January 20, 2023

Via Electronic Mail

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

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

Re: Advanced Notice of Proposed Rulemaking on Resolution-Related Resource Requirements for Large Banking Organizations. Docket No. R–1786; RIN 7100-AG44; RIN 3064-AF86.

Dear Ms. Misback, Mr. Sheesley:

The Bank Policy Institute (**BPI**)[1] submit this letter in response to the October 24, 2022, advance notice of proposed rulemaking of the Board of Governors of the Federal Reserve System (**Federal Reserve**) and the Federal Deposit Insurance Corporation (**FDIC** and together with the Federal Reserve, the **Agencies**) "regarding whether an extra layer of loss-absorbing capacity could improve optionality in resolving a large banking organization or its insured depository institution, and the costs and benefits of such a requirement."[2]

Since the global financial crisis, the Agencies, together with the Office of the Comptroller of the Currency (**OCC**), have implemented an effective and comprehensive regulatory framework to reduce the

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

[2] Federal Reserve and FDIC, Resolution-Related Resource Requirements for Large Banking Organizations, 87 Fed. Reg. 64,170, 64,170 (Oct. 24, 2022) (**ANPR**).

possibility of failure of both global systemically important bank holding companies (**GSIBs**) and non-GSIB large banking organizations (**LBOs**) and to provide for the orderly resolution of GSIBs and non-GSIB LBOs in the event of their failure. Key aspects of the regulatory framework applicable to non-GSIB LBOs include capital planning and stress testing requirements, enhanced capital requirements, liquidity requirements, risk management requirements, single counterparty credit limits, and resolution planning requirements. As noted in the ANPR, the Agencies' prudential and resolution-related requirements are tiered such that not all the requirements applicable to GSIBs apply to non-GSIB LBOs in the same manner; and in certain cases, requirements applicable to GSIBs do not apply at all to non-GSIB LBOs. This regulatory framework, which has enhanced the resilience of the U.S. financial system, reflects statutory requirements to differentiate prudential requirements on the basis of a risk-based assessment.[3] In light of the significant difference in systemic risk profiles of GSIBs versus non-GSIB LBOs, the regulatory framework most directly related to systemic risk in the resolution context differentiates between GSIBs and non-GSIB LBOs in that GSIBs are subject to TLAC and long-term debt requirements, and non-GSIB LBOs are not.[4]

The ANPR, however, questions whether the existing resolution framework, which was significantly revised as recently as 2019, remains suitable to limit the effect of a non-GSIB LBO's potential failure on the Deposit Insurance Fund (**DIF**) and the U.S. financial system. To this end, the Agencies request comment on a number of questions relating to whether and, if so, how they should expand the application of GSIB-like resolution-related requirements to non-GSIB LBOs. We recognize that periodic re-examination of key aspects of the regulatory system, including the resolution framework, is appropriate even if there is an absence of evidence that the existing framework has not worked in practice or analysis demonstrating that the existing framework is flawed. We believe, however, that changes in the framework that impose substantial additional cost or create competitive imbalance require compelling evidence or analysis. Neither is present here.

As is the case with any proposed regulatory requirement, the evaluation of a potential proposed resolution-related requirement requires an analysis of both the benefits and costs of the potential requirement. The fact that an additional loss-absorbency requirement (whether "going" or "gone") could reduce the risk to the DIF is part of that analysis but not conclusive. The amount of that risk reduction (which includes the likelihood of both occurrence and potential loss to the DIF), and any other benefits, must be estimated and then measured against the adverse consequences, such as higher cost and lower availability of credit for the broader economy. With respect to the ANPR, we believe both the risk of occurrence and the risk of loss are remote, whereas the costs of a new long-term debt requirement would be tangible, substantial and immediate.

Because the existing prudential and resolution planning framework is effective for non-GSIB LBOs, additional resolution-related requirements for them are not necessary and would be inappropriate under a regulatory framework that, as required by statute, must reflect actual risks. As discussed in greater detail below, our general premise is that no additional requirements are necessary. If, nonetheless, the Agencies decide to pursue rule-making for new resolution-related standards, we also include preliminary observations for how the Agencies could implement any GSIB-like resolution-related

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[3] *See*, *e.g.*, 12 U.S.C. § 5365(a)(2).

[4] *See, e.g.*, Federal Reserve, Requirements for Domestic and Foreign Banking Organizations (Oct. 10, 2019), *available at* https://www.federalreserve.gov/aboutthefed/boardmeetings/files/tailoring-rule-visual-20191010.pdf.

requirements for non-GSIB LBOs as consistently as possible within the context of a broader, tiered regulatory framework.

I. GSIB-Like Resolution-Related Requirements are Neither Necessary nor Appropriate for Non-GSIB LBOs

The ANPR seems to adopt the predicate conclusion that GSIB-like resolution-related requirements may be necessary or appropriate for non-GSIB LBOs. This conclusion, however, appears to be based on a number of incorrect assumptions.

First, the ANPR reflects an incorrect assumption that there is insufficient optionality for resolving non-GSIB LBOs and that only a GSIB or other large financial institution could acquire a non-GSIB LBO in distress or resolution.[5] Non-GSIB LBOs are resolvable, and their resolution plans are credible and feasible without creating undesirable policy outcomes. Supported by detailed analysis and the Agencies' information requirements, the required existing resolution plans of non-GSIB LBOs—at both the holding company and insured depository institution (**IDI**) levels—equip the Agencies to pursue a variety of resolution options. Optionality is valuable given that the optimal approach to resolving a banking organization could vary based on the characteristics of the failed institution or the broader context in which the failure occurs. We believe that the current resolution framework provides the Agencies with sufficient optionality to resolve a non-GSIB LBO without untoward consequences.

Resolution plans of non-GSIB LBOs with large IDIs generally provide for resolution of the IDI through a receivership under the Federal Deposit Insurance Act (**FDIA**). The IDI resolution plans vary to some degree, but, in all cases, they contemplate multiple options for resolution that can be achieved effectively and within a reasonable period of time without risk of loss to the DIF. These include a number of options for the separation of the IDI's business into smaller parts and sales of those parts to multiple purchasers (the basis of possible separation (*e.g.*, geographic, business lines, portfolios, etc.) varies across IDIs); or the sale of the main IDI to another institution. These multiple resolution options, and variations within the basic options, would allow the FDIC to dispose of various components in different ways in response to prevailing market forces, including through sales of discrete businesses or portfolios.[6] Other entities, including the parent company, would generally be separately resolved,

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[5] *See* ANPR, 87 Fed. Reg. at 64,171 ("For the vast majority of bank resolutions, the FDIC pursues a strategy of selling the failed IDI to another depository institution, as this has been the course of action which was least costly to the Deposit Insurance Fund (DIF) and minimized disruption to local communities and to the financial system. During the global financial crisis, there were limited and undesirable options available to the FDIC for resolving the largest failed IDIs including disruptive and costly liquidation strategies or the sale of large banks to even larger financial institutions. The challenges associated with the acquisition of a large, failed IDI continue to be significant, both operationally and financially; as a result, the universe of potential acquirers is limited.").

