August 29, 2023

MEMORANDUM TO: The Board of Directors

FROM: James L. McGraw, Acting Director
Division of Complex Institution Supervision
& Resolution

SUBJECT: Publication of *Federal Register* Notice Regarding Long-Term Debt for Certain Insured Depository Institutions

Summary: The FDIC, the Board of Governors of the Federal Reserve System (FRB), and the Office of the Comptroller of the Currency (OCC) (collectively, the Agencies) are jointly proposing to require that insured depository institutions (IDIs) that are not consolidated subsidiaries of U.S. global systemically important banks (G-SIBs) and that (i) have at least $100 billion in consolidated assets or (ii) are affiliated with IDIs that have $100 billion in consolidated assets (covered IDIs) have outstanding a minimum amount of eligible long term debt (LTD).

Under the proposal, covered IDIs that are consolidated subsidiaries of covered bank holding companies and savings and loan holding companies (covered entities) would be required to issue the LTD internally to their covered entity parents, or another entity that consolidates the covered IDI. Covered IDIs that are not consolidated subsidiaries of covered entities would be permitted to issue their LTD to affiliates or to non-affiliates. Only debt instruments with certain features (related to, for example, subordination, term, and acceleration) making them better able to absorb losses in a resolution proceeding or provide stable funding would qualify as eligible LTD under the proposal. The proposal would improve the resolvability of covered entities and covered IDIs because the LTD would be available to absorb losses in the event of the failure of a covered entity or covered IDI, and

provide the FDIC a broader range of options for resolving a covered IDI. The proposal would also reduce the costs to the Deposit Insurance Fund (DIF) by reducing the risk of loss to depositors. Reducing the risk of loss to uninsured depositors will mitigate financial stability and contagion risks and may decrease the likelihood and speed of deposit withdrawals by uninsured depositors in the event of stress.

Recommendation: Staff recommends that:

A. The FDIC Board of Directors (FDIC Board) approves the attached Notice of Proposed Rulemaking (NPR) entitled "**Long-term Debt Requirements for Large Bank Holding Companies, Certain Intermediate Holding Companies of Foreign Banking Organizations, and Large Insured Depository Institutions,"** seeking public comment on, among other things, the proposal related to requiring covered entities and covered IDIs to maintain LTD, for publication in the *Federal Register* with a comment period ending on November 30, 2023.

B. The FDIC Board authorizes the General Counsel, or designee, and the Executive Secretary, or designee, to make technical, non-substantive or conforming changes to the text of the draft NPR to prepare for publication in the *Federal Register*.

I. Introduction

The Agencies are proposing a rule that would improve the resolvability of covered IDIs by requiring they maintain outstanding a minimum amount of LTD that can absorb losses in the event of a covered IDI's failure. In providing loss-absorbing capacity, LTD can offer the FDIC greater flexibility in responding to the failure of an IDI, and may increase the likelihood of an orderly least-cost resolution for the IDI. Even where the amount of issued LTD is not sufficient to absorb all losses at the failed IDI, its presence may expand the range of options available to the FDIC as receiver.

In conjunction with the proposal to require covered IDIs to maintain outstanding a certain amount of LTD, the FRB is proposing to require the covered entities of such IDIs to also maintain outstanding a prescribed amount of LTD and to comply with specified clean holding company requirements akin to those required of GSIBs. The FRB is also proposing making changes to its existing TLAC rule applicable to GSIBs to improve harmony between provisions within the TLAC rule and address items that have been identified through the administration of the TLAC rule.

The proposed LTD requirements would improve the resolvability of covered entities and covered IDIs because LTD can be used to absorb losses and create equity in resolution. In particular, because LTD at the covered IDI is subordinate to deposits and general unsecured creditors and can be left behind in the receivership of a failed IDI, it can absorb losses in the resolution of a covered IDI and mitigate the risk that any depositors would take losses in the resolution of the IDI. Because LTD absorbs losses before deposits—including the DIF (as subrogee of insured depositors)—an LTD requirement at the covered IDI would give the FDIC greater flexibility, including to potentially transfer all deposit liabilities (including uninsured deposit liabilities) of a failed IDI to an acquirer or to a bridge depository institution in a manner consistent with the least-cost requirement under the Federal Deposit Insurance Act of 1950, as amended (the FDI Act). LTD may also expand the range of options available in exit from a bridge depository institution by improving the ability to capitalize and stabilize the bridge, allowing time to restructure and sell or exit in a capital markets transaction.

