



February 19, 2016

*By electronic submission to [www.federalreserve.gov](http://www.federalreserve.gov)*

Mr. Robert deV. Frierson  
Secretary  
Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue, N.W.  
Washington, D.C. 20551

Re: Comment Letter on the Notice of Proposed Rulemaking on Internal TLAC, Long-Term Debt, Clean Holding Company and Other Requirements Applicable to the U.S. IHCs of Foreign G-SIBs

Docket No. R-1523; RIN 7100 AE-37

Ladies and Gentlemen:

The Clearing House Association (“TCH”), the Securities Industry and Financial Markets Association (“SIFMA”), the American Bankers Association (“ABA”), the Financial Services Roundtable (“FSR”) and the Financial Services Forum (“FSF”) (collectively, the “Associations”)<sup>1</sup> welcome the opportunity to comment on the proposed rule issued by the Board of Governors of the Federal Reserve System that would impose internal total loss-absorbing capacity (“TLAC”), long-term debt, clean holding company and other requirements on the U.S. intermediate holding companies (“covered IHCs”) of foreign global systemically important banking groups (“foreign G-SIBs”).<sup>2</sup>

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<sup>1</sup> See [Annex 3](#) for a description of each of the Associations.

<sup>2</sup> Notice of Proposed Rulemaking, Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations; Regulatory Capital Deduction for Investments in Certain Unsecured Debt of Systemically Important U.S. Bank Holding Companies, 80 Fed. Reg. 74926 (Nov. 30, 2015) (the “NPR”).

This comment letter relates solely to the proposed rule as it would apply to covered IHCs of foreign G-SIBs and is divided between a high-level summary of our major points in the body of this letter, and a more detailed description and explanation of our comments in [Annex 1](#). The Associations have filed a separate comment letter (the “**U.S. G-SIB Comment Letter**”) on the proposed rule as it would apply to the top tier bank holding companies (“**covered BHCs**”) of U.S. G-SIBs. We have submitted them as separate comment letters to highlight more effectively the most important concerns and considerations of each group.<sup>3</sup>

The Associations strongly support the Financial Stability Board’s (“**FSB’s**”) goal of imposing a properly structured and calibrated TLAC requirement on each resolution entity within a G-SIB, including multiple resolution entities within a foreign G-SIB (an “**MPOE G-SIB**”) that is expected to be resolved under a multiple-point-of-entry (“**MPOE**”) strategy in the event of failure.<sup>4</sup> We also support the Federal Reserve’s goal of establishing appropriate and reasonable TLAC requirements for covered IHCs.

While the proposed rule is intended to achieve this purpose, it contains a number of weaknesses that are counterproductive or unnecessary to achieving this goal. We believe that the Federal Reserve can and should resolve these weaknesses in the proposed rule while still achieving the important policy objectives by making each of the following changes:

- Eliminating the Separate Long-Term Debt Requirements. The proposed rule’s separate long-term debt requirements are unnecessary and should be eliminated.
- Treating Resolution Entity IHCs the Same as Covered BHCs. The Federal Reserve should treat resolution entity IHCs the same as covered BHCs under the proposed rule, except for any differences based on U.S. G-SIB status.
  - Accordingly, resolution entity IHCs should be permitted to satisfy their minimum TLAC requirements with any combination of external and internal TLAC.
  - In addition, the proposed TLAC (and if retained, long-term debt) requirements applicable to resolution entity IHCs should be reduced to reflect the same allowances for balance-sheet depletion that were reflected in the proposed requirements for covered BHCs.
- Reducing TLAC Requirements Applicable to Non-Resolution Entity IHCs. The proposed internal TLAC (and if retained, long-term debt) requirements applicable to

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<sup>3</sup> Attached for your convenience as [Annex 2](#) is a glossary showing all the defined terms used in our comment letter.

<sup>4</sup> Financial Stability Board, Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution: Total Loss-absorbing Capacity (TLAC) Term Sheet at 9 (Nov. 9, 2015).

- non-resolution entity IHCs should be reduced to not more than 75% of the TLAC (and if retained, long-term debt) requirements applicable to resolution entity IHCs.<sup>5</sup>
- Otherwise, U.S. host resolution authorities will have an undesirable incentive to engage in ex-post ring-fencing instead of cooperating with the top-tier parent's home resolution authority in order to ensure a successful single-point-of-entry ("SPOE") resolution of the foreign G-SIB.
  - Moreover, the high proposed internal TLAC requirements set out in the proposed rule also increase the likelihood of "misallocation risk," which can make the overall firm less resilient and more prone to failure.<sup>6</sup>
- Contractual Versus Structural Subordination and the 5% Allowance for Unrelated Liabilities. The Federal Reserve should permit covered IHCs to rely on either structural or contractual subordination, and covered IHCs relying on structural subordination should be permitted the same 5% allowance for unrelated liabilities as is permitted for covered BHCs.
  - No Contractual Triggers. The Federal Reserve should eliminate the proposed requirement that eligible internal long-term debt contain contractual triggers exercisable outside of insolvency proceedings by the Federal Reserve in order to avoid a variety of adverse consequences, including adverse consequences under the U.S. Federal and State tax laws.
  - Same Acceleration Events as EDS. Eligible internal long-term debt should be permitted to contain the same acceleration events as permitted for EDS issued by covered BHCs.
  - Capital Contribution Agreements. Covered IHCs should be permitted to satisfy their minimum TLAC and long-term debt requirements with capital contribution agreements.
  - Not Imposing Any Domestic Internal TLAC. The Federal Reserve should not impose any domestic internal TLAC or long-term debt requirements for the U.S. subsidiaries of covered IHCs.

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<sup>5</sup> If the long-term debt requirements are retained, the Associations support in the alternative the approach recommended in the comment letter filed by the Institute of International Bankers that the long-term debt requirement for non-resolution entity IHCs be established as a supervisory expectation that internal long-term debt be required to comprise no more than 33% of internal TLAC.

<sup>6</sup> 80 Fed. Reg. at 74949.

Part I of this letter describes the wide range of legal, regulatory and practical steps taken by regulators to improve the resiliency and resolvability of foreign G-SIBs that inform the broader framework and context within which the proposed rule and its policy objectives must be evaluated. Parts II through X of this letter provide high level summaries of our key concerns and recommendations on the most important aspects of the proposed rule. Finally, Part XI of this letter provides an overview of the annexes to this letter, which collectively provide supplemental information and detail about our comments on the proposed rule.

**I. Any final rule should acknowledge and take into account the numerous legal, regulatory and practical steps already taken by regulators to improve resiliency and resolvability.**

The FSB, the European banking regulators, their counterparts around the world and the foreign G-SIBs themselves have made significant progress in ending the risk that some foreign G-SIBs might be treated as “too big to fail” (“**TBTF**”). Indeed, Paul Tucker, Chairman of the Systemic Risk Council, former Deputy Governor for Financial Stability at the Bank of England and former Chairman of the FSB’s Resolution Steering Committee, has said that Europe has the laws in place to resolve European G-SIBs and that with a sufficient amount of TLAC that is structurally or contractually subordinated to operating liabilities the European G-SIBs should be resolvable as a practical matter.<sup>7</sup> Federal Deposit Insurance Corporation (“**FDIC**”) Chairman Martin J. Gruenberg has described this progress as “impressive” and “transformational.”<sup>8</sup> The progress has been made in two ways. First, the regulators have imposed enhanced prudential standards on the foreign G-SIBs, including dramatically enhanced capital and liquidity requirements, which have made the foreign G-SIBs substantially more resilient against failure and thus have substantially reduced the probability of their failure.<sup>9</sup> Second, if one or more of these organizations fail despite their increased resiliency, the regulators have developed strategies for resolving the foreign G-SIBs that are designed to eliminate the potential harm

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<sup>7</sup> Paul Tucker, Chairman of the Systemic Risk Council, Oral Remarks, *Ending Too Big to Fail: Reform and Implementation*, a conference co-sponsored by the Hoover Institution and the Bipartisan Policy Center (Jan. 22, 2016), available at <http://www.hoover.org/events/ending-too-big-fail-reform-and-implementation> (video webcast at 56:38-59:24). See also Paul Tucker, Deputy Governor for Financial Stability at the Bank of England, *Solving Too Big to Fail—Where Do Things Stand on Resolution?*, Remarks at the Institute of International Finance 2013 Annual Membership Conference (Oct. 12, 2013), available at <http://www.bankofengland.co.uk/publications/Documents/speeches/2013/speech685.pdf> (“US authorities could resolve most US SIFIs right now.”).

<sup>8</sup> Martin J. Gruenberg, Chairman of the FDIC, *A Progress Report on the Resolution of Systemically Important Financial Institutions*, Speech at the Peterson Institute for International Economics (May 12, 2015).

<sup>9</sup> See, e.g., 80 Fed. Reg. at 74927; Basel Committee on Banking Supervision, *Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems* (Dec. 2010, revised Jun. 2011); Basel Committee on Banking Supervision, *Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools* (Jan. 2013).

that might be caused to the financial system or the wider economy and thereby eliminate the historical motive for considering such firms as TBTF.<sup>10</sup>

Among these resolution strategies are SPOE and MPOE strategies designed to impose all of the losses of a failed G-SIB on its private sector investors in a manner that avoids any threat to financial stability or harm to the broader economy.<sup>11</sup> Most foreign G-SIBs expect to be resolved under an SPOE strategy,<sup>12</sup> but certain foreign G-SIBs believe that an MPOE strategy would be more appropriate and expect to be resolved under an MPOE strategy.<sup>13</sup>

Most foreign G-SIBs have taken actions to make SPOE or MPOE more feasible at the request of their home supervisors. For example, fifteen of the foreign G-SIBs that are active dealers in derivatives or participants in securities financing transactions have adhered to the ISDA 2015 Universal Resolution Stay Protocol,<sup>14</sup> which was designed to override cross-defaults in certain financial contracts that the Financial Stability Board identified as an important obstacle to successful resolution of the G-SIBs.<sup>15</sup> Certain foreign G-SIBs have also taken steps to

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<sup>10</sup> See, e.g., Bank of England and the FDIC, *Resolving Globally Active, Systemically Important, Financial Institutions* (Dec. 10, 2012); Bank of England, *The Bank of England's approach to resolution* (Oct. 2014); Financial Stability Board, *Key Attributes for Effective Resolution Regimes for Financial Institutions* (Oct. 2011; Updated version Oct. 2014); FDIC, *Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy*, 78 Fed. Reg. 76614 (Dec. 18, 2013). See also Bipartisan Policy Center, *Too Big to Fail: The Path to a Solution* (May 9, 2013).

<sup>11</sup> See, e.g., Bank of England and the FDIC, *Resolving Globally Active, Systemically Important, Financial Institutions* (Dec. 10, 2012). For a step-by-step graphical illustration of a two-entity SPOE strategy, see [Annex 5](#) to the U.S. G-SIB Comment Letter. For a description of a one-entity SPOE resolution strategy, see Thomas H. Jackson, *Building on Bankruptcy: A Revised Chapter 14 Proposal for the Recapitalization, Reorganization, or Liquidation of Large Financial Institutions*, in *MAKING FAILURE FEASIBLE: HOW BANKRUPTCY REFORM CAN END "TOO BIG TO FAIL"* (Hoover Institution 2015) (Kenneth E. Scott, Thomas H. Jackson & John B. Taylor, eds.).

<sup>12</sup> For example, Barclays, BNP Paribas, Credit Suisse, Deutsche Bank, MUFG and UBS have all stated in the public summaries of their 2015 resolution plans submitted under Section 165(d) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank Act**") that they expect to be resolved by their home resolution authorities pursuant to an SPOE strategy. FDIC, Title I and IDI Resolution Plans, *available at* <https://www.fdic.gov/regulations/reform/resplans/>.

<sup>13</sup> For example, Banco Santander and HSBC both stated in the public summaries of their 2015 resolution plans submitted under Section 165(d) of the Dodd-Frank Act that they expect to be resolved pursuant to an MPOE strategy. FDIC, Title I and IDI Resolution Plans, *available at* <https://www.fdic.gov/regulations/reform/resplans/>.

<sup>14</sup> International Swaps and Derivatives Association ("**ISDA**"), *Adhering Parties: ISDA 2015 Universal Resolution Stay Protocol* (last updated Feb. 9, 2016), *available at* <https://www2.isda.org/functional-areas/protocol-management/protocol-adherence/22>.

<sup>15</sup> See, e.g., Financial Stability Board, Consultative Document, *Cross-border recognition of resolution actions*, at 11-12 (Sep. 29, 2014).

ensure the continuity of shared services during the resolution of their U.S. operations,<sup>16</sup> demonstrate the operational readiness of their U.S. operations for resolution, and simplify and improve the alignment of the legal structures of their U.S. operations to improve the resolvability of their U.S. operations, as required by the FDIC and the Federal Reserve.<sup>17</sup>

## **II. The proposed rule's separate long-term debt requirements are unnecessary and should be eliminated.**

While the Associations strongly support the goal of establishing appropriate and reasonable TLAC requirements for covered IHCs, the Associations believe that the separate long-term debt requirements are completely unnecessary to ensure that the covered IHCs have enough TLAC at the point of failure to be recapitalized at Basel III levels. We also do not believe that any minimum long-term debt requirement is necessary for internal TLAC since internal TLAC does not serve any market discipline purpose the way external TLAC does. At the same time, we would oppose any proposal to exclude long-term debt securities<sup>18</sup> from eligible TLAC, effectively limiting eligible TLAC to equity securities. Instead, we believe that covered IHCs should be able to satisfy their minimum TLAC requirements by freely substituting equity for long-term debt securities and long-term debt securities for equity, subject to applicable regulatory capital requirements.

Furthermore, it is unlikely that any covered IHC would choose to satisfy its entire TLAC requirement with equity rather than long-term debt securities, since long-term debt securities are a less expensive form of loss-absorbing capacity. Based on the initial level of minimum required TLAC in the proposed rule, a covered IHC is virtually certain to have sufficient TLAC at the point of failure to recapitalize the group at Basel III levels without a separate minimum long-term debt requirement. It would be counterintuitive to prohibit a covered IHC from substituting equity for long-term debt securities since equity can absorb losses both inside and outside of a bankruptcy or Title II proceeding, and therefore function as both going-concern and gone-concern capital. In contrast, absent a consensual debt restructuring outside of a bankruptcy or Title II proceeding or activation of the proposed contractual trigger by the

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<sup>16</sup> “**Shared services**” refers to services, such as legal, compliance, intellectual property or data processing services, provided by one or more legal entities within an affiliated group to one or more other legal entities within the group.

<sup>17</sup> See, e.g., FDIC and Federal Reserve, Press Release, *Agencies Provide Feedback on Second Round Resolution Plans of “First Wave” Filers* (Aug. 5, 2014) (requiring first-wave filers to take various actions, including “ensuring the continuity of shared services that support critical operations and core business lines throughout the resolution process,” “demonstrating operational capabilities for resolution preparedness, such as the ability to produce reliable information in a timely manner,” and “establishing a rational and less complex legal structure that would take into account the best alignment of legal entities and business lines to improve the firm’s resolvability”).

