June 7, 2019

Via Electronic Mail

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

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

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington D.C. 20429

Re: Regulatory Capital Treatment for Investments in Certain Unsecured Debt Instruments of Global Systemically Important U.S. Bank Holding Companies, Certain Intermediate Holding Companies, and Global Systemically Important Foreign Banking Organizations (Docket ID OCC–2018–0019 and RIN1557–AE38; FRB Docket No. R–1655 and RIN 7100 AF43; FDIC RIN 3064–AE79)

Ladies and Gentlemen:

The Bank Policy Institute, the Financial Services Forum and the Securities Industry and Financial Markets Association (the "Associations")[1] welcome the opportunity to comment on the agencies' proposal[2] addressing the regulatory capital treatment of advanced approaches firms' investments in certain unsecured debt instruments of U.S. GSIBs, foreign GSIBs and the U.S.

1 See Annex A for a description of each of the Associations.

2 84 Fed. Reg. 13814 (Apr. 8, 2019).

IHCs of foreign GSIBs ("Covered IHCs"), including debt that qualifies as total loss-absorbing capacity ("TLAC") but does not qualify as regulatory capital ("TLAC-eligible debt").

The Associations strongly support the maintenance of robust capital by all banking organizations as an essential tool for promoting safety and soundness. The Associations also appreciate the importance of the agencies' objective of addressing risks that could arise from the failure of a GSIB, including interconnectedness risk. The proposal could, however, significantly constrain the ability of advanced approaches firms to make markets in TLAC-eligible debt and other debt instruments issued by U.S. GSIBs, foreign GSIBs and subsidiaries of foreign GSIBs, including Covered IHCs. Although the proposal would significantly expand the scope of instruments subject to the deductions framework, it would not recalibrate the general 10% threshold for non-significant investments. In addition, although the proposal includes a separate 5% threshold intended to facilitate market-making activity, the design and calibration of the threshold would prevent it from achieving its intended purpose. The absence of appropriately designed and calibrated thresholds for market-making activity would negatively affect the liquidity and (from the issuer's perspective) price of TLAC-eligible debt, as well as market efficiency and GSIBs' ability to issue TLAC-eligible debt quickly, including in times of financial stress. We are also concerned that the proposal would impose requirements on advanced approaches firms that would be complex and impracticable to implement and that the breadth of debt instruments subject to potential deduction could have the unintended consequence of interfering with ordinary interbank transactions.

Many aspects of the U.S. bank regulatory framework already address interconnectedness and other risks relating to a GSIB's failure. The proposal would be only one of a number of regulatory requirements to do so. Among the other requirements are single counterparty credit limits, restrictions on default rights in qualified financial contracts, mandatory clearing requirements and margin requirements for uncleared swaps, as well as requirements relating to recovery and resolution planning, TLAC, capital (including the GSIB surcharge), liquidity and stress testing. These other requirements have contributed to substantial reductions in the risks the proposal is intended to address, and the agencies should take the broader regulatory framework into account when assessing the design and calibration of the proposed deductions.

We provide in this letter a number of recommendations that would allow the final rule to address interconnectedness and other risks relating to a GSIB's failure more appropriately. Our recommendations would further the policy objectives of efficiency and simplicity in regulation.[3] Our recommendations would also facilitate the ability of advanced approaches firms to engage in market-making activity, which supports the depth and liquidity of markets for TLAC-eligible debt. In particular, our recommendation regarding the proposed 5% threshold would mitigate the potential pro-cyclicality of the proposed deductions framework as it relates to the negative impact on liquidity of TLAC-eligible debt of the proposed deductions during periods of financial stress. During periods of financial stress, an advanced approaches firm's capital may decline. Because the thresholds are based on a firm's capital, a decline in capital would correspondingly reduce the size of the threshold and, therefore, the advanced approaches firm's capacity to serve as a market maker. Market making is critical to the maintenance of orderly, deep and

[3] *See*, *e.g.*, Federal Reserve, *Supervision and Regulation Report* (May 2019), at 1-2, *available at* https://www.federalreserve.gov/publications/files/201905-supervision-and-regulation-report.pdf.

liquid markets during times of financial stress. Limiting an advanced approaches firm's ability to serve as a market maker during periods of financial stress could exacerbate adverse market conditions.

I. Executive Summary.

- The final rule should use the framework of the Volcker Rule to identify which positions are held for market-making purposes and eligible to be designated as within the proposed separate 5% market-making threshold, instead of creating a new regulatory test to identify market-making activity.
  - The agencies should eliminate the proposed 30-business-day requirement because it is unworkable for many market-making activities.
  - Allowing U.S. GSIBs and subsidiaries of GSIBs to use the framework of the Volcker Rule to determine eligibility for the proposed separate 5% market-making threshold would promote efficiency and simplicity in regulation, as well as the objectives of the threshold.
- The design and calibration of the proposed separate 5% market-making threshold must be revised in order for the threshold to allow advanced approaches firms to support a deep and liquid market for TLAC-eligible debt.
  - The market-making exposure subject to the threshold should be measured on a net long basis instead of a gross long basis.
  - The final rule should allow firms to recognize additional short positions when determining their net long position in a covered debt instrument.
- The final rule should include an additional, separate 5% threshold for market-making activity in a U.S. GSIB's or advanced approaches Covered IHC's own covered debt instruments.
- The agencies should realign the general 10% threshold for non-significant investments in light of the broader population of instruments that would be included within that threshold.
- The proposed definition of "covered debt instrument" is overly broad and impracticable to implement.
  - The agencies should revise the scope of "covered debt instruments" to include only TLAC-eligible debt, determined under applicable home-country standards.
    - The agencies could achieve their supervisory objectives if "covered debt instruments" included only TLAC-eligible debt.
    - Treating any *pari passu* or subordinated unsecured debt instrument as a "covered debt instrument" could interfere with ordinary interbank transactions.