Finally, the separate and related requirement being proposed by the FRB that covered holding companies issue a commensurate amount of LTD provides additional optionality in resolution by supporting the option of a single point of entry (SPOE) resolution at the holding company, which may be appropriate or necessary in instances in which the failure and resolution of the banking group may present systemic risk to the U.S. economy and where a resolution at the parent level would be most effective in mitigating that risk. Where the conditions for a resolution under the Orderly Liquidation Authority provided in Title II of the Dodd-Frank Act are met, the eligible LTD at the holding company and related requirements proposed by FRB will support an SPOE resolution under that authority.

II. Background

A. *Benefits of LTD in resolution*

In an FDI Act resolution, the FDIC as receiver has a variety of strategic options to resolve the failed IDI, including selling the IDI's assets and transferring its deposits to healthy acquirers, or executing an insured deposit payout and liquidation of the assets of the failed bank. In some cases, the FDIC can transfer assets and deposit liabilities of a failed IDI to a newly-organized bridge depository institution that the FDIC continues to operate. This resolution option can allow the FDIC to effectively stabilize the failed IDI and better preserve its franchise value, making it more attractive to a greater number of potential acquirers.

While there are many strategies the FDIC can employ to resolve a failed IDI, the FDIC is required by section 13(c) of the FDI Act to resolve an IDI in a manner that poses the least cost to the DIF. Depending on the losses at an IDI and on its liability structure, the FDIC could be required to impose losses on uninsured depositors in order to comply with the least-cost requirement. If uninsured depositors at large IDIs and regional banking organizations experience the risk of losses or interrupted access to their deposits, contagion can spread to other institutions, cause deposit runs beyond the failing IDI, and give rise to systemic risk.

LTD at an IDI would improve the resolvability of the IDI because LTD can be used to absorb losses[1] and make it less likely that liquidation will be the least-costly option, which enables other resolution options that may be better for financial stability. LTD at the IDI generally would give the FDIC greater flexibility, including to potentially transfer all deposit liabilities (including uninsured deposit liabilities) of the failed IDI to an acquirer, or to utilize a bridge depository institution to preserve franchise value and provide additional time to pursue resolution options. Expanding the FDIC's range of options for resolving a failed IDI to include the use of a bridge depository institution can significantly improve the prospect of an orderly resolution and reduce the probability of contagion.

Use of a bridge depository institution can afford the FDIC additional time to find an acquirer for the IDI's assets and deposit franchise, or to consider and execute a variety of other resolution strategies, such as selling the IDI in pieces over time, or to effectuate a spin-off of parts of the IDI's operations or business lines. The ability to utilize a bridge

[1] LTD would be unsecured debt, which is subordinate to claims of depositors, general unsecured creditors, and those of the FDIC for administrative expenses associated with administering the receivership. *See* 12 U.S.C. 1821(d)(11)(A).

depository institution is particularly important when an IDI fails quickly, or in the absence of a ready acquirer.

The availability of LTD also improves the FDIC's options for resolving a failed IDI by increasing re-sale value, reducing depositors' incentives to run prior to failure, improving the marketability of the failed IDI, and reducing the need to use DIF resources to stabilize the institution or support a purchaser. In a scenario where liquidation is still necessary, the additional loss absorption from the LTD would reduce losses to the DIF.

Finally, where conditions for a resolution of a banking organization under Title II of the Dodd-Frank Act are met, including that such a resolution would be necessary to mitigate systemic risk to the U.S. economy, the issuance of LTD at the covered holding company, together with the clean holding company provisions proposed by the FRB, would support such a resolution option.

