BANK POLICY INSTITUTE

June 5, 2024

Via Electronic Mail

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

Federal Deposit Insurance Corporation
550 17th Street NW
Washington, D.C. 20429
Attention: James P. Sheesley, Assistant Executive Secretary, Comments/Legal OES

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

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

Ladies and Gentlemen:

The Bank Policy Institute[1] submits this letter to supplement our January 16, 2024, comments on the joint proposal that would extend long-term debt requirements to regional banks.[2]

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1 The Bank Policy Institute is a nonpartisan public policy, research and advocacy group that represents universal banks, regional banks, and the major foreign banks doing business in the United States. The Institute produces academic research and analysis on regulatory and monetary policy topics, analyzes and comments on proposed regulations, and represents the financial services industry with respect to cybersecurity, fraud, and other information security issues.

2 *See* OCC, Federal Reserve, FDIC, *LTD Requirements for Large Bank Holding Companies, Certain Intermediate Holding Companies of Foreign Banking Organizations, and Large Insured Depository Institutions*, 88 Fed. Reg.

We appreciate the Agencies' consideration of our prior comment letter, as well as the opportunity to meet with the Agencies on February 14, 2024, to discuss the proposal. As a threshold matter, we continue to recommend that the Agencies finalize any new LTD requirement only after any Basel III Endgame rule has been implemented. Because any Basel III Endgame rule would directly affect LTD requirements, it is impossible to know the true costs of the proposal until the Basel III Endgame rule is implemented.[3] We continue to urge the Agencies to thoroughly consider the effects of any capital changes on the calibration of an additional loss-absorbing capacity requirement for covered institutions, together with the other costs we identified in our prior comment letter and in Section V of this letter.[4] Failing to do so may lead to the LTD final rule being arbitrary and capricious under the Administrative Procedure Act's requirements, as interpreted by the Supreme Court.[5]

As described in our January comment letter and elaborated upon below, we continue to believe the proposed LTD requirements would be much costlier than the Agencies estimate. The Agencies should therefore significantly revise the proposal's calibration and design to avoid unnecessary and outsized costs for regional banks and other Covered Entities. Our January comment letter described our recommended revisions in detail. This supplemental comment letter provides more detail on certain of these issues and summarizes additional research BPI has conducted regarding the expected costs of the proposal.

Section I describes the disconnect between the proposed calibration based on a "full capital refill" framework and other aspects of the proposal, as well as the August 2023 resolution planning proposals. This disconnect would result in requiring Covered Entities to raise materially more LTD than required by the resolution strategies that the Agencies have otherwise indicated appropriate for Covered Entities. Section II reiterates that the intention of Congress, as implemented by legislation binding on the Federal Reserve, is for the Federal Reserve to tailor any LTD requirements at the holding company level. Although

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64,524 (Sept. 19, 2023). The proposal would require certain large depository institution holding companies ("<u>Covered Holding Companies</u>"), certain U.S. intermediate holding companies of foreign banking organizations ("<u>Covered IHCs</u>"), and certain insured depository institutions that are not subsidiaries of global systemically important banks ("<u>GSIBs</u>") ("<u>Covered IDIs</u>" and, together with Covered Holding Companies and Covered IHCs, "<u>Covered Entities</u>") to issue and maintain outstanding a minimum amount of LTD ("<u>LTD</u>").

3 The proposal stated that the "Basel III reforms proposal would, if adopted, increase risk-weighted assets across covered entities" and these changes "would lead mechanically to increased requirements for LTD under the LTD proposal." At the same time, the agencies state that "increased capital that would be required under the Basel III proposal could also reduce the cost of various forms of debt for impacted firms due to the increased resilience that accompanies additional capital." However, "the size of the estimated LTD needs and costs presented in this section do not account for either of these potential effects of the Basel III proposal."

4 At a March 6, 2024, House Financial Services Committee hearing, Chairman Powell seemed to agree, responding to questions about the timing implications of a possible Basel III Endgame re-proposal for the long-term debt proposal by saying, "…that's a question we'd be asking ourselves … what would be the implication for other rules including for the long-term debt [proposal]."

5 The Administrative Procedure Act authorizes courts to set aside agency action that is arbitrary and capricious. 5 U.S.C. § 706(2). The Supreme Court has held that agencies are required under the APA to "examine the relevant data and articulate a satisfactory explanation for its action" and determined that a rule promulgated after the agency "entirely failed to consider an important aspect of the problem" is generally arbitrary and capricious. *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983). The Supreme Court has also held that a statutory requirement that an agency determine whether "regulation is appropriate and necessary" is not "an invitation to ignore cost." *Michigan v. EPA*, 576 U.S. 743, 753 (2015).

we continue to believe the internal LTD requirement should be eliminated and banking organizations should not be required to issue LTD at both the bank and holding company levels, Section III provides additional detail on how the Agencies could implement a more flexible gone-concern loss-absorbing capacity ("GLAC") requirement at a lower cost that would still meet the aims of the proposal. Section IV addresses the Agencies' proposed $400,000 minimum denomination requirement, which would have an adverse impact on the market for LTD and is not necessary to limit retail investment in LTD. Specifically, it describes how existing laws and regulations, the supervisory process, and existing market structures provide retail investor protections. Section V describes additional BPI research showing the proposal would be even costlier than estimated in our prior comments due to the larger buffers covered institutions may need to ensure compliance with the requirements, including during times of market stress when it may be more challenging or expensive to issue LTD.

I. The proposed "full capital refill" calibration conflicts with the pending resolution planning proposals.

In our prior comments, we noted that the proposed "full capital refill" calibration is not necessary to achieve the Agencies' stated objectives to protect uninsured depositors from losses in the event of a banking organization's failure, to provide the FDIC with more flexibility in resolution through facilitating additional mechanisms that would meet the least-cost resolution requirement and minimize losses to the DIF, and to enhance market discipline. In our subsequent meetings with the Agencies, it has been suggested that one of the key intended benefits of providing the FDIC with this greater flexibility would be to support bridge bank resolution strategies that may involve the FDIC operating the bridge bank for an extended time, in particular with the intent of resolving the bridge bank through sales to multiple acquirers or through an initial public offering.