[6] There appears to be an implicit assumption in the ANPR that a sale to a single purchaser would be unacceptable, or at least highly undesirable. We believe that such a broad assumption is questionable. A sale of a non-GSIB LBO (even assuming that the definition of non-GSIB LBO is limited to Category II and III banks) would increase the nationwide market share of the purchaser by only between 1.9% and 2.7%, and even the largest GSIB would, as a result of such an acquisition, hold a nationwide market share of only about 15%. Moreover, many geographic banking markets where GSIBs and non-GSIB LBOs have overlapping presence are so unconcentrated that such an acquisition would not have a significantly adverse competitive impact in those markets. If any such local adverse effect did exist, it could be cured with a divestiture requirement.

through a sale, liquidation, or other restructuring, without any material effects on U.S. financial stability due to the limited scope and minimal systemic risk profiles of non-GSIB LBOs.[7]

Furthermore, in light of the myriad regulatory and supervisory improvements since the global financial crisis, it is unlikely that there would be a broad systemic failure of underwriting and risk management leading to losses across all portfolios of a non-GSIB LBO, which, in most cases, are diversified in nature or concentrated in simple, low-risk assets and activities. As a result, the vast majority of assets could be separated and sold in an orderly manner. Moreover, the FDIC would not necessarily be required to execute any of the resolution plan options over a "resolution weekend," but could use a longer period for disposal and restructuring after the establishment of a bridge bank. The prompt corrective action framework further supports the resolution of any IDI by aligning the "adequately capitalized" threshold with the minimum requirements under the current, post-crisis bank regulatory capital rules. The framework allows the Federal banking agencies to intervene early in the event of an IDI's distress, extending the amount of time the Agencies have to address a bank's weakness. Today, intervention would occur much earlier than was the case under the pre-crisis framework, which was aligned to pre-crisis capital requirements. Moreover, beyond the prompt corrective action framework, other aspects of the current regulatory framework would alert the Agencies about potential financial distress at a non-GSIB LBO long before the non-GSIB LBO approaches the point of non-viability and resolution. For example, the capital rules currently include buffer requirements that apply in addition to the minimum requirements, and non-GSIB LBOs participate in the Federal Reserve's supervisory stress tests on an annual basis.

The detailed information provided to the Agencies under existing resolution planning requirements would provide the FDIC with the practical information necessary not only to execute one of the common resolution strategies among non-GSIB LBOs, but also to craft a unique strategy as may be appropriate to address any idiosyncratic situation. Specifically, the relevant regulations and guidance include requirements relating to, among other topics, planning for operational continuity,[8] mapping of business lines to critical functions,[9] and separability analysis.[10] Non-GSIB LBOs must also provide detailed information pertaining to organizational structure[11] and management information systems[12] so that regulators have the practical information necessary to meaningfully evaluate options and operate the entity as long as is necessary to execute the chosen resolution strategy.

In addition, the Federal Reserve has recognized in its approval orders that an acquisition can mitigate financial stability risks by, among other things, applying a higher level of regulation and regulatory scrutiny and enhancing the liability mix of the acquirer. This is not to argue that an acquisition by a GSIB should be unqualifiedly acceptable, but that it should not be unqualifiedly unacceptable.

7 For example, a retail broker-dealer of a non-GSIB LBO could be resolved in an orderly manner through the existing Securities Investor Protection Act framework.

8 12 CFR 243.5(c)(1)(iv). *See generally* 12 CFR 360.10(c)(2).

9 12 CFR 243.5(c)(1)(iv); 12 CFR 360.10(c)(2)(iii); Federal Deposit Insurance Corporation, *Statement on Resolution Plans for Insured Depository Institutions* at 6 (Jun. 25, 2021), *available at* https://www.fdic.gov/resources/resolutions/resolution-authority/idi-statement-06-25-2021.pdf (**FDIC IDI Plan Guidance**).

10 *See* 12 CFR 243.3(c)(5); *FDIC IDI Plan Guidance* at 6.

11 12 CFR 243.5(e); 12 CFR 360.10(c)(2)(ii).

12 12 CFR 243.5(f); *FDIC IDI Plan Guidance* at 8.

Supporting the fact that non-GSIB LBOs have developed credible and feasible resolution options, since the inception of the resolution planning requirements over a decade ago, none of the required resolution plans of non-GSIB LBOs has been deemed "not credible," or even deficient, by the Agencies. There has not been any change in circumstances that would warrant the imposition of an entirely new type of resolution-related standard for non-GSIB LBOs. To the extent that any material changes arise, the Agencies could and should use the existing resolution planning framework to address those changes. The existing framework centers on the development and enhancement of resolution plans, taking into account, among other things, feedback from the Agencies. The Agencies should not implement costly and burdensome GSIB-like resolution-related standards for non-GSIB LBOs to address a hypothetical concern about a lack of optionality that does not actually exist or a change in circumstances that has not occurred and may never occur.

Second, the ANPR reflects an incorrect assumption that the failure of a non-GSIB LBO could have systemic consequences.[13] Non-GSIB LBOs generally are not critical participants in financial market infrastructure or important providers of liquidity to other financial market participants. Moreover, although the non-GSIB LBOs have grown in absolute terms in recent years, the Agencies also recognize that "their proportion of the total banking sector assets has remained relatively constant."[14] The low, or non-existent, growth on a relative basis reflects that the systemic profiles of non-GSIB LBOs have not changed. The Agencies have consistently and repeatedly recognized that non-GSIB LBOs do not present systemic risk. When the Federal Reserve adopted its GSIB identification methodology in 2015, it noted that "across many potential metrics, there is a clear separation in systemic risk profiles between the eight U.S. [GISBs] and other bank holding companies."[15] The Agencies, together with the OCC, have also indicated that the "clear separation in systemic risk profiles" between GSIBs and other banking organizations means that, among U.S. firms, the U.S. GSIBs are the only systemically significant institutions at the domestic level as well as at the global level.[16] Although these findings were made several years ago, as noted above, there has been no change that would suggest a different conclusion. Because the systemic risk of non-GSIB LBOs is so low (or non-existent) to begin with, even if the Agencies were to determine that GSIB-like resolution-related requirements would improve non-GSIB LBOs' resolvability, these requirements would not materially decrease risk to U.S. financial stability. The Agencies should not impose unwarranted, GSIB-like resolution-related requirements on non-GSIB LBOs in light of the differences in systemic risk profiles of GSIBs and non-GSIB LBOs.

