



February 2, 2015

Financial Stability Board  
Bank for International Settlements  
Centralbahnplatz 2  
CH-4002 – Basel  
Switzerland

Re: Adequacy of Loss-Absorbing Capacity of Global Systemically Important Banking Groups in Resolution – Consultative Document, dated November 10, 2014

Ladies and Gentlemen:

The Clearing House Association L.L.C. (“**The Clearing House**”), the Securities Industry and Financial Markets Association, the American Bankers Association and the Financial Services Roundtable (collectively, the “**Associations**”)<sup>1</sup> welcome the opportunity to respond to the Financial Stability Board’s request for comment on the above-captioned consultative document setting forth the FSB’s Proposal for total loss-absorbing capacity of global systemically important banking groups. The Proposal, developed in consultation with the Basel Committee on Banking Supervision, includes introductory comments, thirteen guiding Principles and a Term Sheet with 24 sections.<sup>2</sup>

We wish to confirm expressly at the outset our continued support for a well-structured and appropriately-applied TLAC requirement. As the FSB itself has indicated, TLAC is a critical step, and perhaps the most important remaining step, in ending “too-big-to-fail.” Together with single point of entry (“**SPOE**”) and other resolution strategies, TLAC marks a profound and effective change in how G-SIBs will be resolved. These complementary measures ensure that creditors and shareholders, and not taxpayers, bear losses in the event of failure. These measures also reflect the lessons of Lehman Brothers and other disorderly failures by ensuring that there is a regime in place—for U.S. G-SIBs, under both the U.S. Bankruptcy Code and the orderly liquidation authority in Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act—to resolve a top-tier holding company, and minimize

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<sup>1</sup> See [Annex A](#) for a description for each of the Associations.

<sup>2</sup> Capitalized terms and acronyms used in this letter and not separately or specifically defined are used with their commonly recognized meanings.

systemic risk, by enabling critical subsidiary operating companies either to (i) remain solvent and open, providing financial services to customers or (ii) be wound down in an orderly manner that does not destabilize the financial system.

As to SPOE in particular, while it has been widely acknowledged as conceptually sound and has become a model around the world, a strong consensus has also emerged that two potential problems existed. The first was the potential for cross-default provisions in derivatives contracts allowing for early terminations at the operating subsidiary level even if the subsidiary itself were not in default; that problem is in the process of being solved by an industry protocol and complementary regulatory changes. The second was the possibility that there would not be sufficient loss absorbency at the holding company level that would be available to the operating subsidiaries; TLAC is the solution to this problem.

Moreover, we agree with key aspects of the FSB's approach, noting in particular:

- the overarching premise, addressed in Principle No. 7, that holders of TLAC instruments issued by resolution entities ("**External TLAC**") must be "able to absorb losses in a time of stress in the financial markets without spreading contagion and without necessitating the allocation of loss to liabilities where that would cause disruption to critical functions or significant financial instability;"
- limiting the scope of minimum TLAC that must be issued by material subsidiaries that are "incorporated in a national jurisdiction other than that in which the resolution entity is incorporated"—*i.e.*, prepositioning ("**Internal TLAC**")—to only those cross-border arrangements between a parent resolution entity in a home country and a material subsidiary in a host country where it is needed "in order to facilitate co-operation between home and host authorities and implementation of cross-border resolution strategies that are feasible and credible;"<sup>3</sup>
- the Proposal's recognition that, in some respects, the international framework establishing TLAC needs to be sufficiently flexible to accommodate both differences among countries' legal frameworks for resolution and different structures of banking groups, which is implicit in the Proposal's decision not to narrowly define which entities within a G-SIB group are resolution entities;<sup>4</sup> and
- the Proposal's recognition that collateralized guarantees, which we assume include collateralized commitments to contribute capital to material subsidiaries, should be substitutable for Internal TLAC.

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<sup>3</sup> Term Sheet § 20.

<sup>4</sup> See Term Sheet § 2, which specifies that a "resolution entity is the entity or entities to which resolution tools will be applied in accordance with the resolution strategy for the G-SIB." This language accommodates the practice both in jurisdictions where regulatory authorities identify a G-SIB's resolution entity or entities (*see, e.g.*, with respect to G-SIBs in the European Union, Directive 2014/59 of the European Parliament and of the Council of 15 May 2014 Establishing a Framework for the Recovery and Resolution of Credit Institutions and Investment Firms, 2014 O.J. (L173) 190) and in jurisdictions where the G-SIB itself may initially identify its resolution entity or entities (*see, e.g.*, with respect to U.S. G-SIBs, Resolution Plans Required, 12 C.F.R. § 243 and 12 C.F.R. § 381 (2011)).

Notwithstanding our agreement and support on these key aspects, we believe that a number of crucial aspects of the Proposal require modification or refinement before the FSB finalizes its TLAC framework as an international standard, some of which are important to ensuring international consistency. Those aspects include:

- a data-driven, analytically sound calibration of External TLAC, including the implementation of a single, straightforward and transparent Pillar 1 requirement for External TLAC and elimination of the Proposal's Pillar 2 component;
- the scope of excluded liabilities in Term Sheet § 12 and the interplay between Term Sheet § 12's definition of excluded liabilities and Term Sheet § 13's priority provisions;
- certain details of the eligibility requirements for External TLAC; and
- clarification of certain aspects of the Internal TLAC requirement, including its calibration, the definition of material subsidiary and the treatment of collateralized guarantees.

Given the significant practical impacts of a TLAC framework on G-SIBs and the inevitable collateral consequences of the framework on the markets in which they raise capital, their operations and, ultimately, their customers, it is exceedingly important that the final TLAC framework be grounded in sound quantitative analyses. Requiring TLAC in excess of what is necessary to support the orderly resolution of G-SIBs, or structuring or defining TLAC in an unnecessarily restrictive way, would constrain G-SIBs in managing their balance sheets, with the consequence not only being economic inefficiency but possibly even the impairment, instead of the promotion, of the safety and soundness of these institutions. Moreover, an unnecessarily restrictive definition of eligible TLAC also would narrow the base of investors from which G-SIBs can raise loss-absorbing capacity, thereby undermining the widely-recognized benefits for individual institutions and the financial system of a broad and diverse investor base for systemically important institutions.

Last fall, The Clearing House undertook its own preliminary analysis ("**The Clearing House TLAC Analysis**") that considered the relationship between loss experience in times of stress (*i.e.*, capital depletion) and the calibration of External TLAC.<sup>5</sup> This Analysis summarizes the results of two methodologies for quantifying capital depletion in times of stress, one of which is forward-looking, using losses and pre-provision net revenue ("**PPNR**") projections published by the Board of Governors of the Federal Reserve System in connection with its 2014 Dodd-Frank Act stress testing exercise ("**DFAST**"), and one of which is historical.<sup>6</sup> Those methodologies show that aggregate loss-absorbing capacity comprised of an External TLAC requirement equal to 16.0% of risk-weighted assets ("**RWAs**") plus the 2.5% capital conservation buffer plus the RWA-weighted average U.S. G-SIB buffer (for which the methodologies used 1.6% based on RWAs as of September 30, 2013) is far larger than necessary, at least

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<sup>5</sup> A copy of The Clearing House TLAC Analysis is attached as [Annex B](#).

<sup>6</sup> The Clearing House TLAC Analysis also included a third methodology, a forward-looking approach that excluded projected PPNR, in order to examine the most conservative approach. We continue to believe there is no logical basis for not giving credit for PPNR, which is not excluded from Federal Reserve stress testing. The results of the third methodology, the forward-looking approach excluding projected PPNR, are noted in [Annex B](#).

for the eight U.S. G-SIBs. Specifically, The Clearing House TLAC Analysis shows that a calibration of 16.0% plus the buffers would produce loss-absorbing capacity of:

- 4.4 times losses (*i.e.*, capital depletion) using the Federal Reserve’s loss estimates under its severely adverse scenario for the 2014 DFAST stress testing and Comprehensive Capital Analysis and Review (“**CCAR**”) exercise; and
- 2.6 times losses under a backwards-looking (*i.e.*, historical) methodology addressing loss experience at seven large U.S. financial institutions that either failed or were acquired.<sup>7</sup>

We appreciate that the FSB, as indicated in its introductory comments to the Proposal, will undertake comprehensive impact assessment studies in early 2015, consisting of a quantitative impact study, both micro- and macro-economic impact assessments, a market survey to gauge the depth of markets for eligible External TLAC instruments, and a “survey of historical losses and recapitalisation needs” (together, the “**FSB Studies**”) “to inform the calibration of the Pillar 1 element of the common Minimum TLAC requirement for all G-SIBs.”<sup>8</sup> For all of the reasons we have described, it is critically important that the FSB Studies be robust and that the calibration of External TLAC be credibly supported by the FSB Studies. The FSB Studies should include both forward-looking and historical approaches, like The Clearing House TLAC Analysis, and historical analyses should be based on losses at institutions like the G-SIBs today that are subject to comprehensive regulation and have diverse operations and exposures, and, importantly, not on institutions that were not diversified (*e.g.*, focused on higher risk mortgage lending) and largely unregulated. We strongly believe that, once the FSB Studies are completed, the FSB should make them public and allow an appropriate period for interested parties to supplement their comments on the Proposal in view of the FSB Studies’ results.

Part I of this letter sets forth an executive summary of our comments. Part II addresses our overarching concerns and recommendations with respect to the calibration of External TLAC, the proposal that it include a Pillar 2 component, the Proposal’s approach as to which capital instruments and liabilities are counted as eligible External TLAC and (in the case of debt) subject to write-down or conversion into equity (*i.e.*, “**bail-in**”) upon a resolution,<sup>9</sup> and certain aspects of the Proposal’s treatment of Internal TLAC. Part III addresses our additional recommendations with respect to External TLAC. Part IV addresses our additional recommendations with respect to Internal TLAC. Part V addresses certain other considerations. Finally, Part VI responds to certain of the specific questions posed by the FSB.

## I. Executive Summary

A well-structured TLAC requirement is a critical step, and perhaps the most important remaining step, in ending “too-big-to-fail,” and we appreciate the substantial progress the FSB has made with the Proposal. We also endorse the FSB’s commitment to undertake the FSB Studies and to use the FSB Studies’ results in finalizing the TLAC framework, including the calibration of the External TLAC

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<sup>7</sup> See Part II.A.2 and Annex B for a more complete discussion of these analyses.

<sup>8</sup> Proposal at p. 8.

<sup>9</sup> We are using the terms “**failure**” and “**resolution**” interchangeably to mean a bankruptcy, insolvency or similar proceeding initiated under the G-SIB’s home country law to address the G-SIB’s financial distress at the point of non-viability.

requirement. As noted in the introductory paragraphs to this letter, once the FSB Studies are completed, we strongly believe that the FSB should make them public and allow an appropriate period for interested parties to supplement their comments on the Proposal in view of the FSB Studies' results.

Notwithstanding that the Proposal is a substantial step forward, we believe that significant modifications should be made in the final TLAC framework in order to enhance its clarity, transparency and effectiveness, promote competitive equality across jurisdictions, and avoid unnecessary market impacts (particularly with respect to the issuance and secondary market liquidity of External TLAC debt instruments). Our key comments and suggestions are summarized below, with parenthetical references to the relevant parts of this letter where the comments and suggestions are discussed in more detail.

- ***The final TLAC framework should establish the minimum amount of required External TLAC through the use of a simple, single Pillar 1 requirement that is empirically calibrated to serve TLAC's express policy purpose—to ensure that G-SIBs have sufficient loss-absorbing capacity to permit their resolution and recapitalization without taxpayer assistance.***
- **Eliminate Pillar 2 Component.** The RWA measure for minimum External TLAC should be set as a single Pillar 1 requirement. The G-SIB buffer—irrespective of whether it is included in External TLAC or “sits on top”—already imports into G-SIBs' loss-absorbing capacity a substantial component tailored to individual G-SIBs' characteristics, incorporating many of the same factors a supervisor would consider in establishing a Pillar 2 component. Moreover, simplicity and transparency as well as level-playing-field considerations argue for a single Pillar 1 percentage. (Part II.A.1.)
  - **Standard and Ratio.** The FSB should both (i) identify and explain the standard it uses in calibrating External TLAC and (ii) support its calibration against that standard with empirically-based forward-looking stressed analyses as well as analyses of losses experienced by comparable systemically important financial institutions historically, including during the financial crisis. We believe the calibration standard should be that the resolution entity in the period shortly after failure, and after giving effect to the bail-in (*i.e.*, write-down or conversion into equity in accordance with the home country's laws and rules, including bankruptcy and insolvency laws as applicable), should meet its Basel III<sup>10</sup> minimum regulatory capital requirements plus the capital conservation buffer, meaning common equity Tier 1 (“**CET1**”) of 7.0%, Tier 1 capital of 8.5% and Total capital of 10.5%. A standard that requires a G-SIB post-resolution to meet its minimum capital requirement plus the capital conservation buffer, as opposed to merely meeting its minimum capital requirements as the regulatory standard for viability, may be appropriate in view of uncertainties as to the behavior of market participants in a crisis environment. However, we do not believe that the standard should be higher than minimum ratios plus the capital conservation buffer. Imposing a higher post-failure capital expectation would move the rationale for TLAC from the post-failure objectives described above to a pre-failure resiliency

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<sup>10</sup> “**Basel III**” refers to the Basel Committee, *Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems* (Dec. 2010 (rev. June 2011)).

standard designed to minimize the likelihood of a failure. The two methodologies considered by the Associations for U.S. G-SIBs show that an External TLAC requirement calculated at 16.0% of RWAs, considered together with the 2.5% capital conservation buffer and the applicable G-SIB buffer (and effectively meaning aggregate loss-absorbing capacity of 19.5% to 21% of RWAs, or higher if super-equivalent G-SIB surcharges are imposed as recently proposed by the Federal Reserve for U.S. G-SIBs), is more than sufficient to ensure that bail-in produces sufficient capital to cover losses in an extreme stress scenario and permits the recapitalized G-SIB to continue to provide critical financial services. (Part II.A.2.)

- **Leverage Floor.** Term Sheet § 4’s treatment of the “2x leverage floor” for External TLAC creates ambiguities as to the expectations in jurisdictions where regulatory authorities have adopted a higher Basel III leverage ratio, including through the addition of buffers. We urge the FSB to eliminate any ambiguity in the final TLAC framework by simply specifying that minimum External TLAC must be at least 6% of the Basel III leverage ratio exposure amount. (Part II.A.3.)

➤ ***The final TLAC framework’s binary approach to excluded liabilities should be revised to, among other things, provide G-SIBs with sufficient flexibility to maintain holding company liabilities that, while not included as External TLAC, nonetheless rank pari passu with External TLAC.***

- **Refine Treatment of Excluded Liabilities.** The Proposal’s binary approach to the treatment of a G-SIB resolution entity’s liabilities—treating liabilities as either (i) included in External TLAC (*i.e.*, the liability counts in the numerator of the External TLAC ratio) and subordinated to all excluded liabilities or (ii) not included in External TLAC (*i.e.*, the liability is an excluded liability that does not count in the numerator) and senior to External TLAC—does not work. It fails to accommodate two other possibilities:
  - First, a resolution entity may have liabilities that should not be included in External TLAC but that, in a resolution, nevertheless would be available to absorb losses and, accordingly, would and should be bailed in before other excluded liabilities are bailed in (*e.g.*, liabilities that no longer count as External TLAC merely because the remaining period to maturity is too short). In other words, a resolution entity should be permitted to have excluded liabilities that are not contractually, legally or structurally preferred to External TLAC (and, accordingly, rank *pari passu* with External TLAC) but should be bailed in upon a resolution.
  - Second, there is a category of liabilities that a resolution entity should be permitted to maintain that are not—and should not be—included in External TLAC and should not be bailed in before other excluded liabilities upon a failure, but should be allowed to rank *pari passu* with External TLAC. This category includes some types of liabilities that an entity cannot avoid maintaining—*e.g.*, vendor and other liabilities necessary to function as a holding company.

We believe it is essential that the FSB refine its treatment of excluded liabilities to accommodate these possibilities and have outlined an approach for doing so. (Part II.B.1.)

