January 12, 2024

VIA ELECTRONIC SUBMISSION

Chief Counsel's Office
Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E–218
Washington, DC 20219
Docket ID OCC–2023–0011

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
Docket No. R–1815; RIN 7100–AG

James P. Sheesley, Assistant Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
RIN 3064–AF86

Re: Long-Term Debt Requirements for Large Bank Holding Companies, Certain Intermediate Holding Companies of Foreign Banking Organizations, and Large Insured Depository Institutions

Ladies and Gentlemen:

Discover Financial Services ("Discover") appreciates the opportunity to submit this letter to the Office of the Comptroller of the Currency ("OCC"), the Federal Reserve Board ("FRB") and the Federal Deposit Insurance Corporation ("FDIC," and together, the "Agencies") on their proposed rule (the "Proposal") to require large banking organizations ("covered banking organizations") to hold minimum amounts of long-term debt ("LTD").[1] The Proposal would newly subject Discover to minimum LTD requirements as a Category IV bank holding company ("BHC") with an insured depository institution ("IDI") subsidiary with $100 billion or more in assets.

Discover is a member institution of the American Bankers Association, the Bank Policy Institute, and the Risk Management Association, and generally supports the recommendations included in their respective comment letters regarding the Proposal. Discover also joined with several other Category III and IV banks for coalition comments on this proposal.

In this separate letter, however, we wish to highlight three key observations and recommendations should the Agencies move forward with applying the Proposal:

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[1] Long-Term Debt Requirements for Large Bank Holding Companies, Certain Intermediate Holding Companies of Foreign Banking Organizations, and Large Insured Depository Institutions, 88 Fed. Reg. 64524 (Sept. 19, 2023).

1. The Proposal fails to analyze the impact on the market for LTD issuances by covered banking organizations, and the Agencies risk saturating the market with this debt during a time of economic uncertainty. The final rule should reflect a careful and rigorous analysis of the broader financial and economic impacts of the Proposal.
2. The final rule should not require BHCs to issue LTD both internally from the IDI subsidiary *and* externally from the holding company, as this approach would be unnecessarily prescriptive and result in a more punitive outcome than for global systemically important banking organizations ("G-SIBs").
3. The final rule should not use the capital refill framework as the basis for calculating the LTD requirements for non-GSIBs and instead should calibrate LTD requirements to the level of uninsured deposits at the IDI.

We summarize each of these points in greater detail below.

1. The final rule should reflect a careful and rigorous analysis of the financial and economic impacts of the Proposal.[2]

Although the Proposal provides for a gradual transition period over three years, the proposed implementation structure would require all covered banking organizations that would need to issue new LTD to issue such LTD at approximately the same time. The Proposal, however, does not evaluate the financial and economic impact of requiring covered banking organizations to simultaneously flood the market with new eligible LTD. We note that the proposed increase in LTD supply is also significantly more than what was contemplated in the original advanced notice of proposed rulemaking regarding these new LTD requirements, which was only focused on Category II and III banking organizations.[3]

In particular, the Agencies have failed to consider (1) the potential demand for the new LTD as compared to the vast supply increase in LTD that could result from a large number of new LTD issuers; and (2) the effect of the current interest rate environment on pricing of the new LTD (and how this will impact covered banking organizations, particularly if interest rates continue to fluctuate). It is critical that the Agencies undertake to analyze the potentially significant costs associated with the Proposal, including in the form of increased pricing for LTD and knock-on effects to the broader economy and financial stability.

We recommend that before issuing the final rule, the Agencies perform a further economic analysis of the impacts of the LTD issuance requirements on both the market and covered banking organizations. We also recommend that the Agencies consider other implementation options, including adjusting the calibration (discussed below), lengthening the transition period or staggering the implementation of the new LTD requirements for different banks or types of banks to ensure the Category II, III and IV banking organizations are not competing with each other to issue new LTD at the same time in a crowded marketplace.

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[2] This section is responsive to Questions 53-57.

[3] Resolution-Related Resource Requirements for Large Banking Organizations, 87 Fed. Reg. 64170 (Oct. 24, 2022).