In considering the respective regulatory regimes appropriate for GSIBs and non-GSIB LBOs, the very material difference in their respective GSIB scores should be determinative. As shown in Figure 1 below, the "clear separation" between GSIBs and non-GSIB LBOs persists. The non-GSIB LBOs are more comparable to Category IV firms, which are not the focus of the ANPR, than to GSIBs.

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13 *See* ANPR, 87 Fed. Reg. at 64,172 ("As the profile of large banking organizations continues to evolve, with larger balance sheets and increased volume of uninsured deposits, and potentially more complex organizations, the agencies are considering whether additional measures are warranted to address financial stability impacts that might be associated with the failure of such firms.").

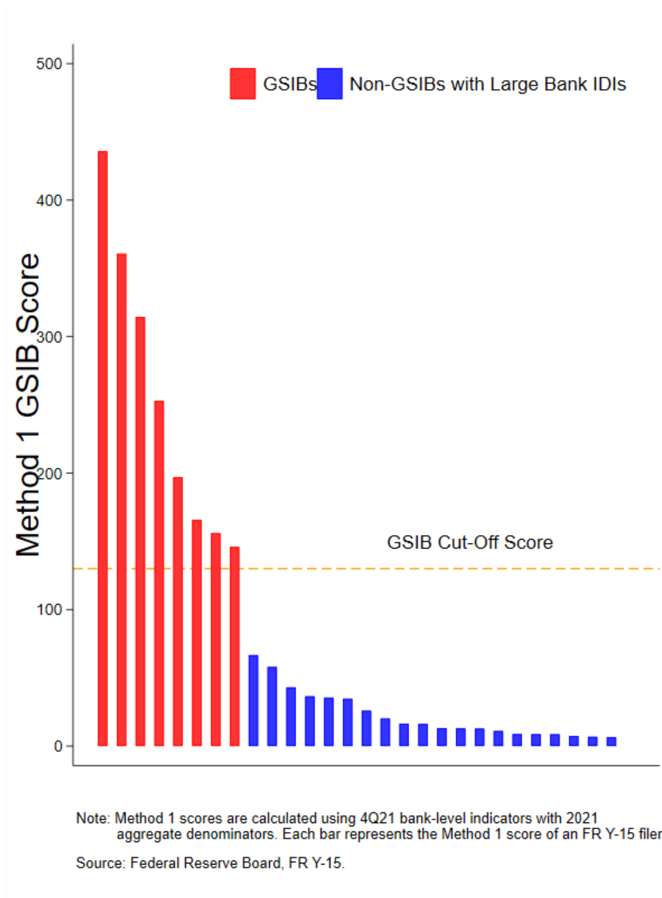
14 ANPR, 87 Fed. Reg. at 64,171.

15 Federal Reserve, 80 Fed. Reg. 49,082, 49,084 (Aug. 14, 2015).

16 *See* Basel Committee, Regulatory Consistency Assessment Programme (RCAP): Assessment of Basel III G-SIB framework and review of D-SIB frameworks – United States (Jun. 2016), *available at* https://www.bis.org/bcbs/publ/d369.pdf.

Currently, the lowest score among GSIBs is 146 and the average score is 254, while the average score among non-GSIB LBOs is only 35,[17] with Category IV LBOs having an average score of 11.

Figure 1: Method 1 Scores of GSIBs and Non-GSIB LBOs[18]



Third, the ANPR reflects an incorrect assumption that two IDI failures at the outset of the global financial crisis—Washington Mutual and IndyMac—are relevant precedents in the context of considering resolution-related prudential standards for non-GSIB LBOs today.[19] The regulation and risk profiles of those institutions are fundamentally different from those of non-GSIB LBOs. Washington Mutual and IndyMac were regulated by the now-defunct Office of Thrift Supervision, which positioned

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[17] This average reflects the scores for domestic Category II and Category III LBOs, consistent with the focus of the ANPR. *See* ANPR, 87 Fed. Reg. at 64,171, fn.4.

[18] Population comprised of FR Y-15 filers, which include U.S. BHCs and covered SLHCs with total consolidated assets of $100 billion or more, FBOs with combined U.S. assets of $100 billion or more, including, if applicable, any U.S. IHC of the FBO regardless of the size of the IHC, and U.S.-based organizations designated as GSIBs that do not otherwise meet the consolidated assets threshold.

[19] FDIC, Statement by Martin J. Gruenberg, Acting Chairman, FDIC Board of Directors, Advance Notice of Proposed Rulemaking: Resolution-Related Resource Requirements for Large Banking Organizations (Oct. 18, 2022), *available at* https://www.fdic.gov/news/speeches/2022/spoct1822b.html ("The challenges posed by a large bank failure are illustrated by two examples from the financial crisis: Washington Mutual Bank and IndyMac Bank.").

itself as a "light touch" regulator.[20] Those institutions had highly concentrated and risky business lines, loan portfolios and funding profiles. They also had weak underwriting and risk management practices. Just as Bear Stearns and Lehman are not regarded as relevant precedent for banking organizations because of the major differences in regulation and risk, these two IDI failures are not precedential and should not be a basis for increased resolution-related requirements.[21]

Moreover, even if these two institutions, or any institution that confronted serious financial difficulty in 2008, could be considered precedential at the time, they no longer are precedential because of the comprehensive enhancement of the regulatory system in the ensuing 14 years.[22] Non-GSIB LBOs are subject to supervisory and regulatory frameworks that apply at both the IDI and consolidated holding company levels and that are considerably more stringent than, and ultimately not in any way comparable to, the supervisory and regulatory frameworks that existed prior to the global financial crisis. Among other things, the two cornerstones of bank failure prevention—capital and liquidity requirements—are today much higher. In 2008, there were no resolution planning requirements or even liquidity requirements analogous to the Regulation YY liquidity risk management and buffer requirements or standardized liquidity requirements in effect today. Even had there been failures by large regionals in 2008, that hypothetical scenario should have no bearing on the resolvability of a non-GSIB LBO today. The Agencies should not implement or design resolution-related standards for non-GSIB LBOs based on non-precedential and indeed non-relevant situations involving vastly different regulatory standards.