- Limited Unsecured Liabilities on Derivatives. It is particularly important—and especially for G-SIB groups that have a non-operating bank holding company (“BHC”) as the top-tier entity, as is common in the United States—that the final TLAC framework permit the BHC to have limited unsecured liabilities on collateralized derivative contracts. BHCs need to enter into swaps to hedge interest rate, foreign exchange and other risks, and limited unsecured liabilities can arise even on collateralized swaps due to (i) gaps between daily postings of variation margin and (ii) required initial margin postings. These limited liabilities, together with certain other liabilities discussed in Part II.B.2 (and defined in our proposed language as “**Type III excluded liabilities**”), are liabilities that should be excluded from External TLAC but otherwise should be allowed to rank *pari passu* with External TLAC under Term Sheet § 13.
- ***The final TLAC framework should reflect a revised approach to Internal TLAC by identifying a range for the potential calibration of Internal TLAC and a universe of cross-border subsidiaries that must receive such support in a way that better reflects its purpose—to provide host country authorities with sufficient confidence that systemically important subsidiaries will receive support from the resolution entity and thereby remain solvent and open.***
- Refinements to Approach. Prepositioning raises inherent risks—most importantly, trapping resources in non-distressed subsidiaries and, as a consequence, limiting resources that may be quickly moved to a distressed subsidiary where problems may be arising. Nevertheless, to the extent the final TLAC framework includes any prepositioning, we agree with the Proposal’s limitation of prepositioning to cross-border support by a resolution entity in one country of a material subsidiary in another country. We believe the Proposal’s approach to Internal TLAC should be refined in the final TLAC framework in several important respects, as follows:
    - Calibration Range. The 75% to 90% calibration range for Internal TLAC in the Proposal should be replaced with a 65% to 75% range, with the FSB stating a presumption toward the lower end of the range. A 65% to 75% range would constitute a more than sufficient down payment such that a home country regulator would have every incentive to use loss-absorbency resources to recapitalize the subsidiary and maintain its franchise value. This level also provides sufficient flexibility to leave meaningful TLAC resources at the group level for deployment when and where needed while reducing the risk that the aggregate of the group’s Internal TLAC in its material subsidiaries will exceed the group’s External TLAC requirement. (Part II.C.)
    - Threshold for Identification of Material Subsidiaries. The 5% threshold for identification of material subsidiaries should be supplemented with a second test—namely, that in order to be a material subsidiary, the subsidiary must also have been determined to be systemically important to the financial

stability of the host country, either as determined by the host country authority in a certification provided to the home country authority or by application of a framework in the host country for determination of domestic systemically important financial institutions status. (Part IV.B.)

- Additional Clarifications. The final TLAC framework should clarify that (i) a 33% debt requirement does not apply to Internal TLAC (Part III.F), (ii) collateralized guarantees include capital commitment and support agreements and may be supported by a single collateral pool (Part IV.A), (iii) Internal TLAC may be bailed in before commencement of a bankruptcy or resolution proceeding in the host country only upon the mutual agreement of the home country and the host country regulators (Part IV.C), and (iv) eligible Internal TLAC may be owned directly or indirectly by the parent resolution entity (including through an intermediate holding company in the same jurisdiction as the material subsidiary) or, where appropriate, measured and applied at the level of an intermediate holding company in the host jurisdiction instead of its operating subsidiaries. (Part IV.D.)

➤ ***The final TLAC framework should carefully craft any limitations on G-SIBs' holdings of other G-SIBs' External TLAC and, in any event, must include an exception for bona fide underwriting and market making activities.***

- G-SIB Holdings of TLAC. While it is reasonable to address contagion risk, if G-SIBs were effectively prohibited or significantly limited in making markets in other G-SIBs' TLAC instruments through a deduction requirement, the market impact would include significantly decreased liquidity in TLAC instruments, potentially reduced demand for these instruments in the secondary market, impaired price discovery, wider bid/ask spreads, slower execution, increased volatility, decreased demand for new issuances, and artificially higher interest and dividend rates on these instruments. To mitigate these distortive outcomes, Term Sheet § 18's deduction of holdings by G-SIBs of other G-SIBs' External TLAC must be carefully crafted in order, among other things, to make clear that holdings of External TLAC in the form of senior debt are deducted from the holder's senior debt and do not impact existing regulatory capital ratios. Additionally, the final TLAC framework must include an exception for holdings of other G-SIB's External TLAC as part of *bona fide* underwriting and market making activities. (Part III.A.)

➤ ***The final TLAC framework should define the scope of liabilities that qualify as External TLAC in a manner that better reflects the loss-absorbing capacity of various instruments, including structured notes, long-term debt instruments with meaningful remaining maturity, and instruments governed by foreign law.***

- Structured Notes. The final TLAC framework should not adopt a presumption that structured notes are ineligible for inclusion in External TLAC. Most structured notes have a readily ascertainable claim amount, like other debt securities. A particular issue of structured notes should be excluded from External TLAC only if it fails to satisfy the standards that apply to plain-vanilla instruments (*e.g.*, it has an original



maturity of less than one year) or if the relevant national supervisory authority concludes that the fair value (or other claim amount) of the structured notes of the relevant issue cannot be readily determined. (Part III.B.1.)

- Minimum Maturity. Term Sheet § 11 provides that eligible External TLAC “must have a minimum remaining maturity of at least one year.” We urge the FSB to revise this standard to provide, in the final TLAC framework, that eligible External TLAC must have an original maturity at issuance of at least one year but a remaining maturity at any point in time of at least six months. Adopting that approach is supported by experience during the financial crisis with respect to the period between an institution’s distress becoming apparent and its failure, the “laddering” of maturities generally required of financial institutions’ debt components, and analogies to the treatment of available stable funding with a residual maturity of more than six months and less than one year under the Basel Committee’s recently finalized net stable funding ratio. (Part III.B.3.)
- Governing Law. Term Sheet § 16’s requirement concerning External TLAC governed by the laws of a jurisdiction other than the issuing G-SIB’s home country should not apply if the only type of bail-in authorized by the home country insolvency or resolution regime is a bridge bail-in as opposed to a direct bail-in. (Part III.D.)
- Redemption Rights. We request that the FSB clarify or simplify certain aspects of the Proposal’s treatment of External TLAC and excluded liabilities, including the following:
  - confirm our understanding that senior and subordinated debt that is redeemable at the issuer’s option is included in eligible External TLAC and that the issuer’s redemption right is not considered a “derivative-linked” feature that precludes inclusion under Term Sheet § 12.D (Part III.B.2); and
  - eliminate any requirement for prior regulatory approval of redemption of External TLAC liabilities. (Part III.C.)

➤ ***The FSB should consider whether the minimum debt requirement is necessary and should also take into account tax considerations when finalizing the TLAC framework.***

- Minimum Debt Requirement. If a minimum debt requirement is imposed, it should only apply to External TLAC. Moreover, we do not understand the need for the Term Sheet’s minimum debt requirement or the rationale for choosing 33% as the percentage. If the FSB re-opens comment on the Proposal for an appropriate period after completion of the FSB Studies, as we propose in the introductory paragraphs to this letter, we urge the FSB, at the same time, to explain the reasoning behind both the need for debt as a component of External TLAC and the choice of 33%. (Part III.F.)
- Tax Considerations. It is important that the FSB coordinate development of the TLAC framework with tax authorities in relevant jurisdictions in order to ensure that

TLAC debt securities are treated consistently as debt in all relevant jurisdictions.  
(Part V.A.)

## II. Overarching Concerns and Recommendations

### A. Calibration of External TLAC

- 1. The RWA measure for minimum External TLAC should be set as a single Pillar 1 requirement supported by rigorous analyses—based on forward-looking stress testing and historical experience—and the Pillar 2 component should be eliminated.**

The Term Sheet divides External TLAC into two components: a uniform Pillar 1 requirement applicable to all G-SIBs and a Pillar 2 component to be determined, where applicable, by the home country regulatory authority “in discussion with Crisis Management Groups and validated through the Resolvability Assessment Process.”<sup>11</sup> The Associations urge the FSB to eliminate from the final TLAC requirement the Proposal’s Pillar 2 component and, instead, to calibrate required External TLAC as a single Pillar 1 percentage of each G-SIB’s RWAs or leverage exposure amount, as applicable. We have three principal reasons for this view.

First, CET1 buffer amounts are available to absorb losses, irrespective of whether the final TLAC framework retains the Proposal’s “buffers sit on top” approach or includes buffers in External TLAC. In either case, the G-SIB buffer already imports into the External TLAC requirement a substantial component tailored to individual G-SIBs’ characteristics, incorporating many of the same factors a supervisor would consider in establishing a Pillar 2 component. Under the Basel Committee’s formulation of the G-SIB buffer, the buffer is calibrated as an additional 1% to 3.5% of RWAs based on the five factors and twelve indicators designed to measure the G-SIB’s international footprint and connectivity that contribute to its firm-specific global systemic importance. Moreover, the Federal Reserve’s G-SIB buffer proposal for U.S. BHCs, released for comment in December 2014, if adopted as proposed, would result in substantially higher G-SIB buffers than the Basel Committee standard, with expected surcharges ranging from 1% to 4.5% and possibly higher.<sup>12</sup> A Pillar 2 component would have the effect of imposing two tailored G-SIB components, one established under a transparent international standard and the other entirely subjective and, by its terms, unreviewable.

Second, a core objective of the final TLAC framework should be to make its application as simple, clear and transparent as possible, both for the G-SIBs themselves and for market participants that buy G-SIB capital and debt securities. For market participants, it will be exceedingly important that they have a clear understanding of the amount of External TLAC required of the G-SIBs that they invest in or face as counterparties, where their own exposures rank in a resolution of the G-SIB, and the cushion that the G-SIB maintains above minimum requirements. We strongly believe that considerations from the perspective of all three constituents—the G-SIBs themselves, regulators and market participants—argue for an explicit Pillar 1 minimum External TLAC requirement and elimination of the Pillar 2 component. A Pillar 2 component inherently creates uncertainty and opaqueness.

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<sup>11</sup> Term Sheet § 6.

<sup>12</sup> Risk-Based Capital Guidelines: Implementation of Capital Requirements for Global Systemically Important Bank Holding Companies, 79 Fed. Reg. 75473 (Dec. 18, 2014).

The Basel Committee has produced a transparent, public methodology for calculating the G-SIB surcharge. At any point in time, market participants will know what a G-SIB's required buffer is, how it was calculated, and what factors may bear on a change in the buffer. That is very different from a Pillar 2 approach as envisioned in the Proposal, which would rely on supervisory and inherently subjective judgment and not be tethered to a publicly available and transparent, or uniform, standard.

Third, TLAC should be a common international standard, uniformly applied to support a level playing field for G-SIBs, at least as to this one and very significant aspect of supervision and regulation. Having a Pillar 2 component based on supervisory discretion creates a significant likelihood of very different treatment of G-SIBs by different national regulators, which is particularly unnecessary given the conservative calibration of the Pillar 1 component if it is calibrated as we suggest in Part II.A.2.

2. **The FSB should both (i) identify and explain the standard it uses in calibrating External TLAC and (ii) support its calibration against that standard with empirically-based forward-looking stressed analyses and analyses of losses experienced by comparable systemically important financial institutions historically, including during the financial crisis. Under the two methodologies considered by the Associations for U.S. G-SIBs, an External TLAC calibrated at 16.0% of RWAs, considered together with the capital conservation buffer and the applicable G-SIB buffer, results in more than sufficient loss-absorbing capacity to ensure that bail-in produces sufficient capital to cover losses in an extreme stress scenario and to permit the recapitalized firm to continue to provide critical financial services.<sup>13</sup>**

The FSB did not tie the Proposal's indicative calibration of External TLAC—(i) a Pillar 1 component of 16%-20% of RWAs (exclusive of buffers) but not less than twice the Basel III leverage exposure plus (ii) a Pillar 2 component—to any explicit standard for how TLAC should be calibrated or to a quantitative framework and analysis for its calibration. By an “explicit standard,” we mean a standard against which the calibration of External TLAC can be evaluated that is more informative than a mere statement of a general objective. By a “quantitative framework and analysis,” we mean a framework and analysis that draw a nexus among (i) the amount of required TLAC, (ii) the application of conservative standards in stress scenarios to losses that a G-SIB might incur in a resolution after exhaustion of its capital conservation and G-SIB buffers, and (iii) the levels of necessary capital of the G-SIB in the period shortly after commencement of the resolution proceeding.

We believe it is essential that the final TLAC framework's calibration be responsive to a clearly enunciated standard for its calibration and that the application of that standard to the calibration be supported by a credible quantitative framework and analysis. Applying the standard, discussed further below, that shortly after failure and the bail-in of TLAC instruments the G-SIB in resolution should meet minimum capital requirements plus the capital conservation buffer, we believe required External TLAC should not exceed 16.0% of the relevant G-SIB's RWAs.<sup>14</sup> ***External TLAC equal to 16.0% of RWAs, taken together with the 2.5% capital conservation buffer and the applicable G-SIB buffer (1.0%***

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<sup>13</sup> Because no jurisdiction to date has imposed a countercyclical capital buffer, we are not specifically addressing that buffer in this discussion. If a countercyclical capital buffer were imposed, however, it would provide even greater loss-absorbing capacity.

<sup>14</sup> Additionally, as discussed in Part II.A.3, if a leverage requirement is imposed, we believe the leverage floor on the 16.0% RWA requirement should be 6.0% of the resolution entity's Basel III leverage ratio exposure measure.

**to 2.5% as currently calibrated under international standards),<sup>15</sup> effectively means loss-absorbing capacity of 19.5% to 21% of RWAs.**

The Standard. Although the Proposal addresses the purpose of TLAC, it does not identify or explain the standard against which minimum TLAC is supposed to be calibrated. It is important that the FSB clearly identify and explain that standard. Calibrating External TLAC against an identified and explained standard will enhance the market's confidence that TLAC will make possible orderly resolutions without interruption of critical functions. Equally important, the application of a clear standard (and explanation of the thought process behind the standard) will enhance the understanding of the taxpaying public more generally and their elected officials as to how taxpayers are protected—what measures have been taken to eliminate the “too-big-to-fail” risk and resultant taxpayer bail-out concerns. Moreover, absent a clearly stated standard as a benchmark for analysis, it is impossible for interested parties to comment meaningfully on a proposed calibration.

The Proposal includes two statements of purpose—essentially objectives to be achieved through TLAC. They are in Principle No. 1 and Term Sheet § 6 and use substantially identical language. Quoting Principle No. 1, “[t]here must be sufficient loss absorbing and recapitalization capacity available in resolution to implement an orderly resolution that minimizes any impact on financial stability, ensures the continuity of critical functions, and avoids exposing taxpayers (that is, public funds) to loss with a high degree of confidence.” And Principle No. 5, perhaps coming a degree closer to a standard for calibration, states that the “institution or successor institution (*e.g.*, bridge institution) has to meet at least the minimum conditions for authorization in order that supervisors may allow it to continue performing authorized activities, in particular critical functions.” Generally speaking, we agree with the Proposal's formulation of the purpose of TLAC and Principle No. 5's formulation of a minimum condition. But, as a standard for benchmarking, what amount of TLAC is necessary to satisfy these objectives?

We believe the standard in calibrating the External TLAC requirement should be that the resolution entity, in the period shortly after commencement of the resolution proceeding and after giving effect to the bail-in (*i.e.*, write-down or conversion in accordance with the home country's laws and rules, including bankruptcy and insolvency laws, as applicable), should meet its Basel III minimum regulatory capital requirements plus the capital conservation buffer, meaning CET1 of 7.0%, Tier 1 capital of 8.5% and Total capital of 10.5%.<sup>16</sup>

A case can be made that it is sufficient if the failed institution emerges with capital meeting its Basel III minimum capital requirements alone and exclusive of the capital conservation buffer. As the Proposal notes in Principle No. 5, “[r]esolution is not resurrection. But nor is it insolvency.” A resolution entity that meets minimum regulatory capital requirements is by definition a viable going concern. The Basel Committee noted in its final Basel III framework that:

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<sup>15</sup> This assumes that G-SIB buffers range from 1% to 2.5%, as reflected in the FSB's November 2014 estimation of buffer requirements for the 30 G-SIBs, which left the 3.5% G-SIB bucket empty. Applying the U.S. Federal Reserve Board's recently published proposal for a super-equivalent G-SIB buffer for U.S. G-SIBs, with a top bucket of 4.5% (and under some circumstances, even higher), an External TLAC equal to 16% of RWAs means loss-absorbing capacity of up to 23% (or conceivably even more).