<sup>18</sup> By “**long-term debt securities**” we mean debt securities with an original maturity of one year or more.

Federal Reserve,<sup>19</sup> long-term debt securities can only absorb losses in a bankruptcy or Title II proceeding, and therefore generally function only as gone-concern capital. Thus, we believe that long-term debt securities should be permitted but not required to satisfy any minimum TLAC requirements in excess of regulatory capital requirements.

We do not believe that a separate minimum long-term debt requirement is necessary in order for the FDIC to be appointed receiver under Title II while a covered IHC still has enough TLAC to be recapitalized at Basel III levels (i.e., satisfy the capital refill goal). It is true that Title II of the Dodd-Frank Act cannot be invoked until a covered IHC is “in default or in danger of default.”<sup>20</sup> But that standard does not require the Treasury Secretary to wait until a covered IHC is balance-sheet insolvent before invoking Title II. It allows the Treasury Secretary to invoke Title II before balance-sheet insolvency based on a determination that the covered IHC is unlikely to be able to pay its debts as they come due. Covered IHCs and their supervisors would have a strong incentive to commence a resolution proceeding in advance of balance-sheet insolvency in order to ensure that the covered IHC has enough TLAC to be recapitalized at Basel III levels.

Moreover, the Federal Reserve can respond to a depletion in a covered IHC’s TLAC outside of a bankruptcy or Title II through its other regulatory and supervisory tools. In addition, a covered IHC can achieve capital restoration similar to a recapitalization under an MPOE or SPOE resolution strategy outside of a bankruptcy or Title II proceeding. Finally, because a covered IHC is permitted to file a voluntary petition under Chapter 11 of the Bankruptcy Code before it becomes balance-sheet insolvent or even before it becomes unlikely to be able to pay its debts as they come due, the covered IHC can achieve the same recapitalization goal by filing a voluntary petition under Chapter 11, without the need for a separate minimum long-term debt requirement.

If the Federal Reserve nevertheless decides to retain separate long-term debt requirements, the Associations believe that the final rule should include a one-year cure period for any breaches of those long-term debt requirements, provided that all minimum TLAC requirements are complied with during the cure period. Such a cure period seems appropriate and reasonable, in our view, in light of the fact that separate long-term debt requirements are unnecessary to ensure that the covered IHCs have enough TLAC at the point of failure to be recapitalized at Basel III levels for the reasons stated above. Moreover, any supervisory action taken after the permitted cure period should be reasonable and proportional in light of the circumstances giving rise to the breach.

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<sup>19</sup> For reasons elaborated further in [Annex 1](#), the Associations do not believe that the contractual trigger requirement should be retained.

<sup>20</sup> Dodd-Frank Act, § 203(b)(1). The term “in default or in danger of default” is broadly defined to include balance-sheet insolvency or likely insolvency, the failure or likely failure to be able to pay one’s debts as they come due or the commencement or likely commencement of a voluntary or involuntary proceeding under the Bankruptcy Code. *Id.* § 203(c)(4).

**III. The Federal Reserve should treat resolution entity IHCs the same as covered BHCs under the proposed rule, except for any differences based on U.S. G-SIB status.**

**A. Resolution entity IHCs should be permitted to satisfy their minimum TLAC requirements with any combination of external and internal TLAC.**

The Associations believe that resolution entity IHCs should be permitted to satisfy any minimum TLAC requirements by any combination of internal and external TLAC. If the Federal Reserve agrees with this proposal, the Associations believe that the modified definitions of eligible debt securities (“EDS”) and “unrelated liabilities” and the grandfathering provisions that were proposed for external long-term debt securities and other capital structure liabilities<sup>21</sup> in the U.S. G-SIB Comment Letter should apply to any external long-term debt securities and other capital structure liabilities of resolution entity IHCs.

The Federal Reserve’s principal rationale for limiting a resolution entity IHC’s TLAC to internal instruments issued to a foreign parent is that this would “ensure that losses incurred by the U.S. IHC of a foreign G-SIB would be upstreamed to a foreign parent rather than being transferred to other U.S. entities . . . [minimizing] the risk that such losses pose to the financial stability of the United States.”<sup>22</sup> This rationale makes no sense as applied to resolution entity IHCs because they are expected to be resolved in a U.S. bankruptcy (or Title II proceeding, if necessary)<sup>23</sup> pursuant to an MPOE strategy. This approach would also increase systemic risk by concentrating losses on the foreign parent. Therefore, to avoid unequal treatment as compared to covered BHCs, resolution entity IHCs should be permitted to use external TLAC.

While the Associations do not believe there should be any separate long-term debt requirements, if separate long-term debt requirements are retained, the Associations believe that the arguments above apply equally to using external instruments to satisfy any minimum long-term debt requirements.

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<sup>21</sup> By “**capital structure liabilities**” we mean all equity, hybrid and long-term debt securities that can absorb losses without threatening financial stability. The term does not include short-term debt or other operating liabilities. By “**operating liabilities**” we mean an institution’s short-term debt, liabilities on most qualified financial contracts, liabilities for rent, utilities and similar other critical services, and liabilities arising other than by contract such as those arising from litigation judgments. By “**short-term debt**” we mean any debt with an original maturity of less than one year or with a put option exercisable by the debt holder in less than one year after the original issuance of the debt, including demand deposits and other short-term deposits.

<sup>22</sup> 80 Fed. Reg. at 74941.

<sup>23</sup> Title II of the Dodd-Frank Act empowers the FDIC to take a failing financial company, like a covered IHC, into receivership if the firm’s failure would have serious adverse effects on U.S. financial stability.

**B. The proposed TLAC (and if retained, long-term debt) requirements applicable to resolution entity IHCs should be reduced to reflect the same allowances for balance-sheet depletion that were reflected in the proposed requirements for covered BHCs.**

The Associations believe that any minimum TLAC requirements imposed on resolution entity IHCs should be calibrated based on the same methodology that the Federal Reserve uses to calibrate the corresponding requirements applicable to covered BHCs, except for any G-SIB surcharges or enhanced supplementary leverage ratio (“SLR”) requirements, unless the resolution entity IHC itself has been designated as a U.S. G-SIB. We believe that failure to do so would be inconsistent with the principle of national treatment and the principle that similarly situated companies should be treated the same under the Federal Reserve’s proposed TLAC rules, except for any U.S. G-SIB surcharges or SLR enhancements, if applicable.

The minimum TLAC requirements applicable to resolution entity IHCs properly excluded any U.S. G-SIB surcharges and enhanced SLR requirements. This reflects a material difference between covered BHCs and resolution entity IHCs that have not themselves been designated as U.S. G-SIBs.

In contrast, there is no material difference between covered BHCs and resolution entity IHCs as far as any expected balance sheet depletion is concerned at the point of failure and entry into resolution. Both will suffer losses and have smaller balance sheets at the point of failure and entry into resolution. Resolution entity IHCs are, by definition, expected to be resolved under an MPOE resolution strategy rather than an SPOE strategy. As a result, they are expected to enter U.S. bankruptcy (or Title II proceeding, if necessary) and be resolved just like a covered BHC.

Despite this essential similarity as far as balance sheet depletion is concerned, the minimum risk-weighted long-term debt ratio applicable to resolution entity IHCs does not reflect a 1 percentage point allowance for expected balance-sheet depletion the way the corresponding ratio for covered BHCs has been calibrated. Nor does the minimum long-term debt SLR or the minimum on-balance-sheet long-term debt leverage ratio reflect a 0.5 percentage point allowance to reflect expected balance-sheet depletion the way the corresponding ratio for covered BHCs has been calibrated. Finally, neither the minimum TLAC SLR nor the minimum on-balance-sheet TLAC leverage ratio reflects a 0.5 percentage point allowance for expected balance-sheet depletion the way the corresponding ratio for covered BHCs has been calibrated.

The Federal Reserve provided no explanation in the proposed rule for this differential treatment. The Associations believe that the Federal Reserve should amend the proposed rule so that the minimum TLAC requirements applicable to resolution entity IHCs reflect the same allowances for balance sheet depletion as the corresponding ratios for covered BHCs. We believe that if the Federal Reserve recalculated the minimum TLAC requirements applicable to

resolution entity IHCs to reflect the same allowances for balance-sheet depletion as the corresponding ratios for covered BHCs, the properly calibrated amounts would be as shown in the table below.

Proposed Minimum Required Ratio or Buffer	Resolution Entity IHCs (MPOE Strategy)		
	Risk-Based Ratio	SLR	On-Balance Sheet Leverage Ratio
Minimum Internal TLAC Ratio	18%	6.75% <sup>24</sup>	7.5% (instead of 9%)
Internal TLAC Buffer	2.5% + countercyclical buffer <sup>25</sup>	N/A	N/A
Minimum Internal Long-Term Debt Ratio	None <sup>26</sup>	None	None

Furthermore, for the reasons set forth in the U.S. G-SIB Comment Letter, the Associations believe that the Federal Reserve should reduce the minimum TLAC requirements applicable to resolution entity IHCs to the reduced levels proposed for covered BHCs in that letter, excluding any G-SIB surcharges or any SLR enhancements. If the Federal Reserve did so, the minimum TLAC requirements would be reduced to the levels shown in the following table.

Proposed Minimum Required Ratio or Buffer	Resolution Entity IHCs (MPOE Strategy)		
	Risk-Based Ratio	SLR	On-Balance Sheet Leverage Ratio
Minimum Internal TLAC Ratio	14%	6%	7.5%
Internal TLAC Buffer	None	N/A	N/A
Minimum Internal Long-Term Debt Ratio	None <sup>27</sup>	None	None

Finally, the Associations believe that resolution entity IHCs that are subject to the SLR should only be required to calculate and comply with the TLAC risk-based and SLR ratios, and not the TLAC on-balance-sheet leverage ratios. Conversely, resolution entity IHCs that are not subject to the SLR should only be required to calculate and comply with the TLAC risk-based

<sup>24</sup> It appears that the Federal Reserve calibrated the minimum internal TLAC SLR based on the fully phased-in external TLAC SLR proposed in the FSB's final international standard.

<sup>25</sup> The countercyclical buffer is currently set at zero and in any event would only apply to resolution entity IHCs with total assets of at least \$250 billion or total foreign exposures of at least \$10 billion.

<sup>26</sup> While we do not believe that the proposed rule should contain any minimum long-term debt requirements, if the Federal Reserve nevertheless decides to include them, the proposed risk-based long-term debt requirement should be 6% (instead of 7%), the proposed long-term debt SLR should be 2.5% (instead of 3%) and the long-term debt on-balance sheet leverage ratio should be 3.5% (instead of 4%), reflecting 0.5%-1.0% allowances for balance sheet depletion.

<sup>27</sup> See note 26.

and on-balance sheet leverage ratios, and not the TLAC SLR ratios. If resolution entity IHCs are required to calculate and comply with both ratios, it would result in unequal treatment compared to covered BHCs and would have the tendency of turning the TLAC requirements applicable to resolution entity IHCs into super-equivalent rather than equivalent requirements.

We also believe that the SLR and on-balance sheet leverage requirements should be calibrated as back-up requirements, rather than binding constraints, for the reasons set forth in the U.S. G-SIB Comment Letter.

**IV. The Federal Reserve should reduce the proposed internal TLAC (and if retained, long-term debt) requirements applicable to non-resolution entity IHCs to not more than 75% of the TLAC (and long-term debt) requirements applicable to resolution entity IHCs.**

**A. The proposed internal TLAC and long-term debt requirements for non-resolution entity IHCs are a classic form of ex-ante ring-fencing and will increase the risk of ex-post ring-fencing if set at excessive levels.**

The purpose of internal TLAC is fundamentally different from external long-term debt and other TLAC. The external long-term debt and other TLAC requirements are intended to ensure that a resolution entity like a covered BHC or resolution entity IHC will always have enough usable TLAC to be recapitalized in the event of failure. By contrast, internal TLAC requirements for non-resolution entity IHCs are intended to encourage home and host resolution authorities to cooperate in an SPOE resolution of the foreign G-SIB's top-tier parent to ensure the success of such a resolution. If a non-resolution IHC does not have enough TLAC, the home resolution authority of its top-tier foreign parent may not have sufficient incentive to use the foreign parent's resources to recapitalize the non-resolution entity IHC and keep it out of U.S. bankruptcy or Title II proceedings. If a non-resolution IHC has too much internal TLAC, its U.S. host authority will have a strong incentive to ring-fence the non-resolution IHC's assets because the U.S. host authority can resolve the non-resolution IHC without cooperating with the foreign G-SIB's home resolution authority. The purpose of internal TLAC requirements on non-resolution IHCs is to strike the right balance that provides an incentive to both home and host authorities to cooperate with each other in the SPOE resolution of the foreign G-SIB's top-tier foreign parent.

The proposed internal TLAC and long-term debt requirements for non-resolution entity IHCs are a classic form of ex-ante ring-fencing. While internal TLAC requirements can be benign if the conditions described in the prior paragraph are satisfied, they will be a significant obstacle to the rapid and orderly resolution of foreign G-SIBs under an SPOE strategy if they are higher than necessary to ensure the recapitalization of non-resolution entity IHCs or if they are set at levels that increase the risk that U.S.-host resolution authorities will not cooperate with the foreign G-SIB's home-country resolution authority or the risk that assets of the foreign G-SIB parent will be misallocated. The Associations believe that the proposed internal TLAC and long-

term debt requirements are calibrated at excessively high levels that will substantially increase the risk of ex-post ring-fencing and misallocation risk.

**B. The proposed TLAC (and if retained, long-term debt) requirements applicable to non-resolution entity IHCs are excessive and unless reduced to an appropriate level will provide an undesirable incentive for U.S. host resolution authorities to engage in ex-post ring-fencing of covered IHCs instead of cooperating with their top-tier foreign parent's home resolution authority to facilitate a successful SPOE resolution of the foreign G-SIB.**

The proposed TLAC and long-term debt requirements applicable to non-resolution entity IHCs are currently calibrated at 90% of the TLAC requirements applicable to resolution entity IHCs and 100% of the long-term debt requirements applicable to resolution entity IHCs.

For the reasons more fully set forth in Annex 1, the Associations believe that the Federal Reserve should calibrate the proposed TLAC requirements applicable to non-resolution entity IHCs at not more than 75% of the requirements applicable to resolution entity IHCs.

If the Federal Reserve were to calibrate its internal TLAC requirements applicable to non-resolution entity IHCs at 75% of the corresponding requirements applicable to resolution entity IHCs (as recalibrated to reflect the same balance sheet depletion allowance used for covered BHCs), the resulting minimum TLAC ratios applicable to non-resolution entity IHCs would be as set forth in the following table:

Proposed Minimum Required Ratio or Buffer	Non-Resolution Entity IHCs (SPOE Strategy)		
	Risk-Based Ratio	SLR	On-Balance Sheet Leverage Ratio
Minimum Internal TLAC Ratio	13.5%	5.0%	5.625%
Internal TLAC Buffer	1.875% + 75% of countercyclical buffer <sup>28</sup>	N/A	N/A
Minimum Internal Long-Term Debt Ratio	None <sup>29</sup>	None	None

<sup>28</sup> See note 25.