  - o Applying the own holdings deduction to instruments that are not TLAC-eligible is excessively punitive and not necessary to achieve the agencies' supervisory objectives.

- It is not practicable for advanced approaches firms to determine whether unsecured debt instruments are "covered debt instruments" because making these determinations would entail a searching inquiry, potentially involving a review and analysis of hundreds (and in some cases thousands) of outstanding instruments of each issuer, and the information necessary to make the determinations is not readily accessible.

➢ The final rule should eliminate the asymmetric application of the corresponding deduction approach for U.S. GSIBs and advanced approaches Covered IHCs.

➢ The final rule should include an implementation period of at least eighteen months following adoption and should not require deductions as to any unsecured debt instrument until the information necessary to determine whether the instrument is a "covered debt instrument" is available.

II. The final rule should use the framework of the Volcker Rule to identify which positions are held for market-making purposes and eligible to be designated as within the proposed separate 5% market-making threshold, instead of creating a new regulatory test to identify market-making activity.

A. The agencies should eliminate the proposed 30-business-day requirement because it is unworkable for many market-making activities.

The proposal includes activity-based requirements for U.S. GSIBs and subsidiaries of GSIBs, limiting the proposed separate 5% market-making threshold to positions held for 30 business days or less and for the purpose of short-term resale or with the intent of benefiting from actual or expected short-term price movements, or to lock in arbitrage profits. The agencies should eliminate the proposed 30-business day requirement because it would make the proposed separate 5% market-making threshold unavailable for many market-making activities, including activities that support the depth and liquidity of the markets for TLAC-eligible debt.

In particular, market making in derivatives is important to the liquidity and depth of markets for TLAC-eligible debt, including by mitigating price volatility for securities in a distressed market by offering investors that are seeking to de-risk an alternative to selling their holdings. The proposed separate 5% market-making threshold would not, however, be workable for derivatives. If a designated excluded covered debt instrument is not sold within 30 business days, the position is automatically and immediately subject to deduction. Derivatives are not ordinarily "sold". Accordingly, a U.S. GSIB or subsidiary of a GSIB would not be able to use the proposed 5% threshold for derivative positions because of an aging requirement that is a poor fit for derivatives. The agencies have recognized that an aging metric—such as the proposed 30-business-day holding period—does not provide useful information about whether a derivative position relates to market-making activities. As part of their 2018 notice of proposed rulemaking addressing the Volcker Rule, the agencies proposed to "[e]liminate inventory aging data for derivatives because aging, as applied to derivatives, does not appear to provide a meaningful indicator of potential impermissible trading activity or excess risk-taking."[4] The same rationale applies for eliminating the 30-business-day holding period: the proposed holding period requirement would not be a meaningful indicator of whether a derivative position relates to market making. As discussed below, the framework of the Volcker Rule offers a better approach to identify whether a derivative position (or any other position) relates to market making.

Further, a U.S. GSIB or subsidiary of a GSIB may have a long position in a cash instrument to hedge a derivative market-making position. Because such a hedge of a derivative position would be held for more than 30 business days, a U.S. GSIB or subsidiary of a GSIB would be precluded from using the proposed 5% threshold for that position. Allowing the proposed 5% threshold to be available for derivative positions and cash long positions that hedge derivative positions would promote the ability of GSIBs to act as market makers and support the depth and liquidity of markets for TLAC-eligible debt. Accordingly, the proposed 30-business-day requirement should be eliminated in the final rule.

B. Allowing U.S. GSIBs and subsidiaries of GSIBs to use the framework of the Volcker Rule to determine eligibility for the proposed separate 5% market-making threshold would promote efficiency and simplicity in regulation, as well as the objectives of the threshold.

The activity-based requirements relating to the proposed separate 5% market-making threshold are intended to identify positions held in connection with market-making activities.[5] As noted above, the activity-based requirements provide that, to be eligible for the threshold, the position must, among other things, be held the for the purpose of short-term resale or with the intent of benefiting from actual or expected short-term price movements, or to lock in arbitrage profits. This would establish a requirement that is consistent with the criteria for a position to be a "trading position" under the Market Risk Capital Rule.[6]

In the United States, there is a pre-existing regulatory framework to identify market-making positions: the Volcker Rule, which incorporates the "trading position" definition under the Market Risk Capital Rule. Creating an additional framework to identify market-making positions, as contemplated by the proposal, would increase regulatory complexity without a corresponding supervisory benefit.[7] Creating such an additional framework would also impose

---

4 OCC, FRB, FDIC, SEC and CFTC, *Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds*, 83 Fed. Reg. 33432, 33495 (July 17, 2018).

5 *See* 84 Fed. Reg. at 13821.

6 The Market Risk Capital Rule defines a "trading position" as a position that is held by a banking organization for the purpose of short-term resale or with the intent of benefiting from actual or expected short-term price movements, or to lock in arbitrage profits.

7 The same rationale applies for using the Volcker Rule's framework to identify underwriting positions to exclude from the scope of "covered debt instruments" and "investments in the capital of unconsolidated financial institutions," instead of the five-day limit reflected in the proposal (with

undue burdens on advanced approaches firms. Advanced approaches firms have designed and implemented systems and processes to comply, and demonstrate compliance, with the Volcker Rule's provisions on market making, as well as the Volcker Rule's requirements regarding documentation and monitoring of metrics. Introducing an additional regulatory framework to identify market-making positions would require advanced approaches firms to develop new systems and processes for purposes of that framework even though their existing systems and processes are well suited to identify, and allow supervisors to identify, which positions are held for market-making purposes. Accordingly, the definition of "excluded covered debt instrument" should be revised to replace the 30-business-day and purpose requirements with a requirement that the position qualify as a permitted market-making position, or permitted hedge of a market-making position, under the Volcker Rule.

