



## Bigger Management Buffers: An Update on the Costs of the Long-Term Debt Proposal

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The federal banking agencies have proposed a rule that would require U.S. banking organizations with total assets of \$100 billion or more, excluding U.S. global systemically important banks (GSIBs), to issue a minimum amount of unsecured long-term debt.<sup>1</sup> The proposal attempts to improve the resolvability of these institutions by increasing their gone concern loss absorbency. In our previous [post](#), we identified five factors that the agencies had not considered while estimating the size of the shortfalls and the overall funding costs. As a result, we demonstrated that the proposal significantly underestimates the cost of implementing the long-term debt requirement.

One of these factors is that banks will necessarily maintain levels of long-term debt well above the minimum required amount—a so-called “management buffer.” Doing so is a function of prudent risk management. This buffer ensures that the bank is not forced to replace maturing debt with new debt issuances at inopportune times, such as during periods of market deterioration or volatility when spreads are higher and the cost of the debt is thus far greater.

In our previous post, we based our regulatory cost and shortfall estimates on an assumption that banks would maintain a six-month management buffer.<sup>2</sup> This assumption was based on the average duration banks were not issuing long-term debt during the period when there were no long-term debt requirements. However, the introduction of the requirements will necessitate that banks operate with larger buffers of long-term debt to ensure that they comply with the rule. Because of this, in this post, we update our estimates assuming larger management buffers that we believe better reflect true bank behavior.

Specifically, instead of calculating the shortfall and costs to manage the debt maturing in the next six months as we assumed in our prior post, we are estimating the shortfall and corresponding total funding costs for the longest period of time that banks did not participate in issuing new debt between 2007 and 2023: 21 months (or 1¾ years) for Category III banks and 32 months (or 2¾ years) for Category IV banks, which tend to have higher bond spreads. These are the average values of the longest duration without new issuance for Category III and IV banks.

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<sup>1</sup> U.S. GSIBs are already subject to similar requirements. These include a total loss absorbing capacity (TLAC) requirement, a stand-alone long-term debt requirement applied to the top-tier holding company in the organization, and internal resource pre-positioning requirements imposed through resolution planning guidance.

<sup>2</sup> We constructed estimates for 6-month management buffers because that was the average duration between long-term debt issuance for Category III and IV banks.

In terms of the long-term debt requirement, this means that Category III banks would, on average, want to hold a 1.3-percentage-point buffer above the 6-percent long-term debt requirement, and Category IV firms would aim for a 2.0-percentage-point management buffer.

Under these revised assumptions on management buffers, total bank funding costs for covered banks are projected to reach \$6.6 billion, 4.5 times the proposal’s estimated costs of \$1.6 billion. The assumption of higher management buffers accounts for an approximately 35-percent increase in the costs associated with the long-term debt proposal.

## Time Interval between the Dates on Which Banks Issued New Debt

We collected data from Bloomberg on every single issuance of senior unsecured bonds between 2009 and 2023 for the banks subject to the long-term debt proposal.<sup>3</sup> We included bonds issued by the bank, the bank holding company and any entity subsequently acquired by the bank holding company. The data also include the issuer-level rating of the bond-issuer’s ultimate parent at the time of issuance. We also used issuer-level credit spreads to illustrate the level of credit and liquidity risks during the period in which banks are not tapping the bond market to replace maturing debt.