<sup>29</sup> While we do not believe that the proposed rule should contain any minimum long-term debt requirements, if the Federal Reserve nevertheless decides to include them, the proposed risk-based long-term debt requirement should be 4.5%, the proposed long-term debt SLR should be 1.875% and the long-term debt on-balance sheet leverage ratio should be 2.625%. In the alternative, the Associations support the approach recommended in the comment letter filed by the Institute of International Bankers that the long-term debt requirement for non-resolution entity IHCs, if retained, be established as a supervisory expectation that internal long-term debt be required to comprise no more than 33% of internal TLAC.

Furthermore, if the Federal Reserve agrees to reduce the minimum TLAC requirements applicable to covered BHCs as requested in the U.S. G-SIB Comment Letter, the minimum risk-based TLAC ratio would be as set forth in the following table:

Proposed Minimum Required Ratio or Buffer	Non-Resolution Entity IHCs (SPOE Strategy)		
	Risk-Based Ratio	SLR	On-Balance Sheet Leverage Ratio
Minimum Internal TLAC Ratio	10.5%	4.5%	5.625%
Internal TLAC Buffer	None	N/A	N/A
Minimum Internal Long-Term Debt Ratio	None <sup>30</sup>	None	None

Finally, the Associations believe that non-resolution entity IHCs that are subject to the SLR should only be required to calculate and comply with the TLAC risk-based and SLR ratios, and not the TLAC on-balance sheet leverage ratios. Conversely, non-resolution entity IHCs that are not subject to the SLR should only be required to calculate and comply with the TLAC risk-based and on-balance sheet leverage ratios, and not the TLAC SLR ratios. As discussed above with respect to resolution entity IHCs, if non-resolution entity IHCs are required to calculate and comply with both ratios, it would likewise result in unequal treatment compared to covered BHCs.

We also believe that the SLR and on-balance sheet leverage requirements should be calibrated as back-up requirements, rather than binding constraints, for the reasons set forth in the U.S. G-SIB Comment Letter.

**C. The proposed 50% haircut for long-term debt securities with a remaining maturity between one and two years is unnecessary and should be eliminated.**

For the reasons discussed more fully in [Annex 1](#) and in the U.S. G-SIB Comment Letter, the Associations believe that if the long-term debt requirements are retained, the Federal Reserve should eliminate the 50% haircut applicable to EDS with a remaining maturity between one and two years. In addition to the reasons discussed in the U.S. G-SIB Comment Letter, a 50% haircut is even less appropriate in the context of internal long-term debt because there is no risk that the covered IHC will lose market access and be unable to replace internal long-term debt as it approaches maturity; it can simply replace it with new internal long-term debt from a foreign affiliate.

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<sup>30</sup> See note 29.

**V. The Federal Reserve should confirm that covered IHCs can rely on either structural or contractual subordination and permit covered IHCs relying on structural subordination to have the same 5% allowance for unrelated liabilities as applies to covered BHCs.**

The Associations believe that all covered IHCs should be permitted to rely on either structural or contractual subordination for their eligible internal long-term debt. The text of the proposed rule only requires that EDS be “the most subordinated debt claim of the... covered IHC,” suggesting that either structural or contractual subordination will suffice.<sup>31</sup> However, the preamble to the proposed rule states that eligible internal long-term debt must be contractually subordinated to all third-party liabilities.<sup>32</sup> The Associations believe that all covered IHCs should have the option to satisfy this priority requirement by either contractual or structural subordination and request the Federal Reserve to confirm that they may do so.

Furthermore, the requirement that EDS be the most subordinated debt claim precludes any liabilities of the covered IHC from being held *pari passu* with the EDS. The Associations believe that in the case of covered IHCs that rely on structural subordination, this requirement would unnecessarily restrict the operations of covered IHCs and that covered IHCs should instead be permitted the same 5% allowance for third-party operating liabilities and other unrelated liabilities, and no restriction on liabilities to affiliates or contingent liabilities to affiliates or third parties, as permitted to covered BHCs. We believe that these modifications are required in order for the requirements applicable to covered IHCs to be consistent with the principle of national treatment.

**VI. The Federal Reserve should eliminate the proposed requirement that eligible internal long-term debt contain contractual triggers exercisable outside of insolvency proceedings by the Federal Reserve in order to avoid a variety of adverse consequences, including adverse consequences under the U.S. Federal and State tax laws.**

For the reasons more fully set forth in Annex 1, the Associations believe that covered IHCs should not be required to include any contractual triggers in their long-term debt securities that permit the Federal Reserve to convert such long-term debt securities to equity outside of a bankruptcy or Title II proceeding. First, the Associations believe that resolution entity IHCs should be exempt from this requirement. Under an MPOE resolution strategy, the resolution entity IHC would be placed into a resolution proceeding, where debt can be written down or converted to equity as appropriate. There is no need for a contractual trigger to write down or convert debt to equity outside of such proceedings.

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<sup>31</sup> 80 Fed. Reg. at 74962; Proposed Rule § 252.161– definition of “eligible internal debt security”.

<sup>32</sup> 80 Fed. Reg. at 74942.

Second, in an SPOE resolution, the foreign parent that is being resolved would already have strong incentives to recapitalize the covered IHC to maximize the value of the covered IHC for the benefit of its stakeholders since its franchise value is likely to be substantially higher than its liquidation value. Furthermore, certain mandated features of eligible internal long-term debt, especially the contractual trigger and deep subordination, will give rise to significant uncertainty over whether eligible internal long-term debt may properly be characterized as debt, and not equity, for U.S. federal income tax purposes, creating uncertainty about the tax deductibility of interest payments on eligible internal long-term debt and whether these payments are subject to withholding tax. If eligible internal long-term debt were treated as equity for U.S. federal income tax purposes, it would result in an uneven playing field by unfairly and substantially increasing the cost of complying with the Federal Reserve's requirements for covered IHCs as compared to covered BHCs.

**VII. Eligible internal long-term debt should be permitted to contain the same acceleration events as permitted for EDS issued by covered BHCs.**

For the reasons more fully set forth in Annex 1, the Associations believe that eligible internal long-term debt should, at a minimum, be allowed to contain acceleration clauses based on an insolvency or payment default, as is permitted for external EDS. The prohibition on all acceleration clauses contained in the proposed rule is unfairly much stricter than the requirements for covered BHCs. Our proposed change will be particularly important to the extent the Federal Reserve agrees that resolution entity IHCs should be permitted to satisfy their minimum requirements by issuing either internal or external TLAC.

**VIII. Covered IHCs should be permitted to satisfy their minimum TLAC and long-term debt requirements with capital contribution agreements.**

For the reasons more fully described in Annex 1, the Federal Reserve should provide covered IHCs with the flexibility to satisfy their internal TLAC requirements by entering into capital contribution agreements with foreign affiliates, thereby mitigating any misallocation risk. As discussed in greater detail in the U.S. G-SIB Comment Letter, prepositioned debt or equity imposes significant costs owing to misallocation risk, such that prepositioning could actually undermine a successful resolution. Instead, covered IHCs should be permitted to satisfy TLAC requirements with committed assets held at the foreign parent subject to capital contribution agreements. Such an approach would allow the foreign G-SIB to allocate its resources more efficiently among its subsidiaries in a resolution and re-direct those resources where they are most needed, rather than trapping resources that may not be needed in the covered IHC through prepositioning. If long-term debt requirements are retained, the Associations believe the above arguments apply equally to any minimum long-term debt requirements.

**IX. The Associations believe that a variety of technical and other modifications would improve the effectiveness of the proposed rule without undermining the key objectives of TLAC.**

For the reasons more fully described in Annex 1, the Associations urge the Federal Reserve to amend the proposed rule as follows:

- Permit covered IHCs to issue or transfer otherwise eligible Tier 1 capital securities or EDS to a foreign affiliate, rather than just a foreign parent.
- Eliminate the provision that would treat a foreign banking organization as a foreign G-SIB based on its own assessment under the BCBS methodology.
- Create an exception from the prohibition on short-term debt for secured liquidity provided by the FDIC to facilitate an SPOE or other resolution under Title II of the Dodd-Frank Act.
- Modify the prohibition on cross-defaults in parent guarantees or subsidiary liabilities guaranteed by the parent to permit cross-defaults that are consistent with the ISDA 2015 Universal Resolution Stay Protocol or any future regulations implementing the ISDA Protocol in the United States.
- Clarify that the term qualified financial contract (“QFC”) does not include a guarantee of a subsidiary’s obligations on a QFC, provided that neither the guarantee nor the QFC contains an impermissible cross-default (as modified by the request in the preceding bullet).
- Extend the phase-in period for any SLR-based TLAC requirements (and if the Federal Reserve retains separate long-term debt requirements, both the risk-based and SLR-based long-term debt requirements) to January 1, 2022, consistent with the proposed phase-in for risk-based and SLR-based requirements under the FSB’s international standard.<sup>33</sup>

**X. The Federal Reserve should not impose any domestic internal TLAC or long-term debt requirements for covered IHCs.**

For the reasons discussed more fully in Annex 1 and in the U.S. G-SIB Comment Letter, the Federal Reserve should not impose any domestic internal TLAC or long-term debt requirements on U.S. IHCs. Such requirements would be particularly unnecessary for covered IHCs because a foreign G-SIB’s U.S. operations are already sufficiently regulated to support a

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<sup>33</sup> Financial Stability Board, Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution: Total Loss-absorbing Capacity (TLAC) Term Sheet at 21-22 (Nov. 9, 2015).

successful resolution through the imposition of TLAC requirements on the covered IHC. But if the Federal Reserve were to impose domestic internal TLAC on U.S. IHCs, it should not impose a one-size-fits-all requirement; rather, covered IHCs should be allowed to retain the option to satisfy any such internal domestic TLAC requirements with any combination of contributable resources, prepositioned resources or capital contribution agreements.

## **XI. Description of Annexes**

The following Annexes to this cover letter form the core of our comment letter and are incorporated into this cover letter by reference.

**Annex 1 (Discussion)** contains a detailed analysis of our comments and recommendations. Because of the length and complexity of this annex, we have included an interactive table of its contents. By clicking on any item in the table of contents, you will be hyperlinked to the relevant section in **Annex 1**.

**Annex 2 (Glossary)** contains a glossary of defined terms used throughout our comment letter.

**Annex 3 (Associations)** contains a description of each of the Associations.

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We thank the Federal Reserve for its consideration of our comments. If you have any questions, please do not hesitate to contact any of the undersigned.

Sincerely,



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Managing Director and Deputy General  
Counsel  
The Clearing House Association



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**ANNEX 1**

**To Cover Letter of Comment Letter on the Notice of Proposed Rulemaking on Internal TLAC, Long-Term Debt, Clean Holding Company and Other Requirements Applicable to the U.S. IHCs of Foreign G-SIBs**

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This Annex 1 supplements the cover letter to which it is attached (the “**Foreign G-SIB Cover Letter**”) and together with that cover letter and all annexes thereto constitutes the comment letter of the Associations (the “**Foreign G-SIB Comment Letter**”). The separate comment letter filed by the Associations on behalf of the U.S. G-SIBs is referred to in the Foreign G-SIB Comment Letter as the “**U.S. G-SIB Comment Letter.**” All terms defined in the Foreign G-SIB Cover Letter have the same meanings in this Annex 1. Attached for your convenience as Annex 2 to the Foreign G-SIB Cover Letter is a glossary showing all the defined terms in one place.

## **I. Guiding Principles**

The main comments and recommendations made in this comment letter are based on three guiding principles.

**Principle No. 1:** All similarly situated companies should be treated the same under the Federal Reserve’s proposed TLAC rules, except for any differences based on U.S. G-SIB status.

Companies that are similarly situated should be treated the same under the proposed rule. Resolution entity IHCs are similar to covered BHCs in that both are resolution entities that are expected to enter into their own resolution proceedings if they become undercapitalized and fail. Non-resolution entity IHCs are similar to the subsidiaries of covered BHCs in that both are expected to be kept out of their own resolution proceedings pursuant to an SPOE resolution strategy. Both resolution entity IHCs and non-resolution entity IHCs are significantly different from covered BHCs, however, in that none of the IHCs have themselves been designated as U.S. G-SIBs. These similarities and differences between covered IHCs and covered BHCs should be reflected in the proposed rule as applied to covered IHCs.

Based on this Principle No. 1, for example, whatever modifications the Federal Reserve makes to the proposed rule for covered BHCs should be reflected in the rules applicable to covered IHCs, except for any changes related to G-SIB status, unless the covered IHCs are themselves designated as U.S. G-SIBs.

**Principle No. 2:** The proposed TLAC requirements applicable to resolution entity IHCs should be calibrated based on the same methodology that the Federal Reserve uses to calibrate the requirements applicable to covered BHCs, except for any U.S. G-SIB surcharges or enhancements, unless the resolution entity IHCs have been designated as U.S. G-SIBs.

Principle No. 2 follows logically from Principle No. 1. Accordingly, the Associations believe that the Federal Reserve should amend the proposed rule so that the minimum TLAC requirements applicable to resolution entity IHCs reflect the same allowances for balance sheet depletion as the corresponding ratios for covered BHC, but not to reflect any U.S. G-SIB surcharges or SLR enhancements. Furthermore, for the reasons set forth in the U.S. G-SIB Comment Letter, the Associations believe that the Federal Reserve should reduce the minimum TLAC requirements applicable to resolution entity IHCs to the reduced levels proposed for covered BHCs in that letter, excluding any U.S. G-SIB surcharges or SLR enhancements. Finally, the Associations believe that resolution entity IHCs that are subject to the SLR should only be required to calculate and comply with the TLAC risk-based and SLR ratios, and not the TLAC on-balance sheet leverage ratios; and conversely, resolution entity IHCs that are not subject to the SLR should only be required to calculate and comply with the TLAC risk-based and on-balance sheet leverage ratios, and not the TLAC SLR ratios.

All of these considerations apply equally to non-resolution entity IHCs, since the minimum TLAC requirements for non-resolution entity IHCs are set at a percentage of the requirements for resolution entity IHCs.

**Principle No. 3:** All U.S. ring-fencing of non-resolution entity IHCs is a serious new obstacle to the successful resolution of the foreign G-SIBs of which they are subsidiaries under an SPOE resolution strategy, whether that ring-fencing takes place before or after the top-tier parent's failure.

The proposed internal TLAC and long-term debt requirements for non-resolution entity IHCs are a classic form of ex-ante ring-fencing. The purpose of internal TLAC requirements for non-resolution IHCs is to strike the right balance that provides an incentive to both home and host authorities to cooperate with each other in the SPOE resolution of the foreign G-SIB's top-tier foreign parent in order to ensure a successful SPOE resolution of the foreign parent. While internal TLAC requirements can be benign if certain conditions are satisfied, they will be a significant obstacle to the rapid and orderly resolution of foreign G-SIBs under an SPOE strategy if they are unnecessary to ensure the recapitalization of non-resolution entity IHCs or if they are set at levels that increase the risk that host-country supervisors (including U.S. supervisors) will not cooperate with home-country resolution authorities or the risk that assets of the G-SIB parent will be misallocated.