In addition to promoting efficiency and simplicity in regulation, using the framework of the Volcker Rule would further the objectives of the proposed separate 5% market-making threshold—supporting the depth and liquidity of the markets for TLAC-eligible debt—by facilitating market-making activities of U.S. GSIBs and subsidiaries of GSIBs. Allowing firms to use the framework of the Volcker Rule to identify which positions relate to market-making activities for purposes of the proposed deductions framework and which positions, up to 5% of their CET1 capital, would be included within the proposed 5% threshold would address the weakness of the proposed 30-business-day requirement by making the threshold available for derivative positions and cash long positions that hedge derivative positions.

III. The design and calibration of the proposed separate 5% market-making threshold must be revised in order for the threshold to allow advanced approaches firms to support a deep and liquid market for TLAC-eligible debt.

The proposal includes an additional 5% threshold for non-significant investments in covered debt instruments to facilitate market making. Although we strongly support the agencies' objective of allowing sufficient market-making activities to support a deep and liquid market for TLAC-eligible debt, the additional threshold would not achieve that goal unless the agencies revise the design and calibration of the threshold.

A. The market-making exposure subject to the threshold should be measured on a net long basis instead of a gross long basis.

Applying the threshold on a net long—instead of gross long—basis would recognize the role of hedges in connection with market-making activity. Applying the threshold on a net long basis would also be consistent with the overall architecture of the deductions framework, which bases deductions on a firm's net long positions. Applying the threshold on a gross long basis would unduly constrain the ability of an advanced approaches firm to engage in market-making activities.

B. The final rule should allow firms to recognize additional short positions when determining their net long position in a covered debt instrument.

---

respect to the definition of "covered debt instruments") and the capital rules (with respect to the definition of "investments in the capital of unconsolidated financial institutions").

Section 22(h) of the capital rules allows a firm to adjust the gross long position by a short position so long as the short position is "in the same instrument." The proposal should be revised to allow firms to recognize short positions considered market-making hedges of a long position per a firm's internal risk management framework so long as the short position is in an instrument that is *pari passu* with or subordinated to the long position, subject to the existing maturity conditions in Section 22(h).[8] Recognizing short positions in *pari passu* or subordinated instruments would appropriately reflect the risk-mitigating characteristics of those positions. It would also be consistent with the treatment of other eligible hedges under the Federal Reserve's single counterparty credit limits.[9]

IV. The final rule should include an additional, separate 5% threshold for market-making activity in a U.S. GSIB's or advanced approaches Covered IHC's own covered debt instruments.

The proposed 5% threshold would apply only to non-significant investments in covered debt instruments. It would not apply to a U.S. GSIB's or an advanced approaches Covered IHC's positions in its own covered debt instruments in connection with market-making activities. Accordingly, holdings of own covered debt instruments would be subject to an automatic and immediate deduction, without regard to amount or holding period. A U.S. GSIB is typically the most active market maker in its own debt. A separate threshold for market-making positions involving a firm's own debt would further the objective of the proposed 5% threshold, namely to promote deep and liquid markets for TLAC-eligible debt.

The additional, separate 5% threshold for own holdings should reflect our recommendations in Sections II and III to eliminate the 30-business-day requirement, to use the framework of the Volcker Rule to identify market-making positions eligible for the threshold, to apply the threshold on a net long basis and to recognize additional short positions. This additional, separate threshold should apply to any investment in own covered debt, including direct holdings of TLAC-eligible debt, positions resulting from index holdings, indirect holdings, such as through investments funds, and synthetic positions, such as through derivatives.

The additional, separate 5% threshold for own holdings should address direct holdings of a U.S. GSIB's or advanced approaches Covered IHC's own covered debt instruments because those holdings could, in many cases, result in deductions under the proposal. Under Section 22(h)(2)(ii) of the agencies' regulatory capital rules, the gross long position for an exposure that is held directly and is not an equity exposure or a securitization exposure (*e.g.*, a direct holding of TLAC-eligible debt) is the "exposure amount", as defined in Section 2 of the capital rules. Section 2, in turn, provides that the exposure amount of such a position is the GAAP carrying value. Under U.S. GAAP, when, for example, a broker-dealer subsidiary of a U.S. GSIB acquires the U.S. GSIB's own TLAC-eligible debt in connection with market-making activities, the holding is not necessarily eliminated in consolidation. Accordingly, the carrying

---

8 Although we provide this recommendation in the context of comments on the proposed separate 5% market-making threshold, this recommendation has broader applicability and should apply for all purposes of the deductions framework and for both advanced and non-advanced approaches firms.

9 *See* 12 C.F.R. § 252.74(e) and § 252.174(e).

value—and, therefore, the exposure amount—can be greater than zero. A positive carrying value results in a deduction. Accordingly, the additional, separate 5% threshold for own holdings should apply to direct holdings and should not be limited to positions resulting from index holdings, indirect holdings and synthetic positions.

V. The agencies should realign the general 10% threshold for non-significant investments in light of the broader population of instruments that would be included within that threshold.

The 10% CET1 capital threshold for deductions of non-significant investments in the capital of unconsolidated financial institutions was designed and calibrated based on a symmetrical corresponding deductions approach, where the only instruments giving rise to deductions are regulatory capital instruments. As a result of the proposal, the basis underlying the design and calibration of the threshold would no longer apply. The agencies have previously recognized that it is appropriate to increase a deductions threshold when the scope of instruments subject to the threshold expands. When the agencies proposed to revise the deductions framework for non-advanced approaches firms, they proposed both to remove the distinctions among significant and non-significant investments in the capital of unconsolidated financial institutions and to apply a new, higher deduction threshold of 25% for all those investments.[10] The same principle applies here: the proposal would expand the scope of instruments within the threshold and the agencies should correspondingly realign the threshold to reflect that broader scope.

