January 16, 2024

Via Electronic Mail

Chief Counsel's Office
Attention: Comment Processing, Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E-218
Washington, DC 20219

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

Mr. James P. Sheesley
Assistant Executive Secretary
Attention: Comments/Legal OES
(RIN 3064-AF86)
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Re: Long-Term Debt Requirements for Large Bank Holding Companies, Certain Intermediate Holding Companies of Foreign Banking Organizations, and Large Insured Depository Institutions: OCC Docket ID OCC-2023-0011; Federal Reserve Docket No. R-1815, RIN 7100-AG66; FDIC RIN 3064-AF86

Dear Sirs and Madams:

We value the opportunity to comment on the proposed joint rulemaking by the Board of Governors of the Federal Reserve System (the "Federal Reserve"), the Federal Deposit Insurance Corporation (the "FDIC"), and the Office of the Comptroller of the Currency (the "OCC" and, together with the Federal Reserve and the FDIC, the "Agencies") on long-term debt ("LTD")

requirements (the "LTD Proposal").[1] This letter expresses the collective views of: Ally Financial Inc., Detroit, Michigan; Citizens Financial Group, Inc., Providence, Rhode Island; Discover Financial Services, Inc., Riverwoods, Illinois; Fifth Third Bancorp, Cincinnati, Ohio; First Citizens Bancshares, Inc., Raleigh, North Carolina; Huntington Bancshares Incorporated, Columbus, Ohio; KeyCorp, Cleveland, Ohio; New York Community Bancorp, Inc., Hicksville, New York; and Regions Financial Corporation, Birmingham, Alabama (the "Responding Banking Organizations"), highlighting specific concerns of Category IV banking organizations.[2]

The LTD Proposal was proposed on July 27, 2023 and published for comment on September 19, 2023 along with (a) a proposal by the Agencies to implement major changes to the current U.S. Basel III capital rules (the "Basel III Endgame Proposal")[3] and (b) a proposal by the FDIC to make major changes to the FDIC's resolution planning rule[4] (the "Resolution Planning Proposal"[5] and, together with the LTD Proposal and the Basel III Endgame Proposal, the "Three Proposals").

The Responding Banking Organizations consist primarily of traditional regional banking organizations focused predominantly on domestic business activities. Each of the Responding Banking Organizations and other domestic Category IV banking organizations have relatively simple operating models and none engage in significant trading or international activities or have meaningful interconnections with other financial firms. The domestic Category IV banking organizations, including the Responding Banking Organizations, are integral to the Main Street economy, but are less complex and much less likely to pose a systemic risk to the U.S. financial system than Category I-III banking organizations. Overall, the domestic Category IV banking organizations have total assets that are only ~13% of the total asset of Category I banking organizations (~10% of the total assets of Category I-III banking organizations) and total deposits that are only 18% of the total deposits of Category I banking organizations (~14% of the total deposits of Category I-III banking organizations). Although Silicon Valley Bank, First Republic Bank and Signature Bank demonstrated that banking organizations with less than $250 billion in assets can pose risks, those three institutions all had unique features that created undue exposure and made them very different from the Responding Banking Organizations

[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. 64,524 (Sept. 19, 2023). Comments provided for: Federal Reserve Docket No. R-1815, RIN 7100-AG66; FDIC RIN 3064-AF86; and OCC Docket ID OCC-2023-0011.

[2] Category IV banking organizations refer to those U.S. banking organizations with total consolidated assets of $100 billion or more that, because they have consolidated assets of less than $250 billion and have less than $75 billion in weighted short-term wholesale funding, non-bank assets, or off-balance sheet exposure are not assigned to a higher category (*i.e.*, Category I, II and III) under the Federal Reserve's tailored framework for regulatory capital and liquidity requirements.

[3] Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity, 88 Fed. Reg. 64,028, 64,168 (Sept. 18, 2023). Notice of the Basel III Endgame Proposal was originally made in July 2023. *See*, *e.g.*, Notice of Proposed Interagency Rulemaking on Amendments to the Regulatory Capital Rule Applicable to Large Banking Organizations and to Banking Organizations with Significant Trading Activity, FDIC FIL-38-2023 (July 27, 2023).

[4] 12 C.F.R. § 360.10.

[5] Resolution Plans Required for Insured Depository Institutions With $100 Billion or More in Total Assets; Informational Filings Required for Insured Depository Institutions With at Least $50 Billion But Less Than $100 Billion in Total Assets, 88 Fed. Reg. 64,579 (Sept. 19, 2023).

(*e.g.*, rapid growth in deposits that outstripped their ability to productively deploy funding through diverse lending activity, resulting in large interest-sensitive portfolio exposures; rapid business growth that outstripped their ability to enhance corporate governance and risk management to levels commensurate with their size; overwhelming reliance on uninsured deposits; and concentrated business models with higher-risk customers).

It is far from clear that an LTD requirement would have prevented any of these three banks from failing, but it is very clear that the costs imposed by the LTD Proposal – even without taking into account the enhanced costs that will result from the impact of the Basel III Endgame Proposal – will adversely impact the availability and pricing of lending and other banking products. The Responding Banking Organizations are an important source of credit within our respective operating footprints and to the financial lives of the many consumers and small- and mid-size businesses that we serve. Although the Responding Banking Organizations support thoughtful responses to the failures in early 2023, we believe that the cost of the LTD Proposal to our communities and customers would significantly outweigh any potential benefits.