The full capital refill approach is, however, inconsistent with the Agencies' pending resolution planning proposed guidance. As such, it would unnecessarily increase costs to Covered Entities by assuming resolution strategies different from those carefully developed by Covered Entities with explicit Agency guidance and review. The first inconsistency, discussed at length in our prior comments, is that the current resolution strategies of most Category II and III Covered Entities that would be subject to the resolution planning guidance employ a multiple-point-of-entry ("MPOE") resolution strategy. Under this strategy, material entities would be resolved in separate resolution proceedings. The insured depository institution would be resolved by the FDIC, likely through a bridge bank structure or purchase and assumption transaction, neither of which require a full capital refill. The holding company would be permitted to fail. Recognizing the appropriateness of such an approach, the Federal Reserve and FDIC 165(d) resolution planning guidance for triennial full filers states that the Agencies "are not proposing further expectations concerning capital to firms whose plans contemplate an MPOE resolution strategy, as an MPOE strategy assumes most material entities do not continue as going concerns upon entry into resolution."[6] Consistent with this statement, a holding company, the subsidiaries of which will be permitted and even expected to fail, does not require LTD at both the holding company and IDI level, in each case calibrated based on a full capital refill approach. The long-term debt proposal does not provide

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6 Federal Reserve and FDIC, *Guidance for Resolution Plan Submissions of Domestic Triennial Full Filers*, 88 Fed. Reg 64,626, 64,628 (Sept. 19, 2023). The proposed guidance for foreign triennial full filers similarly states: "The agencies are not proposing further expectations concerning capital to firms whose plans contemplate a U.S. MPOE resolution strategy, as a U.S. MPOE strategy assumes most material entities do not continue as going concerns upon entry into resolution." Federal Reserve and FDIC, *Guidance for Resolution Plan Submissions of Foreign Triennial Full Filers*, 88 Fed. Reg. 64,641, 64,644 (Sept. 19, 2023).

any justification for applying a full capital refill approach when the 165(d) proposal, issued on the same day, declines to adopt any resolution-related debt or capital expectations for firms with an MPOE strategy.[7]

Second, if a primary purpose of the capital refill approach is to facilitate establishing and operating a bridge bank, as some Agency statements suggest,[8] such a prescriptive and costly requirement is premature. The FDIC's pending IDI resolution plan rule proposal would require institutions to develop a bridge bank resolution scenario as an "identified strategy." This indicates a greater interest at the FDIC in promoting and developing bridge bank strategies and capabilities in the future.[9] But there is not yet evidence that the proposed amount of long-term debt would be necessary to execute this strategy across the board, or that such a strategy would be suitable for each and every IDI that will be subject to the rule. In fact, the IDI proposal explicitly states: "the FDIC is aware that for some group A CIDIs, the structure and profile of the institution may suggest that another resolution strategy is better suited to the goals described in the proposed rule."[10] Together, the proposals suggest that the long-term debt calibration is intended to support a specified bridge bank resolution strategy, while simultaneously recognizing such a strategy will not be well-suited to every institution subject to the requirements. Furthermore, the proposals cite little, if any, evidence from the resolution planning framework—including the vast submissions that have been filed over the past decade—that the proposed calibration is rationally connected to the stated purposes in the long-term debt proposal, particularly given that none of the MPOE resolution plans submitted by the triennial filers have been found to be not credible, even without those filers having been subject to any long-term debt requirement at all.

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7 As discussed in Section III below, it is even less clear why dual requirements at the holding company and insured depository institution levels and the proposed full capital refill calibration are necessary for non-GSIB firms that adopt single-point-of-entry ("SPOE") strategies. The requirement that non-GSIB SPOE firms hold LTD at the insured depository institution level imposes a rigid structure and reduces the flexibility the Agencies have allowed for under the resolution planning guidance. With respect to the proposed LTD requirement at the holding company level, the capital and liquidity levels necessary to effectuate an SPOE strategy (and thereby recapitalize material entities) have been robustly modelled by SPOE firms through the so-called RCEN/RCAP and RLEN/RLAP methodologies. Therefore, as proposed, the long-term debt requirements are unnecessary for SPOE firms and could impose significant unnecessary costs for these firms.

8 *See* 88 Fed. Reg. at 64,627 ("LTD issued by the IDI could help support resolution strategies by, among other things, recapitalizing a bridge depository institution and facilitating its exit from resolution as a newly chartered IDI that would have new ownership.").

9 *See* FDIC, *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, 64,582 (Sept. 19, 2023) ("[W]hile a transaction with a single acquirer over closing weekend poses the least execution risk for the FDIC, and is often the least disruptive and most efficient, it may not be available. In that case, the FDIC would likely consider an approach that relies on the establishment of a limited-duration BDI…"). BPI does not support requiring a bridge bank strategy as an identified strategy, for the reasons discussed in our comments on the IDI proposal. *See* BPI Comment Letter regarding Request for Public Comment on Proposed Revisions to 12 C.F.R. Part 360 (Nov. 30, 2023) ("The FDIC should revert to its approach under the June 2021 Policy Statement, which requires presenting a range of options for resolving a CIDI and relies on the identification of franchise value components, instead of one identified strategy. BPI believes that the current approach would provide the FDIC with the meaningful optionality that it seeks—without requiring a specific identified strategy.").

10 88 Fed. Reg. at 64,582.

These inconsistencies with the pending resolution planning proposals further demonstrate the proposed long-term debt requirements are inappropriately calibrated. We reiterate our prior comments that a lower calibration – we propose 2% of RWAs and similar adjustments to leverage ratio requirements – would promote the same objectives while avoiding unnecessary and outsized costs.

II. Any holding company LTD requirements must be tailored as required by statute.

We are concerned that the Federal Reserve has not fully committed to tailoring the LTD requirements as clearly required by binding law—specifically, S. 2155. Chairman Powell's recent testimony before the Senate Banking Committee indicates the Federal Reserve will be "considering" and "looking at" tailoring the LTD requirements; however, these steps are not sufficient to satisfy the statutory mandate.[11]

Any LTD requirement at the holding company level would clearly be an enhanced prudential standard adopted under Section 165 of the Dodd-Frank Act and, as such, subject to the tailoring requirement. The Federal Reserve has recognized as such with respect to the 2016 TLAC rule that imposed LTD requirements on GSIBs: "The Board is issuing the final rule under section 165 of the Dodd-Frank Act."[12] Indeed, the proposal would amend Regulation YY, Enhanced Prudential Standards, to apply the LTD requirements to Category II, III and IV holding companies. This is the same regulation the Federal Reserve previously acknowledged was issued under section 165.