<sup>16</sup> It is important to keep in mind that the post-resolution entity inevitably will be somewhat, and likely substantially, diminished as compared to the original entity, both in its size as well as systemic importance.

“banks will be able to conduct business as normal when their capital levels fall into the conservation range as they experience losses. The constraints imposed only relate to distributions, not the operation of the bank.”<sup>17</sup>

A standard that requires a G-SIB post-resolution to meet its minimum capital requirement plus the capital conservation buffer, as opposed to merely meeting its minimum capital requirements as the regulatory standard for viability, may be appropriate in view of uncertainties as to the behavior of market participants in a crisis environment. However, we do not believe that the standard should be higher than minimum ratios plus the capital conservation buffer. Imposing a higher post-failure capital expectation would move the rationale for TLAC from the post-failure objectives described above to a pre-failure resiliency standard designed to minimize the likelihood of a failure.

Quantitative Framework and Analysis. The FSB indicated, in the introductory paragraphs to the Proposal, that the FSB Studies will include “[a] survey of historical losses and recapitalization needs” and that that survey, along with other components of the FSB Studies, will be used to calibrate the External TLAC requirement. We understand the FSB will consider all available data as it calibrates External TLAC, including The Clearing House TLAC Analysis and analyses of losses and recapitalization needs that other commenters may submit.

The Clearing House TLAC Analysis, attached as Annex B, includes an analysis of capital depletion applying two methodologies. Because The Clearing House is a trade association for U.S. banks and non-U.S. banks having U.S. operations, its focus is on and its analyses are of the U.S. G-SIBs and U.S. markets. One of the methodologies used in The Clearing House TLAC Analysis is a forward-looking analysis of capital depletion—*i.e.*, losses as projected for the eight U.S. G-SIBs over the nine quarters commencing with October 2013 and continuing through December 2015. This methodology used the Federal Reserve’s loss estimates and PPNR projections<sup>18</sup> as to the eight U.S. G-SIBs released in March 2014 in connection with the 2014 DFAST stress testing exercise. The data shows losses based on the Federal Reserve’s severely adverse scenario, which assumes macro-economic conditions that we understand are intended to be at least as severe as, if not more severe than, those during the 2008 financial crisis and its aftermath. The second methodology is backwards-looking (*i.e.*, historical) and addresses loss experience at seven U.S. financial institutions, with the losses being incurred during the financial crisis as to six of the institutions and, as to one of the institutions (Continental Illinois), in connection with its failure in 1984. These methodologies and related assumptions are explained in more detail in The Clearing House TLAC Analysis.

The two methodologies used in The Clearing House TLAC Analysis show that External TLAC of 16%—which means actual loss-absorbing capacity of 20.1% when taken together with the 2.5% capital conservation buffer plus the RWA-weighted average U.S. G-SIB buffer applying the FSB’s framework (and not the Federal Reserve Board’s super-equivalent) as estimated using RWAs as of September 30, 2013—results in:

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<sup>17</sup> Basel III, at ¶ 129.

<sup>18</sup> The Clearing House TLAC Analysis, in order to examine the most conservative approach, also applied a methodology that addressed losses and resulting capital ratios without giving the G-SIBs credit for PPNR. See Annex B. However, we continue to believe there is no logical basis for not giving credit for PPNR.

- loss coverage of 4.4x for the DFAST-based forward-looking methodology;<sup>19</sup> and
- loss coverage of 2.6x for the historical methodology.<sup>20</sup>

Applied to the standard for the calibration of External TLAC discussed above—that in the period shortly after commencement of the resolution proceeding and after giving effect to the bail-in of eligible TLAC instruments a G-SIB should meet its minimum Basel III capital requirements plus the capital conservation buffer—and assuming the 20.1% loss-absorbing capacity described above and that all External TLAC is converted into common equity, the average post-failure and post-bail-in risk-based capital ratios would exceed the minimum plus capital conservation buffer standard of 7.0%, 8.5% and 10.5% for the CET1 ratio, Tier 1 ratio and Total capital ratio, respectively:

- under the DFAST-based forward-looking methodology, by 8.5 percentage points for the CET1 ratio, 6.6 percentage points for the Tier 1 ratio, and 4.4 percentage points for the Total capital ratio;<sup>21</sup> and
- under the historical methodology, by 5.3 percentage points for the CET1 ratio, 3.8 percentage points for the Tier 1 ratio, and 1.8 percentage points for the Total capital ratio.

Consideration of Buffers in Calibrating External TLAC. Term Sheet § 4 provides that External TLAC for purposes of the minimum requirement “does not include any applicable regulatory capital buffers”—*i.e.*, buffers “sit on top.” The Proposal distinguishes between (i) regulatory capital buffers, which must be useable “without entry into resolution,”<sup>22</sup> and (ii) TLAC, which “must be sufficient . . . in resolution to implement an orderly resolution, minimize the impact on financial stability, ensure the continuity of critical functions, and avoid exposing taxpayers’ funds to loss with a high degree of confidence.”<sup>23</sup>

Although we are neutral as to whether buffers should be included in or excluded from the calculation of External TLAC, we believe that the calibration of TLAC, comparing capital depletion in a stress scenario against loss-absorbing capacity, must take into account buffers irrespective of whether buffers are formally included in External TLAC. The existence and amount of capital buffers, designed to minimize the likelihood of a failure occurring, cannot be divorced from the quantification of minimum External TLAC, designed to address what happens in a resolution. For the eight U.S. G-SIBs, based upon reported RWAs at September 30, 2014 and assuming application of the Basel Committee’s G-SIB buffer percentages, as opposed to the U.S. banking agencies’ higher proposed percentages, on a fully phased-in basis, the aggregate buffer amounts (both capital conservation and G-SIB) would have been

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<sup>19</sup> The projected capital depletion under the DFAST-based methodology is 4.6% of RWAs.

<sup>20</sup> The projected capital depletion under the historical methodology is 7.8% of RWAs (or 5.3% of RWAs when only the most relevant institutions are included). See Annex B.

<sup>21</sup> Capital depletion under the supervisory severely adverse stress scenario is based on Table 3 in “Dodd-Frank Act Stress Test 2014: Supervisory Stress Test Methodology and Results,” March 2014, Board of Governors of the Federal Reserve System.

<sup>22</sup> Principle No. 9.

<sup>23</sup> Term Sheet § 6.

approximately \$281 billion (based on RWAs at June 30, 2014). That is an enormous amount of capital that is available to absorb losses and cannot and should not be ignored.

The timing of a resolution is key to this issue—when does the failure occur. Any determination of loss coverage must come to grips with the choice of whether the starting point is TLAC plus buffers or only TLAC, as outlined in the Proposal. The FSB highlights this issue in Principle No. 4 when it states that “[i]n setting minimum TLAC, authorities should make appropriately prudent assumptions about losses incurred prior to resolution, as well as losses realized in the prudent valuation necessary to inform resolution actions.” We believe the starting point must be TLAC plus buffers. Supervisors are more broadly and deeply engaged than ever before in their oversight role and have more tools than ever before to initiate a resolution in a timely manner. External TLAC should be calibrated on the premise that regulators act reasonably decisively when the point of non-viability is reached, without unreasonable delay. It is irrelevant whether losses at a G-SIB resolution entity are absorbed by capital buffers prior to a failure or by other eligible External TLAC instruments after failure.

Other Considerations. During the past 18 months, as the FSB and other national regulators (including the Federal Reserve) have been working to develop TLAC and related proposals, the Associations have had a number of discussions with regulators relating to considerations bearing on methodologies for analyzing losses in connection with the calibration process. The comments below address certain important aspects of those discussions.

First, regulators have asserted that loss experience during the financial crisis may be understated because losses incurred would have been greater had governments not intervened and provided the support they did, including through capital infusions, asset purchases and debt guarantee programs for banks and non-banks. We acknowledge that a loss avoidance impact of governmental intervention may have existed, but it is very difficult, if not impossible, to quantify it. In any event, one of the two methodologies applied in The Clearing House TLAC Analysis was forward-looking, and forward-looking estimates are not affected in any obvious way by past governmental interventions.

Moreover, the extent and depth of market and bank reforms since the financial crisis act strongly in the other direction. Changes in risk profiles of G-SIBs, in large part resulting from these reforms, offset and possibly outweigh any understatement of losses resulting from government intervention. It is indisputable that, were a financial crisis to occur today of equal magnitude to the 2008 global crisis, G-SIBs would weather the crisis much more easily and emerge with stronger capital. Put another way, if all the global systemically important financial institutions had been in compliance with today’s capital and liquidity standards, and subject to counterparty credit limits and clearing requirements at the end of 2007, it would be very difficult to assert that the governmental interventions noted above would have been required.

The risk profiles of today’s G-SIBs are much different from 2008. That is in part due to regulatory reform. Capital (both as to levels and content) is much more robust than pre-crisis. As Mark Carney, Governor of the Bank of England and Chair of the FSB noted in a recent speech:

“Capital requirements for banks are much higher, as are risk weights and the quality of bank capital. In all, new capital requirements are at least seven times the pre-crisis standards for most banks. For globally systemic banks, they are more than ten times []. Large internationally active banks are on course to meet the new requirements 4 years ahead

of the 2019 deadline. Despite the scale of the changes, the aggregate shortfall of those banks that still have shortfalls was €15bn at end 2013, having been €115bn two years ago.”<sup>24</sup>

Liquidity reform measures, revolving around the Basel III liquidity coverage ratio and net stable funding ratio, have also much improved liquidity risk management. As Daniel Tarullo, a Governor of the Board of Governors of the Federal Reserve System, noted in recent testimony:

“The accelerated phase-in of the U.S. LCR reflects our objective that large U.S. banking firms maintain the improved liquidity positions they have already built following the financial crisis, in part because of our supervisory oversight. We believe the LCR will help ensure that these improved liquidity positions will not weaken as memories of the financial crisis fade.”<sup>25</sup>

Additionally, other areas of reform have been finalized or implemented or are well on their way (even in advance of mandatory compliance dates or, in some cases, even finalization), including limits on large exposures to related counterparties, derivatives reform (including both margining and clearing of standardized derivatives through central counterparties), expanded data gathering (important to both management and supervisors) and reporting requirements, and improved risk management and governance requirements. Supervisory oversight is more intense than ever, and bank managements have greatly expanded resources devoted to risk management.

Second, banks and regulators have debated whether TLAC-like initiatives should be analyzed and calibrated against the performance of the most extreme cases—the outliers—or against averages. We think neither is correct. The calibration should be against the worst performers that are legitimately comparable to G-SIBs. Accordingly, we strongly believe that the analysis and calibration should not focus on outliers identified by some regulators, not because they were outliers in terms of losses but because they were outliers in terms of business models and concentrations. The institutions classified as G-SIBs have much more diversified businesses than the commonly cited outliers during the global crisis—such as the thrift-chartered institutions in the United States and similar banking organizations outside the United States, such as Anglo Irish in Ireland and Northern Rock in the United Kingdom. Each was not only a monoline in terms of real estate lending, but, even within real estate lending, had a concentration on weaker credits.

Third, as indicated above, we believe that the appropriate approach to calibrating External TLAC is to compare loss or capital depletion under the most relevant and reliable historical and forward-looking methodologies against a principled post-resolution capital benchmark. Moreover, it is important to keep in mind that G-SIBs will not maintain either TLAC or capital, including buffers, at minimum levels. Managing to minimum requirements creates the risk that, upon unanticipated (and perhaps even relatively insignificant) events, an institution could fall into its buffer zone and be limited in the dividends and employee compensation it may pay and perhaps become subject to other limitations on operations. Consistent with historical practice and prudent management, loss-absorbing

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<sup>24</sup> Mark Carney, Governor of the Bank of England, *2014 Monetary Authority of Singapore Lecture* (Nov. 17, 2014), at 4.

<sup>25</sup> Daniel K. Tarullo, Member, Board of Governors of the Federal Reserve System, *Statement before the U.S. Senate Committee on Banking, Housing and Urban Affairs* (Sept. 9, 2014), at 4.



capacity at the beginning of a period of distress likely will exceed the minimum requirements plus buffers. At June 30, 2014, we estimate the RWA-weighted average of the CET1 ratio for the eight U.S. G-SIBs exceeds their minimum ratios plus buffers (calculated as though the buffers were already applicable) by 2.9%. The likely maintenance of cushions on top of buffers should provide regulators additional comfort that our suggested approach for calibrating the External TLAC requirement is reasonable and conservative.

**3. The calibration of External TLAC against the Basel III leverage exposure amount, like the calibration against RWAs, should be specified as a fixed percentage of the leverage exposure amount.**

Term Sheet § 4 states that the minimum Pillar 1 External TLAC amount, in addition to being expressed as a percentage of RWAs, “must also be at least twice the quantum of capital required to meet the relevant Tier 1 leverage ratio requirement – that is, if the Basel 3 leverage ratio were set at 3% for G-SIBs, at least 6% of the Basel 3 leverage ratio denominator.” Term Sheet § 4’s formulation creates ambiguity as to the calculation of the leverage floor for G-SIBs in home countries, such as the United States, whose national regulators have adopted a higher Basel III leverage ratio.<sup>26</sup>

We urge the FSB to eliminate any ambiguity in the final TLAC framework by simply specifying that minimum External TLAC must be at least 6% of the Basel III leverage ratio exposure amount. Doing so would eliminate the ambiguity in the Proposal’s formulation and is consistent with Principle No. 3’s statement that “[a] common Pillar 1 floor is necessary to help achieve a level playing field internationally.”

**B. Excluded Liabilities**

Term Sheet § 12 excludes a number of categories of debt instruments from eligible External TLAC. Term Sheet § 12’s exclusion of these instruments, taken together with Term Sheet § 13’s requirement that External TLAC must be structurally, contractually or legally subordinate to excluded liabilities, has two consequences:

- first, the excluded instruments would not “count” for purposes of determining the amount of External TLAC an institution has outstanding; and
- second, the excluded liabilities must be given a preferred ranking by adding subordination provisions to the External TLAC instruments or moving the excluded instruments from the resolution entity to a subsidiary.

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<sup>26</sup> Under the U.S. banking agencies’ Basel III-based capital rules, the Basel III-based leverage ratio (called the supplementary leverage ratio in those rules), as applied to G-SIBs that are BHCs, includes a 3% minimum requirement and a 2% buffer on top of the minimum. Regulatory Capital Rules: Regulatory Capital, Revisions to the Supplementary Leverage Ratio, 79 Fed. Reg. 57725, 57727 (Sept. 26, 2014). Depository institution subsidiaries of G-SIB BHCs must maintain a supplementary leverage ratio of at least 6% in order to be well-capitalized under the U.S. banking agencies’ prompt corrective action regulations. We believe that Term Sheet § 4’s intent is that the External TLAC leverage requirement for a U.S. G-SIB, taking into account the U.S. banking agencies’ super-equivalent approach, is 6%, and not (i) for a U.S. G-SIB BHC 2 x 5%, or 10%, because the 2% add-on is a buffer and the Proposal provides that buffers are not included in, and sit on top of, External TLAC or (ii) for a depository institution subsidiary of such a G-SIB 2 x 6%, or 12%, because the prompt corrective action standards are not minimum requirements. However, the FSB’s international formulation should avoid any ambiguity as to the calculation of the leverage floor.

In some cases, these provisions appear appropriate to ensure that (i) sufficient External TLAC will actually be available for bail-in when and if resolution occurs (and, importantly, will not be repaid or extinguished prior to resolution) and (ii) disputes or delays during the resolution process will be avoided. In other cases, however, the provisions do not appear to be necessary for any of these purposes, or otherwise relevant to the utility of the instrument for resolution purposes.

We believe the question of “excluded liabilities” must be divided into three parts. First, which liabilities should be both excluded from External TLAC and insulated from losses by being contractually, legally or structurally senior to an External TLAC “shield”? Second, which liabilities should be subject to bail-in but not included in External TLAC? Third, which liabilities should be excluded from both External TLAC and bail-in, but nevertheless be allowed to be *pari passu* with External TLAC?