Fourth, the ANPR reflects an incorrect assumption that, among non-GSIB LBOs today, there is a heightened risk that uninsured depositors might not be made whole in an FDIA receivership of a large IDI and that the risk to uninsured depositors could give rise to associated runs on uninsured deposits at other banks.[23] Although the Agencies observe that "some large banking organizations have increased their reliance on large uninsured deposits to fund their operations over the past decade," the ANPR does not take into account the aspects of the regulatory and resolution framework that mitigate related risks. As noted above, those aspects applicable to non-GSIB LBOs include, with particular relevance to this issue, capital planning and stress testing requirements, enhanced capital requirements, and liquidity

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[20] *See, e.g.*, Statement of Scott M. Polakoff, Senior Deputy Director Office of Thrift Supervision concerning Industrial Loan Companies before the Committee on Banking, Housing, and Urban Affairs United States Senate (Oct. 4, 2007), *available at* https://www.occ.gov/static/ots/testimony/ots-testimony-ts149-10-04-2007.pdf. ("The OTS holding company oversight program appropriately balances the need for effective supervision with the interests of a holding company enterprise to avoid excessive regulatory intrusion in its affairs.")

[21] We also note that the DIF suffered no loss from the failure of Washington Mutual. Although the DIF did suffer a major loss from the failure of IndyMac, it had less than $50 billion in assets. Accordingly, the size of the loss was a function of the magnitude of the failures of management and regulators, as opposed to the size of the institution.

[22] It is noteworthy that the large regionals in 2008 were widely regarded as the soundest banking institutions. None required special government assistance. Although one of those regional banks, National City, did experience financial stress, it was purchased in a private sector transaction, and there were several regional bidders.

[23] ANPR, 87 Fed. Reg. at 64,171-72 ("[Uninsured] deposits may be less stable relative to insured deposits under conditions of firm-specific stress and resolution. Uninsured deposits comprise a significant portion of Category II and III banking organizations' funding base, standing at roughly 40% of total deposits as of the first quarter of 2022 as a group. * * * Additional loss-absorbing resources could limit contagion risk by reducing the likelihood of uninsured depositors suffering loss.").

requirements, as well as risk management requirements and resolution planning requirements that reduce both the risk that a non-GSIB LBO might fail and the losses uninsured depositors might face in the event of failure. Moreover, the potential failure of a non-GSIB LBO would not present contagion risk in light of the development of credible resolution plans by the non-GSIB LBOs, together with the public disclosure regarding those resolution plans, and the other aspects of the post-crisis prudential framework. The Agencies should not design resolution-related standards for non-GSIB LBOs in light of perceived risks relating to increases in uninsured deposits without taking into account all the aspects of the current regulatory and resolution framework that mitigate those risks.

Fifth, the ANPR appears to reflect an incorrect assumption that GSIB-like resolution-related requirements are appropriate for non-GSIB LBOs.[24] On the contrary, the GSIB resolution framework, including the TLAC and long-term debt requirements, is designed for GSIBs and the resolution strategies developed by GSIBs. The key attributes of that framework are not suited or appropriate for the resolution of a non-GSIB LBO. Due in large part to the nature and extent of their activities conducted through complex networks of material legal entities, as well as their extensive cross-border operations, the U.S. GSIBs have adopted the single point of entry (**SPOE**) resolution strategy. The SPOE strategy is designed to impose resolution-related losses on shareholders and creditors of the top-tier holding company while its multiple large operating subsidiaries continue operating without entering receivership, bankruptcy, insolvency or other resolution proceedings in a multitude of jurisdictions. The TLAC and associated long-term debt requirements provide the loss-absorbing capacity necessary to recapitalize these subsidiaries and allow them to continue operating as going concerns, thereby avoiding individual resolution proceedings and the resulting disruptions to critical functions and other negative impacts on financial stability.[25] The resolution strategies of non-GSIB LBOs do not contemplate recapitalizing subsidiaries as this is by and large irrelevant given their structures. GSIB-like requirements, and in particular a long-term debt requirement, are not necessary in this distinguishable resolution context.

Further, imposing GSIB-like resolution-related requirements could inhibit competition in the banking sector. In his statement on the ANPR, Acting Comptroller of the Currency Hsu noted that "it is critical that our actions as regulators promote competition."[26] Imposing GSIB-like resolution-related

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[24] ANPR, 87 Fed. Reg. at 64,173 ("The agencies are interested in public comment on how appropriately-adapted elements of the GSIB resolution-related standards . . . could be applied to large banking organizations to enhance financial stability by providing for a wider range of resolution options and address related risks to safe and sound banking, the potential costs of such changes, and how these policies might be structured to achieve those goals most effectively and efficiently."). This wording suggests that the question being reviewed by the Agencies is not *whether* additional requirements should be imposed, but to presume such additional requirements and then ask *how* those requirements should be formulated. The predicate question, however, which we address, should be *whether* the current resolution regime for non-GSIB LBOs requires any supplementation from the GSIB resolution regime.

[25] *See, e.g.*, Financial Stability Board, Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution (Nov. 9, 2015) ("There must be sufficient loss-absorbing and recapitalisation capacity available in resolution to implement an orderly resolution that minimises any impact on financial stability, ensures the continuity of critical functions, and avoids exposing taxpayers (that is, public funds) to loss with a high degree of confidence. This is the main guiding principle from which the other principles flow. Instruments or liabilities that are not eligible as TLAC will still be subject to potential exposure to loss in resolution, in accordance with the applicable resolution law.").

[26] OCC, Acting Comptroller Issues Statement on FDIC and Federal Reserve Board ANPR on Resolution-Related Resource Requirements for Large Banking Organizations (Oct. 18, 2022), *available at* https://www.occ.gov/news-issuances/news-releases/2022/nr-occ-2022-129.html.

requirements on non-GSIB LBOs would run counter to that goal by dissuading non-GSIB LBOs and other banking organizations from seeking to grow and be more competitive—and provide more credit to the economy—in order to avoid or mitigate the effects of those new requirements. Continuing to apply long-term debt requirements only to GSIBs, as the Federal Reserve determined was appropriate in adopting the TLAC rule and again in adopting the tailoring framework, would reflect the differing systemic risk profile of GSIBs versus non-GSIB LBOs, maintain a tiered, risk-based regulatory framework and promote competition in the banking sector.