Any final LTD rule must satisfy the statutory mandate to tailor prudential standards for large bank holding companies and should clearly articulate how it does so. In particular, the Federal Reserve must differentiate the application of enhanced prudential standards (either on an individual basis or by category) based on a bank holding company's capital structure, riskiness, complexity, financial activities, size, or other risk-related factors[13] and make an affirmative determination in order to apply enhanced prudential standards to any bank holding company or bank holding companies with total consolidated assets between $100 billion and $250 billion.[14]

III. Any internal loss-absorbency requirement for Covered IDIs should take the form of a more flexible internal GLAC requirement instead of a separate internal LTD requirement.

In our January comment letter, we recommended that the Agencies eliminate the separate

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11 The Agencies have in the past tailored capital and liquidity requirements for insured depository institutions in line with the tailoring for holding company requirements based on "the agencies' longstanding policy of applying similar standards to holding companies and their depository institution subsidiaries" and should do so with respect to any LTD requirements that may apply at the insured depository institution level. OCC, Federal Reserve, FDIC, *Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements*, 84 Fed. Reg. 59,230, 59,245 (Nov. 1, 2019).

12 *See* Federal Reserve, *Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations*, 82 Fed. Reg. 8,266, 8,267 (Jan. 24, 2017); *see also* 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 (including "TLAC/Long-term debt" in the visual describing the Federal Reserve's Tailoring Rule).

13 *See* 12 U.S.C. §5365(a)(2)(A).

14 *See* 12 U.S.C. §5365(a)(2)(C).

internal LTD requirement for Covered IDIs. This remains our primary recommendation: a banking organization should not be required to issue LTD at both the holding company and IDI levels in the highly prescriptive manner contemplated in the proposal. A Covered Holding Company or Covered IHC should be able to satisfy its LTD requirement either with external debt issued at the holding company level or with debt issued at the IDI level.

However, if the Agencies believe that it is necessary to require Covered IDIs to be subject to regulatory requirements for internal loss-absorbing capacity, they should replace the proposed internal LTD requirement with a more general GLAC requirement. In our January comment letter, we recommended that the Agencies permit that GLAC requirement to be satisfied by any combination of the following elements:

- First, eligible LTD;

- Second, any internal demand deposit or other short-term extensions of credit to a Covered IDI or any Level 1 HQLA of a Covered Holding Company, Covered IHC, or funding affiliate, if pledged by the holding company to secure its obligation to use those financial assets to recapitalize the Covered IDI subsidiary, without any such internal deposit or other short-term extension of credit being required to satisfy the conditions of eligible internal debt securities; and

- Third, any other means jointly approved by the Federal Reserve and the FDIC under the 165(d) resolution planning process or otherwise.

In order to implement such a GLAC requirement, the Agencies could require Covered IDIs to maintain eligible GLAC in an amount that is no less than specified percentages of risk-weighted assets ("RWAs"), total leverage exposure (if the Covered IDI is subject a supplementary leverage ratio requirement) and average total consolidated assets.[15] We discuss each of these three elements below.

A. Eligible LTD

Outstanding eligible LTD should count toward the GLAC requirement to the same extent as it would count toward the proposed internal LTD requirement, with 100 percent or 50 percent of the outstanding principal amount counting toward the requirement depending on whether the principal is due to be paid in two or more years or one to two years. However, to provide greater flexibility to institutions to manage their funding in the most cost-effective manner, we would recommend that eligible LTD may count towards an institution's overall GLAC requirement whether it is issued internally to the Covered IDI's parent company or externally to the market by the Covered IDI. As we have discussed in our meetings with the Agencies, any final rule should not specify the level at which eligible LTD must be issued to the market. There is variation among firms in their desire and ability to issue debt directly from the IDI. Any final rule should preserve this natural variation by permitting both and should not mandate an identical funding structure for every institution. The agencies can achieve this flexibility by allowing eligible LTD to count at the IDI-level, whether it is issued internally or externally. For IDI resolution purposes, there is no

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[15] As explained in Section IV.B.2 of the January Comment Letter, any risk-based loss-absorbency requirement should equal two percent of RWAs, rather than the proposed six percent of RWAs, and the recalibrated risk-based requirement should carry through to any leverage-based requirements so that any leverage-based requirements can serve their intended roles as backstops and not binding constraints.

discernable reason to prefer debt issued to a parent company rather than directly to the market from the IDI.

B. Other Qualifying Internal Funding Mechanisms

With regard to the second element, the carrying value of any pledged internal demand deposit claim against or receivable on any other short-term extension of credit to the Covered IDI, or the fair value[16] of any pledged Level 1 HQLA (i.e., any pledged assets of the type described in Section 20(a)(3)-(6) of the LCR rule) could count toward the GLAC requirement if (i) pledged by the holding company or funding affiliate to secure its obligation to use those financial assets to recapitalize the Covered IDI subsidiary, (ii) subject to a secured support agreement, and (iii) the Covered IDI provides the Agencies with the same type of detailed legal analysis of the potential state law and bankruptcy law challenges and mitigants to the planned provision of support to the Covered IDI subsidiary, including analysis of potential legal obstacles such as creditor challenges and breach of fiduciary duties, that are currently provided by the U.S. GSIBs pursuant to the resolution planning guidance from the Federal Reserve and FDIC.[17] This analysis could be provided upon request or through the resolution planning process to satisfy the Agencies that the boards of directors of the holding company or funding affiliate will determine that it is in the best interest of their respective companies and shareholders and otherwise consistent with their fiduciary duties to direct their companies to perform their obligations under the secured support agreement and that the secured support agreement is resilient against challenge to its enforceability in accordance with its terms by any creditors in a resolution scenario, i.e., in the context of the entry of the Covered IDI into a receivership and the commencement of bankruptcy or other resolution proceedings for the holding company. If a Covered IDI conducts this analysis of its pledge and support arrangements and reaches these conclusions, there is no supervisory or policy reason why the Covered IDI should not be permitted to satisfy an internal loss-absorbency requirement through those pledge and support arrangements. Such arrangements would be as effective as eligible internal debt securities; at the same time, they may be more consistent with the Covered IDI's overall funding program and, thus, less costly. This flexible approach would also have the benefit of mitigating the trapped liquidity problem discussed in our January comment letter.

C. Mechanisms Approved through Resolution Planning Processes

The third element would permit a Covered IDI to satisfy a GLAC requirement through any other means jointly approved by the Federal Reserve and the FDIC under the 165(d) resolution planning process or otherwise. This element is designed to maintain flexibility in the framework, which could help to reduce the costs of any internal loss-absorbency requirement as well as to reduce friction with the 165(d) resolution planning framework.