We, therefore, recommend that the agencies revise the general 10% threshold for non-significant investments to be, for a U.S. GSIB or an advanced approaches Covered IHC, 10% of TLAC and, for any other advanced approaches firm (such as a depository institution subsidiary of a U.S. GSIB), 10% of its total capital. For U.S. GSIBs and Covered IHCs, basing the threshold on TLAC instead of CET1 capital would appropriately reflect that, as a result of the proposal, the scope of instruments within the scope of the threshold would expand significantly and that the threshold would no longer be limited to capital instruments. For other advanced approaches firms, basing the threshold on Total capital instead of CET1 capital would achieve similar objectives. Although we believe that TLAC is the most appropriate metric for the threshold in light of the changes contemplated by the proposal, using Total capital for advanced approaches firms that are not U.S. GSIBs or Covered IHCs would appropriately reflect the implications of the proposal without introducing undue complexity into the deductions framework.

VI. The proposed definition of "covered debt instrument" is overly broad and impracticable to implement.

A. The agencies should revise the scope of "covered debt instruments" to include only TLAC-eligible debt, determined under applicable home-country standards.

---

[10] OCC, FRB and FDIC, *Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996*, 82 Fed. Reg. 49984, 49993 (Oct. 27, 2017).

1. The agencies could achieve their supervisory objectives if "covered debt instruments" included only TLAC-eligible debt.

The proposal would require advanced approaches firms to deduct from Tier 2 capital certain of their investments in "covered debt instruments" issued by U.S. G-SIBs and foreign GSIBs, as well Covered IHCs and other subsidiaries of foreign GSIBs. The term "covered debt instruments" would be defined as including:

- for debt issued by a U.S. GSIB or a Covered IHC, unsecured debt instruments that meet the eligibility criteria for TLAC under the Federal Reserve's TLAC rule,[11] or unsecured debt instruments that are *pari passu* with or subordinated to any such TLAC-eligible debt instruments, other than any debt instruments that qualify as Tier 2 capital, and

- for debt issued by a foreign GSIB or any of its subsidiaries (other than a Covered IHC), unsecured debt instruments issued for the purpose of absorbing losses or recapitalizing the issuer or any of its subsidiaries in connection with a resolution, receivership, insolvency, or similar proceeding of the issuer or any of its subsidiaries ("loss-absorbency purposes"), or unsecured debt instruments that are *pari passu* with or subordinated to any such debt instruments, other than any debt instruments that qualify as regulatory capital of the issuer.

In the United States, as the agencies note,[12] the clean holding company requirements in the Federal Reserve's TLAC rule limit the amount of debt that a U.S. GSIB or Covered IHC can issue that is not TLAC-eligible but is *pari passu* with or junior to TLAC-eligible debt.[13] As discussed below, similar limitations apply under the Financial Stability Board's Final TLAC Term Sheet, the international standard on TLAC requirements for GSIBs.[14] These limitations substantially mitigate potential interconnectedness and other risks relating to advanced approaches firms' investments in such ineligible debt. The U.S. clean holding company requirements and international TLAC standard provide that significant amounts of such debt should not be outstanding.

Sections 10 and 11 of the FSB's Final TLAC Term Sheet contain limits analogous to those in the Federal Reserve's clean holding company requirements. Sections 10 and 11 of the FSB Final Term Sheet generally limit the amount of "excluded liabilities" of an issuer of TLAC-eligible debt to 5% of its TLAC. "Excluded liabilities" include, among other things, deposits and

---

[11] *See* 12 C.F.R. Part 252, Subpart G (with respect to U.S. GSIBs) and Subpart P (with respect to Covered IHCs).

[12] 84 Fed. Reg. at 13819.

[13] 12 C.F.R. § 252.64(b) (with respect to U.S. GSIBs) and § 252.166(b) (with respect to Covered IHCs).

[14] Financial Stability Board, *Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution: Total Loss-absorbing Capacity (TLAC) Term Sheet* (Nov. 9, 2015), *available at* http://www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf.

structured notes, as well as liabilities relating to derivatives, tax liabilities and other non-contractual liabilities.

Further, even where the 5% limit in the FSB Final Term Sheet does not apply, it is not appropriate to treat "excluded liabilities" as "covered debt instruments." Section 11 of the FSB Final Term Sheet provides that the 5% limit is not applicable where TLAC-eligible debt is subject to bail-in powers but, by statute, all "excluded liabilities" are not. In those cases, the excluded liabilities have fundamentally different loss-absorbing characteristics from the TLAC-eligible debt because the excluded liabilities are not subject to bail-in powers but TLAC-eligible debt instruments are. Although the excluded liabilities may rank equally or junior to TLAC-eligible debt in a liquidation of the issuer, in the context of a bail-in resolution, those excluded liabilities would effectively rank senior to TLAC-eligible debt. In the context of a bail-in resolution, TLAC-eligible debt would be converted into equity or written down through the application of bail-in powers, but those bail-in powers would not apply to the excluded liabilities. Accordingly, for purposes of the deductions framework, unsecured debt instruments that are "excluded liabilities" should not be treated in the same manner as TLAC-eligible debt even if the excluded liabilities are *pari passu* with or subordinated to TLAC-eligible debt.

Treating only TLAC-eligible debt as a "covered debt instrument" would promote efficiency and simplicity in regulation. As discussed below, our recommended approach would (i) prevent the potential unintended consequences of requiring deductions for unsecured debt instruments that are "excluded liabilities" under the FSB Final TLAC Term Sheet, (ii) address the proposal's excessively punitive treatment of own holdings of unsecured debt instruments that are not TLAC-eligible but are *pari passu* or subordinated to TLAC-eligible debt, and (iii) to a limited degree, mitigate the significant operational burdens the proposed definition would impose.