2. The final rule should not require BHCs to issue LTD both internally from the IDI subsidiary *and* externally from the holding company.[4]

The Proposal would require covered BHCs to issue LTD externally and have their subsidiary IDIs issue a matching internal debt instrument. This approach, however, is overly prescriptive and fails to account for the practical realities of large domestic bank resolution plans, which often do not provide for a single-point-of-entry ("SPOE") resolution strategy. The Proposal also inappropriately would impose this more onerous requirement on domestic Category II, III and IV banking organizations but not on U.S. GSIBs.

In particular, banking organizations such as Discover may determine that the preferred resolution strategy is a multiple-point-of-entry strategy where different legal entities enter their own respective resolutions, including the IDI. For banks with this resolution approach, it could be more appropriate to issue external LTD from the IDI, for example, rather than from the holding company. The Proposal, however, prevents banks from having the flexibility to issue the LTD in a manner best suited to its resolution plan.

FDIC Vice Chairman Travis Hill recognized that the prescriptive nature of the Proposal's approach would not be appropriate for most domestic banking organizations due to the likelihood of the FDIC resolving the IDI separately. As he aptly noted in his statement accompanying the Proposal, "more than 75 percent of the domestic firms subject to the proposal have more than 97 percent of their assets within the bank. For most of these institutions…the FDIC would resolve the bank subsidiary, meaning the long-term debt we care about needs to be at the bank – and only at the bank."[5] Requiring a dual-level LTD issuance would not "simplify administration" of LTD as the Agencies suggest,[6] but rather would limit the flexibility of banking organizations to structure the debt in a manner most supportive of their resolution strategies.

Further, because of the dual-level nature of the LTD issuance requirement, covered banking organizations like Discover would be forced to issue additional amounts of LTD in excess of the minimum requirement in order to meet liquidity and funding needs outside of the subsidiary IDI. This would have the effect of inflating the calibration of LTD even higher and putting covered banking organizations like Discover at a competitive disadvantage as compared to the U.S. GSIBs.[7]

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[4] This section is responsive to Questions 11 and 13.

[5] FDIC, "Statement by Vice Chairman Travis Hill on the Proposed Long-term Debt Requirements for Large Banks," (Aug. 29, 2023) *available at* https://www.fdic.gov/news/speeches/2023/spaug2923l.html.

[6] 88 Fed. Reg. at 64534.

[7] FDIC Director Jonathan McKernan noted in his statement accompanying the Proposal that he was worried that the dual-level issuance for covered banking organizations like Discover "is actually more prescriptive than the prepositioning expectations applicable to U.S. GSIBs" and that "this disparity could put covered banking organizations at a competitive disadvantage relative to the U.S. GSIBs, whether now or in the future." FDIC, "Statement by Jonathan McKernan, Director, FDIC Board of Directors, on the Proposed Long-term Debt Requirements for Certain Banking Organizations," (Aug. 29, 2023) *available at* https://www.fdic.gov/news/speeches/2023/spaug2923e.html.

For these reasons, we recommend that if the LTD requirement is applied to banking organizations like Discover, that we be given the flexibility to choose whether to issue the required external LTD from the parent holding company or from the subsidiary IDI in the final rule. We also recommend that the final rule eliminate the requirement for the IDI subsidiary to issue internal LTD.

3. The final rule should not use the capital refill framework as the basis for calculating the LTD requirements for non-GSIBs and instead should calibrate LTD requirements to the level of uninsured deposits at the IDI.[8]

The Proposal would require covered banking organizations to issue LTD from the holding company at levels calibrated based on the so-called capital refill framework.[9] The capital refill framework, however, is premised on an SPOE resolution strategy, which is the strategy that has generally been adopted by the U.S. GSIBs but is not the preferred approach for most other large domestic banking organizations. Indeed, both FDIC Vice Chairman Travis Hill[10] and Director Jonathan McKernan[11] expressed doubts in their statements accompanying the Proposal about the costs and appropriateness of the capital refill approach. Further, applying this same calibration approach in the Proposal would inappropriately penalize consumer-focused business models rather than considering the risks posed by different institutions, their businesses and resolution strategies.

A better approach would be to focus on the level of uninsured deposits at the IDI (similar to the FDIC's special assessment)[12] and to consider the characteristics of the deposit bases (e.g., whether retail versus commercial), which would more directly relate to a firm's resolution risk and risk to the Deposit Insurance Fund ("DIF"). FDIC Chairman Martin J. Gruenberg in fact

8 This section is responsive to Questions 5 and 6.

9 88 Fed. Reg. at 64530.