Additionally, and as a core principle, all unsecured indebtedness for borrowed money with an original maturity of at least one year, irrespective of the remaining maturity,<sup>27</sup> should be subject to bail-in upon a resolution, whether or not the indebtedness is counted toward required External TLAC. Creditors holding instruments evidencing such indebtedness should be aware—and will become aware, to the extent they are not already,<sup>28</sup> as External TLAC requirements are implemented and disclosure in offering documents and periodic reports is enhanced—that their claims will be bailed in in a resolution of the issuer. There is no reason to prefer any creditors on such instruments over other creditors in resolution, as they all have agreed to provide longer-term funding. There is value in financial companies being able to issue a variety of instruments to obtain required funding, depending on market conditions, investor appetite, and the tenor and amount of funding required. Only those excluded liabilities that need to be preferred to avoid a threat to financial stability, such as debt with an original maturity of less than one year or other operating liabilities as distinguished from capital structure liabilities, should be required to be structurally, legally or contractually preferred to External TLAC.

Also as a core principle, all unsecured indebtedness for borrowed money with an original maturity of at least one year and a remaining maturity of at least six months should be included in eligible External TLAC unless there is reason to believe that the instruments can and will be repaid or extinguished in anticipation of a resolution proceeding (*e.g.*, because the instrument includes a put right exercisable by the holder). In other words, eligible External TLAC should include all the instruments that can be relied upon to be available to be bailed in when a resolution proceeding is begun, and all instruments that can be bailed in should be bailed in in resolution whether or not they are included in Eligible TLAC. There can be no disagreement that it is better for a regulatory authority administering a resolution to have more rather than less liabilities that can be bailed in.

We have provided more specific comments concerning excluded liabilities and the criteria for eligible External TLAC below in this Part II.B and in Part III.B.

**1. The final TLAC framework should permit G-SIBs to incur and maintain unsecured liabilities that (i) are not eligible for inclusion as Eligible TLAC but (ii) do not pose a threat to financial stability such that regulators would be**

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<sup>27</sup> See Part III.B.3 where we address why we believe the FSB should change the Proposal’s standard for External TLAC of a remaining maturity of at least one year to a remaining maturity of at least six months.

<sup>28</sup> Creditors in the United States are already aware of the possibility of bail-in, which is priced into the funding costs for large banks. See U.S. Gov’t Accountability Office, GAO14-621, Large Bank Holding Companies: Expectations of Government Support 46-55 (2014).

**tempted to protect them—*i.e.*, to “bail them out”—in a resolution. These unsecured liabilities should be bailed in in a resolution, even if they do not count toward Eligible TLAC. Additionally, the Term Sheet’s priority provision should be refocused to require subordination of External TLAC only to liabilities, such as unsecured operating company derivatives that are subject to immediate close-out upon default, that must be preferred to an External TLAC “shield” to avoid a threat to financial stability.**

Term Sheet §§ 12 and 13, read together, take an approach to a G-SIB resolution entity’s liabilities that is binary. A liability is either:

- included in External TLAC (*i.e.*, the liability counts in the numerator of the External TLAC ratio) and subordinated to all excluded liabilities; or
- not included in External TLAC (*i.e.*, the liability is an excluded liability that does not count in the numerator) and senior to External TLAC.

This approach is the consequence of Term Sheet § 13’s requirement that all excluded liabilities be contractually, legally or structurally preferred to all External TLAC. It fails to accommodate two other possibilities:

- first, that a resolution entity may have liabilities that should not be included in External TLAC but that, in a resolution, nevertheless would be available to absorb losses and, accordingly, would and should be bailed in, on a *pari passu* basis with External TLAC (*e.g.*, liabilities that no longer count as External TLAC merely because the remaining period to maturity is too short). In other words, a resolution entity should be permitted to have excluded liabilities that are not contractually, legally or structurally preferred to External TLAC but should be bailed in upon a resolution; and
- second, that there is a category of liabilities that a resolution entity should be permitted to have, that are not and should not be included in External TLAC and should not be bailed in upon a resolution, but should be allowed to rank *pari passu* with External TLAC. This category includes some types of liabilities that an entity cannot avoid maintaining—*e.g.*, vendor and other liabilities necessary to function as a holding company.

In order to address these considerations, we believe the FSB should revise the definition of excluded liabilities in Term Sheet § 12 to accommodate three different types (“**Types**”) of excluded liabilities, which we are labeling as “**Type I excluded liabilities**”, “**Type II excluded liabilities**” and “**Type III excluded liabilities**”. The common feature of the three Types of excluded liabilities is that they all are excluded from External TLAC (*i.e.*, not counted in the numerator of the External TLAC ratio). The three Types differ in respect to (i) whether under Term Sheet § 13 they would be required to be structurally, contractually or legally preferred to External TLAC (Type I would, but Types II and III would be *pari passu* with External TLAC) and (ii) whether they would be subject to bail-in before Type I excluded liabilities, which as preferred liabilities would be the last liabilities to be bailed in (Type II would, but Type III would not). More specifically:

- Type I excluded liabilities: these are unsecured liabilities that (i) should be excluded from External TLAC and (ii) must be structurally, contractually or legally preferred to External TLAC in order to insulate them from losses until External TLAC is exhausted to avoid a threat to financial stability.

Type I excluded liabilities include:

- insured deposits (Term Sheet § 12.a);<sup>29</sup>
  - debt securities having an original maturity of less than one year and unsecured derivative contract liabilities (e.g., those of operating companies) that do not qualify as Type III excluded liabilities; and
  - any other liabilities that, under the laws governing the issuing entity, cannot be effectively written down<sup>30</sup> or converted into equity by the relevant resolution authority and that do not qualify as Type III excluded liabilities (Term Sheet § 12.g).
- Type II excluded liabilities: these are unsecured liabilities that (i) should be excluded from External TLAC but (ii) should be subject to bail-in upon a failure and (iii) should not be required to be structurally, contractually or legally preferred to External TLAC under Term Sheet § 13. G-SIB resolution entities should be permitted to incur these liabilities notwithstanding that they do not count as External TLAC. The reason for our proposed treatment is that these liabilities do not permit their holders to withdraw cash on demand or within an original period of less than one year like short-term debt; a bail-in of these liabilities will not threaten financial stability if they are allowed to rank *pari passu* with External TLAC that is subject to bail-in; and there is no impediment to bailing in these liabilities upon a failure.<sup>31</sup>

Type II excluded liabilities include:

- any debt instrument that had an original maturity of at least one year but has a remaining maturity of less than one year (or six months if the FSB accepts our recommendation) and that does not qualify as a Type III excluded liability;<sup>32</sup>
- liabilities that are funded directly by the issuer or a related party of the issuer, except where the relevant home and host authorities in the Crisis

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<sup>29</sup> Term Sheet references are to Sections of the Term Sheet that correspond to our allocation of excluded liabilities among the three Types, albeit in some cases with edits in our descriptions.

<sup>30</sup> For example, in a resolution strategy that uses a bridge company (as is contemplated in the United States for a SPOE strategy under Title II of the Dodd-Frank Act), this would include liabilities that the resolution authority determines cannot be left behind in the receivership.

<sup>31</sup> See Part III.B.1.

<sup>32</sup> The Term Sheet addresses maturing long-term debt in Term Sheet § 11. The subject seems more appropriately addressed in Term Sheet § 12's consideration of excluded liabilities. See Part III.B.3 concerning the choice of six months versus one year for the remaining maturity standard.

Management Group (“**CMG**”) agree that it is consistent with the resolution strategy to count eligible liabilities issued to a parent of a resolution entity towards External TLAC (Term Sheet § 12.c); and

- any debt instrument with an original maturity of at least one year (i) to the extent of the principal amount of the debt instrument that is puttable by the holder to the issuer within one year (or six months if the FSB adopts our recommendation for minimum remaining maturities) of the determination date without the issuer’s consent or (ii) the claim amount of the debt instrument in a failure is not readily ascertainable.
- Type III excluded liabilities: these are unsecured liabilities that should be excluded from both External TLAC and bail-in upon a resolution, but otherwise should be allowed to rank *pari passu* with External TLAC under Term Sheet § 13. In a direct bail-in, these liabilities would be assumed by the bail-in entity or allowed to be repaid in the ordinary course; in a bridge bail-in, these liabilities would be transferred to the bridge or allowed to be repaid in the ordinary course.

Type III excluded liabilities include:

- liabilities that are preferred to normal unsecured creditors under the relevant insolvency law, such as certain tax liabilities that have a statutory preference (Term Sheet § 12.f);
- vendor and operating liabilities, such as for utilities, rent, fees for services, and obligations to employees;
- guarantees by a resolution entity of liabilities of operating subsidiaries on derivatives and other contracts;
- limited unsecured liabilities on derivative contracts that, for example, may (i) arise during any gaps between daily postings of variation margin or (ii) represent required initial margin;<sup>33</sup> and
- liabilities arising other than through a contract (Term Sheet § 12.e).

We have attached as Annex C suggested revisions to Term Sheet §§ 12 and 13 that address the treatment of excluded liabilities described above as well as certain of our other comments in Part III.B concerning the Proposal’s eligibility criteria for External TLAC.

For the avoidance of doubt, the FSB should confirm in its final TLAC framework that all secured liabilities, to the extent of such security, are both excluded from External TLAC for purposes of Term Sheet § 12 and considered to be legally senior to External TLAC for purposes of Term Sheet § 13.

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<sup>33</sup> See Part II.B.2 where we discuss temporary unsecured liabilities on secured derivative contracts.

2. **Unsecured liabilities that can arise on derivative contracts at the top-tier parent BHC of U.S. G-SIBs are appropriately treated as Type III excluded liabilities because (i) the overwhelming majority of derivative contract liabilities of U.S. G-SIBs are incurred at the operating subsidiary level and are therefore structurally senior to External TLAC, (ii) only an immaterial amount of derivative contract liabilities exist at the top-tier parent level, and (iii) reforms in the regulation and conduct of derivatives activities and markets, including enhanced collateral requirements and the requirement that most derivatives clear through central counterparties (“CCPs”), make it unnecessary to require such unsecured liabilities to be subject to the subordination requirements in Term Sheet § 13.**

Term Sheet § 12.d treats liabilities arising from derivatives<sup>34</sup> as excluded liabilities. As discussed in Part II.B.1, the practical consequence of that treatment, taken together with Term Sheet §13’s priority provisions, is to preclude the top-tier BHC parent of a U.S. G-SIB from having any derivatives, even when used to hedge the BHC’s own risks.

The vast majority of a U.S. G-SIB’s derivative contract liabilities are incurred at the operating subsidiary level and function as operating liabilities. Such derivative contract liabilities should both be excluded from External TLAC and required to be structurally, contractually or legally senior to the External TLAC “shield” to reduce the threat to financial stability of their default, termination and close out.

In contrast, derivatives on the balance sheet of top-tier BHC parents are minimal, arise as a consequence of risk hedging activities, and are generally fully secured. Except for the limited amounts of exposures that are unsecured (as described below), they satisfy the requirements in Term Sheet § 13 even if they remain on the BHC’s balance sheet because their secured status means that they are legally senior to External TLAC. A BHC should not be precluded from having these secured derivative contract liabilities.

An issue with respect to these secured liabilities only arises because, as noted above, a portion of such liabilities can be temporarily unsecured during gaps in time between daily postings of variation margin, and initial margin may need to be held to meet regulatory requirements. Unless such limited unsecured liabilities are treated as Type III excluded liabilities, BHCs would no longer be able to hedge risks that arise as a result of issuing liabilities. We do not believe such an outcome is justified, because the volume of such limited unsecured derivative liabilities is immaterial. In addition, two major aspects of derivatives reform ensure that unsecured derivatives liabilities will remain immaterial: (i) the enhanced margin requirements for swaps and exchange traded futures and options and (ii) the requirement that most swaps be cleared through CCPs. These reforms address, we believe, most remaining concerns that may have caused the FSB to categorize derivatives as liabilities that not only do not count toward External TLAC but that also must be contractually, legally or structurally preferred to External TLAC. That is why in Part II.B.1 we have categorized limited unsecured liabilities on derivatives contracts as Type III excluded liabilities—*i.e.*, excluded liabilities that upon a failure need not be structurally, contractually or legally preferred to External TLAC under Term Sheet § 13.

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<sup>34</sup> We are using the term “**derivatives**” with the meaning we understand the FSB to be using in the Proposal—*i.e.*, to encompass both swaps and exchange-traded futures and options.

In most jurisdictions, the initial and variation margin requirements for uncleared swaps that have been proposed by regulatory authorities, and that are expected to be implemented in the near term, will require that variation margin be posted and collected on all amounts due under uncleared transactions and that margin be segregated and maintained by an independent custodian. In addition, the parties to an uncleared swap will be required to pay and collect variation margin in amounts that will cover each day's movements in the net value of the swaps. These requirements will significantly reduce the risk that, upon a counterparty default, the unsecured exposure of the non-defaulting counterparty is more than an immaterial amount. Moreover, for swaps required to be cleared through CCPs, end-user counterparties' direct exposure to each other has largely been eliminated.<sup>35</sup>

It is essential that resolution entities that must issue senior and subordinated debt as components of their External TLAC be able to hedge risks arising out of these issuances. Derivatives have been used by BHCs for many years to hedge their market risks and it is essential to the safe and sound operation of their businesses that transactions in such instruments continue to be permitted on a *pari passu* basis with instruments eligible to be counted as External TLAC. Given the limited amount of unsecured exposure on these derivatives, it is not necessary to force BHCs to push hedging activities through subsidiaries that would face third-party counterparties instead of the BHC facing third-party counterparties.

If the final TLAC framework does not address this issue by categorizing limited unsecured derivatives liabilities as Type III excluded liabilities, we strongly believe that, at the least, the final framework should be sufficiently flexible to permit national regulators to allow G-SIB resolution entities to have derivative liabilities that are not preferred to External TLAC if the regulator concludes that permitting the liabilities will not materially impede successful resolution upon a failure. This is particularly important for U.S. G-SIBs that are BHCs and that are expected to be resolution entities in an SPOE resolution (and is likely to apply to holding companies in other jurisdictions as well).

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<sup>35</sup> Although counterparties to cleared swaps will, of course, have exposure to the CCPs through which the swaps are cleared, and market participants that are not themselves clearing members will have exposure to the clearing members through whom they clear, given the margin requirements of the CCPs and the regulation of those organizations, we do not believe any temporary unsecured portions of these liabilities pose risks that should result in the resolution entities of G-SIBs being precluded from having temporary unsecured positions of swap transactions on their books. In addition, we note that the risks arising from cleared swaps are substantially similar to those arising in connection with listed futures products, which include futures contracts and related options on interest rates, securities, indices and other underlyers. These products are another category of derivatives, which are subject to separate but similar margin and clearing requirements. Financial institutions have utilized futures for hedging purposes for many years and the futures margining and clearing model, in many respects, formed the basis of the Dodd-Frank regulatory regime with respect to swaps. The use of futures similarly eliminates bilateral credit risk but exposes a market participant to clearing house credit risk and, if the participant is not itself a clearing member, to the credit risk of its clearing member.

- C. **Prepositioning raises inherent risks that regulators and banks are well aware of; most importantly, trapping resources in non-distressed subsidiaries and, as a consequence, limiting resources that may be quickly moved to a distressed subsidiary where problems may be arising. Nevertheless, to the extent some limited amount of prepositioning in the cross-border context, implemented through the Internal TLAC requirement, is required, we urge the FSB, as it refines the Internal TLAC proposal, to calibrate Internal TLAC at the minimum level necessary to engender sufficient cross-border trust.**

Internal TLAC should be unnecessary in principle. Resolution entities will have the means, motive and opportunity to support material subsidiaries. External TLAC provides the means to do so. The economic motive comes both from a resolution entity holding company's concern that allowing a material subsidiary to fail will adversely impact the rest of the group's operations and a desire to maximize returns, which in any conceivable case will encourage an institution to use its resources to support and maintain the franchise value of material subsidiaries and avoid realizing only their much lower liquidation values. And resolution planning and strategies now required—living wills and resolution plans in the United States—ensure that resolution entities and regulators will be prepared to act.