As discussed in Section I, the Agencies should repropose the Basel III Endgame Proposal after the publication of the quantitative impact study results of the Federal Reserve's recently announced quantitative impact study with respect to the Basel III Endgame Proposal (the "Quantitative Impact Study").[6] The Agencies should then repropose the LTD Proposal after *both* (a) a rule to implement the Basel III endgame has been finalized and (b) the Agencies have conducted a holistic review of the combined impact of all Three Proposals and any of the publicized potential changes to liquidity and/or interest rate risk management frameworks.

As discussed in Section II, the Agencies should exclude Category IV banking organizations altogether from any LTD and clean holding company ("CHC") requirements and focus instead on appropriately tailored capital and liquidity requirements for these organizations. Alternatively, if Category IV banking organizations are in scope, we recommend the following to more appropriately tailor the LTD and CHC requirements to any systemic risks posed by Category IV banking organizations:

(a) The Agencies should replace the current LTD requirements for Category IV banking organizations with more tailored requirements that take into account the characteristics of Category IV banking institutions and that are focused on minimizing the risk of loss to the Deposit Insurance Fund (the "DIF") in a resolution proceeding.

(b) The Agencies should give Category IV banking organizations the flexibility to meet their LTD requirement at either the parent bank holding company ("BHC") level or at the insured depository institution ("IDI") level, but not require both. Furthermore, the Agencies should permit a Category IV banking organization to satisfy any LTD requirement at the IDI level by any combination of: (i) an internal debt issuance, (ii) an external debt issuance or (iii) through holding a

[6] *See* Joint Press Release, Federal Reserve Board launches data collection to gather more information from the banks affected by the large bank capital proposal it announced earlier this year (Oct. 20, 2023).

deposit pledged by the parent BHC, which deposit may not be withdrawn if such a withdrawal could reasonably be expected to result in the IDI failing to meet its LTD requirements.

(c) The Agencies should give credit under the LTD requirement for certain other types of capital and liquidity that protect the DIF.

(d) The Agencies should exempt those Category IV banking organizations that have non-single point of entry ("non-SPOE") resolution strategies from the CHC requirements.

(e) If the Agencies impose CHC requirements on Category IV banking organizations with non-SPOE resolution strategies, then the Agencies should prohibit only upstream guarantees and offset rights.

(f) The Agencies should provide additional exemptions under the CHC requirements for certain transactions that could potentially involve qualified financial contracts ("QFCs") and yet do not implicate the policy concern underlying the prohibition on third-party QFCs.

As discussed in Section III, because LTD is generally more expensive than the short-term funding banking organizations could otherwise use, the LTD Proposal is likely to raise funding costs in the long run – particularly for Category IV banking organizations. This additional cost would reduce the ability of BHCs and IDIs to increase their capital ratios in preparation for any final rule to implement the Basel III endgame. Accordingly, banking organizations would need to make more impactful changes to their lending activity to comply with the new rules, which would, in turn, potentially reduce credit availability and raise costs for borrowers.

Furthermore, the transition periods to implement the final rules to implement the Basel III Endgame Proposal and the LTD Proposal should run consecutively, rather than concurrently, to allow banking organizations to prioritize raising their capital ratios through common equity tier 1 ("CET1") capital accretion or otherwise without the increased funding costs related to the issuance of new LTD (*i.e.*, the first year of the transition period for any new LTD requirements would begin following the end of the transition period for any final rule to implement the Basel III endgame).

As discussed in Section IV, we recommend that the Agencies revisit the LTD requirements periodically to make sure that they are serving their intended purpose and are not unduly burdensome when considered holistically with other regulatory requirements and are consistent with safety and soundness principles.

In addition to the comments in this letter, the Responding Banking Organizations also support the comments submitted on the LTD Proposal by the American Bankers Association and by the Bank Policy Institute (the "BPI").

I. The Agencies should conduct a holistic review of the LTD Proposal in conjunction with other expected rulemakings and issue a revised proposed rulemaking only at the conclusion of that review.

A. Lack of consideration of the effect of the Basel III Endgame Proposal.

The Agencies acknowledge that they did not consider the potential effects of the Basel III endgame rules in their LTD Proposal, noting that, if adopted as proposed, the Basel III endgame revisions would "lead mechanically to increased requirements for LTD under the LTD proposal."[7] Significantly, the LTD Proposal understates the amount of LTD required because risk-weighted assets ("RWAs") for covered entities are only calculated under the current rules, rather than on the increased RWAs generally resulting from the proposed expanded risk-based approach.[8]

The Agencies have also not analyzed the interrelationship between the two proposals in terms of overall costs, whether and how either proposal should factor into the design or calibration of the other, or otherwise. For example, the Agencies assert that the changes brought on by Basel III "could . . . reduce the cost of various forms of debt for impacted firms due to the increased resilience that accompanies additional capital."[9] However, the Agencies provide no analysis to support this assertion, nor do they account for the potential increased cost of debt because numerous banking organizations will need to be in the market for external debt at the same time to meet the LTD requirement that will be imposed under the LTD Proposal.