Accordingly, the Associations believe that the proposed internal TLAC requirements are calibrated at excessively high levels that will substantially increase the risk of ex-post ring-fencing and misallocation risk. In particular, the Associations believe that the Federal Reserve should calibrate the proposed TLAC requirements applicable to non-resolution entity IHCs at not more than 75% of the requirements applicable to resolution entity IHCs.

For similar reasons, and as discussed in Section VIII (“Consideration of U.S. Domestic Internal TLAC and Long-Term Debt Requirements”) of Annex 1 to the U.S. G-SIB Comment Letter, the Federal Reserve should not impose domestic internal TLAC or long-term debt requirements on the U.S. subsidiaries of covered IHCs. Such requirements are unnecessary given that there is no reason for U.S. regulators of an IHC’s subsidiaries to distrust the U.S. regulators of the IHC, and vice versa. U.S. regulators should be able to coordinate to make sure that the subsidiaries of a covered IHC are properly recapitalized in a resolution event affecting the covered IHC.

## **II. Internal TLAC and Long-Term Debt Requirements for IHCs of Foreign G-SIBs**

The proposed rule would impose internal TLAC and long-term debt requirements on the covered IHCs of foreign G-SIBs. The proposed rule makes a distinction between resolution entity IHCs and non-resolution entity IHCs. A resolution entity IHC “is expected to enter resolution if a foreign parent fails” pursuant to an MPOE resolution strategy.<sup>1</sup> A non-resolution entity IHC is expected to be “maintained as a going concern while a foreign entity is resolved” pursuant to an SPOE strategy.<sup>2</sup> A non-resolution entity IHC is a covered IHC for which “the home country resolution authority for the top-tier foreign banking organization that controls the covered IHC has certified to the [Federal Reserve] that the authority’s planned resolution strategy for the foreign banking organization does not involve the covered IHC or the subsidiaries of the covered IHC entering resolution, receivership, insolvency or similar proceedings in the United States.”<sup>3</sup> A covered IHC would be presumed to be a resolution entity IHC unless its home country resolution authority provides such a certification to the Federal Reserve.<sup>4</sup> Despite this presumption, the NPR states that most covered IHCs are expected to be treated as non-resolution IHCs.<sup>5</sup>

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<sup>1</sup> 80 Fed. Reg. at 74940.

<sup>2</sup> 80 Fed. Reg. at 74940.

<sup>3</sup> Proposed Rule, § 252.164(d). *See also* 80 Fed. Reg. at 74940.

<sup>4</sup> 80 Fed. Reg. at 74940.

<sup>5</sup> 80 Fed. Reg. at 74941.

The Associations support the Financial Stability Board's goal of establishing TLAC requirements for each resolution entity within a G-SIB, including multiple resolution entities within a foreign G-SIB that is expected to be resolved under an MPOE strategy in the event of failure.<sup>6</sup> We also support the Federal Reserve's goal of establishing appropriate and reasonable TLAC requirements for covered IHCs. But to satisfy this appropriate and reasonable standard, any TLAC requirements applicable to resolution entity IHCs need to be calculated based on the same methodology that the Federal Reserve used to calibrate the requirements applicable to covered BHCs, except for any U.S. G-SIB surcharges or enhancements, unless the resolution entity IHCs are designated as U.S. G-SIBs. Any internal TLAC requirements applicable to non-resolution entity IHCs should be calibrated at levels that encourage cooperation between U.S. host resolution authorities and the foreign G-SIB's home resolution authority in an SPOE resolution of the foreign G-SIB, without giving U.S. host resolution authorities an excessive incentive to ring-fence. We believe that any such minimum requirements should be calibrated at not more than 75% of the level of any requirements applicable to resolution entity IHCs, not at the 90-100% levels in the proposed rule.

#### **A. No Separate Long-Term Debt Requirements**

While the Associations strongly support the goal of establishing appropriate and reasonable TLAC requirements for covered IHCs, the Associations believe that the separate long-term debt requirements are completely unnecessary to ensure that the covered IHCs have enough TLAC at the point of failure to be recapitalized at Basel III levels. We also do not believe that any minimum long-term debt requirement is necessary for internal TLAC since internal TLAC does not serve any market discipline purpose the way external TLAC does. At the same time, we would oppose any proposal to exclude long-term debt securities from eligible TLAC, effectively limiting eligible TLAC to equity securities. Instead, we believe that covered IHCs should be able to satisfy their minimum TLAC requirements by freely substituting equity for long-term debt securities and long-term debt securities for equity, subject to applicable regulatory capital requirements.

It is unlikely that any covered IHC would choose to satisfy its entire TLAC requirement with equity rather than long-term debt securities, since long-term debt securities are a less expensive form of loss-absorbing capacity. Based on the initial level of minimum required TLAC in the proposed rule, a covered IHC is virtually certain to have sufficient TLAC at the point of failure to recapitalize the group at Basel III levels without a separate minimum long-term debt requirement. It would be counterintuitive to prohibit a covered IHC from substituting equity for long-term debt securities since equity can absorb losses both inside and outside of a bankruptcy or Title II proceeding, and therefore function as both going-concern and gone-

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<sup>6</sup> Financial Stability Board, Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution: Total Loss-absorbing Capacity (TLAC) Term Sheet, at 9 (Nov. 9, 2015).

concern capital. In contrast, absent a consensual debt restructuring outside of a bankruptcy or Title II proceeding or activation of the proposed contractual trigger by the Federal Reserve,<sup>7</sup> long-term debt securities can only absorb losses in a bankruptcy or Title II proceeding, and therefore generally function only as gone-concern capital. Thus, we believe that long-term debt securities should be permitted but not required to satisfy any minimum TLAC requirements in excess of regulatory capital requirements.

We do not believe that a separate minimum long-term debt requirement is necessary in order for the FDIC to be appointed receiver under Title II while a covered IHC still has enough TLAC to be recapitalized at Basel III levels (i.e., satisfy the capital refill goal). It is true that Title II of the Dodd-Frank Act cannot be invoked until a covered IHC is “in default or in danger of default.”<sup>8</sup> But that standard does not require the Treasury Secretary to wait until a covered IHC is balance-sheet insolvent before invoking Title II. It allows the Treasury Secretary to invoke Title II before balance-sheet insolvency based on a determination that the covered IHC is unlikely to be able to pay its debts as they come due. Covered IHCs and their supervisors would have a strong incentive to commence a resolution proceeding in advance of balance-sheet insolvency in order to ensure that the covered IHC has enough TLAC to be recapitalized at Basel III levels.

Moreover, the Federal Reserve can respond to a depletion in a covered IHC’s TLAC outside of a bankruptcy or Title II through its other regulatory and supervisory tools. In addition, a covered IHC can achieve capital restoration similar to a recapitalization under an MPOE or SPOE resolution strategy outside of a bankruptcy or Title II proceeding. Finally, because a covered IHC is permitted to file a voluntary petition under Chapter 11 of the Bankruptcy Code before it becomes balance-sheet insolvent or even before it becomes unlikely to be able to pay its debts as they come due, the covered IHC can achieve the same recapitalization goal by filing a voluntary petition under Chapter 11, without the need for a separate minimum long-term debt requirement.

If the Federal Reserve nevertheless decides to retain separate long-term debt requirements, the Associations believe that the final rule should include a one-year cure period for any breaches of those long-term debt requirements, provided that all minimum TLAC requirements are complied with during the cure period. Such a cure period seems appropriate and reasonable, in our view, in light of the fact that separate long-term debt requirements are

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<sup>7</sup> For reasons elaborated further in Section II.D.3, the Associations do not believe that the contractual trigger requirement should be retained.

<sup>8</sup> Dodd-Frank Act, § 203(b)(1). The term “in default or in danger of default” is broadly defined to include balance-sheet insolvency or likely insolvency, the failure or likely failure to be able to pay one’s debts as they come due or the commencement or likely commencement of a voluntary or involuntary proceeding under the Bankruptcy Code. *Id.* § 203(c)(4).

unnecessary to ensure that the covered IHCs have enough TLAC at the point of failure to be recapitalized at Basel III levels for the reasons stated above. Moreover, any supervisory action taken after the permitted cure period should be reasonable and proportional in light of the circumstances giving rise to the breach.

## **B. Resolution Entity IHCs**

### **1. Internal vs. External TLAC**

Under the proposed rule, only Tier 1 capital securities and EDS held by a foreign parent entity of the covered IHC would count toward the covered IHC's minimum internal TLAC requirements. The proposed rule would not permit a covered IHC, including a resolution entity IHC, to satisfy its minimum TLAC requirements by issuing Tier 1 equity or long-term debt securities to third parties (i.e., with external Tier 1 capital securities or EDS).<sup>9</sup> Based on Principle No. 1, the Associations believe that this limitation is overly restrictive for resolution entity IHCs and strongly urge the Federal Reserve to permit them to satisfy any minimum TLAC requirements by any combination of internal and external TLAC. If the Federal Reserve agrees, the Associations believe that the modified definitions of EDS and "unrelated liabilities" and the grandfathering provisions that were proposed for external long-term debt securities and other capital structure liabilities in the U.S. G-SIB Comment Letter should apply to any external long-term debt securities and other capital structure liabilities of resolution entity IHCs.

The Federal Reserve's principal rationale for limiting a resolution entity IHC's TLAC to internal instruments issued to a foreign parent is that this would "ensure that losses incurred by the U.S. IHC of a foreign G-SIB would be upstreamed to a foreign parent rather than being transferred to other U.S. entities . . . [minimizing] the risk that such losses pose to the financial stability of the United States."<sup>10</sup> This rationale makes no sense as applied to resolution entity IHCs because they are expected to be resolved in a U.S. bankruptcy (or Title II proceeding, if necessary)<sup>11</sup> pursuant to an MPOE strategy. Therefore, to avoid unequal treatment as compared to covered BHCs, resolution entity IHCs should be permitted to use external TLAC.

Moreover, covered BHCs are allowed to satisfy their minimum TLAC requirements with Tier 1 equity and EDS issued to third parties. The NPR acknowledges that resolution entity IHCs

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<sup>9</sup> The proposed rule also would not permit a covered IHC to meet its minimum internal TLAC and long-term debt requirements with Tier 1 capital securities or otherwise eligible internal long-term debt securities that are issued or transferred to an affiliate, even if the affiliate is a foreign company. For the Associations' argument that covered IHCs should be permitted to issue or transfer eligible long-term debt to foreign affiliates, see Section II.D.5.

<sup>10</sup> 80 Fed. Reg. at 74941.

<sup>11</sup> Title II of the Dodd-Frank Act empowers the FDIC to take a failing financial company, like a covered IHC, into receivership if the firm's failure would have serious adverse effects on U.S. financial stability.

are analogous to covered BHCs in that both are resolution entities that are expected to enter into resolution and be recapitalized.<sup>12</sup> While resolution entity IHCs could satisfy their requirements entirely with internal TLAC, it would be inconsistent with Principle No. 1 above that similarly situated companies should be treated equally to deny resolution entity IHCs the option to satisfy at least part of their requirements with external TLAC. Such an approach would also increase systemic risk by concentrating losses on the foreign parent.

The Federal Reserve also states that the requirement of issuance to the foreign parent rather than to U.S. affiliates or third parties would “prevent the conversion of eligible internal TLAC into equity from effecting a change of control over the covered IHC. A change in control could create additional and undesirable regulatory and management complexity during a failure scenario and would severely disrupt an SPOE resolution strategy.”<sup>13</sup> First, the Federal Reserve’s concern is limited, by its own words, to an SPOE strategy, and therefore this rationale should not apply to resolution entity IHCs that are expected to be resolved pursuant to an MPOE strategy, which will inevitably involve multiple changes of control. Second, the Associations refer here to the arguments for allowing internal TLAC to be issued to foreign affiliates, as discussed in Section II.D.5 below.

Finally, requiring resolution entity IHCs to satisfy their minimum TLAC requirements entirely with instruments held by a foreign parent would be inconsistent with existing law and practice. Such a requirement would create a disconnect with the Basel III capital rules, which allow externally issued instruments for capital calculation purposes. It would also be highly disruptive of IHCs’ existing practices since at least some resolution entity IHCs routinely issue Tier 1 capital and long-term debt securities to third parties.

For all these reasons, the final rule should permit resolution entity IHCs to satisfy their minimum TLAC requirements with instruments issued to third parties.

While the Associations do not believe there should be any separate long-term debt requirements for the reasons set forth in Section II.A above, if separate long-term debt requirements are retained, the Associations believe that the arguments above apply equally to using external instruments to satisfy any minimum long-term debt requirements.

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<sup>12</sup> Indeed, that was the principal reason given in the NPR for subjecting resolution entity IHCs to the same level of minimum TLAC and long-term debt requirements as covered BHCs, other than the G-SIB buffers. 80 Fed. Reg. at 74941.

<sup>13</sup> 80 Fed. Reg. at 74941-42.

## 2. Calibration

The proposed rule would impose the minimum TLAC and long-term debt requirements on resolution entity IHCs as shown in Table 1 below. For the sake of comparison, Table 1 also shows the corresponding minimum TLAC and long-term debt requirements for covered BHCs.

**Table 1**

Proposed Minimum Required Ratio or Buffer	Resolution Entity IHCs (MPOE Strategy)			Covered BHC	
	Risk-Based Ratio	SLR	On-Balance Sheet Leverage Ratio <sup>14</sup>	Risk-Based Ratio	SLR
Minimum Internal / External TLAC Ratio	18%	6.75% <sup>15</sup>	9%	18%	9.5%
Internal / External TLAC Buffer	2.5% + countercyclical buffer <sup>16</sup>	N/A	N/A	2.5% + countercyclical buffer + Method 1 G-SIB surcharge	N/A
Minimum Internal / External Long-Term Debt Ratio	7%	3%	4%	6% + Method 2 G-SIB surcharge	4.5%

The Associations believe that any minimum TLAC requirements applicable to resolution entity IHCs should be calibrated based on the same methodology that the Federal Reserve uses to calibrate the corresponding requirements applicable to covered BHCs, except for any U.S. G-SIB surcharges or enhanced SLR requirements, unless the resolution entity IHC itself has been designated as a U.S. G-SIB. We believe that failure to do so would be inconsistent with the principle of national treatment and Principle No. 1 that similarly situated companies should be treated the same under the Federal Reserve’s proposed TLAC rules, except for any U.S.G-SIB surcharges or SLR enhancements, if applicable.

The minimum TLAC requirements applicable to resolution entity IHCs properly excluded any U.S. G-SIB surcharges and enhanced SLR requirements. This reflects a material difference

<sup>14</sup> The on-balance sheet leverage ratio reflects TLAC or long-term debt as a percent of the covered IHC’s average total consolidated assets.

<sup>15</sup> It appears that the Federal Reserve calibrated the minimum internal TLAC SLR based on the fully phased-in external TLAC SLR proposed in the FSB’s final International Standard.

<sup>16</sup> The countercyclical buffer is currently set at zero and in any event would only apply to resolution entity IHCs with total assets of at least \$250 billion or total foreign exposures of at least \$10 billion.

between covered BHCs and resolution entity IHCs that have not themselves been designated as U.S. G-SIBs.