This element is especially critical because of the uncertain interactions with the resolution planning regime. An internal LTD requirement would be incoherent for an institution that utilizes a single point of

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16 The carrying value should be used for liabilities of the Covered IDI pledged to the Covered IDI because, if used to recapitalize the Covered IDI, the liability would be extinguished. In contrast, the fair value should be used to value assets to be contributed to the Covered IDI because, upon receipt by the Covered IDI, the assets would generally increase the equity of the Covered IDI to the extent of their fair values.

17 *See* Federal Reserve, FDIC, *Final Guidance for the 2019 165(d) Resolution Plan Submissions for Domestic Covered Companies that Submitted Resolution Plans in July 2017*, 84 Fed. Reg. 1,438, 1,451–1,452 (Feb. 4, 2019). Recently proposed guidance from the Federal Reserve and FDIC reiterates the need to provide this legal analysis. 88 Fed. Reg. at 64,635.

entry ("SPOE") resolution strategy along with Resolution Capital Adequacy and Positioning ("RCAP"). RCAP is specifically designed to provide for adequate maintenance of loss-absorbing resources, either at the parent or material subsidiaries, such that all material subsidiaries, including IDIs, could be recapitalized in the event of resolution under the SPOE resolution strategy. Any separate internal LTD requirement would be completely unnecessary and duplicative for institutions that adopt SPOE resolution strategies with RCAP capabilities and might exceed the amount of GLAC needed to effectuate their SPOE strategies. Providing flexibility for the Federal Reserve and FDIC to acknowledge other means of loss-absorbency through the 165(d) resolution planning process would allow institutions to update their parent company resolution strategies without being permanently locked into a rigid internal LTD requirement designed to support a narrower bridge bank resolution strategy.

IV. The proposed $400,000 minimum denomination requirement is not necessary in light of the existing regulatory framework under the U.S. securities laws and the structure of the current market for debt securities.

The proposal, as well as our meetings with agency staff, indicate that one of the concerns driving the $400,000 minimum denomination is that retail investors might not be able to understand the risks of LTD.[18] But many existing regulatory requirements address investor protection, and it is unnecessary for the LTD rule to create a separate and disruptive minimum denomination requirement.

First, as noted in the January comment letter, the minimum denomination requirement reflected in the proposal would be at odds with the disclosure-based framework created by the federal securities laws. The investor protection regime of the U.S. federal securities laws is premised on disclosure. Companies that issue securities to the public are required to provide the detailed disclosures provided by SEC rules, as well as any additional material information as may be necessary to make the required statements, in the light of the circumstances under which they are made, not misleading. There is no reason why retail investors would be unable to fully understand the risks relating to an investment in external LTD through disclosure required by the federal securities laws.

In fact, when offering debt securities that qualify as eligible LTD under the existing TLAC rule, a U.S. GSIB is already required to disclose a description of the financial consequences to unsecured debtholders of the U.S. GSIB entering into a resolution proceeding in which the top-tier holding company is the only entity that would be subject to the resolution proceeding.[19] In adopting this disclosure requirement, the Federal Reserve noted that it "has long supported meaningful public disclosure by banking organizations, with the objective of improving market discipline and encouraging sound risk-management practices."[20] The Federal Reserve further acknowledged that disclosure encourages potential investors to carefully consider the risks of their investment, leading to improved market pricing and signaling regarding the financial condition and risk profile of an issuer.[21]

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18 88 Fed. Reg, at 64,538 ("[M]ore sophisticated investors are more likely to appreciate that LTD that satisfies the requirements of the proposed rule may present different risks than other types of debt instruments issued by covered entities, covered IDIs, or other firms.").

19 *See* 12 C.F.R. 252.65.

20 82 Fed. Reg. at 8,303.

21 *Id.* Consistent with the disclosure-based framework of the securities laws and existing disclosure

Second, the protections of the federal securities laws also require broker-dealers to act in a retail customer's best interest in a securities transaction.[22] For example, Regulation BI would apply whenever a broker-dealer recommends that a retail customer acquire LTD issued by a Covered Holding Company or U.S. GSIB, whether or not the broker-dealer is affiliated with the issuer of the LTD.[23] In that scenario, when making a recommendation to a retail customer involving LTD securities, a broker-dealer would be required to act in the retail customer's best interest and cannot place its own interests ahead of the customer's interests.[24] In addition, the broker-dealer would have a care obligation that would require them to exercise reasonable diligence, care and skill to understand the risks, rewards and costs of a recommendation to a retail customer and have a reasonable basis to believe that the recommendation is in the best interest of a particular retail customer, based on the retail customer's investment profile and the potential risks, rewards, and costs associated with the recommendation.[25] Separately, if a retail investor has a discretionary wrap-fee account[26] managed by a broker-dealer that is both a registered investment adviser and affiliated with a Covered Holding Company or U.S. GSIB, any acquisition of LTD issued by the Covered Holding Company or U.S. GSIB would be subject to the investor's advance consent under Section 206(3) of the Investment Advisers Act of 1940,[27] as well as the investment adviser's fiduciary duty to its retail investor client. Further, any registered investment adviser would be subject to a fiduciary duty to its retail clients in providing investment advice and in other aspects of the relationship.

Third, any activities relating to recommendations or sales of LTD by an insured depository institution would also be subject to supervision and examination by the Agencies. Longstanding interagency guidance addresses concerns about potential customer confusion regarding the FDIC-insured status of various products offered by IDIs.[28] This guidance addresses disclosures and advertising, suitability and sales practices, qualifications and training, and compliance, among other considerations. The Agencies

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requirements for GSIBs and U.S. IHCs of foreign GSIBs, the Agencies could require Covered Entities to disclose risks, in a prominent manner, to unsecured debtholders of a resolution of the Covered Entity.

22 *See* 17 C.F.R. §240.15*l*-1.

23 Regulation BI applies to recommendations of any securities transactions or investment strategy involving securities to a retail customer by a broker-dealer. For purposes of Regulation BI, a "retail customer" is a natural person, or the legal representative of a natural person, who receives a recommendation of a securities transaction or investment strategy involving securities from a broker-dealer and uses the recommendation primarily for personal, family, or household purposes. 17 C.F.R. §240.15*l*-1(b)(1). If Regulation BI does not apply, the suitability requirements in FINRA Rule 2111 would apply to a recommendation from a broker-dealer regarding a recommended securities transaction or securities investment strategy.

24 *See* 17 C.F.R. §240.15*l*-1(a)(1).

25 *See* 17 C.F.R. §240.15*l*-1(a)(2)(ii).