**Table 1: Time Interval Between Dates on Which Banks Issue New Debt**

Bank Name	Average Duration Between LTD Issuances			Maximum Duration Between LTD Issuances				
	Elapsed time between issuance	Bond rating at issuance	Total bond amount issued (2007–23)	Elapsed time between issuance	Bond rating at start of inactivity period	Bond rating at end of inactivity period	Widest bond spread during inactivity period	Bond spread at end of inactivity period
Panel A: Category III Banks								
US Bancorp	2.9mo.	A+	\$106.9bn	14.1mo.	A+	A+	87bp	92bp
PNC Financial Services Group Inc	2.5mo.	A	\$90.3bn	14.6mo.	A+	A	583bp	247bp
Truist Financial Corp	2.8mo.	A	\$88.2bn	13.5mo.	AA-	A+	508bp	552bp
Capital One Financial Corp	4.8mo.	BBB+	\$73.0bn	33.1mo.	BBB+	BBB+	398bp	155bp
Charles Schwab Corp	7.5mo.	A	\$33.5bn	28.5mo.	A	A	203bp	108bp
<b>Category III Average</b>	<b>4.1mo.</b>	<b>A</b>	<b>\$78.4bn</b>	<b>20.7mo.</b>	<b>A</b>	<b>A</b>	<b>356bp</b>	<b>231bp</b>
Panel B: Category IV Banks								
American Express Co	2.4mo.	A	\$129.0bn	27.3mo.	A-	A-	457bp	59bp
Ally Financial Inc	6.0mo.	BB	\$34.8bn	37.3mo.	BB	BB+	386bp	198bp
Fifth Third Bancorp	6.6mo.	A-	\$31.0bn	32.9mo.	AA-	BBB+	626bp	132bp
KeyCorp	5.1mo.	A-	\$29.6bn	13.7mo.	BBB+	BBB+	203bp	135bp
Huntington Bancshares Inc	5.4mo.	BBB+	\$22.8bn	24.1mo.	A-	A-	162bp	176bp
First Citizens BancShares Inc	10.0mo.	BBB	\$19.0bn	40.0mo.	-	-	-	-
Citizens Financial Group Inc	5.9mo.	BBB+	\$18.9bn	24.7mo.	BBB+	BBB+	195bp	202bp
M&T Bank Corp	11.8mo.	A-	\$16.6bn	56.2mo.	A-	A-	692bp	196bp
Synchrony Financial	6.8mo.	BBB-	\$16.4bn	27.1mo.	BBB-	BBB-	629bp	119bp
Discover Financial Services	8.6mo.	BBB	\$15.1bn	34.1mo.	BBB	BBB	537bp	154bp
Regions Financial Corp	14.1mo.	BBB	\$10.4bn	36.1mo.	BBB	BBB-	739bp	126bp
New York Community Bancorp Inc	13.0mo.	BBB-	\$1.3bn	28.1mo.	BBB	BBB-	-	-
<b>Category IV Average</b>	<b>8.0mo.</b>	<b>BBB+</b>	<b>\$28.7bn</b>	<b>31.8mo.</b>	<b>BBB+</b>	<b>BBB</b>	<b>463bp</b>	<b>150bp</b>
<b>Category III-IV Average</b>	<b>6.8mo.</b>	<b>BBB+</b>	<b>\$43.3bn</b>	<b>28.6mo.</b>	<b>A-</b>	<b>BBB+</b>	<b>427bp</b>	<b>177bp</b>

Source: Bloomberg.

Table 1 presents information on the average length of time between the issuance of long-term debt and the longest length of time without the issuance of new debt for covered institutions.<sup>4</sup> In addition, the table provides information on the aggregate bond amount issued by banks, the average rating at issuance, and bond spreads. We use a *heat map* to represent the costs associated with liquidity and credit premiums. The map features a red-green color code to indicate whether costs are high or low.

<sup>3</sup> Although the U.S. bank holding company and U.S.-insured bank subsidiaries of foreign banking organizations are covered by the long-term debt proposal, we excluded them from this analysis because they did not issue long-term debt in the United States during this period.

<sup>4</sup> We excluded Northern Trust from the summary statistics because it is a Category II firm. Given its business model focused on custodial activities, Northern Trust tends to access the market for long-term debt much less frequently than the other covered firms.