We therefore urge the agencies to revise the proposal to provide that "covered debt instruments" would include:

- as to a U.S. GSIB, only "eligible debt securities" as defined in the Federal Reserve's TLAC rule[15] (other than any instrument that qualifies as Tier 2 capital),
- as to a Covered IHC, only "eligible Covered IHC debt securities" as defined in the Federal Reserve's TLAC rule[16] (other than any instrument that qualifies as Tier 2 capital), and
- as to a foreign GSIB or its subsidiaries (other than a Covered IHC), only unsecured debt instruments that, when issued, qualify as TLAC under the applicable home-country standards (other than any instrument that qualifies as regulatory capital).

Similar to the proposed definition, our recommended definition would provide that unsecured debt instruments that qualify as TLAC upon original issuance would continue to be treated as "covered debt instruments" even when the instrument would no longer count toward the issuer's

---

[15] *See* 12 C.F.R. § 252.61.

[16] *See* 12 C.F.R. § 252.161.

TLAC requirements because of the remaining maturity. For example, for a U.S. GSIB or Covered IHC, an instrument that is, at issuance, an "eligible debt security" or "eligible Covered IHC debt security" would continue to be a "covered debt instrument" even if its residual maturity is less than one year (365 days) and the instrument would no longer count toward the U.S. GSIB's or Covered IHC's TLAC requirements.

2. Treating any *pari passu* or subordinated unsecured debt instrument as a "covered debt instrument" could interfere with ordinary interbank transactions.

In some jurisdictions outside the United States, there is no depositor preference regime and a bank entity issues TLAC-eligible debt. In those jurisdictions, deposits can be *pari passu* with TLAC-eligible debt issued by a foreign GSIB or a subsidiary of a foreign GSIB. In addition, deposits could potentially be viewed as an "unsecured debt instrument," as an extension of credit to a bank, analogous to a loan to a bank.[17] An advanced approaches firm's deposit with a foreign GSIB (or a subsidiary of a foreign GSIB) that is *pari passu* with the TLAC-eligible debt issued by the foreign GSIB (or a subsidiary of the foreign GSIB) would, therefore, appear to be a "covered debt instrument" and subject to inclusion in the general 10% threshold for non-significant investments in covered debt instruments and the capital of unconsolidated financial institutions, as well as potential deduction.

Under the framework of the FSB Final TLAC Term Sheet, deposits that are *pari passu* with or subordinated to TLAC-eligible debt must either be limited in amount or, unlike TLAC-eligible debt, not subject to bail-in. In addition, as discussed in the introductory paragraphs of this letter, there are other regulatory requirements addressing the same risks as the proposal—in particular, single counterparty credit limits. Accordingly, it is not necessary for the agencies to treat deposits as "covered debt instruments" to achieve their supervisory objectives even if those deposits are *pari passu* with or subordinated to TLAC-eligible debt, and we urge the agencies to revise the proposal in order to avoid implementing a deductions framework that interferes with ordinary interbank transactions.

Treating deposits as "covered debt instruments" could interfere with ordinary interbank transactions by discouraging advanced approaches firms from placing deposits at foreign GSIBs or their foreign bank subsidiaries. Where there is no depositor preference regime and the deposit would be treated as a "covered debt instrument"—that is, where the deposit would count against the general 10% threshold for non-significant investments and be subject to potential deduction—the costs of placing deposits at a foreign GSIB or its foreign bank subsidiaries would be highest and the incentives not to do so most powerful. There would, however, also be costs—and related disincentives—if an advanced approaches firm placed deposits at any foreign GSIB or foreign bank subsidiary of a foreign GSIB, irrespective of whether the deposit would be a *pari passu* or subordinated instrument counting against the general 10% threshold for non-significant investments and subject to potential deduction. If an

[17] *See*, *e.g.*, 12 C.F.R. § 252.71(h)(1) (providing that for purposes of the single counterparty credit limits a "credit transaction" with respect to a counterparty includes, among other things, "[a]ny extension of credit to the counterparty, including loans, deposits, and lines of credit, but excluding uncommitted lines of credit").

advanced approaches firm has a deposit at a foreign GSIB or one of its foreign bank subsidiaries, the firm would need to determine:

- in the case of a deposit at a foreign GSIB, whether the deposit is *pari passu* or subordinated to the foreign GSIB's debt issued for loss-absorbency purposes, and

- in the case of a deposit at a foreign bank subsidiary of a foreign GSIB, whether the subsidiary has issued debt for loss-absorbency purposes, and, if it has, whether the deposit is *pari passu* or subordinated to such debt.

As discussed below, it would be complex, difficult and, ultimately, impracticable for advanced approaches firms to make this determination with respect to their deposits at each foreign GSIB or foreign bank subsidiary of a foreign GSIB.

3. Applying the own holdings deduction to instruments that are not TLAC-eligible is excessively punitive and not necessary to achieve the agencies' supervisory objectives.

A U.S. GSIB or advanced approaches Covered IHC should not be required to deduct from its Tier 2 capital holdings of its own unsecured debt instruments that do not qualify as TLAC, including "eligible debt securities" (in the case of a U.S. GSIB) or "eligible Covered IHC debt securities" (in the case of an advanced approaches Covered IHC) that cannot count toward TLAC requirements because the remaining maturity is less than one year. These instruments do not count toward TLAC requirements. Requiring a deduction for an instrument for which there is no regulatory credit is excessively punitive. The own holdings deduction is intended to address "double counting."[18] That rationale does not apply with respect to own holdings of instruments that do not receive any regulatory credit, such as unsecured debt instruments that are *pari passu* with or subordinated to TLAC-eligible debt but that do not, themselves, qualify as TLAC, or instruments that are no longer TLAC-eligible debt because the remaining maturity is less than one year. Further, own holdings do not give rise to interconnectedness or any other risk the proposal is intended to address.