Furthermore, prepositioning has at least four costs: (i) it prevents the parent G-SIB from managing the location of capital within its group in the optimal manner during good times; (ii) it prevents the firm's management from managing a potential crisis to avoid failure; (iii) it prevents the firm's supervisors from managing a crisis pre-failure—*e.g.*, in the United States it impinges on source of strength; and (iv) it limits the home resolution authority's power to move assets where they are needed in a resolution proceeding post-failure. Furthermore, too much Internal TLAC can actually reduce incentives for cross-border cooperation because the host authority would have sufficient ring-fenced resources to insulate the local subsidiary.

If the final TLAC framework nevertheless follows the Proposal's approach, we believe that prepositioning should be limited to an amount necessary to address any distrust by host authorities of how home authorities will use a parent G-SIB's assets to recapitalize material foreign subsidiaries post-failure.<sup>36</sup> In particular, we believe that two key aspects of that approach should be retained. The first is its limitation of Internal TLAC, which is prepositioning, to cross-border support by a resolution entity in one country of a material subsidiary in another country. The second, in view of the purpose of Internal TLAC ("in order to facilitate co-operation between home and host authorities and implementation of cross-border resolution strategies that are feasible and credible"),<sup>37</sup> is Term Sheet § 22's recognition that any range for Internal TLAC in the FSB's framework is only indicative, with "the actual figure within that range . . . determined by the relevant host authority in consultation with the home authority."<sup>38</sup>

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<sup>36</sup> It is essential, for multiple reasons, to develop deep-seated trust between home- and host-country regulators. Accordingly, prepositioning should not be viewed as a substitute for development of trust.

<sup>37</sup> Term Sheet § 20.

<sup>38</sup> Term Sheet § 22.



Unlike the calibration of External TLAC discussed above in Part II.A, it is conceptually difficult (and perhaps impossible) to calibrate cross-border Internal TLAC against a quantitative analysis of the type we believe should be applied to the calibration of External TLAC. As reflected in Term Sheet § 20's statement of purpose, discussed above, the appropriate amount ultimately is a matter of judgment to be addressed in consultation between host and home country regulators; it is inherently subjective given its purpose. Generally speaking, we believe that 65% to 75% would strike a better balance for Internal TLAC, with the FSB stating a presumption toward the lower end of the range. This range would provide sufficient loss-absorbing resources in a local jurisdiction to encourage trust while still providing incentives for cooperation and flexibility to allocate capital. Unlike External TLAC, Internal TLAC is not the sole source of recapitalization of a material subsidiary because additional resources will remain at the parent level (which will be substantial if our proposed percentages are used). The substantial Internal TLAC percentages we propose, however, should be more than sufficient to establish trust. The higher the target, the greater are the four costs described above.

Apart from the calibration of Internal TLAC, we believe the approach taken by the FSB can be more principled and analytic in addressing most of the attributes of Internal TLAC. This applies particularly to the identification of material subsidiaries and the mechanics for recognition of guarantees and capital commitments as a substitution for Internal TLAC. Our specific comments in this regard are discussed in Part IV.

**D. The final TLAC framework should, to the maximum extent possible, eliminate provisions that are not supported by the Principles, create competitive advantages, and appear to be negotiated compromises to achieve international agreement.**

We appreciate that international frameworks of necessity involve negotiation and compromise reflecting the particular circumstances of different countries, their markets and institutions. And we agree that TLAC needs to accommodate not just the typical U.S. corporate structure where the parent G-SIB is a non-operating BHC expected to be resolved through an SPOE strategy, but also corporate structures and resolution mechanics in other countries, including universal banks and decentralized archipelago structures. However, we also believe that compromised terms that deviate from underlying principles and objectives should be identified, discussed and explained. The Proposal has several provisions of this type, including:

- inapplicability of the TLAC requirements to G-SIBs in emerging market countries, without any clear rationale for the exclusion or any specific sunset date (especially when those G-SIBs enjoy at least implicit government support);
- Term Sheet § 8's recognition of certain *ex ante* commitments to re-capitalize a G-SIB in resolution as External TLAC; and
- Term Sheet § 13's special treatment of excluded liabilities ranking on a parity with External TLAC (up to 2.5% RWAs) in certain jurisdictions.

Without a clearer understanding of the rationale for these provisions, we cannot meaningfully comment. We urge the FSB, in the final TLAC framework, to expressly address each of these provisions and to include them in the final framework only if the FSB determines they support a compelling objective that has been clearly enunciated and are implemented in a manner that minimizes disparate treatment.

### III. External TLAC

#### A. Term Sheet § 18's deduction of holdings by G-SIBs of other G-SIB's External TLAC must be carefully crafted and must have an exception for holdings of other G-SIB's External TLAC as part of *bona fide* underwriting and market making activities.

Term Sheet § 18 states that a G-SIB's deduction from its own TLAC or regulatory capital of exposures to eligible External TLAC liabilities of other G-SIBs is to be implemented "in a manner generally parallel to the existing provisions in Basel 3 that require a bank to deduct from its own regulatory capital certain investments in the regulatory capital of other banks," and then goes on to assign the Basel Committee the task of developing the provision. Term Sheet § 18 explains the purpose of its limitation on cross-holdings of TLAC as being "to reduce the risk of contagion."

Given the existing limitation on cross-holdings of regulatory capital instruments under Basel III-based capital rules, as well as other initiatives that limit exposures among financial institutions (including the Basel Committee's framework finalized in 2014 on large bank exposures),<sup>39</sup> we do not believe that additional TLAC-based restrictions on cross-holdings are necessary. If, nevertheless, the FSB concludes that a G-SIB's holdings of TLAC instruments of other G-SIBs should be limited, it is important that any limitation be designed in a way that does not result in significantly decreased liquidity in TLAC instruments, potentially reduced demand for these instruments in the secondary market, impaired price discovery, wider bid/ask spreads, slower execution, increased volatility, decreased demand for new issuances, and artificially higher interest and dividend rates on these instruments.

To this end, there are two principal considerations that the FSB (as it finalizes the TLAC framework) and the Basel Committee (as it proceeds to develop a provision responsive to Term Sheet § 18) must take into account—namely:

- it is not possible to simply incorporate limitations on holdings of External TLAC into the Basel III capital framework's treatment of holdings of regulatory capital; and
- it is essential that the detailed provisions include an exception for *bona fide* underwriting and market making activities.<sup>40</sup>

With respect to the first consideration, the Basel III capital framework's treatment of investments in other financial institutions was a product of thorough and iterative comment processes at the international and local levels. Similar processes will have to be undertaken in order to implement limitations on External TLAC. The 10% common equity thresholds for holdings of financial entities were established in Basel III without regard to potential inclusion of unsecured debt, and, as such, without regard to potential impacts of an External TLAC deduction on minimum capital requirements or debt markets. If net External TLAC debt holdings in other G-SIBs were simply included among a bank's other non-significant investments in financial entities, given the way the corresponding deduction approach is

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<sup>39</sup> Basel Committee, *Supervisory Framework for Measuring and Controlling Large Exposures* (Apr. 2014).

<sup>40</sup> Although perhaps implied by the reference to Basel III, which does address underwriting, Section 18 does not expressly address whether its required deduction of TLAC liabilities of other G-SIBs, when a framework is developed by the Basel Committee and implementing rules are adopted by national regulators, is expected to have an exception for holdings acquired by a G-SIB as a result of *bona fide* underwriting or market making activities.

prescribed in Basel III, it would be possible for debt holdings to cause deductions from a bank's common equity ratio. Instead, a distinct threshold and test should be established for G-SIBs' holdings of External TLAC instruments of other G-SIBs that is separate from the deduction for holdings in financial institutions under regulatory capital rules. As in the case of cross-holdings of regulatory capital instruments under the Basel III capital framework, some level of aggregate holdings by a G-SIB of External TLAC of other G-SIBs should not give rise to any deduction. Moreover, the threshold should be determined not with reference to CET1 but, instead, with reference to aggregate holdings of External TLAC instruments.

With respect to the second consideration (the need for an exception for *bona fide* underwriting and market making activities), most of the largest investment banking firms, whose underwriting and market making activities are critical to the ability of G-SIBs to raise TLAC as well as the liquidity of TLAC, are subsidiaries of G-SIBs. The Basel Committee's final framework for the G-SIB capital surcharge uses five indicators to determine whether a particular bank is a G-SIB and therefore subject to higher loss-absorbency requirements, including "size" and "underwritten transactions in debt and equity market" as part of the broader "substitutability" factor.<sup>41</sup> At minimum, the use of these two indicators alone guarantees that banks that have large capital markets operations and therefore are the banks that act as the leading underwriters and market makers in the global securities markets generally are the banks identified as G-SIBs under the Basel Committee's methodology (and therefore will also be subject to the TLAC requirement). The vast majority of trades in the debt markets, both for financial and corporate borrowers, cross through G-SIBs. It is also axiomatic that these very banks also serve as the underwriters and market makers for other banks that issue TLAC-eligible debt and equity securities in order to comply with the requirement set forth in the Proposal.

Underwriting activities represent the crucial link between issuers and investors which allow for the efficient issuance and distribution of External TLAC. Financial institution issuance is a large portion of the investment grade credit markets. If G-SIBs were effectively prohibited or significantly limited in making markets in these instruments through a deduction requirement, the market impacts would be substantial and would include the consequences referenced earlier in this section—namely, significantly decreased liquidity, potentially reduced demand for these instruments in the secondary market, impaired price discovery, wider bid/ask spreads, slower execution, and increased volatility. Decreased liquidity could also lead to a decreased demand for new issuances. The price of new issuances of External TLAC will take into account the reduced liquidity and potentially reduced demand in the secondary markets. Inevitably, given the integration of capital markets, these impacts would also occur in markets for debt securities of non-G-SIB issuers, both corporate and financial institution—*i.e.*, if the cost of senior debt of G-SIBs increases, the cost of senior debt having the same terms and issued by non-G-SIB corporate and financial entities of equivalent credit-worthiness will likewise increase.

Preserving the ability of G-SIBs to effectively engage in underwriting and market making activities without a prohibitive corresponding deduction from their own stock of TLAC is essential to ensuring that External TLAC can be issued system-wide in an efficient and cost effective manner by G-SIBs. While we recognize that non-G-SIBs may be able to also engage in such activities as they may not be subject to the same deduction—especially with respect to non-regulatory capital instruments—

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<sup>41</sup> See Basel Committee, *Global Systemically Important Banks; Updated Assessment Methodology and the Higher Loss Absorbency Requirement* (July 2013); see also Risk-Based Capital Guidelines: Implementation of Capital Requirements for Global Systemically Important Bank Holding Companies, 79 Fed. Reg. 75473 (Dec. 18, 2014).

these other entities lack the size and reach to act as practical substitutes for G-SIBs in this area, as reflected in their overall scores in the Basel Committee’s G-SIB surcharge methodology.

There is ample precedent for these exceptions. As noted above, the Basel Committee explicitly included an exemption for *bona fide* underwriting activities to Basel III’s deduction of significant and non-significant investments in the capital of banking, financial and insurance entities that are outside the scope of consolidation.<sup>42</sup> In its Fundamental Review of the Trading Book, the Basel Committee provides for a dealer exception for holdings of financial entities’ capital instruments in the trading book, where the bank can demonstrate it is “an active market maker.”<sup>43</sup> Similarly, in the United States, Section 619 of the Dodd-Frank Act, the so-called “Volcker Rule,” contains an important exemption for *bona fide* market making to the general prohibition on banks’ proprietary trading activities, and Section 2(a)(5)(B) of the U.S. Bank Holding Company Act includes an underwriting exemption from its limits on acquiring shares of banks. While Basel III does not provide a categorical exemption for market making activities, the deductions for regulatory capital instruments of unconsolidated financial institutions are not absolute, but rather only begin once certain thresholds are exceeded, such as the 10/15% of CET1 threshold for deduction of significant investments in the common stock of unconsolidated financial institutions.<sup>44</sup> Thus, we believe that Term Sheet § 18’s deduction for cross-holdings of Eligible TLAC in the form of regulatory capital instruments should be based on a similar, albeit separate threshold to encompass the flexibility to continue to engage in market making as to such instruments within the already prescribed Basel III limits.<sup>45</sup> With respect to Eligible TLAC that is not in the form of regulatory capital instruments already subject to deduction under capital rules, we believe holdings of such instruments in connection with *bona fide* underwriting and market making activities should be exempted from whatever deduction the Basel Committee and national regulators ultimately develop in order to ensure that G-SIBs can continue to engage in crucial market making activities as described above with respect to such instruments.<sup>46</sup>

Exempting *bona fide* underwriting and market making activities from the External TLAC cross-holding requirement will serve to further the Proposal’s purpose by helping ensure that G-SIBs can continue to issue such instruments in the global capital markets, thereby ensuring that “these firms have sufficient capacity to absorb losses, both before and during resolution.”<sup>47</sup>

## **B. Eligibility Criteria**

The comments below concerning specific aspects of the Proposal’s eligibility criteria further supplement our introductory comments in Part II.B concerning those criteria and the Proposal’s treatment of excluded liabilities. Most importantly, we believe that all unsecured indebtedness for

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<sup>42</sup> Basel III, at ¶¶ 80 and 84; *see also* Capital Adequacy of FDIC-Supervised Institutions, 12 C.F.R. § 324.2 (2014).

<sup>43</sup> Basel Committee, *Fundamental Review of the Trading Book: A Revised Market Risk Framework* (Oct. 2013), at 54.

<sup>44</sup> Basel III, at ¶ 87.

<sup>45</sup> *See* Term Sheet § 18.

<sup>46</sup> The specifics of defining *bona fide* market making activities should be left to national regulators. For example, in the United States, the regulators have implemented comprehensive rules, including quantitative metrics, to identify *bona fide* market making activities in the Volcker Rule context. *See e.g.*, Proprietary Trading and Certain Interests in and Relationships with Covered Funds, 12 C.F.R. § 44.4 (2014). For U.S. G-SIBs, market making activities permitted under this provision should presumptively be permitted *bona fide* market making not limited by Term Sheet § 18.

<sup>47</sup> Proposal at p. 4.

borrowed money with an original maturity of at least one year held by external creditors should be eligible for bail-in.

- 1. The final TLAC framework should not adopt a presumption that structured notes are ineligible for inclusion in External TLAC. Instead, structured notes should be eligible to be included in External TLAC if they satisfy all of the requirements otherwise applicable to eligible TLAC instruments in the final protocol and certain additional conditions designed to ensure operational feasibility of bail-in.**

Term Sheet § 12.d provides that Eligible TLAC must exclude “liabilities arising from derivatives or debt instruments with derivative-linked features, such as structured notes.” The Term Sheet does not define the term “structured notes.” While the term is not a term of art in industry usage, generally speaking, it refers to notes where all or a portion of the principal or interest amounts ultimately due vary with movement in a reference index or indices other than a standard floating interest index (this feature presumably being what the FSB is contemplating when it refers to “a derivative-linked feature”).

We do not believe that a note should be excluded from Eligible TLAC merely because it includes a derivative-linked feature. The inclusion of a derivative-linked feature does not preclude a resolution authority from bailing in the instrument. Nor should there be any confusion among investors as to whether their structured notes will be bailed in upon a resolution. They will be bailed in, and disclosure must be clear. There should be no “lack of clarity” concern.

It may be that the FSB is concerned (i) that bailing in structured notes in a resolution proceeding would be complicated by the fact that the claim represented by the structured note may be difficult to ascertain at that time or (ii) with the possibility that the claim represented by the structured note may fluctuate over the term of the note, making it more difficult to conclude that the quantity of External TLAC a G-SIB reports as of a reporting date will be available if a resolution occurs before the next reporting date.

Structured note obligations do not differ conceptually from plain-vanilla instruments that are hedged such as fixed rate bonds swapped to a floating rate. Issuers of structured notes similarly use swaps to hedge their exposures on the structured notes. In both cases, unsecured claims on the notes can be converted into equity in resolution. The balance sheet impact of bailing in both types of obligations can be ascertained, especially if the additional conditions outlined below are satisfied.