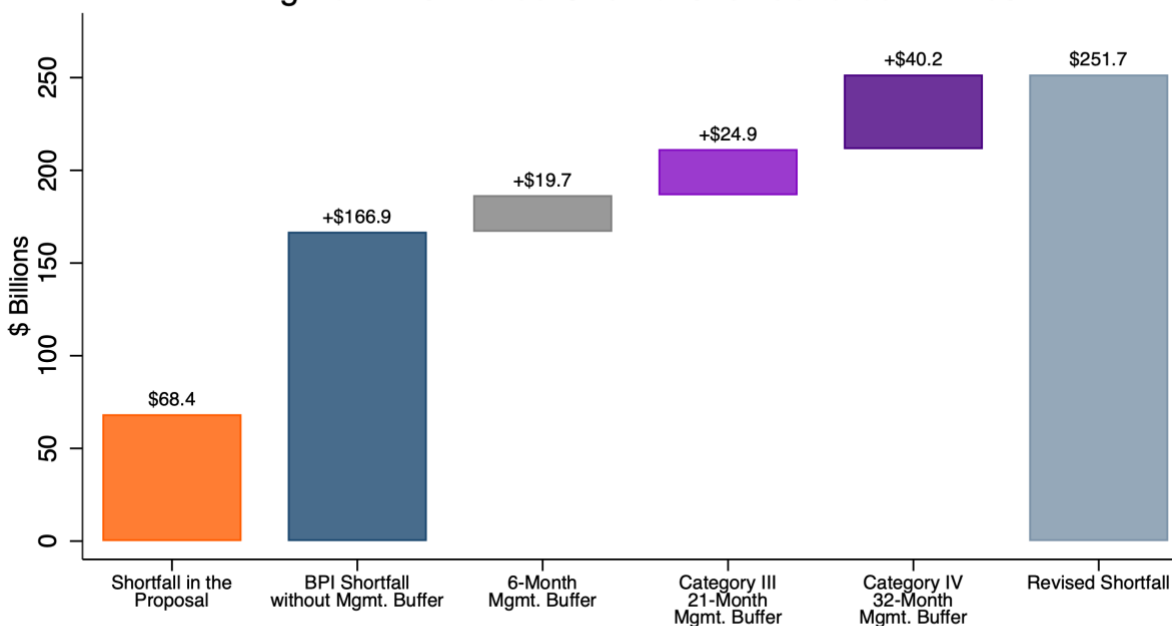
The average time interval between long-term debt issuances was four months for Category III banks (Panel A, column 2) and eight months for Category IV banks during the 16-year window (Panel B, column 2). The longest duration without issuance of long-term debt jumped to nearly 21 months, on average, for Category III firms (Panel A, column 5) and nearly 32 months, on average, for Category IV banks (Panel B, column 5). Moreover, bond spreads are much higher at the start of the inactivity period than when firms resume issuance of long-term debt. This result generally holds for both Category III and IV banks.

The results show that the time interval between issuances of new debt was larger for Category IV banks compared with Category III banks. In other words, it took longer for smaller banks to tap into the bond market during both the normal times and during unfavorable economic conditions. The rating of bonds at issuance did not differ much between normal times and periods when banks chose to delay the issuance of new debt. However, banks with lower ratings tend to have longer periods in which they do not issue long-term debt compared with banks with higher ratings. In addition, banks appear to wait longer to tap the bond market when bond spreads widen. Therefore, a bank’s decision to delay tapping the bond market is likely driven by higher borrowing costs, which is in turn driven by wider bond spreads.

### Effect of Higher Management Buffers on the Cost of the LTD Proposal

Next, we re-estimate the costs of the LTD proposal to account for the fact that banks will need to hold larger management buffers to ensure compliance with minimum requirements. This is because they cannot easily access the market during times of economic stress to replace maturing debt.

Figure 1: Estimated Shortfalls for Covered Entities



Source: Bloomberg, FR Y-9C, FR Y-9LP, FFIEC 101, NIC, Call Report.

Note: This chart displays the aggregate shortfall across all banks subject to the long-term debt proposal, including U.S. subsidiaries of foreign banks.

