; and minus

(C) The ratio (expressed as a percentage) of the Covered IHC's outstanding eligible Covered IHC long-term debt amount to total risk-weighted assets.

(ii) (A) Notwithstanding paragraph (d)(3)(i) of this section, with respect to a resolution Covered IHC, if the ratio (expressed as a percentage) of the resolution Covered IHC's Covered IHC total loss-absorbing capacity amount, as calculated under § 252.165(a), to the resolution Covered IHC's risk-weighted assets is less than or equal to, 18 percent, the Covered IHC's Covered IHC TLAC buffer level is zero.

(B) Notwithstanding paragraph (d)(3)(i) of this section, with respect to a non-resolution Covered IHC, if the ratio (expressed as a percentage) of the non-resolution Covered IHC's Covered IHC total loss-absorbing capacity amount, as calculated under § 252.165(b), to the Covered IHC's risk-weighted assets is less than or equal to 16 percent, the non-resolution Covered IHC's Covered IHC TLAC buffer level is zero.

(4) Limits on distributions and discretionary bonus payments. (i) A Covered IHC shall not make distributions or discretionary bonus payments or create an obligation to make such distributions or payments during the current calendar quarter that, in the aggregate, exceed the maximum Covered IHC TLAC payout amount.

(ii) A Covered IHC with a Covered IHC TLAC buffer level that is greater than the Covered IHC TLAC buffer is not subject to a maximum Covered IHC TLAC payout amount.

(iii) Except as provided in paragraph (d)(4)(iv) of this section, a Covered IHC may not make distributions or discretionary bonus payments during the current calendar quarter if the Covered IHC's:

(A) Eligible retained income is negative; and

(B) Covered IHC TLAC buffer level was less than the Covered IHC TLAC buffer as of the end of the previous calendar quarter.

(iv) Notwithstanding the limitations in paragraphs (d)(4)(i) through (iii) of this section, the Board may permit a Covered IHC to make a distribution or discretionary bonus payment upon a request of the Covered IHC, if the Board determines that the distribution or discretionary bonus payment would not be contrary to the purposes of this section, or to the safety and soundness of the Covered IHC. In making such a determination, the Board will consider the nature and extent of the request and the particular circumstances giving rise to the request.

Table 1 to § 252.165: Calculation of Maximum Covered IHC TLAC Payout Amount

Covered IHC TLAC buffer level	Maximum Covered IHC TLAC payout ratio (as a percentage of eligible retained income)
Greater than the Covered IHC TLAC buffer	No payout ratio limitation applies
Less than or equal to the Covered IHC TLAC buffer, <u>and</u> greater than 75 percent of the Covered IHC TLAC buffer	60 percent
Less than or equal to 75 percent of the Covered IHC TLAC buffer, <u>and</u> greater than 50 percent of the Covered IHC TLAC buffer	40 percent
Less than or equal to 50 percent of the Covered IHC TLAC buffer, <u>and</u> greater 25 percent of the Covered IHC TLAC buffer	20 percent
Less than or equal to 25 percent of the Covered IHC TLAC buffer	0 percent

(v) (A) A Covered IHC is subject to the lowest of the maximum payout amounts as determined under 12 CFR 217.11(a)(2) and the maximum Covered IHC TLAC payout amount as determined under this paragraph.

(B) Additional limitations on distributions may apply to a Covered IHC under 12 CFR 225.4, 225.8, and 263.202.

§ 252.166 Restrictions on corporate practices of intermediate holding companies of global systemically important foreign banking organizations.

(a) Prohibited corporate practices. A Covered IHC may not directly:

(1) Issue any debt instrument with an original maturity of less than 365 days (one year), including short term deposits and demand deposits, to any person, unless the person is an affiliate of the Covered IHC;

(2) Issue any instrument, or enter into any related contract, with respect to which the holder of the instrument has a contractual right to offset debt owed by the holder or its affiliates to the Covered IHC or a subsidiary of the Covered IHC against the amount, or a portion of the amount, owed by the Covered IHC under the instrument;

(3) Enter into a qualified financial contract that is not a credit enhancement with a person that is not an affiliate of the Covered IHC;

(4) Enter into an agreement in which the Covered IHC guarantees a liability of an affiliate of the Covered IHC if such liability permits the exercise of a default right that is related, directly or indirectly, to the Covered IHC becoming subject to a receivership, insolvency, liquidation, resolution, or similar proceeding other than a receivership proceeding under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5381 through 5394) unless the liability is subject to requirements of the Board restricting such default rights or subject to any similar requirements of another U.S. federal banking agency; or

(5) Enter into, or otherwise benefit from, any agreement that provides for its liabilities to be guaranteed by any of its subsidiaries.

(b) Limit on unrelated liabilities. (1) The aggregate amount, on an unconsolidated basis, of unrelated liabilities of a Covered IHC may not exceed 5 percent of the Covered IHC's Covered IHC total loss-absorbing capacity amount, as calculated under § 252.165(c).

(2) For purposes of paragraph (b)(1) of this section, an unrelated liability includes:

(i) with respect to a non-resolution Covered IHC, any non-contingent liability of the non-resolution Covered IHC owed to a person that is not an affiliate of the non-resolution Covered IHC other than those liabilities specified in paragraph (b)(3), and

(ii) with respect to a resolution Covered IHC, any non-contingent liability of the resolution Covered IHC owed to a person that is not a subsidiary of the resolution Covered IHC other than those liabilities specified in paragraph (b)(3).

(3) (i) The instruments that are used to satisfy the Covered IHC's Covered IHC total loss-absorbing capacity amount, as calculated under § 252.165(a);

(ii) Any dividend or other liability arising from the instruments that are used to satisfy the Covered IHC's Covered IHC total loss-absorbing capacity amount, as calculated under § 252.165(c)(2);

(iii) An eligible Covered IHC debt security that does not provide the holder of the instrument with a currently exercisable right to require immediate payment of the total or remaining principal amount; and

(iv) A secured liability, to the extent that it is secured, or a liability that otherwise represents a claim that would be senior to eligible Covered IHC debt securities in Title II

of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5390(b)) and the Bankruptcy Code (11 U.S.C. 507).

(c) A Covered IHC is not subject to paragraph (b) of this section if all of the eligible Covered IHC debt securities issued by the Covered IHC would represent the most subordinated debt claim in a receivership, insolvency, liquidation, or similar proceeding of the Covered IHC.

§ 252.167 Disclosure requirements for resolution Covered IHCs.

(a) A resolution Covered IHC that has any outstanding eligible external debt securities must publicly disclose a description of the financial consequences to unsecured debtholders of the resolution Covered IHC entering into a resolution proceeding in which the resolution Covered IHC is the only entity in the United States that would be subject to the resolution proceeding.

(b) A resolution Covered IHC must provide the disclosure required by paragraph (a) of this section:

(1) In the offering documents for all of its eligible external debt securities; and

(2) Either:

(i) On the resolution Covered IHC's Web site; or

(ii) In more than one public financial report or other public regulatory reports, provided that the resolution Covered IHC publicly provides a summary table specifically indicating the location(s) of this disclosure.

By order of the Board of Governors of the Federal Reserve System, December 15, 2016.

Robert deV. Frierson

Secretary of the Board