B. It is not practicable for advanced approaches firms to determine whether unsecured debt instruments are "covered debt instruments" because making these determinations would entail a searching inquiry, potentially involving a review and analysis of hundreds (and in some cases thousands) of outstanding instruments of each issuer, and the information necessary to make the determinations is not readily accessible.

---

18 *See*, *e.g.*, OCC and FRB, *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule*, 78 Fed. Reg. 62018, 62061 (Oct. 11, 2013) ("To avoid the double-counting of regulatory capital, the proposal would have required a banking organization to deduct the amount of its investments in its own capital instruments, including direct and indirect exposures, to the extent such instruments are not already excluded from regulatory capital.").

The application of the proposed definition of "covered debt instrument" would impose significant operational burdens and, ultimately, would be impracticable to implement. The proposed definition would require advanced approaches firms to identify which debt instruments issued by U.S. GSIBs and Covered IHCs are TLAC-eligible and to determine the purpose for which foreign GSIBs and their subsidiaries issued debt instruments, which, in turn, would require an analysis of the foreign legal and regulatory requirements applicable to foreign GSIBs and their subsidiaries. There is, however, no practicable way for advanced approaches firms to determine and track (i) whether a given debt instrument issued by a U.S. GSIB or Covered IHC is TLAC-eligible debt or *pari passu* with or subordinated to TLAC-eligible debt, (ii) whether a foreign GSIB and its subsidiaries (other than a Covered IHC) issued a given debt instrument for loss-absorbency purposes, (iii) whether a subsidiary of a foreign GSIB (other than a Covered IHC) is required to issue debt for loss-absorbency purposes, or (iv) whether the debt instruments of a foreign GSIB and its subsidiaries (other than a Covered IHC) are *pari passu* with or subordinated to any debt instruments issued for loss-absorbency purposes. Accordingly, the information necessary for advanced approaches firms to implement the proposed definition and determine whether a given debt instrument is a "covered debt instrument" is not readily accessible and, in many cases, may not even be available at all.

Under the proposal, if an advanced approaches firm holds *any* unsecured debt instrument of a U.S. GSIB, Covered IHC, foreign GSIB or subsidiary of a foreign GSIB, the firm would be required to engage in a searching inquiry to determine:

- in the case of an unsecured debt instrument issued by a U.S. GSIB or Covered IHC, first, whether the instrument is TLAC-eligible debt, and, if it is not, whether the issuer of the instrument has *any* TLAC-eligible debt outstanding that is *pari passu* with or senior to the unsecured debt instrument, and

- in the case of an unsecured debt instrument issued by a foreign GSIB or any of its subsidiaries (other than a Covered IHC), first, whether the instrument was issued for loss-absorbency purposes, and, if it was not, whether the issuer of the instrument has *any* debt outstanding that was issued for loss-absorbency purposes and is *pari passu* with or senior to the unsecured debt instrument.

As a result:

- if an advanced approaches firm holds an unsecured debt instrument issued by a U.S. GSIB or Covered IHC that it determines is not TLAC-eligible debt, the firm could not be certain whether it holds a "covered debt instrument" until it has determined the TLAC status of each and every *pari passu* or senior debt instrument of the issuer in order to determine whether the holding ranks equally with or junior to any TLAC-eligible debt,

- if an advanced approaches firm holds an unsecured debt instrument issued by a foreign GSIB or any of its subsidiaries (other than a Covered IHC) that it determines was not issued for loss-absorbency purposes, the firm could not be certain whether it holds a "covered debt instrument" until it has determined the purpose for which each and every *pari passu* or senior debt instrument was issued in order to determine whether the holding ranks equally with or junior to any debt issued for loss-absorbency purposes, and

- if an advanced approaches firm holds an unsecured debt instrument issued by a subsidiary of a foreign GSIB (other than a Covered BHC), the firm would also need to determine whether the subsidiary issuer is subject to TLAC requirements under applicable home-country standards—that is, whether the subsidiary is required to issue debt for loss-absorbency purposes, whether to affiliates or externally, such that there could be "covered debt instruments" with respect to that issuer.

This inquiry would entail analysis and determinations of foreign legal and regulatory frameworks, as well as a review and analysis of hundreds and possibly thousands of instruments of each issuer. Even if such a searching inquiry would be possible to complete—and in most cases it would not be because information about each and every unsecured debt instrument of each U.S. GSIB, foreign GSIB and subsidiary of a foreign GSIB is not publicly available—it represents an undue burden without a corresponding supervisory benefit.

Indeed, the impracticability of implementing the proposed definition of "covered debt instruments" is expected to force advanced approaches firms to make conservative assumptions in their efforts to identify "covered debt instruments," treating unsecured debt instruments that are not, in fact, "covered debt instruments" as such because of the impossibility of accessing the information or conducting the analysis that would allow them to determine otherwise. As discussed above, the proposed definition of "covered debt instruments" is broader than necessary to achieve the agencies' supervisory objectives. Implementing a broader-than-necessary regulatory requirement is inconsistent with the policy goal of efficiency in regulation. If advanced approaches firms were forced to make conservative assumptions in their efforts to identify "covered debt instruments," the practical application of the definition would be even broader, which would further frustrate the policy goal of efficiency in regulation.

VII. The final rule should eliminate the asymmetric application of the corresponding deduction approach for U.S. GSIBs and advanced approaches Covered IHCs.