B. Need to consider liquidity rule and interest rate risk management changes.

In addition, the Agencies have publicly stated their intent to propose changes to the liquidity enhanced prudential standards ("EPS") and have communicated to Category IV banking organizations that they will likely be required to maintain higher levels of liquidity under the revised liquidity EPS.[10] The LTD Proposal does not discuss or analyze the incremental debt that Category IV banking organizations may need to raise to satisfy those enhanced liquidity EPS requirements. The Agencies have also indicated that there may be changes in interest rate risk management requirements. The Agencies should not finalize a rule to implement the LTD Proposal until the liquidity rules and interest rate management changes are finalized.

[7] LTD Proposal, *supra* note 1, at 64,551.
[8] The Agencies have estimated that, under the proposed expanded risk-based approach, RWAs would be approximately $2.2 trillion higher than under the Standardized Approach: approximately $1.8 trillion higher for Categories I and II banking organizations and approximately $400 billion higher for Categories III and IV banking organizations. *See* Basel III Endgame Proposal, *supra* note 3, at 64,168.
[9] LTD Proposal, *supra* note 1, at 64,551.
[10] *See, e.g.*, Statement of Federal Reserve Vice Chairman Michael S. Barr before the U.S. Senate Committee on Banking, Housing, and Urban Affairs (Mar. 28, 2023) ("[Silicon Valley Bank] failed because the bank's management did not effectively manage its interest rate and liquidity risk . . . . [W]e are evaluating whether application of more stringent standards would have prompted the bank to better manage the risks that led to its failure. We are also assessing whether . . . higher levels of capital and liquidity would have forestalled the bank's failure or provided further resilience to the bank.").

C. Need to reconsider cost estimates.

As part of the holistic review, the Agencies also need to reexamine and recalibrate their cost estimates in the LTD Proposal. Applying the "incremental shortfall approach," which assumes the current reported principal amount of LTD issuances at covered entities is a reasonable proxy for the level of such debt that would be maintained in future periods in the absence of the LTD Proposal, the Agencies estimate that the affected banking organizations would need to issue approximately $70 billion of LTD during the proposed rule's three-year phase-in period if the rule is adopted as currently proposed. For Categories II and III banking organizations, the Agencies estimate that the aggregate total shortfall is approximately $20 billion; for Category IV banking organizations, the Agencies' estimated aggregate total shortfall is approximately $50 billion.[11]

Unfortunately, these estimates fall far short of the actual amount of LTD that would need to be issued by Category IV banking organizations.[12] We have already discussed in Section I.A above that the amount of RWAs would materially increase under the Basel III Endgame Proposal for many banking organizations. This, in turn, will increase how much LTD would need to be issued. Similarly, as we discussed in Section I.B above, the LTD Proposal does not discuss or analyze the incremental debt that Category IV banking organizations may need to raise to satisfy enhanced liquidity EPS requirements or the potential changes in interest rate risk management requirements. Further, as discussed below, the LTD Proposal neglects to consider costs related to downstreaming and ignores the fact that banking organizations operate with management buffers, and thus the true cost is not the cost of LTD equal to 6% of RWAs but the cost of LTD equal to the required threshold plus a significant buffer.

Downstreaming would impose significant costs on Category IV banking organizations. The Agencies estimate that Category IV banking organizations would need to issue approximately $50 billion of LTD during the proposed rule's three-year phase-in period assumes that it will be costless both to (a) substitute external holding company debt for IDI-issued debt and (b) downstream resources from the parent BHC to its IDI through internal debt securities to fulfill the requirements of the LTD Proposal and general funding needs. However, these assumptions are faulty because they do not account for the actual costs for (i) the Category IV banking organization to downstream LTD from the parent BHC to its subsidiary IDI, (ii) the BHC to maintain deposits, including demand deposits, with its IDI subsidiary in light of BHC liquidity, rating agency and Regulation W[13] requirements, and (iii) other considerations, such as hedging.

Under the LTD Proposal, BHCs will use cash raised through external debt issuance at the parent BHC to purchase debt issued by the IDI to the BHC to satisfy the IDI's LTD requirements. In this regard, the preamble to the LTD Proposal states: "In practice, the proceeds raised by the issuance of eligible LTD by a [parent BHC] would generally be 'downstreamed' to its . . . IDI subsidiary in return for eligible internal LTD that would satisfy such [parent

[11] LTD Proposal, *supra* note 1, at 64552.
[12] Indeed, in their comment letter, BPI estimates that the actual LTD shortfall for Category IV banking organizations under the LTD Proposal requirements would be more than double the Agencies' estimates.
[13] 12 C.F.R. § 223.14(b)(1)(i)(D).

BHC's] own eligible LTD requirement."[14] As such, none of the proceeds from external issuance to satisfy an IDI's LTD requirement can be used for a parent BHC's liquidity needs.

This back-to-back requirement means that incremental debt issuances at the parent level will be required to meet parent company liquidity needs. Further, Category IV banking organizations, with their generally simpler business model that has the lion's share of assets in the IDI, are particularly negatively impacted because they have to issue a comparatively higher amount of BHC-level debt to maintain parent liquidity.