26 A wrap-fee account is an investment account in connection with which the investor is charged a single fee for a number of services, including investment advice, brokerage services, and administrative expenses. See SEC, *Investor Bulletin: Investment Adviser Sponsored Wrap Fee Programs* (Dec. 7, 2017), *available at* https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib_wrapfeeprograms for an overview of wrap-fee accounts.

27 *See* 15 U.S.C. §80b-6(3).

28 *See* FDIC, Federal Reserve, OCC, *Interagency Statement on Retail Sales of Nondeposit Investment Products* (Feb. 15, 1994).

have elaborated upon this guidance over time.[29] Particularly relevant to this proposal, the OCC already has existing guidance emphasizing that a national bank's sales activities relating to the bank's or its affiliates' debt or equity securities require heightened risk controls relating to customer protections, including the establishment of product specific suitability requirements, elevated levels of supervision and surveillance, tailored product training, enhanced customer disclosures, and targeted compliance testing.[30] The OCC's guidance also addresses supervisory expectations if a bank uses arrangements with affiliated or unaffiliated broker-dealers to offer retail non-deposit investment products to retail customers. Any concerns the Agencies may have that banks may, directly or through arrangements with affiliated or unaffiliated broker-dealers, inappropriately offer LTD issued by their parent holding companies to their retail customers could be addressed through regular supervisory processes. In light of the existing protections for retail investors, any such concern would not justify a minimum denomination requirement, which would negatively affect the liquidity and depth of the market for LTD and therefore increase the cost of any LTD requirement.

Finally, as noted in our January comment letter, a minimum denomination requirement inconsistent with established market practice—especially one as high as the $400,000 minimum in the proposal—would damage the market for LTD. By decreasing market demand and therefore market depth and liquidity, it would unnecessarily increase costs. Moreover, a $400,000 minimum denomination requirement is unnecessary in light of the characteristics of the current market for bank debt in the United States. Typical industry practice for debt securities not marketed to retail investors is a minimum denomination of $1,000 or $2,000—40 or 80 times the $25 standard denomination for debt securities marketed to retail investors.[31] A $400,000 minimum denomination requirement is unnecessary to achieve the Agencies' objectives and would be harmful to market liquidity. We understand that industry groups continue to consider these issues and plan to provide additional comments to the Agencies on the proposal.

V. Additional expected costs demonstrate the importance of recalibrating, redesigning, and appropriately tailoring any LTD requirements for regional banks and other Covered Entities.

The structural recommendations in our January comment letter and the additional information in this supplement are especially critical due to the proposal's significant costs. In our January comment letter, we presented research demonstrating the proposal's costs could be three times higher than the Agencies' estimate under the incremental shortfall approach. More specifically, our previous analysis estimated the management buffer banks would maintain above their LTD requirement based on the average time Covered Entities tapped the bond market in recent years. Subsequent research reveals that after the LTD requirement becomes effective, banks will want to maintain larger management buffers to minimize the costs of LTD issuance, which we estimate to correspond to up to 2 percentage points above the minimum requirement on average. Therefore, the true costs of the proposed LTD requirements are

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29 *See* FDIC, *Uninsured Investment Products: A Pocket Guide for Financial Institutions* (Mar. 15, 2024), *available at* https://www.fdic.gov/regulations/resources/financial/#anchor105598; OCC, *Comptroller's Handbook: Retail Nondeposit Investment Products*, Version 1.0 (Jan. 2015), *available at* https://www.occ.gov/publications-and-resources/publications/comptrollers-handbook/files/retail-nondeposit-invest-products/pub-ch-retail-nondeposit.pdf ("Comptroller's Handbook").

30 *See* Comptroller's Handbook at 4.

31 *See* NYSE Bonds, "Types of Bonds," *available at* https://www.nyse.com/products/bonds (describing retail debt securities as "typically denominated in $50, $25 or $10").

projected to be 4.5 times the proposal's estimated costs under the Agencies' incremental shortfall approach, or $6.6 billion. A blog post describing this research in more detail is attached as an appendix.

Our January comment letter described several factors that the agencies had not considered in their estimates of the size of the LTD shortfalls and overall funding costs. One of these factors is that banks will necessarily maintain higher amounts of LTD than the minimum requirements. These "management buffers" are a function of prudent risk management and are designed to ensure that banks are not forced to replace maturing debt with new debt issuances at inopportune times when the costs could be much greater. Our prior research assumed a 6-month management buffer based on the frequency of LTD issuance by Covered Entities in recent years. Updated research indicates banks will need to operate with larger buffers once the LTD requirement is adopted. Specifically, this research estimates that Category III banks will maintain buffers to cover debt maturing over a 21-month period on average and Category IV banks will maintain buffers to cover debt maturing over a 32-month period on average. Category IV firms are expected to maintain higher management buffers on average because, historically, LTD of those firms tends to have higher bond spreads relative to Category III banks. These larger buffers mean that Category III banks would, on average, want to hold a 1.3 percentage point buffer above the 6-percent requirement and Category IV banks would aim for a 2.0 percentage point buffer. Under these revised assumptions on management buffers, total bank funding costs for covered banks are projected to reach $6.6 billion, 4.5 times the proposal's estimated costs of $1.6 billion under the incremental shortfall approach. The assumption of higher management buffers accounts for an approximately 35-percent increase in the costs associated with the long-term debt proposal.

Another factor contributing to increased costs is the current level of interest rates. When the Agencies began contemplating a long-term debt requirement for regional banks in early 2022, the federal funds rate was still near zero. By the time the Large Bank Resolvability ANPR was proposed in October 2022, the federal funds rate had climbed significantly. By August 2023, when the proposal was released, the federal funds effective rate was 5.3 percent. The economic analysis in the proposal calculated costs based on long-term averages of interest rates. However, if current interest rates are taken into account, the actual annual incremental costs to Covered Entities issuing long-term debt today are estimated to be $10 billion. The higher interest rate environment, along with the need to maintain larger buffers (in part to reduce issuance costs when interest rates rise or bond spreads widen), will result in higher expected costs to regional banks. These heightened costs underscore the urgency of the recommendations we've proposed in our January comment letter and this supplement.

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The Bank Policy Institute appreciates the opportunity to supplement the January comment letter. If you have any questions, please contact me by phone at tedgens@bpi.com.