The existing deductions framework in the agencies' regulatory capital rules consistently incorporates a principle of symmetric like-for-like deductions. Under this approach, an investing firm deducts covered investments in the capital instruments of an unconsolidated financial institution from the corresponding components of the investing firm's own capital stack. The final rule's treatment of covered debt instruments should take an equally symmetric and principled approach. Required deductions for covered debt instruments should be deducted from the corresponding components of the investing firm's own loss-absorbing resources—that is, TLAC-eligible debt in the case of a U.S. GSIB or advanced approaches Covered IHC, not Tier 2 capital.

The proposal includes an asymmetric approach that would apply deductions for covered debt instruments to the Tier 2 capital of U.S. GSIBs and advanced approaches Covered IHCs. Requiring U.S. GSIBs and advanced approaches Covered IHCs to deduct holdings of covered debt instruments from Tier 2 capital is unnecessary to achieve the agencies' supervisory objectives. The agencies note that the proposal is intended to "recognize, for purposes of the agencies' capital rule, the systemic risks posed by banking organizations' investments in 'covered debt instruments,' . . . and to create an incentive for advanced approaches banking organizations to limit their exposure to GSIBs."[19] For U.S. GSIBs and advanced approaches Covered IHCs, a true corresponding deduction approach that requires deductions of covered debt instruments (revised to include only the instruments discussed above in Section VI.A.1) from the investing firm's TLAC, with its direct consequences on the investing firm's ability to satisfy applicable TLAC requirements, should in itself act as a sufficient disincentive to excessive holdings of covered debt instruments. Further, as noted in the introductory paragraphs of this comment letter, there are a number of other requirements that address the risks relating to the failure of a GSIB, including single counterparty credit limits that impose the most stringent requirements on a U.S. GSIB's exposures to another GSIB.

With regard to U.S. GSIBs' and advanced approaches Covered IHCs' holdings of their own covered debt instruments, the proposed departure from the like-for-like approach is excessively punitive. As the Basel Committee on Banking Supervision has recognized, "[o]wn-funded TLAC would generally not appear to meet the TLAC eligibility criteria. However, to the extent that such positions are recognised, reducing TLAC resources would more accurately reflect a G-SIB's TLAC position than continuing to count such instruments in TLAC resources while deducting them from Tier 2 capital."[20] In addition, the proposed asymmetric treatment of own holdings of covered debt instruments is inconsistent with the purpose of the own holdings deduction. As noted above, the own holdings deduction is intended to prevent a firm from "double counting" its own capital. By the same logic, the own holdings deduction for covered debt instruments should be designed to prevent a U.S. GSIB or advanced approaches Covered IHC from "double counting" its own TLAC-eligible debt.

The agencies could implement a symmetrical like-for-like treatment to deductions for covered debt instruments that is consistent with the corresponding deduction approach without introducing undue complexity in their regulatory capital rules. This approach would differentiate between U.S. GSIBs and advanced approaches Covered IHCs, on the one hand, and other advanced approaches firms, on the other, to reflect that U.S. GSIBs and Covered IHCs are subject to TLAC requirements but other advanced approaches firms are not. Because the proposed deductions would apply only to advanced approaches firms, the differentiation would be relevant for a small number of firms subject to the agencies regulatory capital rules, a substantial portion of which would themselves be U.S. GSIBs or Covered IHCs. Specifically, the final rule should provide:

- a U.S. GSIB or advanced approaches Covered IHC would deduct its applicable investments in covered debt instruments from its TLAC-eligible debt for purposes of TLAC requirements, with:

    - investments in covered debt instruments with a remaining maturity of less than one year subject to deduction only to the extent those investments exceed its "eligible debt securities" (in the case of a U.S. GSIB) or "eligible Covered IHC

[19] 84 Fed. Reg. at 13818.

[20] Basel Committee on Banking Supervision, *TLAC Holdings Standard* (Oct. 2016), at 2, *available at* https://www.bis.org/bcbs/publ/d387.pdf.

debt securities" (in the case of an advanced approaches Covered IHC) with a remaining maturity of less than one year,[21] and

- investments in own-funded TLAC-eligible debt subject to deduction only to the extent such positions qualify as TLAC,

- if a U.S. GSIB or advanced approaches Covered IHC has insufficient TLAC-eligible debt to carry out the necessary deductions, any amount not deducted would be treated as an investment in Tier 2 capital, similar to the proposal, and

- an advanced approaches firm that is not a U.S. GSIB or Covered IHC (such as a bank holding company that is not a U.S. GSIB or an insured depository institution, including a subsidiary of a U.S. GSIB or Covered IHC), would treat the investments in covered debt instruments subject to deduction as a Tier 2 instrument, as under the proposal.

VIII. The final rule should include an implementation period of at least eighteen months following adoption and should not require deductions as to any unsecured debt instrument until the information necessary to determine whether the instrument is a "covered debt instrument" is available.

As described above, the information that advanced approaches firms would need in order to determine whether a given unsecured debt instrument would be a "covered debt instrument" is not readily accessible and, in many cases, may not be available at all. Accordingly, an implementation period between the adoption of the final rule and the effectiveness of the deductions framework for covered debt instruments would provide an opportunity for the information that advanced approaches firms would need to implement the framework to become readily available, which would substantially mitigate the operational burdens and, in many cases, the impracticability of implementing the proposed framework. Further, implementing the deductions framework for covered debt instruments will require advanced approaches firms to make significant systems and operational changes in order to be able to identify whether they have investments in covered debt instruments. Before the final rule is adopted, advanced approaches firms can make only limited progress on the changes because they do not know what the applicable requirements will be. An implementation period

[21] Debt with a remaining maturity of less than one year does not count toward TLAC requirements because of supervisory concerns that the debt may not be available to absorb losses in resolution. *See*, *e.g.*, FRB, *Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations*, 82 Fed. Reg. 8266, 8282-83 (Jan. 24, 2017). The same principle makes it appropriate to subject investments in covered debt instruments with a remaining maturity of less than one year to deduction only to the extent those investments exceed a U.S. GSIB's or advanced approaches Covered IHC's own TLAC-eligible debt with a remaining maturity of less than one year. The remaining maturity of less than one year substantially mitigates the risk that the investment might be outstanding and absorb losses in connection with the resolution of the issuer. In addition, our recommended approach would be consistent with the principle of symmetric like-for-like deductions because TLAC-eligible debt does not count toward TLAC requirements if the remaining maturity is less than one year.

of at least eighteen months is therefore appropriate in light of the need for additional information to become available, as well as the changes advanced approaches firms must make to their systems and operations.