B. *Recent failures of large IDIs*

The recent failures of three large IDIs—California-based Silicon Valley Bank (SVB) and First Republic Bank (First Republic), and New York-based Signature Bank (SBNY)—highlighted the risks posed by the failure of a large IDI, including the resulting systemic contagion, and the challenges that the FDIC can face in their resolutions. The absence of alternate funding sources other than equity and deposits increased these banks' vulnerability to deposit runs, and these runs precipitated their failures. Despite prompt action taken by regulators to facilitate the resolution of these failed IDIs, there was contagion in the banking sector, particularly for large IDIs and regional banking organizations,[2] some of which experienced higher than normal deposit outflows during this time.[3]

The presence of long-term debt at all three of these IDIs would have offered many advantages. The FDIC resolved both SVB and SBNY through use of temporary bridge depository institutions, but only after invocation of the "systemic risk exception"[4] to the least-cost requirement. If SVB and SBNY had outstanding LTD as envisaged by the proposed rule at the time they failed, such LTD would have provided additional loss-absorption capacity and would have reduced costs to the depositor class, including the DIF. It may have reduced the speed and severity of bank runs and contagion, and may have made additional options available to the FDIC in resolution for these banks. Though the FDIC had more time to market First Republic and was able to find a buyer for most of its assets and operations without use of a bridge depository institution or the systemic risk exception, the nature of First Republic's capital structure at the time it failed meant the FDIC had limited options for the kind of resolution strategies available and the range of bids it could accept. First Republic having more long-term debt would have enhanced the FDIC's ability to enter into resolution transactions that would have protected the DIF.

III. <u>October 2022 Advance Notice of Proposed Rulemaking (ANPR)</u>

In October 2022, the FRB and the FDIC published an ANPR to solicit public input regarding whether an extra layer of loss-absorbing capacity could improve

---

[2] Regional banking organizations generally are considered those with total consolidated assets between $10 billion and $100 billion. *See, e.g.*, Board's SVB Report.

[3] *See* GAO, Preliminary Review of Agency Actions Related to March 2023 Bank Failures at 32 (April 2023), https://www.gao.gov/assets/gao-23-106736.pdf.

[4] https://home.treasury.gov/news/press-releases/jy1337

optionality in resolving large banking organizations, and the costs and benefits of such a requirement.[5] The ANPR also solicited public input on how such a requirement might be structured, what other requirements might be appropriate, and the scope for such a requirement. The FRB and the FDIC received nearly 65 comments on the ANPR from banking organizations, trade associations, public interest advocacy groups, members of Congress, and private individuals.

IV. The Proposed Rule

As discussed in more detail below, the proposed rule would require that covered IDIs have certain amounts of LTD. Eligible LTD must be issued by the covered IDI and include certain characteristics, including maturity of more than one year and "plain vanilla" features (e.g., the debt is unsecured, creditors have limited acceleration rights, and the debt does not have a credit-sensitive feature.) Eligible LTD would also be required to be subordinate to deposits and to general unsecured creditors. The LTD would thus serve to absorb losses before all deposits – insured and uninsured – and all general unsecured creditors, including trade creditors and foreign deposits (including those that are not dually payable). The proposed rule would impose limitations on a covered IDI's ability to redeem or repurchase any outstanding eligible debt, and would authorize the covered IDI's AFBA (as defined below) to, under certain circumstances, order an IDI to exclude certain debt from the calculation of its outstanding eligible LTD, and to hold a greater amount of LTD than is otherwise required. The proposed rule would provide a three-year phase-in period. The proposed rule would also amend each Agency's capital

---

[5] Resolution-Related Resource Requirements for Large Banking Organizations, 87 *FR* 64170 (Oct. 24, 2022), https://www.federalregister.gov/documents/2022/10/24/2022-23003/resolution-related-resource-requirements-for-large-banking-organization.

rules to account for the existence of LTD issued under this proposal; currently, each Agency's capital rules details special treatment for LTD issued by GSIBs, and the proposed amendments would provide identical treatment for LTD issued by covered IDIs.

Each of the Agencies would promulgate the proposed rule to be applicable to the covered IDIs for which each Agency is the appropriate Federal banking agency (i.e., the OCC's rule would apply to national banks, the FRB's rule would apply to state member banks, and the FDIC's rule would apply to state nonmember banks and state savings associations (the AFBA)). Other than specifying to which covered IDIs the proposed rule would be applicable, the rule promulgated by each Agency would be substantially the same.

In addition to the proposed rule to be issued by each of the Agencies requiring covered IDIs to have a certain amount of LTD, the FRB is issuing a proposed rule requiring that LTD be issued by depository institution holding companies (i.e., bank holding companies, and savings and loan holding companies) that are subject to the FRB's Category II, III or IV enhanced prudential standards, including Category II, III and IV U.S. intermediate holding companies of foreign banking organizations. This holding company-level requirement would impose similar – though less stringent – LTD requirements as those that currently exist for holding companies of the eight U.S. GSIBs, and corresponds with the requirements for eight foreign GSIBs with a U.S. intermediate holding company.[6] Though the proposed rule for the holding company and U.S.