Respectfully submitted,

/s/

Tabitha Edgens
Senior Vice President, Senior Associate General Counsel
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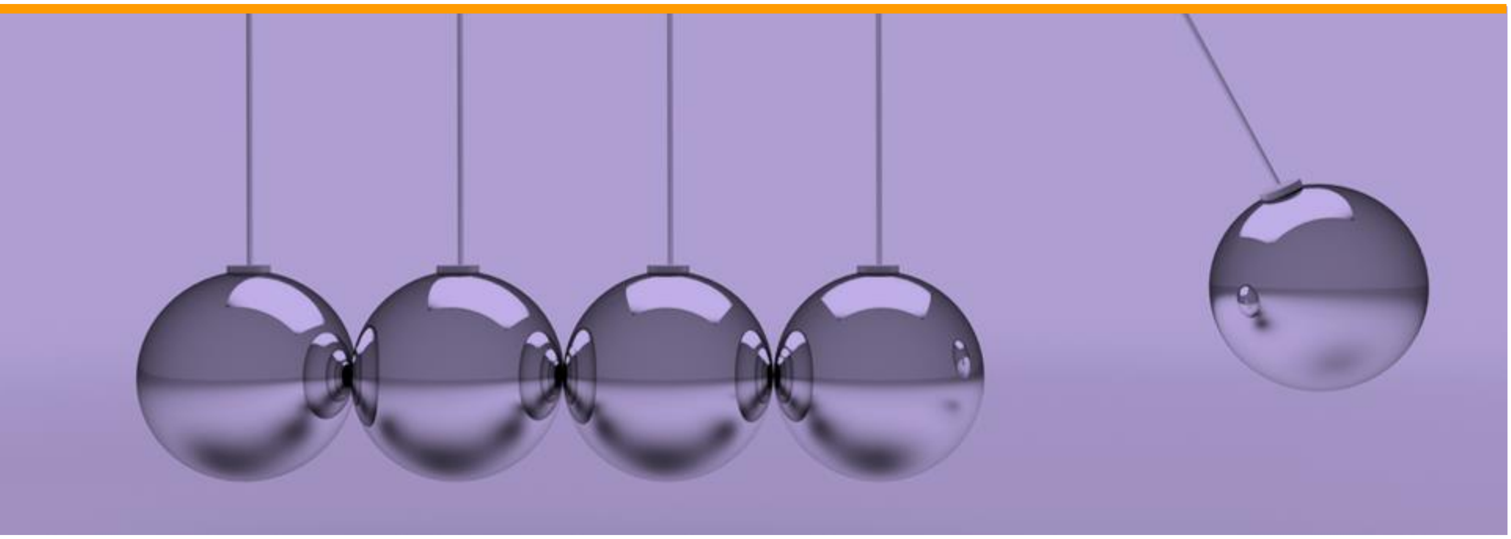
APPENDIX



Bigger Management Buffers: An Update on the Costs of the Long-Term Debt Proposal

Haelim Anderson, Francisco Covas and Felipe Rosa | March 28, 2024

The federal banking agencies have proposed a rule that would require U.S. banking organizations with total assets of $100 billion or more, excluding U.S. global systemically important banks (GSIBs), to issue a minimum amount of unsecured long-term debt.[1] The proposal attempts to improve the resolvability of these institutions by increasing their gone concern loss absorbency. In our previous post, we identified five factors that the agencies had not considered while estimating the size of the shortfalls and the overall funding costs. As a result, we demonstrated that the proposal significantly underestimates the cost of implementing the long-term debt requirement.

One of these factors is that banks will necessarily maintain levels of long-term debt well above the minimum required amount—a so-called "management buffer." Doing so is a function of prudent risk management. This buffer ensures that the bank is not forced to replace maturing debt with new debt issuances at inopportune times, such as during periods of market deterioration or volatility when spreads are higher and the cost of the debt is thus far greater.

In our previous post, we based our regulatory cost and shortfall estimates on an assumption that banks would maintain a six-month management buffer.[2] This assumption was based on the average duration banks were not issuing long-term debt during the period when there were no long-term debt requirements. However, the introduction of the requirements will necessitate that banks operate with larger buffers of long-term debt to ensure that they comply with the rule. Because of this, in this post, we update our estimates assuming larger management buffers that we believe better reflect true bank behavior.

Specifically, instead of calculating the shortfall and costs to manage the debt maturing in the next six months as we assumed in our prior post, we are estimating the shortfall and corresponding total funding costs for the longest period of time that banks did not participate in issuing new debt between 2007 and 2023: 21 months (or 1¾ years) for Category III banks and 32 months (or 2¾ years) for Category IV banks, which tend to have higher bond spreads. These are the average values of the longest duration without new issuance for Category III and IV banks.

[1] U.S. GSIBs are already subject to similar requirements. These include a total loss absorbing capacity (TLAC) requirement, a stand-alone long-term debt requirement applied to the top-tier holding company in the organization, and internal resource pre-positioning requirements imposed through resolution planning guidance.

[2] We constructed estimates for 6-month management buffers because that was the average duration between long-term debt issuance for Category III and IV banks.

In terms of the long-term debt requirement, this means that Category III banks would, on average, want to hold a 1.3-percentage-point buffer above the 6-percent long-term debt requirement, and Category IV firms would aim for a 2.0-percentage-point management buffer.

Under these revised assumptions on management buffers, total bank funding costs for covered banks are projected to reach $6.6 billion, 4.5 times the proposal's estimated costs of $1.6 billion. The assumption of higher management buffers accounts for an approximately 35-percent increase in the costs associated with the long-term debt proposal.

Time Interval between the Dates on Which Banks Issued New Debt

We collected data from Bloomberg on every single issuance of senior unsecured bonds between 2009 and 2023 for the banks subject to the long-term debt proposal.[3] We included bonds issued by the bank, the bank holding company and any entity subsequently acquired by the bank holding company. The data also include the issuer-level rating of the bond-issuer's ultimate parent at the time of issuance. We also used issuer-level credit spreads to illustrate the level of credit and liquidity risks during the period in which banks are not tapping the bond market to replace maturing debt.