In contrast, there is no material difference between covered BHCs and resolution entity IHCs as far as any expected balance sheet depletion is concerned at the point of failure and entry into resolution. Both will suffer losses and have smaller balance sheets at the point of failure and entry into resolution. Resolution entity IHCs are expected to be resolved under an MPOE resolution strategy rather than an SPOE strategy. As a result, they are expected to enter a U.S. bankruptcy (or Title II proceeding, if necessary) and be resolved just like a covered BHC.

The NPR seems to acknowledge these principles in explaining how the minimum TLAC and long-term debt requirements for resolution entity IHCs were intended to be calibrated. First, the NPR noted that because both resolution entity IHCs and covered BHCs are intended to go through a resolution event, they share the same rationale for the calibration of their TLAC and long-term debt requirements—i.e., to ensure that these entities 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.<sup>17</sup> Second, it acknowledged that resolution entity IHCs are analogous to covered BHCs in that both are resolution entities that are expected to enter into resolution and be recapitalized.<sup>18</sup> Third, it indicated that the internal TLAC and long-term debt requirements applicable to resolution entity IHCs were intended to be calibrated based on the same general framework as the Federal Reserve used to calibrate the external TLAC and long-term debt requirements.<sup>19</sup> Finally, it indicated that the Federal Reserve intended to calibrate the long-term debt requirements for resolution entity IHC requirements using the same “capital refill” framework used to calibrate the long-term debt requirements for covered BHCs, adjusted to exclude the effect of any U.S. G-SIB surcharges or the buffer component of the enhanced SLR.<sup>20</sup>

Accordingly, the calibration of the minimum TLAC for resolution entity IHCs should follow the same methodology used to calibrate minimum TLAC requirements for the covered BHCs, except that the elements of that methodology based on the G-SIB surcharge or the 2% buffer component of the enhanced SLR (each of which is applicable only to covered BHCs by virtue of their status as U.S. G-SIBs) should not apply to covered resolution entity IHCs since they are not themselves U.S. G-SIBs, in accordance with Principle No. 2.

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<sup>17</sup> 80 Fed. Reg. at 74940.

<sup>18</sup> 80 Fed. Reg. at 74941.

<sup>19</sup> 80 Fed. Reg. at 74940-41.

<sup>20</sup> 80 Fed. Reg. at 74941.

For covered BHCs, the NPR describes the calibration of the minimum risk-based long-term debt ratio as a three-step process.<sup>21</sup> The first step was to calculate the amount of risk-weighted going concern capital that would need to be replaced for all covered BHCs, exclusive of any particular BHC's G-SIB surcharge. That would be the sum of the minimum CET1 requirement of 4.5% and the capital conservation buffer of 2.5% for a total of 7.0%.<sup>22</sup> The second step was to subtract "a 1 percentage point allowance for balance-sheet depletion," resulting in an adjusted figure of 6%. The NPR explained that "[t]he 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."<sup>23</sup> The final step was to add the applicable Method 2 G-SIB surcharge for each covered G-SIB. Those surcharges currently range from 1.0% to 4.5%, resulting in minimum external risk-based long-term debt ratios ranging from 7.0% to 10.5%.<sup>24</sup>

The NPR describes a similar two-step process for calibrating the minimum long-term debt SLR for covered BHCs.<sup>25</sup> The first step was to calculate the amount of supplementary leverage capital required on a going concern basis. That is simply the enhanced SLR of 5% since the covered BHCs are all G-SIBs.<sup>26</sup> The second and final step was to subtract a "balance-sheet depletion allowance of 0.5 percentage points," resulting in minimum long-term debt SLR of 4.5%.<sup>27</sup>

Although neither the NPR nor the text of the proposed rule describes or provides specifically how the minimum TLAC SLR was calibrated for covered BHCs, it seems clear that it was simply calibrated as the sum of the enhanced SLR under the U.S. Basel III capital rules, of 5%, plus the minimum long-term debt SLR of 4.5%, for a total of 9.5% of the covered BHC's total Basel III exposures.

Unfortunately, the minimum TLAC and long-term debt requirements applicable to resolution entity IHCs do not appear to have been calculated using the methodology that was used to calibrate the corresponding requirements for covered BHCs. Indeed, the minimum risk-weighted long-term debt ratio applicable to resolution entity IHCs was not reduced by a 1

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<sup>21</sup> 80 Fed. Reg. at 74932.

<sup>22</sup> 80 Fed. Reg. at 74932.

<sup>23</sup> 80 Fed. Reg. at 74932.

<sup>24</sup> 80 Fed. Reg. at 74932.

<sup>25</sup> 80 Fed. Reg. at 74932-33.

<sup>26</sup> 80 Fed. Reg. at 74932-33.

<sup>27</sup> 80 Fed. Reg. at 74933.

percentage point allowance to reflect expected balance-sheet depletion the way the corresponding ratio for covered BHCs has been calibrated. Nor does the minimum long-term debt SLR or the minimum on-balance sheet long-term debt leverage ratio reflect a 0.5 percentage point allowance to reflect expected balance-sheet depletion the way the corresponding ratio for covered BHCs has been calibrated. Finally, neither the minimum TLAC SLR nor the minimum on-balance sheet TLAC leverage ratio reflects a 0.5 percentage point allowance for expected balance-sheet depletion the way the corresponding ratio for covered BHCs has been calibrated.

The Federal Reserve provided no explanation in the proposed rule for this differential treatment. The Associations believe that the Federal Reserve should amend the proposed rule so that the minimum TLAC requirements applicable to resolution entity IHCs reflect the same allowances for balance sheet depletion as the corresponding ratios for covered BHCs. We believe that if the Federal Reserve recalculated the minimum TLAC requirements applicable to resolution entity IHCs to reflect the same allowances for balance-sheet depletion as the corresponding ratios for covered BHCs, the properly calibrated amounts would be as shown in Table 2 below.

**Table 2**

Proposed Minimum Required Ratio or Buffer	Resolution Entity IHCs (MPOE Strategy)		
	Risk-Based Ratio	SLR	On-Balance Sheet Leverage Ratio
Minimum Internal TLAC Ratio	18%	6.75%	7.5% (instead of 9%)
Internal TLAC Buffer	2.5% + countercyclical buffer <sup>28</sup>	N/A	N/A
Minimum Internal Long-Term Debt Ratio	None	None	None

The following step-by-step analyses shows why these revised calibrations for resolution entity IHCs are consistent with the methods used to calibrate the corresponding ratios for covered BHCs. As noted above, the proposed external TLAC SLR requirement of 9.5% for covered BHCs is equal to the sum of (i) the enhanced SLR applicable to covered BHCs (which are G-SIBs) under the U.S. Basel III capital rules of 5% and (ii) the proposed minimum long-term debt SLR of 4.5%. By using this method to calibrate the proposed minimum TLAC SLR for resolution entity IHCs, the result is 5.5%, reflecting the sum of (i) the SLR requirement applicable to covered IHCs under the U.S. Basel III capital rules of 3% and (ii) the proposed

<sup>28</sup> See footnote 16.

minimum long-term debt SLR of 2.5% (as recalibrated). But this is lower than the fully phased-in amount of 6.75% from the FSB’s Principles on Loss-Absorbing and Recapitalisation Capacity of G-SIBs in Resolution (the “**International Standard**”),<sup>29</sup> so we propose an SLR TLAC ratio of 6.75% to be consistent with that standard. Similarly, by using this method to calibrate the minimum TLAC on-balance sheet leverage ratio, the result is 7.5%, reflecting the sum of (i) the on-balance sheet leverage requirement applicable to covered IHCs under the U.S. Basel III capital rules of 4% and (ii) the proposed minimum long-term debt on-balance sheet leverage ratio of 3.5% (as recalibrated).

While the Associations do not believe the proposed rule should contain any minimum long-term debt requirements, if the Federal Reserve nevertheless decides to include minimum long-term debt requirements, we believe they should be calculated as follows in order to be consistent with the methodology used in the proposed rule to calculate the long-term debt requirements applicable to covered BHCs. According to the NPR, the calibration of the long-term debt risk-based ratio for covered BHCs was based on a three-step process as described above.<sup>30</sup> By using this same method to calibrate the proposed minimum long-term debt risk-based ratio for resolution entity IHCs, the result is 6%—i.e., the 7% going concern CET1 capital requirement minus the 1 percentage point allowance for balance sheet depletion. Instead, the Federal Reserve appears to have calibrated the resolution entity IHC minimum long-term debt risk-based ratio based on the 7% going concern risk-based ratio requirement, but without reflecting the 1 percentage point allowance for balance-sheet depletion.

According to the NPR, the calibration of the external long-term debt SLR for covered BHCs was based on a two-step process as described above.<sup>31</sup> By using the same method to calculate the minimum long-term debt SLR for resolution entity IHCs, the result is 2.5%—i.e., the 3% Tier 1 capital SLR requirement applicable to certain covered IHCs minus the 0.5 percentage point allowance for balance sheet depletion. Instead, the Federal Reserve appears to have calibrated the resolution entity IHC minimum long-term debt SLR based on the 3% Tier 1 capital SLR requirement without reflecting the 0.5 percentage point allowance for balance sheet depletion.

Finally, although the proposed long-term debt on-balance sheet leverage requirement for resolution entities has no direct parallel to the long-term debt requirements applicable to covered BHCs, the NPR said that the on-balance sheet leverage requirement was intended to be calibrated in a manner that is consistent with the calibration of the proposed long-term debt

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<sup>29</sup> Financial Stability Board, Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution: Total Loss-absorbing Capacity (TLAC) Term Sheet, at 10 (Nov. 9, 2015).

<sup>30</sup> 80 Fed. Reg. at 74932.

<sup>31</sup> 80 Fed. Reg. at 74932.

SLR.<sup>32</sup> The Associations therefore believe that the two-step calibration process applicable to the external long-term debt SLR requirement should generally apply to the calibration of this requirement. By using this method to calibrate the minimum long-term debt on-balance sheet ratio requirement, the result is 3.5%—i.e., the 4% Tier 1 capital on-balance sheet leverage ratio requirement minus a 0.5 percentage point allowance for balance-sheet depletion.

Furthermore, for the reasons set forth in the U.S. G-SIB Comment Letter, the Associations believe that the Federal Reserve should reduce the minimum TLAC requirements applicable to resolution entity IHCs to the reduced levels proposed for covered BHCs in that letter, excluding any U.S. G-SIB surcharges or any SLR enhancements. If the Federal Reserve did so, the minimum TLAC requirements would be reduced to the levels shown in the following table.

**Table 3**

Proposed Minimum Required Ratio or Buffer	Resolution Entity IHCs (MPOE Strategy)		
	Risk-Based Ratio	SLR	On-Balance Sheet Leverage Ratio
Minimum Internal TLAC Ratio	14%	6%	7.5%
Internal TLAC Buffer	None	N/A	N/A
Minimum Internal Long-Term Debt Ratio	None	None	None

Because there is no reason to calibrate the minimum TLAC for resolution entity IHCs using a framework different from that the Federal Reserve used to calibrate the corresponding minimum TLAC requirements applicable to covered BHCs, consistent with Principle No. 2, the Associations believe that the Federal Reserve should amend the proposed rule to recalibrate the minimum TLAC ratios applicable to resolution entity IHCs in the manner shown above.

Furthermore, the Federal Reserve should reserve the power to set lower TLAC requirements on a case-by-case basis where the sum of TLAC requirements applicable to the resolution groups of an MPOE G-SIB exceed the minimum that would apply if the MPOE G-SIB were an SPOE G-SIB, in line with the FSB’s International Standard.<sup>33</sup>

Lastly, the Federal Reserve should clarify that the additional on-balance sheet leverage ratio requirements apply only for covered IHCs that are not subject to the SLR requirements—that is, the two leverage-based measures should be applied in the alternative.

<sup>32</sup> 80 Fed. Reg. at 74941.

<sup>33</sup> Financial Stability Board, Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution: Total Loss-absorbing Capacity (TLAC) Term Sheet, at 9 (Nov. 9, 2015).

We also believe that the SLR and on-balance sheet leverage requirements should be calibrated as back-up requirements, rather than binding constraints, for the reasons set forth in the U.S. G-SIB Comment Letter.

### **C. Non-Resolution Entity IHCs**

The purpose of internal TLAC is fundamentally different from external long-term debt and other TLAC. The external long-term debt and other TLAC requirements are intended to ensure that a resolution entity like a covered BHC or resolution entity IHC will always have enough usable TLAC to be recapitalized in the event of failure. By contrast, internal TLAC requirements for non-resolution entity IHCs are intended to encourage home and host resolution authorities to cooperate in an SPOE resolution of the foreign G-SIB's top-tier parent to ensure the success of such a resolution. If a non-resolution IHC does not have enough TLAC, the home resolution authority of its top-tier foreign parent may not have sufficient incentive to use the foreign parent's resources to recapitalize the non-resolution entity IHC and keep it out of U.S. bankruptcy or Title II proceedings. If a non-resolution IHC has too much internal TLAC, its U.S.-host authority will have a strong incentive to ring-fence the non-resolution IHC's assets because the U.S.-host authority can resolve the non-resolution IHC without cooperating with the foreign G-SIB's home resolution authority. The purpose of internal TLAC requirements on non-resolution IHCs is to strike the right balance that provides an incentive to both home and host authorities to cooperate with each other in the SPOE resolution of the foreign G-SIB's top-tier foreign parent.

The proposed internal TLAC and long-term debt requirements for non-resolution entity IHCs are a classic form of ex-ante ring-fencing. While internal TLAC requirements can be benign if the conditions described in the prior paragraph are satisfied, they will be a significant obstacle to the rapid and orderly resolution of foreign G-SIBs under an SPOE strategy if they are higher than necessary to ensure the recapitalization of non-resolution entity IHCs or if they are set at levels that increase the risk that U.S.-host resolution authorities will not cooperate with the foreign G-SIB's home-country resolution authority or the risk that assets of the foreign G-SIB parent will be misallocated. The Associations believe that the proposed internal TLAC and long-term debt requirements applicable to non-resolution entity IHCs are calibrated at excessively high levels that will substantially increase the risk of ex-post ring-fencing and misallocation risk.

#### **1. Ex-Ante and Ex-Post Ring-Fencing**

Certain officials of the Federal Reserve appear to have suggested from time to time that ex-ante ring-fencing may reduce ex-post ring-fencing by providing assurance to host-country

supervisors that the host-country subsidiaries are resolvable.<sup>34</sup> To the extent this accurately reflects the views of these officials, the Associations do not believe that this is a compelling rationale for imposing the high levels of ex-ante ring-fencing that would apply under the proposed rule.

The Associations agree that ex-post ring-fencing<sup>35</sup> of assets by host-country authorities can impede the successful resolution of a G-SIB under the SPOE strategy and therefore be an obstacle to the rapid and orderly resolution of the G-SIB and achieving the important public policy goal of ensuring a durable end to TBTF. This trapping of assets in a host country under ex-post ring-fencing prevents them from being deployed by the G-SIB's home-country resolution authority where they are needed to recapitalize home-country subsidiaries or subsidiaries located in other host countries. Such a restriction on a home-country authority's freedom to deploy assets where they are needed at the time of failure will impede that authority's ability to maximize the residual value of the G-SIB and preserve its critical operations for the benefit of all of its stakeholders.