In addition to the incorrect assumptions underlying the ANPR, the ANPR does not recognize the significant adverse consequences of imposing GSIB-like resolvability requirements that would outweigh any benefits. The costs and disadvantages of imposing GSIB-like resolvability requirements on non-GSIB LBOs would be tangible, substantial, and immediate. In contrast, the benefits, if any, would be long-term and speculative, given the extremely low risk that a non-GSIB LBO would fail, particularly in light of the myriad post-crisis regulations applicable to these institutions. The GSIB resolvability framework, and in particular long-term debt requirements, carry significant costs and disadvantages for financial institutions, their customers, and the broader financial system. Accordingly, if the Agencies nevertheless proceed to consider new GSIB-like resolution-related requirements for non-GSIB LBOs, the Agencies should proceed carefully and thoughtfully and first conduct a rigorous cost-benefit analysis of any new requirements for non-GSIB LBOs and seek comment on that analysis. In light of the real, immediate costs of any potential long-term debt requirements, the assessment of costs should take into account the context in which the new requirement would be imposed, including prevailing macroeconomic conditions and uncertainties (such as a high and still rising interest rate environment).[27]

Furthermore, a long-term debt requirement could actually decrease safety and soundness for non-GSIB LBOs and the U.S. financial system as a whole. Decreased safety and soundness is another cost the agencies should consider as they evaluate the costs and benefits of any new resolution-related requirements for non-GSIB LBOs. Requiring non-GSIB LBOs to issue long-term debt would require these institutions to shift a portion of their funding mix from stable, low-cost deposits to higher-cost, market-based borrowings.[28] Non-GSIB LBOs would need to seek higher returns commensurate with this higher cost of funding, affecting customers. This could drive more activity to less regulated non-bank providers rather than heavily regulated banks, or otherwise adversely affect the cost and availability of credit.

Imposing a long-term debt requirement on non-GSIB LBOs would also exacerbate the pro-cyclicality of such a requirement in periods of stress, as evidenced at the onset of the COVID-19 pandemic, when deposits increased substantially across the banking sector. Despite the deposit inflows and presence of ample liquidity, many GSIBs needed to access the capital markets—during volatile market conditions and during a period of widening credit spreads—to issue large amounts of long-term debt in order to continue to satisfy TLAC and long-term debt ratio requirements. As shown in Figure 2, the median bond spread of the GSIBs widened more than 200 basis points around March and April 2020, while they had to issue nearly $50 billion in TLAC-eligible long-term debt in respect of the deposit in-flows. The imposition of a long-term debt requirement for non-GSIB LBOs could therefore harm

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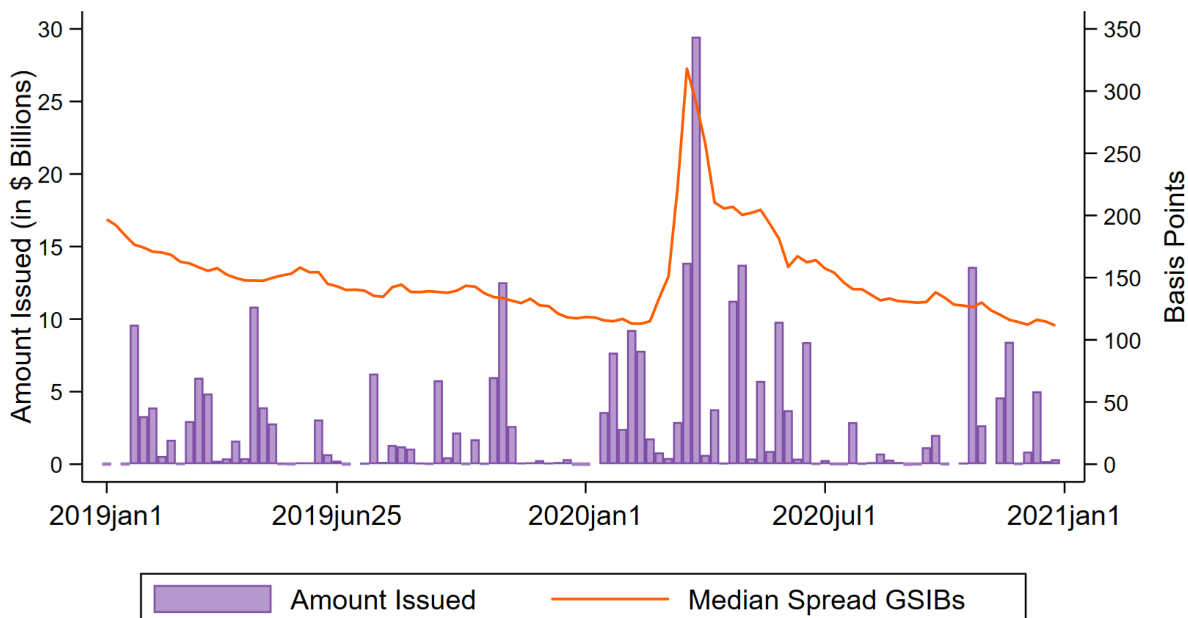
[27] As a result of the current interest rate environment, the cost of a regulatory long-term debt requirement for non-GSIB LBOs would be meaningfully higher than the TLAC equivalent imposed on GSIBs in 2017 in a considerably lower interest rate environment. Moreover, this cost differential would be increased because, as discussed below, the long-term debt issued by non-GSIB LBOs would replace deposits. For GSIBs, TLAC-eligible debt could also replace non-deposit wholesale funding.

[28] The alternative of adding the debt, and the assets in which the debt proceeds are reinvested, to a banking institution's balance sheet is not practical in view of the capital inefficiency and negative rate spread.

financial stability by increasing procyclicality and aggravating the speed and severity of a financial downturn.

Figure 2: Long-Term Bond Issuance by GSIBs



Source: Bloomberg.

Note: Sample includes senior unsecured and subordinated bonds. The option-adjusted spread is defined as the difference between the yield on the bond and that of the corresponding maturity-matched Treasury bond adjusted for the embedded options in the bond.