---

[6] Barclays plc; BNP Paribas SA; Banco Santander, S.A.; Deutsche Bank AG; HSBC Holdings plc; Royal Bank of Canada; The Toronto-Dominion Bank; and UBS Group AG.

intermediate holding company are being issued solely by the FRB, it would be included in the same *Federal Register* publication as the proposed rule regarding covered IDIs because the two proposals are closely related.

A. *Authority*

The proposed rule would be adopted under the authority that allows the Agencies to issue capital rules. In particular, 12 U.S.C. § 5371(b)(7) compels the Agencies to "develop capital requirements applicable to insured depository institutions … that address the risks that the activities of such institutions pose … in the event of … failure of the institution … ."

B. *Scope: Covered IDIs Subject to the Eligible Long-Term Debt Requirement*

The proposed rule would apply to banks that have $100 billion or more of total consolidated assets and are consolidated subsidiaries of Category II, III and IV depository institution holding companies and U.S. intermediate holding companies, but not including IDIs that are subsidiaries of the U.S. GSIBs.[7] This scope is articulated in the proposed regulatory text as any IDI with $100 billion or more in total consolidated assets that is a consolidated subsidiary of either: (1) a depository institution holding company

[7] IDIs that are consolidated subsidiaries of U.S. GSIBs would not be subject to the proposed LTD requirement because their parent holding companies are subject to the LTD requirement under the FRB's total loss-absorbing capacity (TLAC) rule. In addition, U.S. GSIBs are subject to the most stringent capital, liquidity, and other prudential standards in the United States. These firms also have adopted resolution plans reflecting guidance issued by the Agencies, which establishes a capital and liquidity framework for resolution (Resolution Capital Adequacy and Positioning, or RCAP). The guidance (including the provisions related to RCAP) is designed to ensure adequate maintenance of loss-absorbing resources either at the parent or at material subsidiaries such that all material subsidiaries, including IDIs, could be recapitalized in the event of resolution under the single point of entry resolution strategies adopted by the U.S. GSIBs. *See* Guidance for § 165(d) Resolution Plan Submissions by Domestic Covered Companies applicable to the Eight Largest, Complex U.S. Banking Organizations, 84 *FR* 1438 (Feb. 4, 2019), https://www.federalregister.gov/documents/2019/02/04/2019-00800/final-guidance-for-the-2019.

that is subject to a long-term debt requirement as set forth in § 238.182 or § 252.162 and is not a global systemically important BHC (*i.e.*, those holding companies that would be subject to the LTD and clean holding company rule being proposed by the FRB), or (2) a U.S. intermediate holding company that is subject to a long-term debt requirement set forth in § 252.162 (*i.e*., the U.S. intermediate holding companies that would be subject to the LTD and clean holding company rule being proposed by the FRB). These banks are known as internally issuing IDIs. Under the FRB's LTD requirement for covered entities, a parent holding company of an internally issuing IDI, or another entity of which the issuing IDI is a consolidated subsidiary, would be required to purchase the IDI's LTD.

The proposed rule would also apply to externally issuing IDIs,[8] which are defined as banks with $100 billion or more in total consolidated assets and are not subsidiaries of a depository institution holding company or U.S. intermediate holding company that are required to issue long-term debt.

Finally, the proposed rule would also apply to affiliates of internal issuing IDIs and external issuing IDIs, including affiliates with less than $100 billion in total consolidated assets. The Agencies are proposing to include affiliates because when an IDI in a group fails, it is likely that all IDIs in the group fail due to interconnectedness and the statutory cross-guaranty[9] imposed on affiliated IDIs in the event of the failure of an IDI in the group. Therefore, including affiliate IDIs in the definition of a covered IDI

---

[8] The preamble distinguishes between "mandatory externally issuing IDIs" (i.e., a covered IDI that does not have a parent holding company; accordingly it cannot issue LTD to a parent company), and "permitted externally issuing IDIs" (i.e., a covered IDI whose parent company is not a covered entity; it can issue LTD either externally or internally to its parent company).
[9] 12 U.S.C. 1815(e).

would help ensure that a sufficient level of LTD is available at the affiliates if and when they fail following the failure of a sister IDI.