In contrast to ex-post ring-fencing, internal TLAC requirements are a form of ex-ante ring-fencing, which can be benign if they satisfy three conditions.

- They are necessary to encourage the home-country regulator to cooperate with the host-country supervisors to recapitalize the host-country subsidiaries in an SPOE resolution of the parent;
- They are set at levels that do not undermine the incentive of host-country supervisors to cooperate with home-country resolution authorities to maximize the residual value of G-SIBs for the benefit of all their stakeholders at the point of failure; and
- They are set at levels that do not pose a material risk of misallocation, such that assets of an SPOE G-SIB will not be trapped in one subsidiary when needed for the recapitalization of another subsidiary.

Internal TLAC and long-term debt requirements can become obstacles to successful SPOE resolution, however, if any of these conditions is not satisfied. After a certain threshold there will be an inverse relationship between the amount of parent assets trapped in a host country and the incentive of host-country supervisors to cooperate with a G-SIB's home-

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<sup>34</sup> See, e.g., Governor Daniel K. Tarullo, Shared Responsibility for the Regulation of International Banks, Speech at the 18th Annual International Banking Conference, Nov. 5, 2015, *available at* <http://www.federalreserve.gov/newsevents/speech/tarullo20151105a.htm>.

<sup>35</sup> By “**ex-post ring-fencing**” the Associations mean trapping a material portion of the G-SIB's assets in a host country after the G-SIB has reached the point of failure.

country resolution authority to maximize the residual value of the G-SIB for the benefit of all of its stakeholders. If the conversion or write-down of prepositioned long-term debt is sufficient to recapitalize the non-resolution entity IHC as a going-concern, or if the liquidation value of the non-resolution entity IHC after converting or writing down long-term debt held by the foreign parent is sufficient to satisfy all the liabilities of the non-resolution entity IHC, host-country supervisors will have no economic incentive to cooperate with home-country resolution authorities. Instead, there would be a strong incentive for host-country regulators to place the non-resolution entity IHC in local resolution proceedings, increasing the likelihood of ex-post ring-fencing. Such levels of ex-ante ring-fencing could result in an improperly fragmented resolution of a G-SIB with an SPOE strategy and would be a serious impediment to successful SPOE resolution.

Conversely, the foreign G-SIB and its home-country resolution authorities will have every incentive to use the G-SIB's assets to recapitalize the non-resolution entity IHC under an SPOE resolution strategy where the franchise value<sup>36</sup> minus any costs incurred to recapitalize the non-resolution entity IHC exceeds the foreign G-SIB's proportionate share of the liquidation value of the non-resolution entity IHC's assets in a wind-down (including any claims as the holder of internal long-term debt and any residual value as the equity holder). Any ex-ante ring-fencing requiring prepositioning of bail-inable debt should be such that it is high enough to incentivize such recapitalization, but low enough to prevent the U.S.-host resolution authorities from losing the incentive to cooperate in an SPOE resolution.

Such ex-ante ring-fencing need not be set at high levels, because the franchise value of a recapitalized non-resolution entity IHC (minus the costs of recapitalization) is likely to exceed the foreign parent's share of the non-resolution entity IHC's assets in liquidation. First, the going-concern value of a failing entity is likely to be higher than its liquidation value.<sup>37</sup> Second, the foreign parent is the first in line to absorb losses as the holder of the non-resolution entity IHC's equity even without additional internal TLAC requirements. Given these considerations, the foreign parent has enormous incentives to recapitalize the non-resolution entity IHC, even at low levels of internal TLAC. Thus, the Associations believe that a level of ex-ante ring-fencing of no more than 75% of the TLAC requirements imposed on resolution entity IHCs should be sufficient for non-resolution entity IHCs.

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<sup>36</sup> By "**franchise value**" the Associations mean the value of the non-resolution entity IHC as a going-concern.

<sup>37</sup> See, e.g., DOUGLAS G. BAIRD, *ELEMENTS OF BANKRUPTCY LAW* 59-60 (5th ed. 2010) (discussing railroads as the "archetypal case" of a company with a significantly higher going concern value than liquidation value); Andrei Shleifer & Robert W. Vishny, *Liquidation Values and Debt Capacity: A Market Equilibrium Approach*, 47 J. FIN. 1343 (1992) (establishing a model demonstrating that liquidation values during periods of financial distress are substantially lower than going concern values); Frank H. Easterbrook, *Is Corporate Bankruptcy Efficient?*, 27 J. FIN. ECON. 411 (1990) (spotlighting the hidden social costs of auctioning off assets of distressed firms).

Furthermore, trapping the assets of a foreign G-SIB in the form of prepositioned debt of a non-resolution entity IHC increases the risk of misallocation: that parent assets needed for the recapitalization of another subsidiary will be committed to the non-resolution entity IHC, and thus become unusable for recapitalizing any other entity in an SPOE resolution. This would be an additional impediment to proper resolution of the foreign G-SIB. Any prepositioning of debt must therefore strike a careful balance between ensuring there is enough TLAC such that the non-resolution entity IHC will be recapitalized, if necessary, by the foreign G-SIB or its home-country resolution authorities in an SPOE resolution and preventing a permanent misallocation of assets that precludes a successful SPOE resolution.

Finally, the Federal Reserve’s cost-benefit analysis of its proposed internal TLAC and long-term debt requirements does not seem to have taken into account any of these issues. Thus, the Associations believe that the final rule should impose minimum TLAC requirements on non-resolution entity IHCs of at most 75% of the level imposed on resolution entity IHCs.

While the Associations do not believe that the proposed rule should contain separate minimum long-term debt requirements for the reasons set forth in Section II.A above, if the Federal Reserve decides to retain such requirements, the long-term debt requirements applicable to non-resolution entity IHCs should be set at 75% of the level imposed on resolution entity IHCs.

## 2. Calibration

The proposed rule would impose the following internal TLAC and long-term debt requirements on non-resolution entity IHCs.

**Table 4**

Proposed Minimum Required Ratio or Buffer	Non-Resolution Entity IHCs (SPOE Strategy)		
	Risk-Based Ratio	SLR	On-Balance Sheet Leverage Ratio
Minimum Internal TLAC Ratio	16%	6%	8%
Internal TLAC Buffer	2.5% + countercyclical buffer <sup>38</sup>	N/A	N/A
Minimum Internal Long-Term Debt Ratio	7%	3%	4%

The NPR states that the internal TLAC and long-term debt requirements applicable to non-resolution entity IHCs were intended to be “slightly lower” than the requirements

<sup>38</sup> See footnote 16.

applicable to resolution entity IHCs to reflect two purposes.<sup>39</sup> The first purpose is “the desirability of providing support for the preferred SPOE resolution of the foreign G-SIB, which requires that the foreign G-SIB be allowed to have some internal loss-absorbing capacity at the parent level that can be freely allocated to whichever subsidiaries have incurred the greatest losses (including non-U.S. subsidiaries).”<sup>40</sup> The second is to reflect the fact that if the resolution of the foreign parent under the preferred SPOE strategy is successful, “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 pass up the covered IHC’s going-concern losses to the parent foreign G-SIB,” if any, and “to the extent necessary.”<sup>41</sup>

Unfortunately, the requirements for non-resolution entity IHCs do not consistently reflect this approach of applying lower requirements. While the proposed internal TLAC requirements were calibrated at 90% of the levels applicable to resolution entity IHCs, the proposed internal long-term debt requirements were calibrated at 100% of the levels applicable to resolution entity IHCs.

If the proposed internal TLAC ratios applicable to resolution entity IHCs were recalibrated as recommended in Section II.B.2 above (Table 2) and the same percentage reduction (90%) was consistently applied to such recalibrated requirements, and the minimum long-term debt requirement was removed as discussed in Section II.A above, the resulting minimum internal TLAC ratios applicable to non-resolution entity IHCs would be as set forth in the following table:

**Table 5**

Proposed Minimum Required Ratio or Buffer	Non-Resolution Entity IHCs (SPOE Strategy)		
	Risk-Based Ratio	SLR	On-Balance Sheet Leverage Ratio
Minimum Internal TLAC Ratio	16%	6%	6.75%
Internal TLAC Buffer	2.5% + countercyclical buffer <sup>42</sup>	N/A	N/A
Minimum Internal Long-Term Debt Ratio	None	None	None

While the Associations do not believe that the proposed rule should contain any minimum long-term debt requirements for the reasons set forth in Section II.A above, if the

<sup>39</sup> 80 Fed. Reg. at 74941.

<sup>40</sup> 80 Fed. Reg. at 74941.

<sup>41</sup> 80 Fed. Reg. at 74941.

<sup>42</sup> See footnote 16.

Federal Reserve decides to retain them, the ratios would be as follows if calculated as 90% of the ratios applicable to resolution entity IHCs: risk-based long-term debt of 5.4%, an SLR long-term debt of 2.25% and an on-balance sheet leverage ratio of 3.15%.<sup>43</sup>

Even if the proposed internal TLAC requirements are recalibrated in this manner, the Associations nevertheless believe that they would still be unjustified and too high. The proposed internal TLAC and long-term debt requirements are unnecessary to ensure that home-country resolution authorities will use G-SIB assets on a non-discriminatory basis to recapitalize the non-resolution entity IHCs. The existing U.S. capital requirements applicable to non-resolution entity IHCs and their business models make it virtually certain that the franchise values of the IHCs or their subsidiaries are substantially higher than the liquidation values of their U.S. assets. As a result, home-country resolution authorities will have a powerful incentive to use the G-SIB's assets to recapitalize the non-resolution entity IHCs to preserve those franchise values rather than allow their U.S. assets to be liquidated.

The Associations believe that the Federal Reserve should calibrate the proposed TLAC requirements applicable to non-resolution entity IHCs at not more than 75% of the corresponding TLAC requirements applicable to resolution entity IHCs, for several reasons.

First, calibrating these requirements at 90% of the corresponding ratios applicable to resolution entity IHCs does not provide home-country resolution authorities enough freedom to use the foreign parent's loss-absorbing capacity wherever necessary at the time of failure to maximize the residual value of the foreign G-SIB and ensure the success of its resolution under the SPOE strategy.

Second, calibrating internal TLAC ratios for non-resolution entity IHCs at 90% of the level applicable to resolution entity IHCs, or even higher, is at the high end of, or exceeds, the 75%-90% range for foreign internal TLAC requirements established by the FSB's International Standard.

Third, and as discussed in detail in Section II.C.1 above, calibrating internal TLAC ratios for non-resolution entity IHCs at more than 75% of the corresponding ratios applicable to resolution-entity IHCs will increase rather than decrease the incentive of U.S. authorities to engage in ex-post ring-fencing of assets pre-positioned in the United State even if the non-resolution entity IHCs have suffered no losses. Moreover, if the Federal Reserve calibrates its requirements at excessive levels, it will likely inspire other host-country regulators around the world to retaliate against the host-country subsidiaries of both U.S. and non-U.S. G-SIBs by

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<sup>43</sup> In the alternative, the Associations support the approach recommended in the comment letter filed by the Institute of International Bankers that the long-term debt requirement for non-resolution entity IHCs, if retained, be established as a supervisory expectation that internal long-term debt be required to comprise no more than 33% of internal TLAC.

imposing similar internal TLAC requirements on such host-country subsidiaries of G-SIBs, including U.S. G-SIBs. If this happens, the Federal Reserve will be at least partially responsible for creating a serious new obstacle to the rapid and orderly resolution of G-SIBs around the world, including U.S. G-SIBs, under the SPOE strategy, the way the Smoot-Hawley Act was responsible for retaliatory tariffs in the 1930s.

Such internal TLAC requirements will result in a balkanization of G-SIB assets, including those of U.S. G-SIBs, perversely discouraging rather than encouraging cross-border cooperation by increasing rather than decreasing the incentive of host-country supervisors to engage in ex-post ring-fencing of assets that are pre-positioned in their countries. This will create multiple new impediments to the resolvability of G-SIBs, including U.S. G-SIBs, under the SPOE strategy, making G-SIBs and the overall financial system, including U.S. G-SIBs and the U.S. financial system, more brittle in a severely adverse economic scenario.

If the Federal Reserve were to calibrate its internal TLAC requirements applicable to non-resolution entity IHCs at 75% of the corresponding requirements applicable to resolution-entity IHCs (as recalibrated as recommended in Section II.B.2 above (Table 2) to reflect the same balance sheet depletion allowance used for covered BHCs), and the minimum long-term debt requirement was removed as discussed in Section II.A above, the resulting minimum internal TLAC ratios applicable to non-resolution entity IHCs would be as set forth in the following table:

**Table 6**

Proposed Minimum Required Ratio or Buffer	Non-Resolution Entity IHCs (SPOE Strategy)		
	Risk-Based Ratio	SLR	On-Balance Sheet Leverage Ratio
Minimum Internal TLAC Ratio	13.5%	5.0%	5.625%
Internal TLAC Buffer	1.875% + 75% of countercyclical buffer <sup>44</sup>	N/A	N/A
Minimum Internal Long-Term Debt Ratio	None	None	None

While the Associations do not believe that the proposed rule should include any minimum long-term debt requirements for the reasons stated in Section II.A above, if it does, the long-term debt requirements applicable to non-resolution entity IHCs should be 75% of the level applicable to resolution entity IHCs, which would result in a minimum risk-based long-

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<sup>44</sup> See footnote 16.

term debt ratio of 4.5%, an SLR long-term debt of 1.875% and an on-balance sheet leverage ratio of 2.625%.<sup>45</sup>

Furthermore, if the Federal Reserve agrees to reduce the minimum TLAC requirements applicable to resolution entity IHCs as requested in Section II.B.2 above (Table 3) and calibrated the internal TLAC requirements applicable to non-resolution IHCs at 75% of those amounts, the minimum internal TLAC ratios would be as set forth in the following table:

**Table 7**

Proposed Minimum Required Ratio or Buffer	Non-Resolution Entity IHCs (SPOE Strategy)		
	Risk-Based Ratio	SLR	On-Balance Sheet Leverage Ratio
Minimum Internal TLAC Ratio	10.5%	4.5%	5.625%
Internal TLAC Buffer	None	N/A	N/A
Minimum Internal Long-Term Debt Ratio	None	None	None

Lastly, the Federal Reserve should clarify that the additional on-balance sheet leverage ratio requirements apply only for covered IHCs that are not subject to the SLR requirements—that is, the two leverage-based measures should be applied in the alternative, as detailed more fully in Section II.D.1 below.

We also believe that the SLR and on-balance sheet leverage requirements should be calibrated as back-up requirements, rather than binding constraints, for the reasons set forth in the U.S. G-SIB Comment Letter.

### **3. 50% Haircut for Internal Long-Term Debt**

Under the proposed rule, there is a 50% haircut applied to eligible internal debt securities with a maturity between one and two years for the purposes of calculating the level of internal long-term debt. The Federal Reserve’s stated rationale for this requirement is the refinancing risk posed by such debt in a time of stress. The Federal Reserve is concerned that if the debt “[matures] during the period between the time when the covered BHC begins to experience extreme stress and the time when it enters a resolution proceeding . . . the creditor will likely be unwilling to maintain its exposure to the covered BHC and will therefore refuse to roll over the debt or extend new credit.”<sup>46</sup>

<sup>45</sup> See footnote 43.