LTD Proposal cost estimates are also understated because the Agencies did not consider increased hedging costs given increased reliance on long-term, fixed-rate debt to meet LTD requirements. In order to prudently manage interest rate risk, Category IV banking organizations are likely to incur more hedging costs as deposit funding is displaced by long-term fixed-rate debt to meet LTD requirements, expected changes to liquidity EPS requirements, and potential changes to interest rate risk requirements. The combined effect of these factors is that Category IV banking organizations will incur materially more costs than estimated by the Agencies, which will mean greater-than-anticipated effects on their net interest margins and on their earnings.

Finally, as noted above, the Agencies should consider that BHCs and IDIs will – as a practical matter – need to maintain LTD above the specified minimum threshold. BHCs and IDIs will need a management buffer above the required amount to ensure that they do not fall below minimum requirements due to business-as-usual fluctuations in balance-sheet size and asset composition. In addition, BHCs and IDIs will need a buffer that accounts for potential market downturns and LTD maturities. Depending on economic and market conditions, it is conceivable that actual LTD held under the LTD Proposal would be as much as 25-30% higher than the minimum LTD amounts.

D. Recommendations.

1. *The Agencies should repropose the LTD Proposal after a rule to implement the Basel III endgame has been finalized and the Agencies have conducted a holistic review of the combined impact of all Three Proposals and any of the publicized potential changes to liquidity and/or interest rate risk management frameworks.*

The failure of the Agencies to consider each of the Three Proposals and related liquidity rules and interest rate risk holistically could cause material unintended consequences, such as imposing undue increased costs on Category IV banking organizations, thereby making them less, rather than more, safe and sound and increasing, rather than decreasing, the risk to the DIF. Further, this will necessarily have adverse impacts on the availability and pricing of lending and

[14] *See* LTD Proposal, *supra* note 1, at 64,531. We do not interpret the quoted preamble language to mean that a banking organization would be required to satisfy its IDI's LTD requirements by issuing external debt at the BHC level and downstreaming the proceeds. For example, if a banking organization holds excess cash at the parent BHC level, then the banking organization could satisfy some or all of the IDI's LTD requirements by putting excess cash into the IDI as debt without necessarily issuing a corresponding amount of external LTD at the BHC level.

other banking products, which could make less credit to be available to qualified individuals and small- and medium-sized businesses, thereby harming the U.S. economy on a local, regional or national basis.

When the Agencies recently extended the comment period on the Basel III Endgame Proposal to January 16, 2024, the Federal Reserve announced that it would conduct the Quantitative Impact Study with respect to the Basel III Endgame Proposal and make the results public. The Agencies should repropose the Basel III Endgame Proposal after the publication of the Quantitative Impact Study. Only after (a) a rule to implement Basel III endgame has been finalized and (b) the Agencies have also conducted a holistic review of the combined impact (including the quantitative impact) of the Three Proposals and any revised liquidity requirements and any changes to interest rate risk management frameworks should the Agencies repropose an LTD Proposal regarding the LTD requirements for banking organizations.

2. The Agencies should extend the comment period on the current LTD Proposal.

The comment period on the Basel III Endgame Proposal and the LTD Proposal should be extended until at least a period of time after the results of the Quantitative Impact Study are made public. Without the results of the Quantitative Impact Study, banking organizations are unable to fully analyze and respond to the study results.

II. The Agencies should tailor the LTD requirements, as required by statute, to reduce unnecessary burden on Category IV banking organizations.

A. Tailoring requirements.

Section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), as amended by the 2018 Economic Growth, Relief, and Consumer Protection Act, (a) requires the application of EPS to BHCs with $250 billion or more in total consolidated assets, and (b) authorizes the Federal Reserve to apply EPS through a "tailored application" to banking organizations with assets between $100 billion and $250 billion, taking into consideration their capital structure, riskiness, complexity, financial activities, size and any other risk factors that the Federal Reserve deems appropriate.[15] Indeed, the statute provides that, if the Federal Reserve applies EPS to banking organizations below $250 billion, then it "shall . . . differentiate amongst companies on an individual basis or by category," in prescribing prudential standards.[16]

In 2016, the Federal Reserve adopted the Total Loss Absorbing Capacity Rule (the "TLAC Rule") that became fully effective in 2019. The TLAC Rule applies to the top-tier parent companies of the U.S. GSIBs (*i.e.*, to the top-tier parent companies of Category I banking organizations) and imposes (a) TLAC requirements (TLAC consists of Tier 1 capital and eligible LTD), (b) separate eligible LTD requirements and (c) CHC requirements that limit or prohibit (i) the issuance of short-term debt to external investors and (ii) the entry into certain derivatives

[15] 12 U.S.C. § 5365.
[16] 12 U.S.C. § 5365(a)(2)(A).

and certain other types of financial contracts with external counterparties.[17] The LTD Proposal would expand the reach of the LTD and CHC portions of the TLAC Rule to all U.S. banking organizations with $100 billion or more in total assets (*i.e.*, to all Category II, III and IV banking organizations), with no differentiation (*i.e.*, with no tailoring) for organizations in those three categories. Specifically, under the LTD Proposal, Category II, III and IV banking organizations would all, for the first time, be required to maintain:

- *at the BHC level*, outstanding eligible *external* LTD of no less than the greatest of: (i) 6% of RWAs; (ii) 2.5% of total leverage exposure, if subject to the supplemental leverage ratio; and (iii) 3.5% of average consolidated assets; and

- *at the IDI level*, outstanding eligible *internal* LTD in the same amount as above.[18]