In addition, the agencies should revise the proposal so that advanced approaches firms are not required to treat any unsecured debt instrument as a "covered debt instrument" until the information necessary to make that determination is available. Without this change, advanced approaches firms could be in the untenable situation of being subject to a regulatory framework with which they cannot precisely comply because of the lack of available information. For example, if an advanced approaches firm holds an unsecured debt instrument of a subsidiary of a foreign GSIB (other than an IHC), the firm would not be able to determine whether the instrument it holds would or would not be a "covered debt instrument" under the proposal unless (i) the issuer has disclosed whether it is subject to TLAC requirements, and (ii) if the issuer is, whether the instrument was issued for loss-absorbency purposes or whether the instrument is *pari passu* with or subordinated to any instrument issued for loss-absorbency purposes.

IX. Technical matters.

Technical matters are addressed in Annex B of this letter.

* * * * *

The Associations appreciate the opportunity to comment on the proposal. If you have any questions, please contact John Court at (202) 589-2409 (*john.court@bpi.com*), Kevin Fromer at (202) 457-8787 (*kevin.fromer@financialservicesforum.org*) or Carter McDowell at (202) 962-7327 (*cmcdowell@sifma.org*).

Respectfully submitted,

John Court
SVP & Deputy General Counsel
Bank Policy Institute

Kevin Fromer
President and Chief Executive Officer
Financial Services Forum

Carter McDowell
Managing Director and Associate General Counsel
Securities Industry and Financial Markets Association

cc: Michael S. Gibson
Mark E. Van Der Weide
Board of Governors of the Federal Reserve System

Doreen R. Eberley
Nicholas Podsiadly
Federal Deposit Insurance Corporation

Jonathan Gould
Morris Morgan
Office of the Comptroller of the Currency

Annex A: The Associations

The Bank Policy Institute

The Bank Policy Institute is a nonpartisan public policy, research and advocacy group, representing the nation's leading banks and their customers. Our members include universal banks, regional banks and the major foreign banks doing business in the United States. Collectively, they employ almost 2 million Americans, make nearly half of the nation's small business loans, and are an engine for financial innovation and economic growth.

Financial Services Forum

The Financial Services Forum is an economic policy and advocacy organization whose members are the chief executive officers of the eight largest and most diversified financial institutions headquartered in the United States. Forum member institutions are a leading source of lending and investment in the United States and serve millions of consumers, businesses, investors, and communities throughout the country. The Forum promotes policies that support savings and investment, deep and liquid capital markets, a competitive global marketplace, and a sound financial system. https://www.fsforum.com/

The Securities Industry and Financial Markets Association

SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate for legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. 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 http://www.sifma.org.

Annex B: Technical Matters

I. The Federal Reserve should revise the proposed revisions to the Form FR Y-9C to clarify that U.S. GSIBs would not be required to report their LTD and TLAC leverage ratios.

In connection with the proposal, the Federal Reserve proposed revisions to its Form FR Y-9C and the Instructions to Form FR Y-9C.[1] Among the proposed revisions, the Federal Reserve would include a new line item 50 on Schedule HC-R requiring LTD and TLAC leverage ratios to be reported. Under the Federal Reserve's TLAC Rule, Covered IHCs are subject to LTD and TLAC leverage ratios,[2] but U.S. GSIBs are not. (For U.S. GSIBs, the applicable leverage requirements are based on total leverage exposure, the denominator for the supplemental leverage ratio.[3] The ratios based on total leverage exposure would be reported on new line item 51.) Accordingly, the Federal Reserve should revise the proposed form and instruction changes to clarify that only Covered IHCs would be required to report LTD and TLAC leverage ratios on new line item 50.

II. The Federal Reserve should clarify when the proposed revisions to the Form FR Y-9C will become effective in light of the fact that certain of the revisions relate to the proposal and other revisions relate to aspects of the Federal Reserve's TLAC rule that are currently applicable.

The Federal Reserve proposed two types of revisions to its Form FR Y-9C. First, the Federal Reserve proposed to modify the form and related instructions to reflect the proposed deductions. These revisions should not become effective until the deductions under the final rule begin to apply to advanced approaches firms. Second, the Federal Reserve proposed to require that U.S. GSIBs and Covered IHCs disclose information about their long-term debt and TLAC, long-term debt and TLAC ratios, and TLAC buffers. These revisions relate to regulatory requirements under the Federal Reserve's TLAC rule that currently apply to U.S. GSIBs and Covered IHCs. The Federal Reserve should clarify whether both types of revisions would become effective at the same time, or whether the second type of revisions—relating to currently applicable requirements under the Federal Reserve's TLAC rule—would become effective before the deductions under the final rule begin to apply to advanced approaches firms.

---

[1] The proposed revisions to the Form FR Y-9C are available at https://www.federalreserve.gov/reportforms/formsreview/FR_Y-9CTLAC%20form.pdf, and the proposed revisions to the reporting instructions are available at https://www.federalreserve.gov/reportforms/formsreview/FR_Y-9CTLAC%20instruction.pdf.

[2] *See* 12 C.F.R. §§ 252.162 and 252.165.

[3] *See* 12 C.F.R. §§ 252.62 and 252.63.