Table 1: Time Interval Between Dates on Which Banks Issue New Debt

Bank Name	Average Duration Between LTD Issuances			Maximum Duration Between LTD Issuances				
	Elapsed time between issuance	Bond rating at issuance	Total bond amount issued (2007–23)	Elapsed time between issuance	Bond rating at start of inactivity period	Bond rating at end of inactivity period	Widest bond spread during inactivity period	Bond spread at end of inactivity period
	Panel A: Category III Banks							
US Bancorp	2.9mo.	A+	$106.9bn	14.1mo.	A+	A+	87bp	92bp
PNC Financial Services Group Inc	2.5mo.	A	$90.3bn	14.6mo.	A+	A	583bp	247bp
Truist Financial Corp	2.8mo.	A	$88.2bn	13.5mo.	AA−	A+	508bp	552bp
Capital One Financial Corp	4.8mo.	BBB+	$73.0bn	33.1mo.	BBB+	BBB+	398bp	155bp
Charles Schwab Corp	7.5mo.	A	$33.5bn	28.5mo.	A	A	203bp	108bp
Category III Average	4.1mo.	A	$78.4bn	20.7mo.	A	A	356bp	231bp
	Panel B: Category IV Banks							
American Express Co	2.4mo.	A	$129.0bn	27.3mo.	A−	A−	457bp	59bp
Ally Financial Inc	6.0mo.	BB	$34.8bn	37.3mo.	BB	BB+	386bp	198bp
Fifth Third Bancorp	6.6mo.	A−	$31.0bn	32.9mo.	AA−	BBB+	626bp	132bp
KeyCorp	5.1mo.	A−	$29.6bn	13.7mo.	BBB+	BBB+	203bp	135bp
Huntington Bancshares Inc	5.4mo.	BBB+	$22.8bn	24.1mo.	A−	A−	162bp	176bp
First Citizens BancShares Inc	10.0mo.	BBB	$19.0bn	40.0mo.	–	–	–	–
Citizens Financial Group Inc	5.9mo.	BBB+	$18.9bn	24.7mo.	BBB+	BBB+	195bp	202bp
M&T Bank Corp	11.8mo.	A−	$16.6bn	56.2mo.	A−	A−	692bp	196bp
Synchrony Financial	6.8mo.	BBB−	$16.4bn	27.1mo.	BBB−	BBB−	629bp	119bp
Discover Financial Services	8.6mo.	BBB	$15.1bn	34.1mo.	BBB	BBB	537bp	154bp
Regions Financial Corp	14.1mo.	BBB	$10.4bn	36.1mo.	BBB	BBB−	739bp	126bp
New York Community Bancorp Inc	13.0mo.	BBB−	$1.3bn	28.1mo.	BBB	BBB−	–	–
Category IV Average	8.0mo.	BBB+	$28.7bn	31.8mo.	BBB+	BBB	463bp	150bp
Category III–IV Average	**6.8mo.**	**BBB+**	**$43.3bn**	**28.6mo.**	**A−**	**BBB+**	**427bp**	**177bp**

Source: Bloomberg.

Table 1 presents information on the average length of time between the issuance of long-term debt and the longest length of time without the issuance of new debt for covered institutions.[4] In addition, the table provides information on the aggregate bond amount issued by banks, the average rating at issuance, and bond spreads. We use a *heat map* to represent the costs associated with liquidity and credit premiums. The map features a red-green color code to indicate whether costs are high or low.

[3] Although the U.S. bank holding company and U.S.-insured bank subsidiaries of foreign banking organizations are covered by the long-term debt proposal, we excluded them from this analysis because they did not issue long-term debt in the United States during this period.
[4] We excluded Northern Trust from the summary statistics because it is a Category II firm. Given its business model focused on custodial activities, Northern Trust tends to access the market for long-term debt much less frequently than the other covered firms.

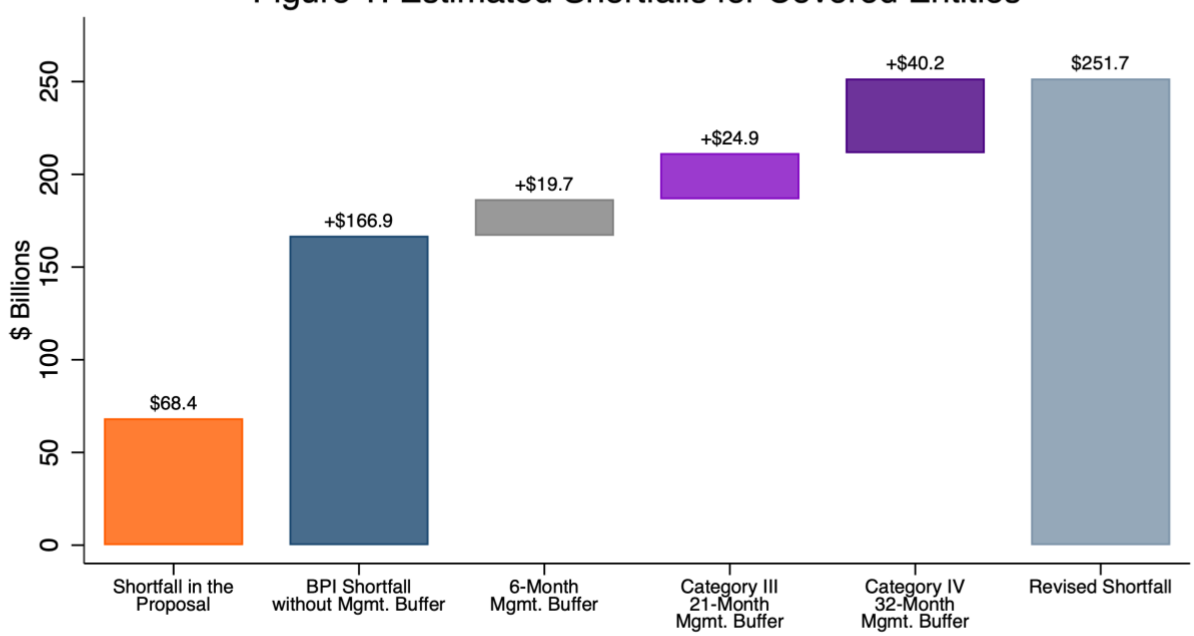
The average time interval between long-term debt issuances was four months for Category III banks (Panel A, column 2) and eight months for Category IV banks during the 16-year window (Panel B, column 2). The longest duration without issuance of long-term debt jumped to nearly 21 months, on average, for Category III firms (Panel A, column 5) and nearly 32 months, on average, for Category IV banks (Panel B, column 5). Moreover, bond spreads are much higher at the start of the inactivity period than when firms resume issuance of long-term debt. This result generally holds for both Category III and IV banks.

The results show that the time interval between issuances of new debt was larger for Category IV banks compared with Category III banks. In other words, it took longer for smaller banks to tap into the bond market during both the normal times and during unfavorable economic conditions. The rating of bonds at issuance did not differ much between normal times and periods when banks chose to delay the issuance of new debt. However, banks with lower ratings tend to have longer periods in which they do not issue long-term debt compared with banks with higher ratings. In addition, banks appear to wait longer to tap the bond market when bond spreads widen. Therefore, a bank's decision to delay tapping the bond market is likely driven by higher borrowing costs, which is in turn driven by wider bond spreads.