In 2019, the Agencies issued the final tailoring rules (the "Tailoring Rules") establishing four categories for determining the applicability and stringency of the EPS:

- Category I – U.S. globally systemically important banks ("GSIBs");
- Category II – Banking organizations with *either* at least $700 billion in total assets *or* at least $75 billion in cross-jurisdictional activity;
- Category III – Banking organizations with *either* at least $250 billion in total assets *or* at least $75 billion in weighted short-term wholesale funding, nonbank assets, or off-balance sheet exposure; and
- Category IV – Banking organizations with at least $100 billion in total assets.[19]

It has been estimated that the LTD Proposal would be more punitive than TLAC at more than half of Category IV banking organizations on its face, thus effectively requiring greater relative liquidity at Category IV banking organizations than at the Category I banking organizations that have been designated as globally systemically important – a result that runs contrary to tailoring as well as basic policy objectives. Furthermore, as noted above, Category IV banking organizations are not positioned the same as Category I-III firms in the eyes of the market. Therefore, the LTD Proposal effectively places Category IV banking organizations at a competitive disadvantage versus their much larger counterparts by increasing their funding cost which, in turn, impacts their net interest margin and overall return on tangible common equity.[20] It is unclear why the Agencies would take action to undermine the ability of the large regional banks to compete with the much larger superregional and national banking organizations.

The unduly high costs imposed by the LTD Proposal would have meaningful consequences for Category IV banking organizations and consumers alike, making it more difficult for regional

[17] 82 Fed. Reg. 8266 (Jan. 27, 2017); 12 C.F.R. part 252, subparts G and P.
[18] The TLAC Rule also currently applies the U.S. intermediate holding companies of foreign GSIBs. The LTD Proposal would extend the LTD requirements of the TLAC to the IDIs of such intermediate holding companies that have $100 billion or more of total consolidated assets.
[19] *See* Federal Reserve, 84 Fed. Reg. 59,032 (Nov. 1, 2019), and Federal Reserve, FDIC and OCC, 84 Fed. Reg. 59230 (Nov. 1, 2019).
[20] *See* Haelim Anderson, Francisco Covas, and Felipe Rosa, "The Long-Term Debt Proposal and Bank Profitability" (Dec. 7, 2023), available at https://bpi.com/the-long-term-debt-proposal-and-bank-profitability/.

banks to offer competitively priced traditional banking services relied upon by a wide range of consumers and communities. Harvard professor and former Federal Reserve Board member Daniel Tarullo emphasized the risks that heightened regulatory requirements pose to mid-sized regional banks, which include several of the Responding Banking Organizations.[21] Professor Tarullo describes the risk that more stringent regulations will create a less competitive and more concentrated industry.[22]

Further, applying essentially the same LTD requirements to all banking organizations with $100 billion or more in total assets, without any consideration of the statutory tailoring factors, would heighten the "cliff effects" associated with crossing the $100 billion asset threshold.[23] Specifically, the high costs imposed on Category IV banking organizations by the LTD Proposal costs would adversely impact competition by acting as a significant deterrent to growth in U.S. banking institutions that are below $100 million but approaching the limit. By penalizing growth, including organic growth in the "near $100 billion" banking organizations, the LTD Proposal would necessarily reduce the competitiveness of such near-Category IV banking organizations.

As discussed below, the Agencies should revise the LTD Proposal to make significant differentiation in the treatment of banking organizations in Categories II, III and IV, consistent with the letter and spirit of Section 165 of the Dodd-Frank Act and consistent with the spirit of the Tailoring Rules.

B. <u>Basis for tailoring LTD requirements for Category IV banking organizations</u>.

In 2019, when the Agencies finalized the EPS standards for Category IV banking organizations under the Tailoring Rules, they appropriately explained that the requirements were less restrictive than those applicable to Category I, II and III banking organizations to "align with the scale and complexity of those banking organizations" and reflect "the lower risk profile of those banking organizations relative to other banking organizations with $100 billion or more in total assets."[24] This differentiation was fundamentally sound because Category IV banking organizations are, by definition, smaller in size (*i.e.*, under $250 billion) than Category I, II and III banking organizations and objectively non-complex (*i.e.*, they must have less than $75 billion in each of (a) weighted short-term wholesale funding, (b) nonbank assets and (c) off-balance sheet exposure). In addition, Category IV banking organizations generally have fewer material operating entities than larger organizations and simpler IDI-centric business models focused on domestic lending and deposit-gathering activities.

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[21] David Wessel, *Talking to Dan Tarullo About Bank Mergers, Stress Tests, and Supervision*, Hutchins Center on Fiscal & Monetary Policy at Brookings (Aug. 10, 2023), https://www.brookings.edu/wp-content/uploads/2023/08/Talking-to-Dan-Tarullo-about-bank-mergers-stress-tests-and-supervision.pdf.
[22] *See generally id.*
[23] Such "cliff effects" could curtail the growth of banking organizations, suppress acquisition activity, harm competition, limit the cost and availability of credit, and constrain the extent of mortgage servicing activity. Also, research published by the American Economic Association has found that regulatory cliff effects can heighten systemic risk. *See generally* Andreas Brogger & Graeme Cokayne, Regulatory Cliff Effects and Systemic Risk, American Economics Association (2018).
[24] 82 Fed. Reg. 59,032, 59,035 (Nov. 1, 2019).