<sup>46</sup> 80 Fed. Reg. at 74936.

As discussed in Section IV.C (“50% Haircut”) of Annex 1 to the U.S. G-SIB Comment Letter, the Associations do not believe that there should be a 50% haircut applied to external EDS. We support this view and believe it applies equally to internal EDS, to the extent minimum long-term debt requirements are retained.

Furthermore, such a haircut is even less appropriate for internal long-term debt, to the extent minimum long-term debt requirements are retained, because such inter-affiliate debt issuances pose even less refinancing risk. Foreign parents and affiliates can be expected to continue to roll over debt or extend new credit to the covered IHC in a period of stress so that the covered IHC could continue to meet any applicable long-term debt requirements. Accordingly, the Associations recommend eliminating the 50% haircut for internal EDS with a remaining maturity between one and two years.

#### **D. All Covered IHCs**

##### **1. On-Balance Sheet Leverage Ratio**

With respect to the proposed minimum TLAC requirements, the Associations believe that covered IHCs that are subject to the SLR should only be required to calculate and comply with the TLAC risk-based and SLR ratios, and not the TLAC on-balance sheet leverage ratios. Conversely, covered IHCs that are not subject to the SLR should only be required to calculate and comply with the TLAC risk-based and on-balance sheet leverage ratios, and not the TLAC SLR ratios. Because these two leverage-based measures serve the same purpose and because covered BHCs, which are similarly situated, would be subject only to SLR requirements and not on-balance sheet leverage ratio requirements, they should be applied in the alternative, not in tandem, for covered IHCs.

The denominators of the on-balance sheet leverage ratio and the SLR serve the same purpose—to measure TLAC on a non-risk-adjusted basis. The Federal Reserve’s only stated rationale in the proposed rule for including the on-balance sheet leverage ratio was that “some covered IHCs may not be subject to the supplementary leverage ratio.”<sup>47</sup> This rationale supports subjecting *certain* covered IHCs—i.e., those that are not subject to the SLR—to TLAC requirements based on their total on-balance sheet assets *in lieu of* subjecting those same covered IHCs to TLAC SLR requirements based on their total leverage exposures. However, this rationale does not support subjecting *all* covered IHCs—including those that are subject to the SLR—to on-balance sheet leverage requirements for TLAC. Therefore, the Federal Reserve should apply these two leverage-based measures in the alternative, rather than simultaneously apply both leverage-based measures to those covered IHCs that are subject to the SLR.

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<sup>47</sup> 80 Fed. Reg. at 74941.

This alternative approach for covered IHCs subject to the SLR would also improve consistency with the approach under the proposed rule for covered BHCs. Under the proposed rule, covered BHCs would only be subject to minimum SLR requirements and would not have to comply with a separate on-balance sheet leverage ratio minimum. Since all covered BHCs are subject to the SLR, they are similarly situated to covered IHCs that are subject to the SLR. Therefore, the tandem approach to SLR and on-balance sheet leverage ratio requirements for covered IHCs treats similarly situated institutions differently, without justification for the disparate treatment.

Finally, applying on-balance sheet leverage ratio requirements for covered IHCs subject to the SLR would be bad public policy. Under the proposed rule, the on-balance sheet leverage ratio requirements would be a binding constraint on only those covered IHCs that make relatively little use of off-balance sheet leverage, such as derivatives and other contingent obligations reflected in the SLR denominator. Thus, the proposed rule would unfairly punish those covered IHCs with relatively simple funding models.

## **2. Structural Versus Contractual Subordination and 5% Allowance for Unrelated Liabilities**

The proposed rule appears to require that the EDS of covered IHCs be contractually subordinated to all third-party liabilities of the covered IHC. The proposed rule text only requires that EDS be “the most subordinated debt claim,” suggesting that either structural or contractual subordination will suffice.<sup>48</sup> However, the proposed rule states that “eligible internal LTD would be required to be contractually subordinated to all third-party liabilities of the covered IHC.”<sup>49</sup> The Associations believe that all covered IHCs should have the option to satisfy this priority requirement by either structural or contractual subordination and request that the Federal Reserve confirm that they may do so.

Furthermore, the requirement that EDS be the most subordinated debt claim precludes any liabilities of the covered IHC from being held *pari passu* with the EDS. The Associations believe that this requirement would unnecessarily restrict the operations of covered IHCs and that covered IHCs relying on structural subordination should instead be permitted the same 5% allowance for third-party operating liabilities and other unrelated liabilities, and no restriction on liabilities to affiliates or contingent liabilities to affiliates or third parties, as permitted to covered BHCs.

The Federal Reserve’s stated rationale for a contractual subordination requirement is that it “would ensure that the foreign parent generally would absorb the covered IHC’s

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<sup>48</sup> 80 Fed. Reg. at 74962; Proposed Rule § 252.161– definition of “eligible internal debt security”.

<sup>49</sup> 80 Fed. Reg. at 74942–43.

losses ahead of the third-party creditors and counterparties of the covered IHC and its subsidiaries. Such a requirement should reduce the risk of third-party challenges to the recapitalization of the covered IHC and reduce the risk that a change in control could result from the recapitalization of the covered IHC.”<sup>50</sup> The Associations believe that these rationales would be satisfied just as effectively with structural subordination. The Associations further believe that these rationales would not be undermined by a 5% allowance for unrelated liabilities.

For resolution entity IHCs, a contractual subordination requirement and the absence of a 5% allowance is inconsistent with Principle No. 1 that similarly situated companies should be treated equally. The NPR has acknowledged that resolution entity IHCs are analogous to covered BHCs in that both are resolution entities that are expected to enter into resolution and be recapitalized.<sup>51</sup> Rather than streaming losses to a foreign parent pursuant to an SPOE resolution strategy, a resolution entity IHC is expected to be resolved in a bankruptcy (or Title II proceeding, if necessary) pursuant to an MPOE resolution strategy. As such, resolution entity IHCs should be permitted to hold external EDS and will face the same practical difficulties as covered BHCs if required to contractually subordinate all of these claims. With respect to the Federal Reserve’s other rationales, covered BHCs are properly not subject to a contractual subordination requirement, although they would be subject to similar concerns about third-party challenges or a change of control.<sup>52</sup> To the extent that it is necessary to subordinate EDS, including securities issued externally, resolution entity IHCs relying on structural subordination should instead be subject to similar clean holding company requirements as apply to covered BHCs, which has the effect of subordinating liabilities that can run or result in the termination of critical services. In particular, they should be permitted to have a 5% allowance for third-party operating liabilities and other unrelated liabilities, as well as no limit on liabilities to affiliates or contingent liabilities to third parties or affiliates that will inevitably arise in the normal course of their operations.

For non-resolution entity IHCs, structural subordination permits losses to be upstreamed to a foreign parent just as well as contractual subordination. Whether or not EDS are subordinated structurally or contractually, the holder of the EDS would be the first to absorb losses in a resolution of the covered IHC. Furthermore, a 5% allowance for unrelated liabilities would not meaningfully reduce the ability of the non-resolution entity IHC’s EDS to upstream losses to the foreign parent and would promote a level playing field between covered IHCs and covered BHCs. Given that such liabilities will be at most 5% of the

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<sup>50</sup> 80 Fed. Reg. at 74943.

<sup>51</sup> 80 Fed. Reg. at 74941.

<sup>52</sup> For the Associations’ additional arguments against the change of control rationale, please see Section II.D.5.

non-resolution entity's level of TLAC, the risk of third-party challenges to a recapitalization or a change of control resulting from a recapitalization are minimal. Thus, and consistent with the principle of national treatment, non-resolution entity IHCs relying on structural subordination should also be subject to similar clean holding company requirements as apply to covered BHCs.

Accordingly, the Associations believe that the Federal Reserve should clarify in the final rule that covered IHCs may satisfy the applicable subordination requirement by either structural or contractual subordination, subject to the same 5% allowance for unrelated liabilities as permitted for covered BHCs. With regards to the structural subordination requirements, the Associations believe that the arguments in Section V ("Clean Holding Company Requirements") of Annex 1 to our U.S. G-SIB Comment Letter apply with equal force to these requirements as they apply to covered IHCs.

### **3. Contractual Conversion Triggers and Tax Issues**

The proposed rule provides that eligible internal long-term debt must contain a contractual trigger that allows the Federal Reserve to issue an internal debt conversion order to convert, exchange or write-down the debt if certain conditions are met. These conditions are that the Federal Reserve has determined that the covered IHC is in default or danger of default, and any of the following three circumstances apply:

- A foreign banking organization ("**FBO**") that directly or indirectly controls the covered IHC or any subsidiary of the IHC parent has been placed into resolution proceedings;
- The home country supervisor of the IHC parent has consented or not objected within 48 hours of notification by the Federal Reserve; or
- The Federal Reserve has made a written recommendation to the Secretary of the Treasury that the FDIC should be appointed as a receiver.<sup>53</sup>

The Federal Reserve states that the principal rationale for the contractual conversion trigger is "to ensure that losses incurred by the covered IHC are shifted to a foreign parent without the covered IHC's having to enter a resolution proceeding."<sup>54</sup>

The Associations believe that this rationale does not apply to resolution entity IHCs and that resolution entity IHCs should be exempt from this requirement. Under an MPOE resolution strategy, the resolution entity IHC would be placed into a resolution proceeding,

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<sup>53</sup> Proposed Rule § 252.163.

<sup>54</sup> 80 Fed. Reg. at 74943.

where debt can be written down or converted to equity as appropriate. There is no need for a contractual trigger to write down or convert debt to equity outside of such proceedings. This is consistent with Principle No. 1 and the Associations' belief discussed above that limiting otherwise eligible long-term debt securities of an IHC to those issued to a foreign parent is an unnecessarily restrictive requirement.

Second, for non-resolution entity IHCs in an SPOE resolution, the foreign parent would already have strong incentives to recapitalize the non-resolution entity IHC to maximize the value of the non-resolution entity IHC for the benefit of its stakeholders since its franchise value is likely to be substantially higher than its liquidation value (as described in Section II.C.1 above). As such, the foreign parent would recapitalize the non-resolution entity IHC in order to preserve its franchise value and prevent its entry into resolution proceedings. A contractual trigger is not necessary to encourage such a recapitalization and could instead hasten a failure of the foreign parent if exercised prematurely or without proper coordination between home- and host-country regulators.

Third, certain mandated features of eligible internal long-term debt, especially the contractual trigger and deep subordination, may give rise to significant uncertainty over whether eligible internal long-term debt is properly characterized as debt, and not equity, for U.S. federal income tax purposes, creating uncertainty about the tax deductibility of interest payments on eligible internal long-term debt and whether these payments are subject to withholding tax. While any contractual trigger will create uncertainty, the uncertainty is exacerbated by ambiguities in the proposed rule concerning how the contractual trigger would in fact operate. In this regard, a key question is whether a foreign parent's equity interest in its IHC must have been written down before a conversion of the IHC's eligible internal long-term debt could be triggered. If eligible internal long-term debt were treated as equity for U.S. federal income tax purposes, it would unnecessarily and substantially increase the cost of complying with the Federal Reserve's requirements, particularly since the full principal amount paid to certain foreign parents upon the retirement of the eligible internal long-term debt would be subject to withholding tax.

Fourth, because covered IHCs are subject to arm's length pricing requirements even for internally placed EDS, the contractual trigger requirement, along with the contractual subordination requirement, will increase the cost of borrowing for covered IHCs. Covered IHCs should not be subject to this additional funding cost, which is not imposed on even the covered BHCs.

Accordingly, the Associations recommend that the Federal Reserve eliminate the proposed contractual trigger requirements as unnecessary, inconsistent with the principle of national treatment and inconsistent with Principle No. 1 that similarly situated companies (e.g., covered BHCs and covered IHCs) should be treated equally. In the alternative, the

Associations recommend that the Federal Reserve coordinate with the Internal Revenue Service to issue guidance on the tax consequences of the issuance, ownership and conversion or write-down of eligible internal long-term debt; in particular, the Associations recommend confirming that the TLAC provisions will be disregarded for purposes of determining whether eligible internal long-term debt will be treated as debt for U.S. federal income tax purposes. Moreover, the Federal Reserve should formulate more detailed rules addressing the operation of the contractual conversion trigger; specifically, the Federal Reserve should clarify that a foreign parent's equity interest in its IHC must have been written down before a conversion of the IHC's eligible internal long-term debt could be triggered.

#### **4. Eligible Internal Long-Term Debt**

The Associations believe that eligible internal long-term debt should, at a minimum, be allowed to contain acceleration clauses based on an insolvency or payment default, as is permitted for external EDS. The prohibition on all acceleration clauses contained in the proposed rule is unfairly much stricter than the requirements for covered BHCs.

The Federal Reserve noted that acceleration upon insolvency should be allowed in external EDS because “the insolvency that triggers the clause would generally occur concurrently with the covered BHC’s entry into a resolution proceeding, in which case the payment obligations would generally be stayed and the debt would remain available to absorb losses.”<sup>55</sup> Similarly, the Federal Reserve noted that acceleration upon a payment default should be allowed in external EDS because such a default “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.”<sup>56</sup>

The Associations believe that these rationales apply with equal force to covered IHCs. For a resolution entity IHC, an insolvency or payment default triggering an insolvency would occur concurrently with the resolution entity IHC’s entry into a resolution proceeding, and the debt containing such acceleration clauses would remain available to absorb losses, consistent with an MPOE strategy. For a non-resolution entity IHC, the foreign parent or its home-country regulator would likely recapitalize the IHC before the occurrence of an insolvency or a payment default leading to insolvency in order to preserve its franchise value, consistent with an SPOE strategy. Although there does not seem to be any incentive for the foreign parent, as the holder of internal EDS, to allow acceleration of such EDS thereby

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<sup>55</sup> 80 Fed. Reg. at 74936.

<sup>56</sup> 80 Fed. Reg. at 74936.

causing the non-resolution entity IHC to enter resolution proceedings, internal EDS would remain available to absorb losses in such a circumstance.

Moreover, prohibiting all acceleration clauses would further increase the risk that eligible internal long-term debt 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 long-term debt and whether these payments are subject to withholding tax, as discussed in greater detail above in Section II.D.3 above. Accordingly, eligible internal long-term debt should, at a minimum, be allowed to contain acceleration clauses based on an insolvency or payment default, as is permitted for external EDS, to mitigate the adverse tax consequences and resulting substantial costs to covered IHCs.

Thus, consistent with Principle No. 1 above that similarly situated companies should be treated equally, covered IHCs should be subject to the same restrictions on acceleration clauses as is applied to covered BHCs. In addition, the Federal Reserve should apply our recommendation to expand the scope of acceleration clauses permitted for EDS, as described in the U.S. G-SIB Comment Letter, to covered IHCs to the extent they are permitted for covered BHCs.