C. *The Required Amount of LTD*

The proposed rule would require covered IDIs to have a minimum outstanding amount of eligible LTD that is at least: (1) 6 percent of the covered IDI's total risk-weighted assets, (2) 2.5 percent of the covered IDI's total leverage exposure, if it is required to maintain a minimum supplementary leverage ratio, and (3) 3.5 percent of the covered IDI's average total consolidated assets, whichever is greater (LTD Requirement).

The proposed IDI LTD Requirement is calibrated so that, assuming a failed IDI's equity capital is significantly or completely depleted, the eligible LTD outstanding would be sufficient to capitalize a newly-formed bridge depository institution to "adequately capitalized" under the Agencies' prompt corrective action regulations, inclusive of the capital conservation buffer applicable to risk-based capital requirements. The calibration would allow such a bridge depository institution generally to comply with the minimum capital requirements plus buffers applicable to ordinary non-bridge IDIs after accounting for some balance sheet depletion.[10] The calibration would also appropriately support the FDIC in resolving covered IDIs under the FDI Act because the eligible LTD at the IDI would improve the FDIC's optionality to complete an orderly resolution by increasing the likelihood that a transfer to a bridge depository institution to preserve franchise value would be less costly to the DIF than liquidating the IDI and paying out insured deposits. The amount of LTD proposed to be required to be positioned at the covered IDI is based

---

[10] A bridge depository institution is exempt from capital requirements; see 12 U.S.C. § 1821(n)(5).

upon the balance sheet of the covered IDI, and would reflect the size and importance of the covered IDI relative to the group. Externally issuing IDIs would be subject to the same calibration as other covered IDIs, as they can have similar risk profiles, asset compositions, and liability structures as other covered IDIs and hence should have similar resolution-related resource needs.

When calculating the LTD requirement, the amount of eligible LTD that is due to be paid between one and two years would be subject to a 50 percent haircut. Additionally, any eligible LTD that is due to be paid in less than one year would not count toward the LTD Requirement. The purpose of this haircut provision is to limit rollover risk of debt instruments that qualify as eligible LTD and ensure that the eligible LTD provides stable funding and will be reliably available to absorb losses in the event that the covered IDI fails and enters resolution. Debt that is due to be paid in less than one year does not adequately serve these purposes because of the relatively high likelihood that the debt will mature during the period between the time when the covered IDI begins to experience extreme stress and the time when it enters a resolution proceeding. If the debt matures during that period, then it is likely that the creditors would be unwilling to maintain their exposure to the institution and would therefore refuse to roll over the debt or extend new credit, and the distressed institution would likely be unable to replace the debt with new LTD that would be available to absorb losses in resolution.

The proposed rule would also include a reservation of authority provision that would allow a covered IDI's AFBA to require a covered IDI to hold an amount of eligible LTD greater than otherwise required by the proposed rule. The AFBA may use this authority if it determines, through notice and comment procedures, that the covered IDI's LTD Requirement is not commensurate with the risk the activities of the institution pose to public and private stakeholders in the event of its material distress and failure. Further, the proposed rule would permit the covered IDI's AFBA, through notice and comment procedures, to order a covered IDI to exclude from its outstanding eligible LTD amount any debt security with features that would significantly impair the debt's ability to absorb losses in the event of the IDI's failure.

D. *Features Required to be Eligible Long-Term Debt*

1. General Requirements of Eligible LTD

Because the purpose of LTD is to absorb losses during a resolution, debt instruments that are eligible to be LTD under this proposed rule would be defined to exclude debt with features that may limit its ability to absorb losses in resolution, or otherwise delay or complicate resolution. The proposed rule's requirements for what can constitute eligible LTD are substantially the same as those under the FRB's rule that requires GSIBs to have LTD.[11]

Specifically, the proposed rule would provide that a covered IDI's eligible LTD:

a. Must not be secured or guaranteed by the covered IDI or a subsidiary or affiliate of the covered IDI, nor be subject to any other arrangement that legally or economically enhances the seniority of the instrument;

b. Must have a maturity of greater than or equal to one year from the date of issuance;

c. Must be governed by the laws of the United States or any state thereof;