Further, larger banking organizations, including Category I firms, typically have submitted resolution plans indicating that they have several material operating entities that would be recapitalized in a resolution situation through an SPOE resolution strategy.[25] Currently, all U.S. GSIBs have adopted SPOE resolution strategies.

A banking organization relying on an SPOE resolution strategy will keep its IDI solvent in resolution. Under an SPOE strategy, the parent BHC pre-positions and maintains additional capital and liquidity resources which would be distributed to its IDI and other material entities immediately before the parent BHC enters bankruptcy and during the resolution period from a funding entity. The operating subsidiaries would then continue in business uninterrupted outside of the parent BHC's bankruptcy proceedings, helping to preserve their going-concern value. In contrast, Category IV banking organizations have, in general, adopted a non-SPOE resolution strategy and would likely be resolved under a non-complex Federal Deposit Insurance Act ("FDIA") resolution proceeding.

C. Recommendations.

In light of the factors discussed above, and in order to more appropriately calibrate the LTD and CHC requirements to any systemic risks posed by Category IV banking organizations and the requirements already imposed on them, we recommend that the Agencies exclude Category IV banking organizations altogether from any LTD and CHC requirements and focus instead on appropriately tailored capital and liquidity requirements.

If Category IV banking organizations are not excluded altogether from any LTD and CHC requirements, then we recommend that the Agencies make the changes detailed below.

1. Replace the current LTD requirements for Category IV banking organizations with a less onerous requirement better focused on minimizing the risk of loss to the DIF in a resolution proceeding.

The current LTD requirements are fundamentally flawed as applied to Category IV banking organizations, particularly those with a non-SPOE resolution strategy. Under the LTD Proposal, LTD operates as a *de facto* form of deposit insurance, as the LTD Proposal would transfer losses that would otherwise be incurred by uninsured depositors in a resolution of the banking organization to the holders of the banking organization's LTD. In this context, FDIC Chair Gruenberg has stated that he believes that imposing losses on uninsured depositors can trigger banking runs and that an expanded LTD requirement would help prevent that outcome.[26]

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[25] Section 165(d) of the Dodd-Frank Act, 12 U.S.C. § 5365(d), requires certain nonbank financial companies and BHCs with total consolidated assets of $250 billion or more to submit resolution plans periodically to the FDIC, the Federal Reserve, and the Financial Stability Oversight Council. In addition, the Federal Reserve may apply any EPS (including the Section 165(d) resolution plan submission requirement) to any firm with total consolidated assets of $100 billion or more, but less than $250 billion, if it makes certain determinations. A non-SPOE resolution strategy covers both banking organizations with a resolution strategy involving an FDIA receivership and banking organizations not subject to the Section 165(d) planning process.

[26] Martin Gruenberg, *The Resolution of Large Regional Banks and Lessons Learned* (Aug. 14, 2023).

As discussed above, Category IV banking organizations generally have IDI-centric business models and their IDIs would likely be resolved under a non-SPOE resolution strategy under an FDIA proceeding. For such organizations, the purpose of the LTD requirement should be to (a) minimize losses to the DIF and (b) provide the FDIC, as receiver, with flexibility in resolving the failed IDI. There would be no need to recapitalize the IDI to the higher level necessary for the IDI to remain a solvent going-concern operating outside the resolution proceeding.

Of the three LTD requirement measures in the LTD Proposal (RWAs, leverage and consolidated assets), the RWAs measure will be the greatest of the three measures for most Category IV banking organizations and thus be the driver of the amount of LTD required at both the BHC and IDI levels. The 6% requirement is designed to provide capacity for *full recapitalization* of an IDI in resolution, inclusive of a conservation buffer (7% CET1, assuming a 1% reduction in RWAs leading to resolution). As such, the 6% requirement is both unduly onerous and unnecessary. Instead, the Agencies should base their LTD requirements on the objective that there should be adequate cushion to protect against loss to the DIF in an FDIA proceeding. We support the recommendations and detailed analysis contained in the BPI comment letter regarding the best appropriate calibrations for each of the three measures.

The cost of debt issuances is particularly impactful on Category IV banking organizations. The BPI recently noted that, on average, over the last 15 years, investors demand a spread that is 81 basis points higher for Category IV firms compared to Category II and III banking organizations.[27] Moreover, during times of market stress, the BPI noted that bond spreads for Category IV banking organizations tend to rise more sharply than for those of Category II and III banking organizations, leading to significantly increased costs when Category IV banking organizations access the bond market in such periods. Forcing Category IV banking organizations to absorb such inflated borrowing costs without a demonstrated need to do so would impose undue costs on banking organizations and undermine safety and soundness principles – both on an individual-institution basis and systemically across the industry.