The GSIB-like resolution-related requirements contemplated by the ANPR are both unnecessary and inappropriate for non-GSIB LBOs. We therefore urge the Agencies not to pursue the GSIB-like resolution-related requirements contemplated by the ANPR any further.[29]

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[29] If the Agencies proceed to propose a rule imposing long-term debt or other GSIB-like resolution-related requirements on non-GSIB LBOs, the assumptions in the ANPR will not support this substantial change in policy. In *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502 (2009), the Supreme Court held that, when an agency is changing position, "the agency must show that there are good reasons for the new policy." *Id.* at 515. The Supreme Court also explained that an agency must sometimes provide "a more detailed justification than what would suffice for a new policy created on a blank slate," such as when an agency's "new policy rests upon factual findings that contradict those which underlay its prior policy; or when its prior policy has engendered serious reliance interests that must be taken into account." *Id.*

As discussed above, applying GSIB-like resolution-related requirements to non-GSIB LBOs would represent a fundamental departure from the Agencies' existing policy that these requirements apply to only GSIBs due to the systemic risk posed by GSIBs. When the Federal Reserve adopted the TLAC rule, the Federal Reserve explained that "the TLAC and [long-term debt] requirements in the final rule focus on the largest and most systemic U.S. banking organizations and the U.S. operations of the largest and most systemic foreign banking organizations, because, as shown in the recent financial crisis, the failure or material financial distress of these companies has the greatest potential to disrupt U.S. financial stability." Federal Reserve, 82 Fed. Reg. at 8,267.

II. Response to RFI Questions

A. Overview

Although we urge the Agencies not to engage in any rulemaking with respect to new resolution-related requirements for non-GSIB LBOs, we understand the Agencies are seeking information to inform their consideration of this issue. Accordingly, in this section we provide some guiding principles to assist the Agencies in considering potential resolution-related requirements for non-GSIB LBOs. These responses are inherently preliminary, and it is difficult to provide complete feedback on potential new resolution-related standards when there has been limited articulation of the problem that the Agencies are trying to solve, and there has been no cost-benefit analysis undertaken regarding a long-term debt requirement for non-GSIB LBOs. The Agencies have publicly announced their intention to release new resolution planning guidance for Category II and III firms.[30] That guidance, and how firms revise their resolution plans in response to that guidance, could further demonstrate that a long-term debt requirement is neither necessary nor appropriate for non-GSIB LBOs and could have a variety of implications for the need for, and design of, any other potential resolution-related standards referenced in the ANPR. Consequently, the Agencies should not propose any long-term debt requirement until they have proposed and finalized any forthcoming resolution planning guidance because it is not possible to comment effectively on any proposal to implement a long-term debt requirement without having visibility into the Agencies' proposed full resolution planning framework.

Moreover, any long-term debt requirement for non-GSIB LBOs should not be proposed until the federal banking agencies finalize their anticipated revisions to the capital framework, including to implement the "Basel III endgame" reforms. These revisions are expected to heighten already robust and stringent post-crisis capital requirements and may also address flaws in current leverage ratio requirements due to the calibration and lack of risk sensitivity in those requirements. Depending on the scope and manner of application of the revisions, they could reduce both the probability of a non-GSIB LBO's failure and the risks in the event of failure. To the extent any changes to the capital framework further reduce the already-low systemic risk profile of non-GSIB LBOs, the changes would provide further reasons why a long-term debt requirement is not necessary. Moreover, the Agencies should not propose any new leverage-based requirement, such as a leverage-based long-term debt requirement, until they have completed their review of current leverage requirements and finalized any related revisions. To do otherwise risks exacerbating the adverse effects of leverage-based requirements in the prudential framework.

There are two points that should guide the Agencies' overall thinking in the consideration of any potential new GSIB-like resolution-related requirements, particularly a long-term debt requirement.

The assumptions in the ANPR reflect factual findings about the systemic significance of non-GSIB LBOs that contradict the findings underlying the existing policy. The ANPR does not provide a "detailed justification," as required by the Supreme Court, addressing this contradiction. Indeed, the two bank failures on which the ANPR relies, Washington Mutual and IndyMac, occurred well before the existing policy was adopted. Moreover, the ANPR does not address the "serious reliance interests"—such as the basic strategic decisions the non-GSIB LBOs have made—that the Supreme Court has mandated "must be taken into account." Likewise, the ANPR provides no evidence that the Agencies have meaningfully considered the tangible, substantial, and immediate costs of any new GSIB-like resolution-related requirements for non-GSIB LBOs.

[30] *See* Federal Reserve and FDIC, Agencies announce forthcoming resolution plan guidance for large banks and deliver feedback on resolution plan of Truist Financial Corporation (Sep. 30, 2022), *available at* https://www.federalreserve.gov/newsevents/pressreleases/bcreg20220930a.htm.

First, due to the heterogeneity in the funding structures of non-GSIB LBOs, any new requirements should allow for flexibility in their application to a particular institution based on its structure, operations and resolution strategy. One-size-fits-all requirements would be neither appropriate nor effective. Second, non-GSIB LBOs have relatively simple organizational structures that do not present complex resolvability issues that GSIB resolution requirements were designed to address. Any potential requirements should take into account the relative simplicity of non-GSIB LBOs' organizational structures and their limited risk to financial stability.

B. Long-Term Debt Requirement

A long-term debt requirement would, at most, only marginally enhance the resolvability of non-GSIB LBOs, and the costs would exceed any marginal benefits. Accordingly, we do not believe a long-term debt requirement should be imposed. Category II and III LBOs have already developed credible resolution plans that reflect their own organizational structures, funding structures, operations, and risk profiles. Category II and III LBOs are also already strongly capitalized and are subject to capital requirements that are qualitatively and quantitatively considerably more stringent than pre-crisis requirements, including the stress capital buffer and associated CCAR stress tests that today determine binding capital requirements. These requirements also include capital buffers with increasingly strict limits on firms' dividends, share repurchases and discretionary bonus payments for firms that breach these buffers. Further, Category II and III LBOs are subject to standardized and substantial liquidity requirements for which there is no pre-global financial crisis analog. As discussed above, imposition of still additional requirements would provide diminishing returns to financial stability and protecting the DIF.

If any long-term debt requirement were to be implemented for non-GSIB LBOs, it should allow for flexibility in (i) which entity issues the debt or liability (parent holding company, IDI, or some combination of the two), (ii) whether IDI-level debt satisfying the requirement can take the form of either traditional debt or intercompany liabilities owed to the parent holding company or an affiliate,[31] (iii) permitting existing debt issued by an IDI to be issued to its parent holding company or externally, and (iv) grandfathering existing long-term debt issued prior to the adoption of any final rule.[32] This flexibility would not inhibit any resolution-related objective of a new long-term debt requirement, but would allow non-GSIB LBOs to adapt a potential long-term debt requirement to their particular funding structures on a somewhat less costly basis.