## **5. Foreign Parent Requirements**

As discussed in Section II.B.1 above, the proposed rule would permit only Tier 1 capital securities and EDS held by a direct or indirect foreign parent entity of covered IHCs to count toward the covered IHC's minimum internal TLAC and long-term debt requirements. The rule would not permit a covered IHC to meet its minimum internal TLAC and long-term debt requirements with Tier 1 capital securities or EDS that are issued or transferred to a foreign affiliate. By "foreign affiliate," the Associations mean any foreign entity within the foreign G-SIB that is majority owned by the same top tier foreign parent entity. The Associations believe covered IHCs should be permitted to issue or transfer otherwise eligible Tier 1 capital securities or EDS to a foreign affiliate, rather than just a foreign parent.

As we discussed in Section II.B.1 above, the Federal Reserve's stated rationale for limiting a covered IHC's TLAC to internal instruments issued to a foreign parent is that this would "would ensure that losses incurred by the U.S. IHC of a foreign G-SIB would be upstreamed to a foreign parent rather than being transferred to other U.S. entities . . . [minimizing] the risk that such losses pose to the financial stability of the United States."<sup>57</sup> The Associations believe that allowing internal TLAC to be issued or transferred to a foreign affiliate would be just as consistent with these goals as issuing or transferring them to a foreign parent. Internal TLAC issued to foreign affiliates would transfer losses outside the U.S.

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<sup>57</sup> 80 Fed. Reg. at 74941.

and would ensure that losses are not transferred to U.S. entities just as well as if internal TLAC had been issued to a foreign parent.

The Federal Reserve further states that the requirement would “prevent the conversion of eligible internal TLAC into equity from effecting a change in control over the covered IHC. A change in control could create additional and undesirable regulatory and management complexity during a failure scenario and would severely disrupt an SPOE resolution strategy.”<sup>58</sup> The Associations do not believe that this is a persuasive rationale for several reasons. First, the top-tier foreign parents by definition will already undergo a change in control. Since the Federal Reserve cannot prevent an indirect change in control of the IHC, it should not use a direct change in control as a rationale for limiting the issuance of internal TLAC or long-term debt to foreign parents.

Second, any change of control issues could be recognized far in advance of a resolution event in the resolution planning stage, and dealt with accordingly. To the extent that too much internal TLAC is issued to a foreign affiliate such that conversion of the TLAC would result in an undesirable change of control, such a result would be plainly ascertainable during resolution planning, and the TLAC could be transferred to a foreign parent or another foreign affiliate well in advance of a resolution event.

Third, for resolution entity IHCs, a foreign parent requirement would be unduly restrictive compared to the TLAC and long-term debt requirements of covered BHCs. The Federal Reserve has not indicated that change in control of a covered BHC would be an issue, even though the resolution of covered BHCs is likely to be much more complex than the resolution of resolution entity IHCs, which are not themselves G-SIBs. Thus, and consistent with Principle No. 1 above, the change of control rationale should not apply to resolution entity IHCs.

Fourth, for non-resolution entity IHCs, any change of control issues that remain after proper resolution planning as a result of the conversion of TLAC held by foreign affiliates is not likely to have a material adverse impact on a successful SPOE resolution. Even if there was a change of control, control would remain within the foreign G-SIB group. Many jurisdictions have reduced or simplified approval requirements for change-in-control events that are part of an internal reorganization within a single group.<sup>59</sup>

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<sup>58</sup> 80 Fed. Reg. at 74941-42.

<sup>59</sup> For instance in the United Kingdom, there is separate, simplified form for change of control approval with respect to an internal reorganization, with only limited information needing to be provided for the new controller in the corporate structure. See Prudential Regulatory Authority, *Submitting, Assessing and Determining a Change in Control*,

Finally, the proposed rule's restrictions would significantly undermine the flexibility of a foreign G-SIB to manage its liquidity and capital effectively without having any corresponding materially beneficial impact on the resolvability of a covered IHC. There are a variety of reasons why a foreign G-SIB may wish to have a covered IHC issue equity or long-term debt to a foreign entity other than a foreign parent. For example, foreign entities besides a foreign parent may have more suitable pools of capital and liquidity. There would also be different tax implications depending on which entity lends the eligible internal long-term debt to the covered IHC.

Accordingly, the Associations believe that a covered IHC should be permitted to issue or transfer internal TLAC to foreign affiliates. If separate long-term debt requirements are retained, despite our comments in Section II.A above, the Associations believe the arguments above would apply equally to any minimum long-term debt requirements.

## **6. Capital Contribution Agreements**

The Associations believe that the final rule should give covered IHCs the option to satisfy internal TLAC and long-term debt requirements not otherwise satisfied by Tier 1 capital and EDS by entering into capital contribution agreements.

The capital contribution agreements would obligate a foreign G-SIB's parent to contribute an amount of assets up to the minimum amount of required internal TLAC and long-term debt in order to recapitalize the covered IHC upon the occurrence of certain appropriate triggers.

Capital contribution agreements should provide the Federal Reserve with just as much security that a sufficient amount of the foreign parent's assets would be available to recapitalize the covered IHC upon the occurrence of the specified trigger events as if the covered IHC had the required amount of prepositioned internal TLAC. But unlike prepositioned TLAC, capital contribution agreements would leave the foreign G-SIB in control of its assets, giving it the flexibility to contribute assets to subsidiaries in need of recapitalization if the covered IHC does not need them. This would reduce the risk that assets would be misallocated and committed to the covered IHC when needed for the recapitalization of another subsidiary.

## **7. Determination of Foreign G-SIB Status**

Under the proposed rule, a top-tier FBO that controls a U.S. IHC (the "**IHC parent**") would be a foreign G-SIB for purposes of the rule if the Federal Reserve determined that:

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<http://www.bankofengland.co.uk/pr/Pages/authorisations/changeincontrol/applying.aspx> (last visited Jan. 25, 2016).

- The IHC parent would be a G-SIB under the Basel Committee on Banking Supervision (“BCBS”) methodology;
- The IHC parent would be identified as a G-SIB BHC under the Federal Reserve’s capital rules relating to G-SIB surcharges; or
- The U.S. IHC itself would be a covered BHC under the Federal Reserve’s capital rules relating to G-SIB surcharges.<sup>60</sup>

The IHC parent would also be a foreign G-SIB if it determines itself that it would be a G-SIB under the BCBS methodology. Each IHC parent must notify the Federal Reserve by January 1 of each year, effective January 1, 2017, whether (i) its home country supervisor or other appropriate home country regulatory authority has adopted standards consistent with the BCBS methodology and (ii) whether the IHC prepares or reports indicators used by the BCBS methodology, and if it does, whether the IHC parent has determined that it has the characteristics of a G-SIB under the BCBS methodology using the data.

The Associations believe that the internal TLAC requirements should only apply to IHCs of FBOs where the FBOs have been identified as G-SIBs by the FSB. The Federal Reserve's methodology for determining whether an institution is a G-SIB is virtually identical to the BCBS methodology and, therefore, should result in the same FBOs being identified as G-SIBs.<sup>61</sup> The additional requirement for covered IHCs to report to the Federal Reserve and, in particular, to conduct their own assessment using the BCBS methodology, is overly complex and burdensome, especially where the covered IHC and its top-tier FBO are not close to the threshold of being determined a G-SIB. This self-assessment and notification requirement is furthermore unnecessary because the FSB already uses the BCBS methodology to examine the IHC parent and publishes its results. It is unclear how or why the IHC parent, applying the same methodology, might reach a different result from the FSB. Consequently there is no apparent need or benefit for the Federal Reserve in imposing a self-assessment and notification requirement on all FBOs with IHCs and creating uncertainty about which FBOs may be designated as a foreign G-SIB.

Accordingly, the Associations recommend eliminating from the final rule the additional "G-SIB" designation approaches for determining the scope of the application of the proposed internal TLAC requirements (and consequently eliminating the self-assessment and notification requirements for IHC parents) and applying the final rule to IHCs of FBOs

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<sup>60</sup> Proposed Rule § 252.153.

<sup>61</sup> The Federal Reserve’s rule does differ from the BCBS methodology in that it introduces an alternative method for calculating a G-SIB score solely for the purposes of determining what an identified G-SIB’s actual G-SIB capital surcharge will be.

where the FBOs have been identified as G-SIBs by the FSB. At a minimum, the Associations recommend eliminating the self-assessment and notification requirement for IHC parents.

## **8. Other Clean Holding Company Requirements**

The Associations generally support the arguments and recommendations made in the U.S. G-SIB Comment Letter, but want to particularly emphasize here the following specific recommendations:

- There should be an exception from the prohibition on short-term debt for secured liquidity provided by the FDIC or the Federal Reserve, to facilitate an SPOE or other resolution under Title II of the Dodd-Frank Act.
- The prohibition on cross-defaults in parent guarantees or subsidiary liabilities guaranteed by the parent should be modified to permit cross-defaults that are consistent with the ISDA 2015 Universal Resolution Stay Protocol or any future regulations implementing the ISDA Protocol in the United States.
- The term qualified financial contract should be clarified so that it does not include a guarantee of a subsidiary's obligations on a QFC, provided that neither the guarantee nor the QFC contains an impermissible cross-default (as modified by the request in the preceding bullet).
- The phase-in period for any SLR-based TLAC requirements (and if the Federal Reserve retains separate long-term debt requirements, both the risk-based and SLR-based long-term debt requirements) should be extended to January 1, 2022, consistent with the proposed phase-in for risk-based and SLR-based requirements under the FSB's International Standard.

For a more detailed discussion of these arguments, please see the corresponding sections of our U.S. G-SIB Comment Letter.

## **9. Domestic Internal TLAC**

As discussed in Section VIII ("Consideration of U.S. Domestic Internal TLAC and Long-Term Debt Requirements") of Annex 1 to the U.S. G-SIB Comment Letter, the Federal Reserve should not impose any domestic internal TLAC or long-term debt requirements on U.S. IHCs. Such requirements would be particularly unnecessary for covered IHCs because a foreign G-SIB's U.S. operations are already sufficiently regulated to support a successful resolution through the imposition of TLAC requirements on the covered IHC. But if the Federal Reserve were to impose domestic internal TLAC requirements on U.S. IHCs, it should not impose a one-size-fits-all requirement; rather, covered IHCs should be allowed to retain

the option to satisfy any such internal domestic TLAC requirements with any combination of contributable resources, prepositioned resources or capital contribution agreements.

Furthermore, for non-resolution entity IHCs, the imposition of an additional domestic internal TLAC or long-term debt requirement would correspond to an additional, “sub-internal” level of prepositioning that is unjustified. Such non-resolution entity IHCs would be subject to TLAC requirements at the level of the foreign parent, at the level of the non-resolution entity IHC, and at the level of the subsidiaries of the non-resolution entity IHC. This would place them at a competitive disadvantage compared to covered BHCs and resolution entity IHCs, neither of which are, nor should be, subject to three separate levels of TLAC requirements.

**Glossary to Foreign G-SIB Comment Letter**

<b>Term / Acronym</b>	<b>Meaning</b>
ABA	American Bankers Association
Associations	TCH, SIFMA, ABA, FSR and FSF
BCBS	Basel Committee on Banking Supervision
capital structure liabilities	all equity, hybrid and long-term debt securities. This term does not include short-term debt and other operating liabilities
covered BHC	top-tier bank holding company of a U.S. G-SIB
covered IHC	U.S. intermediate holding company of a foreign G-SIB
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act
EDS	Eligible debt securities
ex-post ring-fencing	trapping a material portion of the G-SIB's assets in a host country after the G-SIB has reached the point of failure
FBO	foreign banking organization
FDIC	Federal Deposit Insurance Corporation
foreign G-SIB	foreign global systemically important banking group
Foreign G-SIB Comment Letter	letter filed by the Associations in response to the proposed rule as it would apply to covered IHCs, including the Foreign G-SIB Cover Letter and all annexes thereto
Foreign G-SIB Cover Letter	cover letter to the Foreign G-SIB Comment Letter
franchise value	the value of an entity as a going-concern
FSB	Financial Stability Board
FSR	Financial Services Roundtable

<b>Term / Acronym</b>	<b>Meaning</b>
FSF	Financial Services Forum
IHC Parent	a top-tier FBO that controls a U.S. intermediate holding company
International Standard	international TLAC standard established by the FSB in its Principles on Loss-Absorbing and Recapitalisation Capacity of G-SIBs in Resolution (Nov. 9, 2015)
ISDA	International Swaps and Derivatives Association
long-term debt securities	debt securities with an original maturity of one year or more.
MPOE	multiple-point of entry
MPOE-G-SIB	a G-SIB that is expected to be resolved under a multiple-point-of-entry resolution strategy
NPR	notice of proposed rulemaking
operating liabilities	short-term debt, liabilities on most financial contracts, liabilities for rent, utilities and similar other critical services, and liabilities arising other than by contract such as those arising from litigation judgments
QFC	qualified financial contract as defined in Section 210(c)(7)(D)(i) of the Dodd-Frank Act
shared services	services, such as legal, compliance, intellectual property or data processing services, provided by one or more legal entities within an affiliated group to one or more other legal entities within the group
short-term debt	debt with an original maturity of less than one year or with a put option exercisable by the debt holder in less than one year after the original issuance of the debt, including demand deposits and other short-term deposits
SIFMA	Securities Industry and Financial Markets Association
SLR	supplementary leverage ratio

Term / Acronym	Meaning
SPOE	single-point-of-entry
TBTF	too big to fail
TCH	The Clearing House Association
TLAC	total loss-absorbing capacity
U.S. G-SIB	U.S. global systemically important banking group
U.S. G-SIB Comment Letter	letter filed by the Associations in response to the proposed rule as it would apply to covered BHCs, including the cover letter and all annexes and appendices thereto

**A DESCRIPTION OF EACH OF THE ASSOCIATIONS**

The Clearing House. The Clearing House is a banking association and payments company that is owned by the largest commercial banks and dates back to 1853. The Clearing House Payments Company L.L.C. owns and operates core payments system infrastructure in the United States and is currently working to modernize that infrastructure by building a new, ubiquitous, real-time payment system. The Clearing House is the only private-sector ACH and wire operator in the United States, processing nearly \$2 trillion in U.S. dollar payments each day, representing half of all commercial ACH and wire volume. Its affiliate, The Clearing House Association L.L.C. is a nonpartisan organization that engages in research, analysis, advocacy and litigation focused on financial regulation that supports a safe, sound and competitive banking system.

The Securities Industry and Financial Markets Association. SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over \$2.5 trillion for businesses and municipalities in the U.S., serving clients with over \$20 trillion in assets and managing more than \$67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit [www.sifma.org](http://www.sifma.org).

The American Bankers Association. The American Bankers Association is the voice of the nation's \$15 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard \$12 trillion in deposits and extend more than \$8 trillion in loans.

Financial Services Roundtable. *As advocates for a strong financial future™*, FSR represents 100 integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. FSR member companies provide fuel for America's economic engine, accounting directly for \$98.4 trillion in managed assets, \$1.1 trillion in revenue, and 2.4 million jobs. For more information, please visit [www.fsroundtable.org](http://www.fsroundtable.org).

The Financial Services Forum. The Financial Services Forum is a non-partisan financial and economic policy organization comprising the CEOs of 16 of the largest and most diversified financial services institutions with business operations in the United States. The purpose of the Forum is to pursue policies that encourage savings and investment, promote an open and competitive global marketplace, and ensure the opportunity of people everywhere to participate fully and productively in the 21st-century global economy.