2. *Category IV banking organizations should have the flexibility to meet their LTD requirement at either the parent BHC level or at the IDI level, but not be required to meet it at both levels. Furthermore, an IDI should be able to satisfy a requirement at its level by any combination of: (i) internal debt issuance, (ii) external debt issuance or (iii) through holding a deposit pledged by the parent BHC, which deposit may not be withdrawn if such a withdrawal could reasonably be expected to result in the IDI failing to meet its LTD requirements.*

Although the LTD Proposal would require that LTD be issued by the BHC, Category IV banking organizations, particularly because they are smaller, objectively non-complex and generally have IDI-centric business models, should have the flexibility to meet their LTD requirement at either the parent BHC level or at the IDI level, but not be required to meet it at

[27] Haelim Anderson, Francisco Covas, and Felipe Rosa, "The Long-Term Debt Proposal and Bank Profitability" (Dec. 7, 2023), available at https://bpi.com/the-long-term-debt-proposal-and-bank-profitability/.

both. Requiring Category IV banking organizations to issue internal LTD fails to recognize the diverse funding models under which they operate. Restructuring intercompany funding or changing issuing entities may cause serious disruption to the ongoing operations needed to maintain the banking organization on a sound basis. In this regard, an IDI issuing LTD has the potential to issue debt at a lower cost compared to the BHC. Also, the cost of issuing LTD may be more expensive than other forms of funding. These costs would potentially be passed onto consumers through higher fees or reduced services.

Furthermore, an IDI should be able to satisfy an LTD requirement at its level either by internal debt issuance, external debt issuance or through holding a deposit pledged by the parent BHC, which may not be withdrawn if such a withdrawal could reasonably be expected to result in the IDI failing to meet its LTD requirements.

If the Agencies are unwilling to do this for all Category IV banking organizations, then, as an alternative, the Agencies should impose only an IDI-level LTD requirement (and not also a BHC-level LTD requirement) on those Category IV banking organizations that have adopted a non-SPOE resolution strategy. As discussed above, Category IV banking organizations generally have IDI-centric business models and their IDIs would likely be resolved under a non-SPOE resolution strategy under an FDIA proceeding. For such organizations, the purpose of the LTD requirement would be to (a) minimize losses to the DIF and (b) provide the FDIC, as receiver, with flexibility in resolving the failed IDI. There would be no need to recapitalize the IDI to the higher level necessary for the IDI to remain a solvent going-concern operating outside the resolution proceeding. Accordingly, it is unnecessary for there to be liquidity protecting the DIF at the BHC level for Category IV banking organizations with an SPOE resolution strategy.

3. *Give credit for certain other types of capital and liquidity that protect the DIF.*

The Agencies should show flexibility in considering what is included in the numerator of the LTD requirement's measures. For example, we recommend that credit should be given for certain other types of capital and liquidity that protect the DIF, including:

- *CET1 and additional tier 1 ("AT1") capital in excess of that required to be well-capitalized under the Agencies' risk-based capital requirements.* To reflect that the LTD Proposal should require loss-absorbance capacity only to the extent required in an FDIC resolution, the Agencies should permit organizations to include in the LTD requirements CET1 and AT1 requirements in excess of that required to be well-capitalized under the Agencies' applicable risk-based capital rules.

  In this regard, it is important to recognize that the proposed LTD requirements cannot be met simply by converting existing equity to debt at the election of the banking organization. Neither BHCs nor IDIs can compel their equity holders to exchange their common or preferred stock for debt securities. Instead, a conversion would need to be effected through either (a) a *voluntary* exchange of equity securities for debt securities or (b) a recapitalization, such

as the issuance of debt to fund share repurchases. It would be more efficient, and equally effective for loss-absorbency purposes, and thus for protecting the DIF, to simply permit excess CET1 or AT1 equity to count towards the LTD requirements.

- *Excess liquidity beyond that required under existing liquidity regulations.* The Agencies noted that one of the purposes of the LTD Proposal is to reduce the speed and severity of bank runs, and limit the risk of contagion when a bank is under stress. Therefore, liquidity held by banks in excess of current (or future) regulatory requirements should be credited toward the LTD requirements of such banks.

4. *If the Agencies include Category IV banking organization in scope for the CHC requirements, then the Agencies should at least exempt those Category IV banking organizations that have non-SPOE resolutions strategies from the CHC requirements.*

Under the LTD Proposal, the Federal Reserve would apply CHC requirements, with the result that BHCs would, with certain exceptions, be permitted to enter into QFCs only with their own subsidiaries.[28] The proposed CHC requirements are similar to those applicable to U.S. GSIBs under the TLAC Rule. Under the Rule, the top-tier holding companies of U.S. GSIBs in order to improve resolvability are generally prohibited from entering into QFCs with a counterparty that is not a subsidiary of the holding company. The definition of QFCs includes securities contracts, commodity contracts, forward contracts, repurchase agreements, and swap agreements.

The Agencies should exempt Category IV banking organizations with non-SPOE resolution plans from the Proposed Rule's CHC requirements. These requirements were designed to facilitate the orderly resolution of BHCs using a SPOE resolution strategy and would not support an orderly resolution of an IDI using a non-SPOE resolution strategy. Accordingly, they are unnecessary for non-SPOE banking organizations.

5. *If the Agencies impose CHC requirements on Category IV banking organizations with non-SPOE resolution strategies, then the Agencies should prohibit only upstream guarantees and offset rights.*

If the Agencies do impose CHC requirements on Category IV banking organizations with non-SPOE resolution strategies, then the Agencies should place restrictions only on upstream guarantees and offset rights as those are the only items that the Agencies mention in the LTD Proposal where they believe that CHC requirements would be useful in the context of non-SPOE firms.[29]

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[28] In addition, the LTD Proposal would revise the TLAC Rule to align the CHC requirements applicable to the top-tier holding companies of U.S. GSIBs with the proposed CHC requirements for the top-tier holding companies of covered Holding Companies.