Non-GSIB LBOs should be permitted to issue long-term debt at the level of the IDI, the parent holding company, or a combination of the two. Requiring debt to be issued only by the top-tier holding company would limit the resolution strategies that could be pursued by non-GSIB LBOs, which is not

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[31] We note that any liability that satisfies the relevant subordination requirements (as contemplated by footnote 13 of the ANPR) and other eligibility criteria should count toward the requirement. In the remainder of this letter, any reference to "debt" under a potential long-term debt requirement should be understood to include such eligible liabilities.

[32] Further, any new long-term debt requirement should factor into the FDIC's deposit insurance assessments. The current methodology factors long-term unsecured debt into the assessment in recognition of the fact that, under the FDIA, long-term unsecured debt is subordinated to deposits. Any new long-term debt requirement should result in further adjustments to the assessment framework to provide greater recognition of the loss-absorbing capacity of long-term debt. Any adjustment to the deposit insurance assessments, however, would be far outweighed by the costs of a new long-term debt requirement and would not avoid or meaningfully mitigate the adverse consequences of such a requirement discussed in Part I.

warranted. As a form of "gone concern" loss absorbing capacity, debt issued at the IDI level would remain available to absorb losses in resolution. Non-GSIB LBOs have relatively simple organizational structures. Appropriately, non-GSIB LBOs' resolution strategies include the FDIC receivership of their IDIs, as well as the resolution of the top-tier holding company and any other material entities. Imposing GSIB-based resolvability requirements on non-GSIB LBOs, such as a requirement that debt be issued at the parent-company level, would de facto move non-GSIB LBOs to an SPOE resolution strategy and would contradict the resolution optionality statutorily granted to these institutions and recognized in the FDIC's IDI resolution planning rule. Moreover, there seems to be no legitimate analytical basis for such a top-tier requirement for non-GSIB LBOs.

IDIs should be permitted to issue the long-term debt to their parent holding companies, other affiliates or externally. Both externally and internally issued debt will accomplish the ANPR's goal of providing the FDIC with flexibility in resolving a large banking organization. Any long-term debt requirement should therefore not prescribe that the debt be issued either internally or externally, but rather allow for optionality, so that a non-GSIB LBO can adapt the requirement to its own circumstances.

Similar to the approach for the Federal Reserve's GSIB TLAC rule, the Agencies should grandfather long-term debt issued prior to the release of any final rule.[33] The failure to grandfather pre-existing long-term debt could have a significant effect on the impact and cost of any long-term debt requirement.

C. Calibration

Based on the level of risk posed, any calibration should result in a long-term debt requirement for non-GSIB LBOs that is significantly lower than that for GSIBs. The Dodd-Frank Act requires that the stringency of prudential standards differentiate among firms based on risk-related factors.[34] Because non-GSIB LBOs present little to no risk to the stability of the U.S. financial system, the calibration of any long-term debt requirement for non-GSIB LBOs should result in a significantly lower long-term debt requirement than that applicable to GSIBs.

Existing GSIB long-term debt requirements were calibrated based on a capital refill framework designed and applied in the context of the GSIB SPOE resolution strategy. That framework would not be appropriate for non-GSIB LBOs. The capital refill framework, as applied in the GSIB context, is designed to allow the material subsidiaries of a failed GSIB to be fully recapitalized by replenishing their going-concern capital so as to permit the subsidiaries to operate outside resolution proceedings as going concerns. As noted above, non-GSIB LBOs' resolution plans do not involve an SPOE strategy, and the failure of a non-GSIB LBO does not raise financial stability concerns. There is therefore no need to fully replenish the capital of a non-GSIB LBO's subsidiaries to allow them to continue operating as going concerns without ever entering resolution proceedings.

The calibration of any regulatory requirement should reflect the purpose of the requirement. Here, the purpose of a requirement is ostensibly to provide the Agencies with further optionality in resolving a failing non-GSIB LBO. A calibration predicated on a solvent wind-down, outside resolution proceedings, would not be fit for this purpose. The amount of loss-absorbing capacity necessary to provide the Agencies with some incremental flexibility in pursuing available resolution strategies for a

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[33] *See* definition of "Eligible debt security" in 12 C.F.R. § 252.61 (providing different eligibility criteria for debt issued prior to and on or after December 31, 2016).

[34] *See*, *e.g.*, 12 U.S.C. § 5365(a)(2).

failing non-GSIB LBO is inherently materially lower than the amount of loss-absorbing capacity that would be necessary to fully recapitalize all the material operating subsidiaries of a failed GSIB so that each could continue operating as a going concern without needing to enter any resolution proceedings in the first place. For example, a full recapitalization of an FDIC controlled bridge bank would be unnecessary given the powers the FDIC has as receiver under the FDIA and the access to liquidity provided by the DIF and other sources available to the FDIC in managing a bridge bank. Stated differently, the capital requirements of an ongoing IDI that is intended to be operated for the foreseeable future should be considerably higher than for a short-term government-operated bridge bank that has access to government liquidity and is designed to be sold in whole or, more likely, in part or be recapitalized within a short period of time.

Further supporting the fact that a full capital refill approach to loss-absorbing capacity is unnecessary for non-GSIB LBOs, is the manner in which the prompt corrective action framework and the grounds for the appointment of a receiver under the FDIA works. The starting point for recapitalizing a failed IDI subsidiary of a non-GSIB LBO would not be zero, as the Federal Reserve believed could be the case in the context of an SPOE resolution of a failed GSIB, nor would that be the case for the holding company of a non-GSIB LBO given the post-crisis regulatory reforms described above and the nature of the activities and exposures of non-GSIB LBOs. The capital refill framework, as applied to the GSIBs, reflects an assumption that the starting point could be zero because the framework is designed to allow for full recapitalization "in the event that *all* or most of [the GSIB's] capital were depleted."[35] This is not an appropriate assumption in the context of a non-GSIB LBO resolution. Recapitalizing a non-GSIB LBO would therefore require less loss-absorbing capacity than recapitalizations in the context of an SPOE GISB resolution because (i) the capital levels at the start of the process would be higher and (ii) the ending capital levels would be lower. The calibration of any long-term debt requirement should reflect this fact and be appropriate for its purpose.