Additional conditions:

- Appropriate preparations, such as developing a system for determining the aggregate and individual amounts of claims under structured notes, should provide resolution authorities with the information they need to make a bail-in of structured notes just as effective and efficient as a bail-in of plain-vanilla notes.
- In order to determine the amount of bail-inable claims under structured notes in a timely manner for direct or bridge bail-in, G-SIBs must have a crisis-resistant system in place that can:

- periodically produce a list of outstanding structured notes, including those treated as Eligible TLAC;
  - on a daily basis determine what the aggregate and individual amounts of claims would be against the issuer under the structured notes, including those treated as Eligible TLAC, and how much capital would be generated by writing down such claims or converting them to equity; and
  - on a daily basis determine the net hedging positions on derivatives used to hedge the issuer's related liabilities, including swaps against both vanilla notes and structured notes, so that any rebalancing after resolution can be accomplished easily and quickly.
- The amounts determined by this system will be the amounts used to calculate the amount of loss-absorbing capacity of structured notes included in TLAC.
    - In the case of principal protected structured notes, this amount would be (i) the fair value of the notes, adjusted for any issuer-specific credit value adjustment reflected in the fair value on the issuer's balance sheet or (ii) any minimum amount payable upon early termination or entry into resolution.
    - In the case of structured notes that are not principal protected, upon early termination or entry into resolution, this amount would be the fair value of the notes, adjusted for any issuer-specific credit value adjustment reflected in the fair value on the issuer's balance sheet.
  - In order to ensure that it is operationally feasible to notify the holders of structured notes that their claims have been written down or converted into equity, how and when the amount of any equity to be delivered to them in satisfaction of their claims will be determined and delivered in a direct or bridge bail-in, and to actually deliver any such equity in a direct or bridge bail-in, structured notes included in TLAC must be held through a securities settlement system.
- 2. We request that the FSB confirm our understanding that senior and subordinated debt that is redeemable at the issuer's option is included in eligible External TLAC and that the issuer's redemption right is not considered a "derivative-linked" feature that precludes inclusion under Term Sheet § 12.d.**

Term Sheet § 12.d excludes from eligible External TLAC "debt instruments with derivative-linked features." An overly broad and literal reading of the phrase "derivative-linked features" could raise a question as to whether an issuer's redemption right (whether or not currently exercisable) included as a term of plain-vanilla debt is a "derivative-linked feature" making the debt ineligible for inclusion in Eligible TLAC. We assume such a reading was not the FSB's intent. Apart from substantive reasons discussed below why it would not be sensible to exclude from eligible External TLAC debt with issuer redemption rights, Term Sheet §§ 12.b and 15 taken together require that redemption of External TLAC must be subject to supervisory approval unless the debt being redeemed is replaced with other

eligible External TLAC. These provisions impliedly assume that the inclusion of a redemption right does not in and of itself preclude the related liability from eligible External TLAC status.<sup>48</sup>

As to substance, a substantial amount of senior unsecured debt issued in the capital markets with original maturities of 10 years or more includes an issuer redemption right after lapse of a specified no-call period but prior to the final maturity date. The inclusion of an issuer redemption right does not give rise to any run-risk. Nor does it implicate in any other respect the standards we believe should warrant treating a debt instrument as an excluded liability<sup>49</sup>—namely, making it impossible or impractical to determine the claim represented by the debt instrument (which is the standard we believe should apply to Type II excluded liabilities) or creating uncertainty as to whether the instrument can be bailed in (which is the standard we believe should apply to Type I excluded liabilities).

Accordingly, we request that the FSB confirm in the final TLAC framework that an issuer’s redemption right is not a feature—derivative-linked or otherwise—that precludes inclusion of an instrument in External TLAC.<sup>50</sup>

- 3. Term Sheet § 11 provides that eligible External TLAC “must have a minimum remaining maturity of at least one year.” We urge the FSB to revise this standard to provide, in the final TLAC framework, that eligible External TLAC must have an original maturity at issuance of at least one year but a remaining maturity at any point in time of at least six months.**

As noted above, in our view any unsecured debt that had an original maturity of at least one year and remains outstanding at the time of resolution should be subject to bail-in and would serve as TLAC as a result, even if not included in the numerator of the minimum External TLAC requirement. There is no concern either as to whether such debt is bail-inable. Accordingly, the only basis for excluding unsecured debt with a remaining maturity of less than one year from Eligible TLAC would be a concern that such debt would not be available for bail-in at the time of resolution—*i.e.*, that between a calculation date and the date of a G-SIB resolution entity’s failure the debt would mature and not be available as TLAC at the time of failure.

We believe a remaining maturity requirement of at least one year is unnecessarily long and request that the FSB consider replacing this requirement with a requirement that the remaining maturity be at least six months. Even during the financial crisis, the period between an institution’s distress becoming apparent and its collapse was generally less than six months. The enhanced supervisory tools now available to regulators make it even less likely that the period between a G-SIB resolution entity’s distress becoming apparent and failure, were it to occur, would exceed six months.

We note two other considerations in this regard. First, the FSB may have been concerned with a “cliff effect”—*i.e.*, that G-SIB resolution entities may have substantial amounts of

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<sup>48</sup> See Part III.C for our comments on those sections of the Term Sheet.

<sup>49</sup> See the discussion in Part II.B.1.

<sup>50</sup> Our suggested revisions to Term Sheet §§ 12 and 13 address this by, in our proposed definition of Type II excluded liabilities, replacing the general reference to debt instruments with derivative-linked features to debt instruments where there is uncertainty as to whether the claim represented by the instrument is an ascertainable amount readily calculable by the issuer and that will be available for bail-in at the time of resolution.

unsecured debt maturing at or about the same time, creating concerns if the entity cannot refinance the maturing debt. Supervisors have increasingly focused on the maturity schedules of financial institutions' indebtedness with just this point in mind. We believe it can (and has been) addressed as a supervisory and sound management matter and need not be a consideration for determining what is or is not included in External TLAC.

Second, the Basel Committee's recently finalized net stable funding ratio framework applies a 50% available stable funding factor to funding with a residual maturity of more than six months and less than one year, including funding provided by financial institutions.<sup>51</sup> That factor reflects recognition of the relative stability of indebtedness with a maturity of at least six months. It would be consistent for the FSB to similarly recognize the stability of the unsecured debt with a remaining maturity of at least six months by not excluding such debt from External TLAC.

**C. The final TLAC framework should not require prior supervisory approval of redemptions of External TLAC liabilities.**

Term Sheet §§ 12.b and 15, taken together, provide that a G-SIB may redeem liabilities qualifying as External TLAC prior to maturity only if the G-SIB has received prior supervisory approval of the redemption, unless the G-SIB is replacing (impliedly contemporaneously) the External TLAC proposed to be redeemed with new External TLAC of the same or better quality and the replacement is done at conditions which are sustainable for the income capacity of the bank. We believe that each of these provisions should be deleted from the final TLAC framework.

First, there is no compelling substantive reason to require prior supervisory approval of redemptions. The External TLAC requirement is just that—a requirement—and, as a practical matter, a G-SIB could not redeem an External TLAC instrument if the consequence of the redemption would be to cause the G-SIB to fail to meet its External TLAC requirement and subject itself to sanctions.

Second, Term Sheet §§ 12.b and 15 are relevant primarily to senior debt. For External TLAC instruments that are regulatory capital, Basel III generally requires supervisory approval before a bank may redeem a regulatory capital instrument.<sup>52</sup> We are not proposing that the Basel III redemption requirement as already implemented by national regulators be changed. However, senior debt for most G-SIBs represents a substantial portion of total liabilities. If the resolution entity concludes that it no longer needs a certain issue (or portion of an issue) as a funding source or for any regulatory reason and that profitability and operational efficiency will be enhanced by redeeming the senior debt, it should be able to do so. Liabilities are redeemed frequently in the normal course of business and, notwithstanding the good faith efforts of supervisors to respond to redemption requests and requests for common share repurchases reasonably promptly, practical experience with redemptions of regulatory capital instruments shows that it takes time to obtain requested approvals, time which could result in G-SIBs missing out on other opportunities in the market. There is simply no reason to subject issuers to these delays in circumstances where the G-SIB has excess External TLAC.

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<sup>51</sup> Basel Committee, *Basel III: The Net Stable Funding Ratio* (Oct. 2014), at ¶ 24.

<sup>52</sup> Basel III, at ¶¶ 55 and 58.



Third, Term Sheet § 15’s limited exception for prior approval when the instrument being redeemed is replaced with External TLAC liabilities “of the same or better quality” seems inappropriate in the context of the Proposal’s overall approach to TLAC. Unlike capital requirements, where some regulatory capital instruments have more compelling equity characteristics than others and, accordingly, may be “better” capital (*e.g.*, common equity *versus* preferred stock *versus* subordinated notes), that is not the case for External TLAC. The key necessary characteristics are the same across instruments—most importantly, can the instrument be bailed-in with legal certainty.

**D. Term Sheet § 16’s requirement concerning External TLAC governed by the law of a jurisdiction other than the issuing G-SIB’s home country should not apply if the only type of bail-in that is authorized by the home country insolvency or resolution regime is a bridge bail-in as opposed to a direct bail-in.**

Term Sheet § 16 would exclude from Eligible TLAC any instrument governed by the law of a jurisdiction other than that of the issuing G-SIB’s home country unless either (i) the instrument contains a provision specifically recognizing the application of resolution tools by the relevant resolution authority if the resolution entity enters resolution or (ii) there is an equivalent binding statutory provision for cross-border recognition of resolution actions. We believe that this does not adequately recognize the basic legal principles of international comity, and that this failure exaggerates a limited risk to the point where it outweighs the important values of flexibility and diversification for G-SIBs in issuing External TLAC debt.

Courts in most major jurisdictions do abide by the principle of international comity, under which they defer to the legislative, executive or judicial acts of another nation where international duty and convenience are consistent with, or not outweighed by, the rights of its own citizens or of other persons who are under the protection of its laws. For example, in the United States, “[c]omity will be granted to the decision or judgment of a foreign court if it is shown that the foreign court is a court of competent jurisdiction, and that the laws and public policy of the forum state and the rights of its residents will not be violated.”<sup>53</sup> This deference is particularly likely in the case of a foreign insolvency proceeding, and particularly when the policy to which deference is requested is a matter of fundamental public policy recognized broadly by regulators in many jurisdictions, including the United States, and by intergovernmental organizations in which the United States participates.

Term Sheet § 16 should not apply if a bridge bail-in is the only way to effect a bail-in—as is the case in the United States, whether under Title II of the Dodd-Frank Act, the Federal Deposit Insurance Act or the Bankruptcy Code. This is quite different from a direct bail-in as under the EU Bank Recovery and Resolution Directive, where a member state has the option to alter the contractual obligations of the issuer, which continues to remain open and operating.<sup>54</sup> Unlike a direct bail-in, a bridge bail-in is not effectuated by altering the contractual obligations of an issuer that otherwise remains open and operating. Instead, the issuer is closed, placed in a bankruptcy or receivership proceeding, and liquidated in a bridge bail-in, and the bail-in is effected as part of that liquidation. Here are the basic steps of a bridge bail-in:

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<sup>53</sup> *Cunard S.S. Co. v. Salen Reefer Servs. AB*, 773 F.2d 452, 459 (2d Cir. 1985) (“*Cunard*”).

<sup>54</sup> The BRRD requires each EU Member State to have the legal power to write-down or convert liabilities on the balance sheet of a legal entity into equity.

- close the issuer;
- place the issuer in a bankruptcy or a receivership proceeding;
- organize a new bridge company with no assets or liabilities;
- transfer all or a portion of the assets of the failed company to the new bridge company;
- cause the bridge company to assume all of the liabilities of the issuer, other than those left behind in the bankruptcy or receivership proceeding;
- liquidate any assets left behind in the bankruptcy or receivership proceeding, plus any residual claim of the bankruptcy estate or receivership to the equity of the bridge company;
- distribute (i) the equity in the bridge company (or the proceeds thereof) and (ii) any proceeds received from liquidating the assets left behind in the bankruptcy or receivership proceeding to the claimants left behind in the bankruptcy or receivership proceeding in satisfaction of their claims in the order of the priority of their claims; and
- terminate the insolvency or receivership proceeding.

To the extent that the combined value of (i) the equity of the bridge (or proceeds thereof) and (ii) the proceeds of the liquidated assets, is less than the sum of the claims against the issuer in the bankruptcy or receivership proceedings, the holders of any claim that receives a shortfall will be bailed in—*i.e.*, absorb losses to the extent of any shortfall.

To illustrate, if the debt of a U.S. BHC were governed by English law, it would be left behind in the bankruptcy or receivership proceedings and the holders of the debt would be unsecured creditors against the bankruptcy estate or receivership. A suit against the issuer in England could only reach the bankruptcy estate or the receivership of the issuer, and not the assets of the new bridge financial company. The reason is that the bridge financial company was not the original issuer of the debt and did not assume the original issuer's obligations. Instead, creditors' claims would be settled in the bankruptcy or receivership proceedings by distributing the equity of the bridge (or proceeds thereof) and the proceeds of the liquidated assets in the order of their priority of claims in full satisfaction of their claims. Importantly, in this mechanic, the language of the debt instrument is irrelevant.

If Term Sheet § 16 is not deleted in its entirety, we recommend that Term Sheet § 16 be changed to add the following third option: "or (iii) the only type of bail-in that is authorized by the home country insolvency or resolution regime is a bridge bail-in."

**E. The final TLAC framework should clarify that the determination of which entity or entities within a G-SIB group are resolution entities is to be made at the home country level.**

The Proposal does not attempt to specify which entities within a G-SIB group are resolution entities. Term Sheet § 2 simply states:

“a resolution entity is the entity or entities to which resolution tools will be applied in accordance with the resolution strategy for the G-SIB. Depending on the resolution strategy, resolution entities may be parent or subsidiary operating companies, or ultimate or intermediate holding companies.”

We noted in the introductory paragraphs to this letter our agreement with the Proposal’s lack of prescription with respect to the identification of resolution entities.

However, there is one aspect relating to the identification of resolution entities on which we think the final TLAC framework should be specific—namely, that the determination should be made at the level of the parent G-SIB’s home country, applying applicable laws, rules and procedures relevant to establishing a resolution strategy for G-SIBs headquartered in that country, and not by host country authorities for material subsidiaries of G-SIBs. A host country authority should not have the ability to designate a subsidiary of a G-SIB as a resolution entity. Home country authorities, working with G-SIBs headquartered in their jurisdictions, have supervisory responsibility for and oversight of the G-SIB’s enterprise-wide recovery and resolution strategy. It would be very disruptive to resolution planning to permit host country regulators to interfere with that process by designating subsidiaries in their jurisdictions as resolution entities.

**F. We do not understand the need for the Term Sheet’s minimum debt requirement or the rationale for choosing 33% as the percentage. Additionally, we firmly believe that, if a minimum debt requirement is imposed, it should only apply to External TLAC.**

Term Sheet § 7 states that:

“to help ensure that a failed G-SIB has sufficient outstanding long-term debt for absorbing losses and/or effecting a recapitalization in resolution, there is an expectation that the sum of a G-SIB’s resolution entity or entities’ (i) tier 1 and tier 2 capital instruments in the form of debt plus (ii) other eligible TLAC that is not regulatory capital, is equal to or greater than 33% of their Minimum TLAC requirements.”

The FSB did not address in the Proposal its reasoning for imposing a minimum debt requirement or how it arrived at 33% as the required proportion of External TLAC comprised of debt plus other eligible External TLAC that is not regulatory capital. It is not possible to comment meaningfully on the proposed debt requirement without understanding both the rationale and how the percentage was chosen. If the FSB re-opens comment on the Proposal for an appropriate period after completion of the FSB Studies, as we propose in the introductory paragraphs to this letter, we urge the FSB, at the same time, to explain the reasoning behind both the need for debt as a component of External TLAC and the choice of 33%. Without any explanation, the 33% seems to be arbitrary. In any

normal consideration of loss-absorbing capacity, one would expect equity to always be at least as good as debt and, indeed, likely preferred.