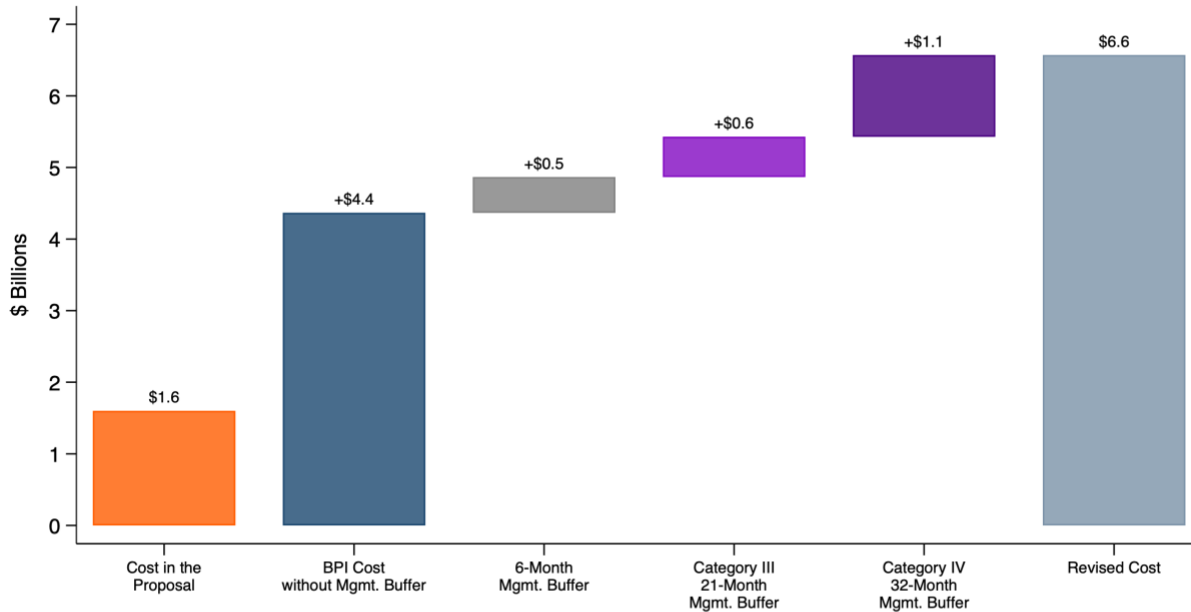
Figure 1 shows the long-term debt shortfall for covered banks when we consider management buffers sufficient to cover long-term debt maturing over the next 21 months for Category III firms and 32 months for Category IV firms.<sup>5</sup> This corresponds to a management buffer that is 1.3 percentage points of risk-weighted assets for Category III firms and 2.0 percentage points for Category IV firms. Our earlier work, which calculated the shortfall and cost for six-month management buffers, shows a shortfall of \$19.7 billion for covered banks, resulting in the total shortfall of \$186.6 billion. Figure 1 shows that the shortfall increases by \$65.1 billion when we consider larger

<sup>5</sup> We did not adjust Northern Trust’s management buffer, given its low bond spread and elevated bond rating.

management buffers that banks will need support regulatory compliance. After accounting for these larger buffers, the total shortfall for covered banks reaches nearly \$252 billion, about 3.7 times the proposal’s estimated \$70 billion shortfall.

Figure 1 also separates the change in the LTD shortfall across Category III and IV banks. Although holding additional debt to ensure compliance with minimum requirements increases the cost associated with the long-term debt requirement for all covered banks, the increases in shortfalls due to management buffers are larger for Category IV banks, both in an absolute sense as well as relative to risk-weighted assets.

**Figure 2: Estimated Additional Annual Costs for Covered Entities**



Source: Bloomberg, FR Y-9C, FR Y-9LP, FFIEC 101, NIC, Call Report.

Note: This chart displays additional annual costs across all banks subject to the long-term debt proposal, including U.S. subsidiaries of foreign banks.

In Figure 2, we have recalculated the annual pre-tax funding costs for covered banks, assuming that they need to hold higher management buffers. Pre-tax funding costs are estimated to increase \$0.5 billion when banks hold buffers for a six-month period. The funding costs increase by \$1.7 billion when banks hold management buffers to cover debt maturing over the next 21 months for Category III banks and 32 months for Category IV banks. With the higher management buffers, the total bank funding costs for covered banks are projected to reach \$6.6 billion, 4.5 times the proposal’s estimated costs of \$1.6 billion.

Figure 2 also presents pre-tax funding costs separately for Category III and IV banks. The total funding cost rises more sharply for Category IV banks compared with Category III banks. Specifically, total funding costs increase from \$0.22 billion to \$0.87 billion for Category III banks and from \$0.23 billion to \$1.25 billion for Category IV banks. These findings highlight the importance of considering management buffers when calculating the potential costs associated with the long-term debt requirement. Smaller banks need to hold larger management buffers to operate smoothly during times of stress. Once such banks are required to hold any amount of long-term debt, the agencies need to factor in that these banks will hold their own buffers on top of minimum requirements, to avoid paying higher bond spreads during times of economic stress and falling below regulatory requirements.

## Conclusion

Our analysis indicates that the costs associated with meeting new long-term debt requirements could increase significantly when we consider that the banks may need to hold large management buffers. Although banks access the market every six months on average to replace maturing debt, after the long-term debt requirements are introduced, they may choose to hold larger buffers to avoid issuing new long-term debt during times of stress.

The banking agencies should consider that banks will need to hold large management buffers because of the uncertainty of funding costs and the need to ensure compliance with minimum requirements. Therefore, the agencies should weigh the differences in the costs to comply with the new requirements among covered entities, adjust the calibration and tailor those requirements appropriately.

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