10 *See* Statement by Vice Chairman Travis Hill, *supra* note 5 ("Under the proposal, the amount of required long-term debt is determined based on the same 'capital refill' methodology that was used in the G-SIB Total Loss Absorbing Capacity (TLAC) rule. However, the G-SIBs have all adopted a single point of entry (SPOE) resolution strategy in which the material entities would be recapitalized and continue operating subject to risk-based and leverage capital requirements. By contrast, the domestic banks subject to the proposal have all adopted a multiple point of entry strategy in which the bank subsidiaries would be resolved under the FDI Act and thus no longer subject to capital requirements. For most of these institutions, a sale of the failed bank franchise is a much more likely resolution outcome than a recapitalization, as was the case in the three failures earlier this year. As a result, I question whether the capital refill framework is the right approach.").

11 *See* Statement by Jonathan McKernan, *supra* note 7 ("I have some reservations about whether the 'capital refill' framework for calibrating the long-term debt requirement is appropriate for all covered banking organizations. In assessing the costs and benefits of this calibration framework, I will be particularly eager to better understand the extent to which certain firms might face different costs in maintaining the required amounts of long-term debt.").

12 Special Assessment Pursuant to Systemic Risk Determination, 88 Fed. Reg. 83329 (Nov. 29, 2023).

acknowledged recently that one of the main purposes of the LTD requirement in the Proposal is to protect depositors and the DIF.[13]

Over 90% of Discover's deposits are insured, as Discover has a mostly individual consumer and retail-oriented customer base. Discover's business model does not present the same resolution risk profile as banks with large uninsured deposit bases that are more susceptible to runs (such as Silicon Valley Bank). Moreover, in its recent special assessment final rule, the FDIC recognized that banks with large uninsured deposit bases are those most likely to be affected by deposit runs that might give rise to a future systemic risk determination.[14] Specifically, the FDIC stated, "[i]n general, large banks and regional banks, and particularly those with large amounts of uninsured deposits, were the banks most exposed to and likely would have been most affected by uninsured deposit runs but for the determination of systemic risk."[15] Indeed, the largest-ever loss to the DIF, caused by failure of both Silicon Valley Bank and Signature Bank, stemmed from the protection of uninsured deposits based on a systemic risk determination.

The final rule should calibrate the LTD requirement to reflect that business models leveraging higher proportions of uninsured deposits create greater potential for the necessity to use the systemic risk exception, and thus are more likely to impact the DIF, which is consistent with the FDIC's recognition that business models similar to Discover's are *less* likely to lead to the need to invoke a systemic risk determination in the event of another banks' failure. Without recognizing the differences in the resolution risk profile and potential impact to the DIF based on firms' business models, the proposed calibration would be unnecessarily punitive to banks such as Discover.

In view of these goals and to more appropriately tailor LTD requirements to the specific risk level of each covered banking organization, Discover recommends that the final rule calibrate LTD requirements based on the level of uninsured deposits at the IDI subsidiary instead of the capital refill framework.

Conclusion

Discover believes that the Agencies should take additional steps to adequately account for the impact of broadening the LTD requirement beyond what was contemplated in the Proposal. Given current economic uncertainties and the prospect of a downturn in the broader economy, it is crucial that the LTD requirements be carefully calibrated and implemented to avoid negative effects on both covered organization balance sheets and the broader market for such debt issuances. Further, such calibration should allow banking organizations flexibility to issue LTD in a way that makes sense for the organization's resolution strategy and that avoids penalizing banking organizations whose business models do not pose the types of risks that the Proposal is intended to address.

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13 FDIC, "Remarks by Chairman Martin J. Gruenberg on Oversight of Financial Regulators: Protecting Main Street Not Wall Street Before the Committee on Banking, Housing, and Urban Affairs, United States Senate," (Nov. 14, 2023) *available at* https://www.fdic.gov/news/speeches/2023/spnov1423.html.

14 88 Fed. Reg. at 83333.

15 *Id.*

Again, Discover values the opportunity to comment on this Proposal and appreciates your consideration of the views expressed in this letter. Please feel free to contact me at (johngreene@discover.com) if you wish to further discuss.

Respectfully submitted,

[redacted]

John Greene
Chief Financial Officer
Discover Financial Services