D. Other Guiding Principles

- **Categorization.** The Agencies should use the existing framework, which is designed to reflect the differing size and risk profiles of institutions, to determine the scope of application of any potential long-term debt requirements. Any further consideration of GSIB-like resolution-related requirements should not undermine the existing framework for assigning firms to Categories I through IV and therefore should not "sub-categorize" institutions within existing categories. "Sub-categorizing" institutions within existing categories would create a more complex regulatory structure without any corresponding safety and soundness or other benefits.

- **U.S. Subsidiaries of Foreign Banking Organizations.** IDI subsidiaries of IHCs of foreign GSIBs should not be subject to any new long-term debt requirement. As the ANPR notes, the parent U.S. holding companies of these IDIs are already subject to long-term debt requirements. Any further requirements, such as an IDI-level long-term debt requirement, would result in duplicative and potentially inconsistent regulatory requirements. More generally, the Agencies should not apply GSIB-like requirements to the U.S. operations of foreign GSIBs based solely on the status of those operations as relating to a foreign GSIB. Currently, any IHC of a foreign GSIB is subject to TLAC and long-term debt requirements, irrespective of the characteristics and risk profile of the

[35] Federal Reserve, 82 Fed. Reg. 8,266, 8,270 (Jan. 24, 2017) (emphasis added).

IHC.[36] Considering the smaller size and risk profile of IHCs, and consistent with the Financial Stability Board's TLAC Term Sheet,[37] the internal TLAC requirement for IHCs of foreign GSIBs that follow an SPOE resolution strategy should be recalibrated to 75% of the external TLAC requirements applicable to domestic GSIBs. Just as non-GSIB LBOs should not be subject to a GSIB-like long-term debt requirement, IHCs of foreign GSIBs that do not present GSIB-equivalent systemic risk to the U.S. financial system should not be subject to GSIB-like resolution-related standards.

- **Potential Effects of Long-Term Debt Requirement.** As the Agencies recognize, a long-term debt requirement could impact the cost and availability of credit.[38] In addition, as noted in Section I above, a long-term debt requirement could create safety and soundness concerns by reducing non-GSIB LBOs' reliance on deposits, which are a stable source of funding. A long-term debt requirement could harm financial stability by increasing procyclicality and thereby aggravating the speed and severity of a financial downturn. Imposing a long-term debt requirement could further harm financial stability by driving more activity to lightly regulated (or not regulated at all) non-bank providers rather than heavily regulated banks as banks must increase the costs of their products and services to match their increased costs of funding.

- **Governance Mechanisms.** The Agencies should not mandate additional particular governance mechanisms relating to timing of entry into resolution. The existing framework—including the prompt corrective action framework and the broad grounds under the FDIA for the appointment of a receiver—is sufficient to permit regulators and the FDIC, as receiver, to commence resolution for an IDI at an appropriate time. Here too, imposing GSIB-based resolvability requirements on non-GSIB LBOs, such as requirements relating to governance mechanisms designed to trigger resolution when eligible debt is available, would de facto move them to an SPOE resolution strategy and would contradict the resolution optionality statutorily granted to these institutions and recognized in the FDIC's IDI resolution planning rule.

- **Clean Holding Company Requirements.** The agencies should not adopt "clean holding company" requirements for non-GSIB LBOs. A clean holding company requirement was developed for an SPOE resolution regime, including qualifying debt being issued at the holding company level.[39] For the reasons previously discussed, an SPOE requirement should not be imposed on non-GSIB LBOs, and non-GSIB LBOs should have the optionality of issuing debt at the IDI level. Therefore, there should be no need for a clean holding company.[40]

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36 *See* 12 C.F.R. § 252.160(a) ("This subpart applies to a U.S. intermediate holding company that is required to be established pursuant to § 252.153 and is controlled by a global systemically important foreign banking organization (Covered IHC).").

37 *See* Financial Stability Board, Total Loss-absorbing Capacity (TLAC) Term Sheet, (Nov. 9, 2015).

38 ANPR, 87 Fed. Reg. at 64,172.

39 *See* 67 Fed. Reg. 64,170, 64,172 (Oct. 24, 2022).

40 Further, the "clean holding company" requirements are meant to "enhance resiliency by reducing complexity and reliance on short-term funding" and "support the orderly resolution of a covered BHC and covered IHC." Federal Reserve, 82 Fed. Reg. at 8,272 . When applied to a public top-tier holding company, these requirements are overbroad in light of this purpose. For example, the existing

- **Separability Requirements.** LBOs, including GSIBs, already perform separability analyses in connection with existing resolution planning requirements.[41] The analyses expected by the Agencies correspond with firms' respective risk profiles and resolution strategies. For example, in addition to the requirements that are generally applicable to LBOs, the Final Guidance for 2019 165(d) Resolution Plans (the "2019 GSIB Guidance")[42] describes the Agencies' GSIB resolution plan expectations regarding separability, including divestiture options, corresponding execution plans, and an impact assessment.[43,44] No further requirements should be imposed, especially given existing requirements and expectations and the acknowledgement in the 2020 guidance on resolution plans for foreign banking organizations that the inclusion of a separability analysis in foreign banking organizations' resolution plans "has yielded limited new insights."[45]

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We appreciate the opportunity to comment on the Agencies' ANPR. If you have any questions, please contact the undersigned by email at John.Court@bpi.com or by phone at (202) 589-2409.

Sincerely,

John Court
Executive Vice President & General Counsel
Bank Policy Institute

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restrictions on qualified financial contracts at the parent-company level have proven to be over-broad and impracticable for public top-tier holding companies. These restrictions apply to, among other things, any contract for the purchase or sale of a security. The breadth of the restrictions has necessitated relief in order for GSIBs to be able to, among other things, enter into underwriting agreements with third-party broker-dealers in connection with the issuance of long-term debt or engage in tender or exchange offers in connection with their LIBOR remediation strategies.

41 *See* 12 C.F.R. § 243.3(c)(5); 12 C.F.R. §360.10(c)(2)(viii); FDIC, *Statement on Resolution Plans for Insured Depository Institutions*, 6 (June 25, 2021), *available at* https://www.fdic.gov/resources/resolutions/resolution-authority/idi-statement-06-25-2021.pdf.

42 84 Fed. Reg. 1438 (Feb. 4, 2019).

43 *Id.* at 1455.

44 In response to public comment, the Agencies modified the proposed guidance to eliminate the expectation that GSIBs maintain active data rooms for divestiture options, in favor of an expectation that GSIBs have the capability to populate data rooms. *Id.* at 1446-1447, 1455.

45 Federal Reserve, 85 Fed. Reg. 83,557, 83,567 (Dec. 22, 2020).