Fact Sheet on Proposed Rule to Require Large Banks to Maintain Long-Term Debt to Improve Financial Stability and Resolution

Background

The federal bank regulatory agencies are inviting public comment on a proposal that would require large banks with total assets of $100 billion or more (hereafter "large banks") to maintain a layer of long-term debt, which would improve financial stability by increasing the resolvability and resiliency of such institutions.

The proposal follows an advance notice of proposed rulemaking issued in October 2022 by the Federal Reserve Board and the Federal Deposit Insurance Corporation that looked at several possible changes, including a long-term debt requirement, to promote more orderly resolutions for large banks. The advance notice cited the risks of resolving large banks, especially those with sizable uninsured deposits, and explored giving regulators more tools for this process.

Several months later, the failure of three large banks in spring 2023 underscored the importance of supplementary, loss absorbing resources that regulators can use to resolve banks in a way that reduces costs and risk of disruption to the banking system.

Applicability

The proposal applies to large banks, or those with more than $100 billion in total consolidated assets. This proposal, however, would not materially change the existing requirements already in place for the largest and most complex banks (i.e. U.S. global systemically important banks, or GSIBs) and it does not apply to community banks.

Proposal

The joint agency proposal aims to increase the resolvability and resiliency of large banks. It would mandate a long-term debt requirement to:

- Give regulators additional resources to resolve failed banks and prevent contagion;
- Foster depositor confidence; and
- Decrease costs to the Deposit Insurance Fund in the event of a large bank failure.

These goals would be accomplished by requiring large banks with total assets of $100 billion or more to maintain a minimum amount of long-term debt that can be used, in the instance of a bank's failure, to:

- Absorb losses; and
- Increase options to resolve the failed bank.

Large banks would be required to maintain a minimum amount of eligible long-term debt equal to the greater of 6 percent of risk weighted assets, 3.5 percent of average total consolidated assets, and for banks subject to the supplementary leverage ratio, 2.5 percent of total leverage exposure under the supplementary leverage ratio. Additionally, the proposal would:

- Prohibit large banks from engaging in certain activities that could complicate their resolution; and
- Disincentivize banks from holding long-term debt issued by other banks to reduce interconnectedness.

Because large banks generally pose less risk than the largest and most complex banks, the proposed requirement would be calibrated at a lower level relative to existing requirements for the eight largest and most complex banks. Under existing rules, the largest and most complex banks are subject to total loss-absorbing capacity (TLAC) requirements, including minimum and buffer requirements, as well as a long-term debt requirement. Under the proposal, a large bank with total assets of $100 billion or more that is not one of the largest and most complex banks would not be subject to TLAC requirements.

If the proposal is adopted, all large banks with total assets of $100 billion or more, including the largest and most complex banks, would be subject to long-term debt requirements and clean holding company requirements. The proposal would also strengthen the capital deductions for investments in the debt holdings of other banking organizations.

Estimated Impact

Long-term debt can provide banks and regulators greater flexibility in responding to a bank's failure by augmenting loss-absorbing capacity. The availability of eligible long-term debt may increase the likelihood of an orderly resolution for a bank that fails and thereby help minimize costs to the Deposit Insurance Fund.

The improvements in resolvability and resilience introduced by the proposal would result in moderately higher funding costs for large banks over time. Importantly, large banks already maintain substantial long-term debt, so most would only need to issue new long-term debt incrementally to meet the proposed requirement.

When factoring in levels of long-term debt at these entities, the agencies estimate that large banks have recently maintained roughly 75 percent of the required amount and would have three years following the proposed rule becoming effective to meet the full requirement.

The proposal includes transition provisions to give banks sufficient time to adapt to the changes while minimizing any potential adverse impact. It would also allow banks to count, as part of the required amounts, certain existing long-term debt.

Comments on the proposal are due by November 30, 2023.