Term Sheet § 7, read alone, clearly is focused on External TLAC. However, there is some ambiguity as to whether the 33% debt requirement might also apply to Internal TLAC. The ambiguity arises out of the statement in Term Sheet § 23 that “[t]he core features of eligible internal TLAC are the same as the core features set out above for eligible external TLAC . . .” The FSB could address the ambiguity by expressly stating in the final version of Term Sheet § 23 that Term Sheet § 7’s debt requirement (if it is retained) does not apply to Internal TLAC.

If the final TLAC framework includes a debt requirement, we strongly believe the requirement should only apply to External TLAC. The corporate structures of all G-SIB groups, and decisions with respect to how the parent G-SIB directly or indirectly funds its subsidiaries, including material subsidiaries in other jurisdictions, are tailored to the particular business needs of the group as well as cross-border tax and other regulatory considerations. Imposing a debt requirement for Internal TLAC, which will directly or indirectly involve a cross-border instrument, poses the danger of needlessly interrupting corporate planning. It could also result in suboptimal capital structures for certain entities given interaction with other regulatory requirements. For example, an entity that meets or more than meets its requirements with equity and cannot reduce the amount of its equity (*e.g.*, through a share repurchase or redemption) would be forced to raise additional amounts of debt only to satisfy this requirement, therefore creating additional Internal TLAC that is clearly “excess.”

#### **IV. Internal TLAC**

As discussed in Part II.C, we have concerns with the prepositioning requirement. We have the following additional comments on the Proposal’s treatment of Internal TLAC.

- A. Term Sheet § 23’s treatment of collateralized guarantees as Eligible TLAC should permit a resolution entity’s agreements to provide capital commitments to material subsidiaries, whether in a single host country or multiple host countries, to be secured by a single collateral pool. Requiring separate collateral pools for each capital commitment, as Term Sheet § 23 appears to do, unnecessarily exacerbates the compartmentalization of capital that is the core problem with prepositioning.**

Term Sheet § 23 provides that home and relevant host authorities in CMGs may agree to substitute for on-balance sheet Internal TLAC off-balance sheet Internal TLAC in the form of collateralized guarantees, subject to six conditions. One of those conditions is that “the collateral backing the guarantee is unencumbered and in particular is not used as collateral to back any other guarantee.”

We appreciate the Proposal’s recognition that unfunded but collateralized guarantees are an appropriate form of Internal TLAC as an alternative to funded instruments. However, we have three comments on the Proposal’s treatment of such guarantees.

First, we assume that the phrase “collateralized guarantees” includes collateralized capital commitment and support agreements. We request that the FSB confirm its agreement with that understanding by inserting the phrase “(including capital commitment and support agreements)” after the phrase “collateralized guarantees” in the fourth paragraph of Term Sheet § 23.

Second, the condition quoted above seems to require that each collateralized guarantee by a resolution entity in favor of a material subsidiary must be collateralized by a segregated pool of collateral. Taking that approach unnecessarily carries forward the compartmentalization of capital that is the core problem with prepositioning. We strongly believe the final TLAC framework should permit resolution entities to create a single collateral pool for all collateralized guarantees in favor of material subsidiaries. For a G-SIB resolution entity that has multiple material subsidiaries, which is the likely base case, doing so will facilitate the resolution entity's or relevant regulatory authority's ability to quickly contribute collateral resources as capital to the material subsidiary where the stress is occurring. The final TLAC framework could address this point by revising this condition to read:

“the resolution entity or intermediate subsidiary has not pledged the collateral backing the guarantee to secure any obligation other than other guarantees in favor of material subsidiaries intended to qualify as Internal TLAC . . . .”

Third, and related to the foregoing, it is very unlikely that, in the case of a resolution entity with multiple material subsidiaries, all such subsidiaries will experience distress resulting in a draw under a collateralized guarantee at the same time. Accordingly, we urge the FSB to consider permitting the amount of pledged collateral to be the greater of (i) a designated percentage less than 100% of the resolution entity's combined guarantee amounts in favor of all material subsidiaries (with the percentage to be determined after further consideration and discussion among regulatory authorities and G-SIBs) and (ii) the aggregate of the guaranteed amount in favor of the two material subsidiaries benefiting from the largest guarantees by amount. Doing so should help address the compartmentalization of capital issue discussed above while at the same time provide significant comfort to the relevant host authorities.

- B. Term Sheet § 21 uses a threshold of 5% of consolidated RWAs, consolidated revenues or total leverage exposure as the measure for identifying material subsidiaries subject to the Internal TLAC requirement. We believe the 5% test should be supplemented with a standard that ties to whether or not the subsidiary is systemically important to the host jurisdiction.**

Term Sheet § 21 defines material subsidiaries by reference to a 5% test based on the size of the subsidiary relative to the G-SIB—*i.e.*, whether the subsidiary represents 5% of consolidated RWAs, 5% of consolidated revenues or 5% of consolidated leverage exposure of the G-SIB.<sup>55</sup> Neither the Proposal, the Principles, nor the Term Sheet provides any qualitative or quantitative rationale for why these should be the relevant tests for identifying material subsidiaries for TLAC purposes.

Application of the proposed 5% threshold, apart from its apparent arbitrariness, could have the consequence that two identical entities that are subsidiaries of different parent resolution entities could be treated differently—*i.e.*, one as a material subsidiary and the other not—merely because application of a 5% threshold to different parent entity's consolidated RWAs, consolidated revenues and consolidated leverage exposures could trip the threshold in the case of one parent but not the other. This would occur irrespective of the fact that the role of the two subsidiaries in the host

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<sup>55</sup> Term Sheet § 21.

country's financial system is identical. Moreover, applying the 5% threshold alone, a subsidiary of a G-SIB resolution entity that crosses a 5% threshold would be deemed to be a material subsidiary even if the entity were not remotely systemically important in the host country.

We recommend that the FSB address these concerns by supplementing the 5% threshold with a second test—namely, that, in order to be a material subsidiary, the subsidiary must also have been determined to be systemically important to the financial stability of the host country, either as determined by the host country authority in a certification provided to the home country authority or by application of a framework in the host country for determination of domestic systemically important financial institution status.<sup>56</sup>

Finally, consistent with the Proposal's determination that the TLAC requirement will not apply (at least initially) to G-SIBs in emerging market countries,<sup>57</sup> for so long as that standard continues to be in effect subsidiaries of G-SIB resolution entities in emerging market countries likewise should not be subject to Internal TLAC requirements. Whatever rationale applies to the non-application of TLAC requirements to G-SIBs in those countries applies as well to subsidiaries in those countries of G-SIBs organized elsewhere. Parallel treatment is required both as a matter of fundamental fairness and for level-playing-field considerations.

- C. We request that, in the final TLAC framework, the FSB clarify that Internal TLAC may be bailed in by a host country authority before commencement of a bankruptcy or resolution proceeding in the host country only upon the mutual agreement of the home and host country regulators.**

The second paragraph of Term Sheet § 23 addresses the circumstances when Internal TLAC may be bailed in by a host country authority—*i.e.*, when the “trigger” for bail-in may be pulled, by a host country authority—outside of a bankruptcy or insolvency proceeding in the host country. Although it appears that the intent is that a bail-in may be triggered by a host authority outside of a bankruptcy or insolvency proceeding in the host country only upon mutual agreement of the home and host country authorities, there is some ambiguity in the formulation. The ambiguity arises partly out of the references to complying with relevant provisions of Basel III (which, of course, only applies to banks and bank holding companies) as well as the juxtaposition of the second and third sentences in the second paragraph of Term Sheet § 23, with the second sentence (beginning “Internal TLAC must . . .”) appearing to say that the host authority must be able to trigger a bail-in “at the point of non-viability . . . without applying resolution tools to the subsidiary” (apparently meaning short of, and likely before, a bankruptcy or insolvency proceeding in the host country). The next sentence (beginning “Any write-down or conversion . . .”), however, appears to qualify the first sentence by saying that “[a]ny write-down or conversion to equity of internal TLAC is subject to consent from the relevant authority in the jurisdiction of the relevant resolution entity, except where Basel 3 provides that such consent is not required.” We request that the FSB, in the final TLAC framework, clarify the interplay between these two sentences by beginning the first sentence with the phrase “Subject to the next succeeding sentence,”

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<sup>56</sup> See *e.g.*, European Banking Authority, *Guidelines: On the criteria to determine the conditions of application of Article 131(3) of Directive 2013/36/EU (CRD) in relation to the assessment of other systematically important institutions (O-SIIs)* (Dec. 16 2014).

<sup>57</sup> See Part II.D.

and beginning the second sentence with the phrase “Notwithstanding (and qualifying) the immediately preceding sentence,”.

Additionally, we request that the FSB delete both references in Term Sheet § 23 to “relevant provisions of Basel 3.” If the material subsidiary is a bank, then the home country’s version of Basel III-based capital rules will apply to regulatory capital instruments included in Internal TLAC in any event. If it is not a bank, then they should not apply.

The underlying concern that causes us to seek absolute clarity with respect to the need for both home and host country authority consent to trigger a bail-in of Internal TLAC by a host country authority is the destabilizing effect that could result if Internal TLAC of a material subsidiary is bailed in by a host country authority absent a bankruptcy or insolvency proceeding. Our worry is that that act could trigger a domino effect causing other host countries to trigger a bail-in and ultimately the parent resolution entity to fail. The lower the threshold for material subsidiary status, the more pressing this concern becomes.

The FSB should make clear, however, that nothing in the FSB TLAC framework would prevent a resolution entity from voluntarily using Internal TLAC before its entry into resolution to increase the capital of a material subsidiary for ordinary risk management, recovery, resolution planning or other purposes.

- D. We request that the FSB clarify that eligible Internal TLAC may be owned directly or indirectly by the parent resolution entity (including through an intermediate holding company in the same jurisdiction as the material subsidiary, which we are referring to as an “In-Jurisdiction IHC”) and need not be owned directly by the resolution entity.**

The requirement for Internal TLAC is that “[e]ach material subsidiary of a G-SIB that is not a resolution entity should meet an internal TLAC requirement by maintaining a minimum amount of eligible internal TLAC[.]”<sup>58</sup> Term Sheet § 20 describes the purpose of such Internal TLAC as to “ensure[] that losses and recapitalization needs from material subsidiaries that are not themselves resolution entities can be passed to a resolution entity without the need for statutory resolution tools to be applied directly to such subsidiaries.” We are concerned that Term Sheet § 20 could be read to require that Internal TLAC be owned directly by a resolution entity, without any intermediate companies controlling the material subsidiary. Although that likely was not the FSB’s intent, we request that the FSB resolve any ambiguity by revising Term Sheet § 20 to confirm that a resolution entity may own Internal TLAC either directly or indirectly through intermediate companies, including an In-Jurisdiction IHC.<sup>59</sup>

As a related point, some G-SIBs conduct all or substantial parts of their operations in countries outside of their home countries through an In-Jurisdiction IHC—*i.e.*, a top-tier holding company in the jurisdiction. Reasons for doing so include risk management (*e.g.*, the containment of risk in discrete subsidiaries), tax considerations (*e.g.*, by creating a consolidated top-tier tax payer in the jurisdiction), funding considerations (*e.g.*, streamlining funding in the jurisdiction and its currency in a

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<sup>58</sup> Term Sheet § 20.

<sup>59</sup> Term Sheet § 20 also provides that certain capital instruments issued externally by a material subsidiary may be eligible to count as Internal TLAC. Those externally-issued instruments would not be affected by the requested clarification.

single vehicle), or regulatory requirements (as in the United States). If a G-SIB conducts its activities in a jurisdiction through an In-Jurisdiction IHC and the IHC has a material subsidiary or subsidiaries in the jurisdiction, it is not clear whether the In-Jurisdiction IHC would be treated as a resolution entity, a material subsidiary, or neither under the Proposal. We request that the FSB clarify the treatment of a G-SIB's tiered holdings in another jurisdiction by specifying that only the top-tier In-Jurisdiction IHC is a material subsidiary subject to a potential Internal TLAC requirement. Internal TLAC should be allowed to be placed in the local parent entity in the jurisdiction of a material subsidiary, as the G-SIB's structure and operation may change over time.<sup>60</sup>

**E. A material subsidiary's assets consisting of obligations of its parent G-SIB or other affiliates should not be taken into account in the subsidiary's Internal TLAC calculations.**

As discussed elsewhere in this letter, the calibration of Internal TLAC requires further consideration in a number of respects. As part of that process, consideration should be given to excluding RWAs of a material subsidiary that consist of obligations of the subsidiary's parent or affiliates. Including them has the potential for the aggregate of a G-SIB resolution entity's holdings of Internal TLAC exceeding the amount of its own External TLAC. Moreover, the risk to a material subsidiary arising out of assets in the form of parent or affiliate obligations is less than many other types of assets, largely because of the incentives that a parent has to maintain subsidiaries as viable entities—particularly subsidiaries that, by definition, are material.

**V. Other Considerations**

**A. It is important that the FSB coordinate development of the TLAC framework with tax authorities in relevant jurisdictions in order to ensure that TLAC debt securities are treated consistently as debt in all relevant jurisdictions.**

We recommend that any proposals for TLAC debt securities be coordinated with the tax authorities of relevant jurisdictions in order to ensure that TLAC debt securities are treated consistently as debt for all tax purposes. This is necessary in order to ensure that, among other things, (i) interest payments on such securities will be deductible for local tax purposes, (ii) interest payments on such securities will be subject to the same withholding tax rules as interest payments on similar debt in that jurisdiction, and (iii) taxpayers in different jurisdictions cannot arbitrage tax rules to have TLAC securities treated as debt for some jurisdictions and not for others. Moreover, although we believe that debt treatment is most appropriate, it is critical that there be certainty as to the treatment of TLAC securities both for issuers and holders regardless of how a taxing authority thinks these instruments should be treated.

The tax treatment of a TLAC debt security (as debt or equity) in a particular jurisdiction may depend upon the way a jurisdiction implements loss absorption features. If a TLAC debt security

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<sup>60</sup> See Mark Carney, Chairman of the Financial Stability Board, Statement to the International Monetary and Financial Committee (Apr. 12, 2014), at 2 (“[t]he location of the GLAC will need to reflect the resolution strategy for each firm[.]”). The Basel Committee has also noted the benefits of simplicity in the capital adequacy framework, specifically noting that an impediment to simplicity is “[B]asing measurement of capital requirements on banks’ internal models, which are continuously evolving to reflect advances in risk management[.]” Basel Committee, *Discussion Paper – The Regulatory Framework: Balancing Risk Sensitivity, Simplicity and Comparability* (July 2013), at 3.



incorporates a “contractual” loss absorption feature that provides for an automatic write-down of the TLAC security or the conversion of the TLAC security into equity of the issuer under certain loss-related circumstances prior to bankruptcy or an event equivalent to bankruptcy, like receivership, there may be a greater risk that the TLAC security could be recharacterized at issuance as an indeterminate hybrid or equity security for tax purposes in some jurisdictions. Also, in some tax jurisdictions, for a security to be treated as debt for tax purposes, it must be contractually senior in priority of payments to equity, and debt holders must have creditors’ rights upon an event of default.

By contrast, often a jurisdiction will still treat a TLAC debt security as debt for tax purposes if the TLAC security is subordinated to, or is longer-dated than, other debt of the issuer, even though such terms may effectively cause the security to bear some loss absorption in a bankruptcy or other resolution proceeding. In such a case, the holder of the TLAC debt security would have the right to pursue all legal remedies to receive its principal amount under the security.

In sum, for the reasons set forth above, it is critically important that any TLAC debt securities be treated as debt for tax purposes in the tax jurisdictions of the FSB’s member countries. We have set forth some of the issues and considerations that may be relevant in this regard. We urge the FSB and its member entities to coordinate and consult with the relevant tax jurisdictions to ensure that these considerations are taken into account when developing any proposals for TLAC debt securities.

**B. U.S. G-SIBs do not enjoy a funding advantage as a result of market perceptions of implicit government support.**

The Proposal asserts that “the added funding costs associated with a TLAC requirement will lead to a reduction of the implicit public subsidy for G-SIBs.” We assume the term “public subsidy” is meant to imply a presumption that a G-SIB, including a U.S. G-SIB, enjoys lower funding costs than they would otherwise absent perceptions of implicit government support in the event of their default.