---

[11] *See* 12 CFR 252.61 "Eligible debt security."

d. Must not provide the holder of the instrument a contractual right to accelerate payment of principal or interest on the instrument, except a right that is exercisable on one or more dates that are specified in the instrument or in the event of (A) a receivership, insolvency, liquidation, or similar proceeding of the covered IDI[12] or (B) a failure of the institution to pay principal or interest on the instrument when due and payable that continues for 30 days or more;

e. Must not have a credit-sensitive feature, such as an interest rate that is reset periodically based in whole or in part on the institution's credit quality;

f. Must not be a structured note;

g. Must not provide that the instrument may be converted into or exchanged for equity of the institution; and

h. Must be contractually subordinated to deposits and general unsecured creditors.

The proposal would also include a grandfathering provision that would allow for any previously-issued debt that complies with a subset of the general requirements of eligible LTD to count for the purposes of the LTD Requirement.[13]

2. Distinguishing Eligible Internal Debt Securities and Eligible External Debt Securities

The proposed rule would distinguish between eligible internal debt securities and eligible external debt securities. In general, an eligible internal debt security is debt that is

---

[12] The preamble explains that this provision should not be construed to mean that an eligible debt security could be accelerated upon a covered IDI merely being insolvent.

[13] Grandfathered LTD would not be required to limit acceleration rights, or to be contractually subordinated to general unsecured creditors.

issued by the covered IDI to, and held by, a company of which the covered IDI is a consolidated subsidiary (*e.g.*, its parent holding company). Internally issuing IDIs must hold eligible internal debt securities to satisfy the LTD Requirement. In contrast, an eligible external debt security is debt that is issued by the covered IDI to, and remains held by, a person that is not an affiliate of the covered IDI, unless the affiliate controls but does not consolidate the covered IDI. Externally issuing IDIs can issue either eligible external debt securities or eligible internal debt securities to satisfy the LTD Requirement, though a mandatory externally issuing IDI could only issue external debt securities because it does not have a parent holding company.

The proposed rule would make this distinction to account for the differences in debt issuance between externally issuing banks and internally issuing banks within a larger holding company structure. The general requirements of both eligible external LTD and eligible internal LTD are largely the same, however eligible external LTD would also require that it be issued in denominations of at least $400,000 to minimize the likelihood that it be purchased by retail investors.[14] This protection would not be needed for eligible internal LTD because it would only be purchased by a covered IDI's affiliates.

E. *LTD Requirement Timing and Phase In*

The LTD Requirement would come into full effect three years after the date on which a covered IDI first becomes subject to the proposed rule. The full amount of LTD covered IDIs would be required to hold, however, would be phased in over this three-year

---

[14] Significant holdings of LTD by retail investors may create a disincentive to impose losses on LTD holders, which runs contrary to the Agencies' intention that LTD holders expect to absorb losses in resolution after equity shareholders

period to reduce the potential for market disruption. The phase-in component of the proposed rule would follow a 25-50-100 structure. Covered IDIs would be required to have 25 percent of the LTD Requirement by one year after the date on which they become subject to the proposed rule. Two years after this date, covered IDIs would be required to hold an additional 25 percent (totaling 50 percent) of the LTD Requirement. By the end of the third year of the phase-in period, covered IDIs would be required to hold 100 percent.

V. Conclusion

Staff recommends that the FDIC Board (1) approve the attached NPR and authorize its publication in the Federal Register with a comment period ending on November 30, 2023 and (2) authorize the General Counsel, or designee, and the Executive Secretary, or designee, to make technical, non-substantive or conforming changes to the text of the draft Federal Register documents to prepare for publication.

CONCUR:

____

Harrel M. Pettway
General Counsel

CONTACTS:

CISR: Jenny G. Traille, Acting Senior Deputy Director

Andrew J. Felton, Deputy Director, Systemic Risk Branch

Ryan P. Tetrick, Deputy Director, Resolution Readiness Branch

Legal: R. Penfield Starke, Acting Deputy General Counsel, Resolution & Receivership Branch

David N. Wall, Assistant General Counsel, Complex Financial Institutions Section

ATTACHMENTS:

Attachment 1: **Board Resolution**

Attachment 2: **Proposed *Federal Register* notice**