[29] *See* LTD Proposal, *supra* note 1, at 64,541.

6. The Agencies should provide additional exemptions under the CHC requirements for certain transactions that could potentially involve QFCs and yet do not implicate the policy concern underlying the prohibition on third-party QFCs.

The Agencies should also provide additional exemptions for certain transactions that could potentially involve QFCs and yet do not implicate the policy concern underlying the prohibition on third-party qualified financial contracts. The LTD Proposal notes that the Federal Reserve "has gained experience with agreements that may constitute QFCs and which the [Federal Reserve] believes may not present the risks intended to be addressed by the [CHC] requirements."[30] Based on this experience, the LTD Proposal would amend the CHC requirements to clarify that the prohibition on QFCs with third parties would not apply to (a) certain underwriting agreements, fully paid structure share repurchase agreements, employee and director stock options compensation agreements, and (b) other agreements that the Federal Reserve determines would not pose a material risk to orderly resolution of the banking organization or the stability of the U.S. banking or financial system. We support this clarification, which we understand to be a codification of exemptions that the Federal Reserve has previously provided to banking organizations that are already subject to the CHC requirements.

The term QFC includes a "securities contract," which is broadly defined to include, among other things, "a contract for the purchase, sale or loan of a security."[31] It is common for a BHC to engage in a variety of contracts for the purchase and sale of securities that – like underwriting agreements, fully paid structure share repurchase agreements, and employee and director compensation agreements – also do not implicate the policy concern underlying the prohibition on third-party QFCs. Accordingly, the Federal Reserve should provide additional exemptions for transactions that, given the wide breadth of the term "securities contract," could potentially involve QFCs, including for: tender offers; exchange offers; consent solicitations; share repurchases; agreements for the spot purchase or sale of securities; and strategic transactions and investments that involve stock purchase, merger or similar agreements.

III. Implementation and ongoing requirements.

The Agencies acknowledge that because LTD is "generally more expensive than the short-term funding banking organizations could otherwise use, the [LTD Proposal] is likely to raise funding costs in the long run."[32] This additional cost would reduce the ability of banking organizations to increase their capital ratios in preparation for any final rule to implement the Basel III endgame. Accordingly, banking organizations would need to make more impactful changes to their lending activity to simultaneously comply with the new rules, which would, in turn, potentially reduce credit availability and raise costs for borrowers. Further, Category IV banking organizations would need to issue debt in an unfavorable high interest rate environment while potentially having to raise significant amounts of new capital from the parallel capital proposal. In addition, favoring the issuance of LTD over other potentially efficient funding

[30] LTD Proposal, *supra* note 1, at 62,547.
[31] 12 U.S.C. 5390(c)(8)(D)(ii).
[32] LTD Proposal, *supra* note 1, at 64,552.

mechanisms may cause market distortions. Banking organizations benefit from a diverse mix of funding sources and this requirement would reduce their flexibility in optimizing their funding structure. An IDI issuing LTD has the potential to issue debt at a lower cost compared to the BHC.

To (a) facilitate the ability of organizations to increase their CET1 capital, (b) minimize harmful impacts to borrowers, and (c) spread out the potential negative impact of too many banking organizations tapping the debt and equity markets at the same time, we recommend that the Agencies coordinate the transition period for any new LTD requirements with the transition periods for any final rule to implement the Basel III Endgame. Specifically, the transition periods should run consecutively, rather than concurrently, to allow banking organizations to prioritize CET1 capital accretion without the increased funding costs related to the issuance of new LTD. Under this approach, the first year of the transition period for any new LTD requirements would begin following the end of the transition period for any final rule to implement the Basel III endgame. This approach would appropriately prioritize the increase of CET1, given its status as the most loss-absorbing form of capital, while also ensuring that banking organizations meet any new LTD requirements in a timely manner. Further, any other approach would prevent the Agencies and banking organizations from having a complete picture of the overall loss-absorbency requirements applicable to these organizations.

Additionally, under the current LTD Proposal, covered BHCs and covered IDIs would have three years to comply with the LTD requirements. Over that three-year period, they would need to meet 25% of their LTD requirement by one year after finalization of the rule, 50% after two years, and 100% after three years, without any tailoring for Category II, III and IV banking organizations. The proposed implementation schedule would cause many banking organizations to enter the debt market simultaneously, which could materially increase borrowing costs because of the higher amount of debt issuance and the increased funding cost per dollar of issuance. Therefore, we recommend extending the implementation schedule from three years to at least five years for Category IV banking organizations.

IV. Periodic review.

We recommend that the Agencies revisit the LTD requirements periodically to make sure that they are serving their intended purpose and are not unduly burdensome when considered holistically with other regulatory requirements and are consistent with safety and soundness principles. Such review would be particularly warranted to the extent that other new or revised regulations imposing compliance burdens on Category IV banking organizations are enacted.

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We appreciate the opportunity to comment on the LTD Proposal and explain our views. Please feel free to contact any of the Responding Banking Organizations, Rosemary Spaziani at rspaziani@wlrk.com or Richard K. Kim at rkim@wlrk.com if you have questions or desire additional information.

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