Effect of Higher Management Buffers on the Cost of the LTD Proposal

Next, we re-estimate the costs of the LTD proposal to account for the fact that banks will need to hold larger management buffers to ensure compliance with minimum requirements. This is because they cannot easily access the market during times of economic stress to replace maturing debt.

Figure 1: Estimated Shortfalls for Covered Entities



Source: Bloomberg, FR Y-9C, FR Y-9LP, FFIEC 101, NIC, Call Report.

Note: This chart displays the aggregate shortfall across all banks subject to the long-term debt proposal, including U.S. subsidiaries of foreign banks.

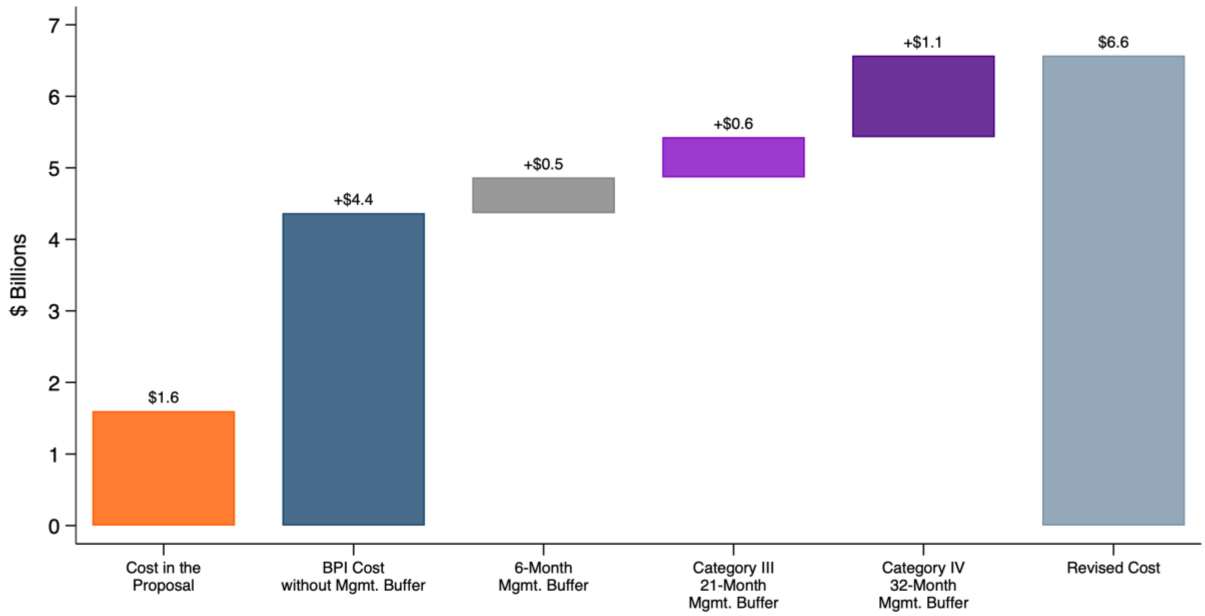
Figure 1 shows the long-term debt shortfall for covered banks when we consider management buffers sufficient to cover long-term debt maturing over the next 21 months for Category III firms and 32 months for Category IV firms.[5] This corresponds to a management buffer that is 1.3 percentage points of risk-weighted assets for Category III firms and 2.0 percentage points for Category IV firms. Our earlier work, which calculated the shortfall and cost for six-month management buffers, shows a shortfall of $19.7 billion for covered banks, resulting in the total shortfall of $186.6 billion. Figure 1 shows that the shortfall increases by $65.1 billion when we consider larger

[5] We did not adjust Northern Trust's management buffer, given its low bond spread and elevated bond rating.

management buffers that banks will need support regulatory compliance. After accounting for these larger buffers, the total shortfall for covered banks reaches nearly $252 billion, about 3.7 times the proposal's estimated $70 billion shortfall.

Figure 1 also separates the change in the LTD shortfall across Category III and IV banks. Although holding additional debt to ensure compliance with minimum requirements increases the cost associated with the long-term debt requirement for all covered banks, the increases in shortfalls due to management buffers are larger for Category IV banks, both in an absolute sense as well as relative to risk-weighted assets.

Figure 2: Estimated Additional Annual Costs for Covered Entities



Source: Bloomberg, FR Y-9C, FR Y-9LP, FFIEC 101, NIC, Call Report.

Note: This chart displays additional annual costs across all banks subject to the long-term debt proposal, including U.S. subsidiaries of foreign banks.

In Figure 2, we have recalculated the annual pre-tax funding costs for covered banks, assuming that they need to hold higher management buffers. Pre-tax funding costs are estimated to increase $0.5 billion when banks hold buffers for a six-month period. The funding costs increase by $1.7 billion when banks hold management buffers to cover debt maturing over the next 21 months for Category III banks and 32 months for Category IV banks. With the higher management buffers, the total bank funding costs for covered banks are projected to reach $6.6 billion, 4.5 times the proposal's estimated costs of $1.6 billion.

Figure 2 also presents pre-tax funding costs separately for Category III and IV banks. The total funding cost rises more sharply for Category IV banks compared with Category III banks. Specifically, total funding costs increase from $0.22 billion to $0.87 billion for Category III banks and from $0.23 billion to $1.25 billion for Category IV banks. These findings highlight the importance of considering management buffers when calculating the potential costs associated with the long-term debt requirement. Smaller banks need to hold larger management buffers to operate smoothly during times of stress. Once such banks are required to hold any amount of long-term debt, the agencies need to factor in that these banks will hold their own buffers on top of minimum requirements, to avoid paying higher bond spreads during times of economic stress and falling below regulatory requirements.

Conclusion

Our analysis indicates that the costs associated with meeting new long-term debt requirements could increase significantly when we consider that the banks may need to hold large management buffers. Although banks access the market every six months on average to replace maturing debt, after the long-term debt requirements are introduced, they may choose to hold larger buffers to avoid issuing new long-term debt during times of stress.

The banking agencies should consider that banks will need to hold large management buffers because of the uncertainty of funding costs and the need to ensure compliance with minimum requirements. Therefore, the agencies should weigh the differences in the costs to comply with the new requirements among covered entities, adjust the calibration and tailor those requirements appropriately.