While we cannot speak with respect to the G-SIBs in all jurisdictions, the Associations strongly disagree with any implication that U.S. G-SIBs enjoy funding advantages as a result of a market perception of implicit government support.

In a July 2014 report, the U.S. Government Accountability Office (“GAO”) found that any funding advantages for large U.S. banks have “declined or reversed” since the 2008 financial crisis.<sup>61</sup> The GAO report analyzed 16 studies they deemed most credible, and then developed a series of statistical models analyzing bond spreads— 42 in all—focused on U.S. BHCs. The vast majority of the GAO’s models found that large U.S. BHCs had higher funding costs than their smaller peers by the end of 2013. The report also assessed the regulatory framework in place for large banks and determined that the largest BHCs have stricter regulatory standards and increased regulatory costs vis-à-vis their small peers.<sup>62</sup>

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<sup>61</sup> U.S. Gov’t Accountability Office, *supra* note 28.

<sup>62</sup> These results are not surprising because most of the research to date fails to distinguish between an unfair advantage resulting from perceptions of possible government interventions in the failure of a G-SIB and other legitimate advantages enjoyed by large institutions in all industries. These types of legitimate advantages may include, for example, greater product and geographic diversification, greater liquidity of debt issuances, broader access to funding during periods of economic difficulty, more historical loss data, economies of scale

While the research in this area does not support the existence of funding advantages for U.S. G-SIBs, additional regulatory developments have had a significant impact on views regarding the likelihood of government support. Through the SPOE Strategy, the U.S. government has signaled in the strongest possible terms that it will not step in to bail out a U.S. G-SIB. Moody's, for example, responding to this signal, has removed all uplift from U.S. government support in the ratings for holding company debt issued by U.S. G-SIBs.<sup>63</sup>

These recent regulatory developments, combined with the absence of persuasive empirical evidence of funding advantages based on expectations of implied government support, make clear that no perceived funding advantage should be presumed to exist. Accordingly, we believe it would be ill-advised to base policy decisions on the assumption that funding advantages exist where none have been persuasively shown to exist and where no market perception of such a funding advantage should reasonably exist.

## **VI. Responses to Certain Specific Questions.**

We have noted below the parts of this letter that address certain of the specific questions posed by the FSB in the introductory comments to the Proposal.

1. *Is a common Pillar 1 Minimum TLAC requirement that is set within the range of 16 – 20% of risk-weighted assets (RWAs), and at a minimum twice the Basel III leverage requirement, adequate in the light of experiences from past failures to support the recapitalization and resolution objectives set out in this proposal? What other factors should be taken into account in calibrating the Pillar 1 Minimum TLAC requirement?*

See the discussion in Part II.A.2.

2. *Does the initial exclusion of G-SIBs headquartered in emerging market economies (EMEs) from meeting the Common Pillar 1 Minimum TLAC requirement appropriately reflect the different market conditions affecting those G-SIBs? Under what circumstances should the exclusion end?*

See the discussion in Part II.D.

3. *What factors or considerations should be taken into account in calibrating any additional Pillar 2 requirements?*

See the discussion in Part II.A.1.

4. *Should TLAC generally be distributed from the resolution entity to material subsidiaries in proportion to the size and risk of their exposures? Is this an appropriate means of supporting resolution under different resolution strategies? Which subsidiaries should be regarded as material for this purpose?*

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and scope, investment research coverage, and other possible factors. Randall S. Kroszner, *A Review of Banking Funding and Cost Differentials* 13 (Nov. 16, 2013).

<sup>63</sup> See Moody's Investors Service, *Moody's Concludes Review of Systematically Important U.S. Banks – Frequently Asked Questions* (Nov. 14, 2013).

See the discussion in Part IV.B. Also, see, generally the discussion in Part II.C.

5. *To what extent would pre-positioning of internal TLAC in material subsidiaries support the confidence of both home and host authorities that a G-SIB can be resolved in an orderly manner and diminish incentives to ring-fence assets? Is a requirement to pre-position internal TLAC in the range of 75 - 90% of the TLAC requirement that would be applicable on a stand-alone basis, as set out in the term sheet (Section 22), appropriate to satisfy the goals of the proposal and ensure that TLAC is readily and reliably available to recapitalize subsidiaries as necessary to support resolution? Can this pre-positioning be achieved through other means such as collateralized guarantees?*

See the discussion in Parts II.C and IV.

6. *Are the eligibility criteria for TLAC as set out in the term sheet (Sections 8-17) appropriate?*

See the discussion in Parts II.B. and III.B.

7. *What considerations bear on the desirability of an expectation that a certain proportion of the common minimum Pillar 1 TLAC requirement consists of (i) tier 1 and tier 2 capital instruments in the form of debt plus (ii) other eligible TLAC that is not regulatory capital?*

See the discussion in Part III.F.

8. *Are the conditions specified in the term sheet (Section 8) under which pre-funded commitments from industry-financed resolution funds to provide resolution funding contribute to TLAC appropriate?*

See the discussion in Part II.D.

9. *Is the manner in which subordination of TLAC-eligible instruments to excluded liabilities is defined in the term sheet (Section 13) sufficient to provide certainty regarding the order in which creditors bear loss in resolution, and to avoid potentially successful legal challenges or compensation claims? Where there is scope for liabilities which are not subordinated to excluded liabilities to qualify for TLAC, are the transparency and disclosure requirements set out in section 13 and 24 sufficient to ensure that holders of these instruments would be aware of the risk that they will absorb losses prior to other equally ranking but excluded liabilities? If not, what additional requirements should be adopted?*

See the discussion in Part II.B.I.

10. *Do you agree that the TLAC requirement for G-SIBs should be integrated with Basel III such that the minimum TLAC requirement should be met first, and only after TLAC is met should any surplus common equity tier 1 (CET1) be available to meet the Basel III buffers?*

See the discussion in Part II.A.2. under the sub-caption "Consideration of Buffers in Calibrating External TLAC."

12. *What restrictions on the holdings of TLAC are appropriate to avoid the risk of contagion should those liabilities be exposed to loss in resolution?*

See the discussion in Part III.A.

15. *What will be the impact on G-SIBs' overall funding costs of the adoption of a Pillar I Minimum TLAC requirement?*

The discussion of the “impact of the proposal on the financial system and the real economy” in the overview preceding the Term Sheet notes that the FSB intends to assess the macroeconomic impacts of the TLAC proposal, as well as the effects on firms and markets. This is appropriate, although that discussion seems somewhat to prejudge the issues. Some initial suggestions as to approaching this part of the impact assessment follow.

First, in assessing the macroeconomic effects of the Proposal, it will be important to consider the potential for increases in the cost of issuance for all corporate borrowers. To the extent that G-SIBs are issuing high volumes of debt, and to maintain high capital and liquidity levels, it seems unlikely that the market would accept lower coupons from similarly rated corporate issuers. This effect will increase with the volume of G-SIB issuance.

Second, the TLAC requirement is likely to have a significant impact on the market for debt under one year (particularly if the suggestion to count as TLAC debt originally issued for over one year with at least six months' remaining maturity is not adopted). Banks are already under significant market regulatory constraints from the LCR, NSFR and Basel III leverage ratio to avoid issuing debt under one year. There are already indications in the U.S. market that the absence of short-term paper is having an effect on money-market funds as supply has diminished significantly. Therefore, the QIS should consider the cumulative effects of TLAC with other regulations on the yield curve within one year to determine the costs of such effects.

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The Associations thank the FSB for the opportunity to respond to the FSB's request for comments. If you have any questions, please do not hesitate to call John Court at 202-649-4628 (e-mail: john.court@theclearinghouse.org) or Carter McDowell at 202-962-7327 (e-mail: cmcdowell@sifma.org).

Respectfully Submitted,



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Rich Foster  
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Financial Services Roundtable

cc: The Honorable Mark Carney  
*Bank of England*

The Honorable Janet Yellen  
*Board of Governors of the Federal Reserve System*

The Honorable Daniel Tarullo  
*Board of Governors of the Federal Reserve System*

The Honorable Sarah Bloom Raskin  
*Board of Governors of the Federal Reserve System*

The Honorable Stanley Fischer  
*Board of Governors of the Federal Reserve System*

The Honorable Jerome Powell  
*Board of Governors of the Federal Reserve System*

The Honorable Lael Brainard  
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The Honorable Martin Gruenberg  
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The Honorable Thomas Hoenig  
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The Honorable Jeremiah Norton  
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The Honorable Richard Cordray  
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## **The Associations**

### The Clearing House

Established in 1853, The Clearing House is the oldest banking association and payments company in the United States. It is owned by the world's largest commercial banks, which collectively hold more than half of all U.S. deposits and which employ over one million people in the United States and more than two million people worldwide. The Clearing House Association L.L.C. is a nonpartisan advocacy organization that represents the interests of its owner banks by developing and promoting policies to support a safe, sound and competitive banking system that serves customers and communities. Its affiliate, The Clearing House Payments Company L.L.C., which is regulated as a systemically important financial market utility, owns and operates payments technology infrastructure that provides safe and efficient payment, clearing and settlement services to financial institutions, and leads innovation and thought leadership activities for the next generation of payments. It clears almost \$2 trillion each day, representing nearly half of all automated clearing house, funds transfer and check-image payments made in the United States. See The Clearing House's web page at [www.theclearinghouse.org](http://www.theclearinghouse.org).

### Securities Industry and Financial Markets Association

The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit [www.sifma.org](http://www.sifma.org).

### American Bankers Association

The American Bankers Association is the voice of the nation's \$15 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard \$11 trillion in deposits and extend more than \$8 trillion in loans.

### Financial Services Roundtable

As advocates for a strong financial future™, Financial Services Roundtable (FSR) represents 100 integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. FSR member companies provide fuel for America's economic engine, accounting directly for \$98.4 trillion in managed assets, \$1.1 trillion in revenue, and 2.4 million jobs.



**The Clearing House TLAC Analysis**

# G-SIB Total Loss Absorbing Capacity -External TLAC-

February 1, 2015



**Loss Coverage Analysis:** The FSB’s proposed TLAC requirement is 2.6–5.2 times larger than the projected capital depletion of U.S. G-SIBs under severely adverse supervisory stress scenario in D-FAST 2014 and historical capital depletion of failed or acquired U.S. financial institutions.

Approach	Loss Coverage <sup>2</sup>			Methodology
	Capital depletion <sup>1</sup>	16% of RWA	20% of RWA	
<p>Projected capital depletion of U.S. G-SIBs under severely adverse supervisory stress scenario.</p> <p><i>Source:</i> Board of Governors of the Federal Reserve System, “Dodd-Frank Act Stress Test 2014: Supervisory Stress Test Methodology and Results,” March 2014, Table 3.</p>	4.6ppt	×4.4	×5.2	RWA-weighted average decline in Tier 1 common ratio of U.S. G-SIBs under severely adverse supervisory stress scenario in D-FAST 2014. The projected decline in Tier 1 common ratio is calculated from the beginning of the stress scenario to its lowest projected level during the 9-quarter planning horizon. <sup>3</sup>
<p>Historical capital depletion of failed or acquired U.S. financial institutions.</p> <p><i>Source:</i> Wells Fargo, “Loss Absorbency Requirements,” August 2013.</p>	7.8ppt	×2.6	×3.1	RWA-weighted average of maximum capital decline as percent of proxy Basel III RWA for: Washington Mutual, Lehman Brothers, Continental Illinois, Wachovia, Merrill Lynch, Bear Stearns, Countrywide.
	5.3ppt	×3.8	×4.5	Diversified institutions only: Continental Illinois, Wachovia, Merrill Lynch. <sup>4</sup>

<sup>1</sup> In percentage points relative to RWA.

<sup>2</sup> Inclusive of 16-20% of RWA requirement, 2.5% capital conservation buffer, and RWA-weighted average of bank-specific G-SIB capital surcharge, which is 1.6% based the FSB’s G-SIB capital surcharge framework and not the Federal Reserve’s proposed framework which is potentially higher. Loss coverage of ×4.4, for example, is derived by dividing (16+2.5+1.6) by 4.6.

<sup>3</sup> Not allowing for pre-provision net revenue (PPNR) during the stress scenario results in a capital depletion of 7.7ppt and loss coverage multiples of ×2.6 and ×3.1, respectively.

<sup>4</sup> The loss experiences of the diversified institutions are the most relevant benchmarks for potential losses U.S. G-SIBs could experience.

<p><b>12. Excluded liabilities</b></p>	<p>Eligible external TLAC must not include Type I excluded liabilities, Type II excluded liabilities, or Type III excluded liabilities.</p> <p>Type I excluded liabilities are unsecured liabilities that (i) should not be bailed in upon a failure of the resolution entity and (ii) must be structurally, contractually or legally preferred to external TLAC under Section 13. Type I excluded liabilities include:</p> <ul style="list-style-type: none"> <li>a. Insured deposits;</li> <li>b. Debt securities having an original maturity of less than one year and unsecured derivatives contract liabilities (e.g., those of operating companies) that do not qualify as Type III excluded liabilities; and</li> <li>c. Any other liabilities that, under the laws governing the issuing entity, cannot be effectively written down or converted into equity by the relevant resolution authority.</li> </ul> <p>Type II excluded liabilities are unsecured liabilities that (i) should be bailed in upon a failure of a resolution entity but (ii) are not required to be structurally, contractually or legally preferred to external TLAC under Section 13. Type II excluded liabilities include:</p> <ul style="list-style-type: none"> <li>a. Any debt instrument that had an original maturity of at least one year but has a remaining maturity of less than [one year] [six months] and that does not qualify as a Type III excluded liability;</li> <li>b. Liabilities that are funded directly by the issuer or a related party of the issuer, except where the relevant home and host authorities in the CMG agree that it is consistent with the resolution strategy to count eligible liabilities issued to a parent of a resolution entity towards External TLAC; and</li> <li>c. Any debt instrument with an original maturity of at least [one year] [six months] (i) to the extent the principal amount of the debt instrument is puttable by the holder to the issuer prior to its maturity without the issuer's consent or (ii) the claim amount of the debt instrument in a failure is determined by the relevant resolution authority to be not readily ascertainable.</li> </ul> <p>Type III excluded liabilities are unsecured liabilities that (i) should not be bailed in upon a failure of a G-SIB resolution entity but (ii) are not required to be structurally, contractually or legally preferred to external TLAC under Section 13. Type III excluded liabilities include:</p> <ul style="list-style-type: none"> <li>a. Liabilities that are preferred to normal unsecured creditors</li> </ul>
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	<p>under the relevant insolvency law, such as certain tax liabilities that have a statutory preference;</p> <ul style="list-style-type: none"> <li>b. Vendor and operating liabilities, such as for utilities, rent, fees for services, and obligations to employees;</li> <li>c. Guarantees by a resolution entity of liabilities of operating subsidiaries on derivatives and other contracts;</li> <li>d. Limited unsecured liabilities on derivative contracts that, for example, may (a) arise during any gaps between daily posting of variation margin or (b) represent required initial margins; and</li> <li>e. Liabilities arising other than through a contract.</li> </ul>
<p><b>13. Priority</b></p>	<p>Eligible external TLAC must absorb losses prior to Type I excluded liabilities in insolvency or in resolution without giving rise to material risk of successful legal challenge or compensation claims; and authorities must ensure that this is transparent to creditors (see Section 24 for requirements for disclosure). In all cases, the risk of successful legal challenge or valid compensation claims, and the transparency of the order in which creditors can expect to bear losses in insolvency or in resolution, is subject to review in the FSB Resolvability Assessment Process.</p> <p>To ensure that eligible external TLAC absorbs losses as described in the preceding paragraph, it must be:</p> <ul style="list-style-type: none"> <li>a. contractually subordinated to all Type I excluded liabilities on the balance sheet of the resolution entity; or</li> <li>b. junior in the statutory creditor hierarchy to all Type I excluded liabilities on the balance sheet of the resolution entity; or</li> <li>c. issued by a resolution entity which does not have Type I excluded liabilities on its balance sheet (for example, a holding company) so that TLAC eligible liabilities are not <i>pari passu</i> or senior to any Type I excluded liabilities. Therefore, there is no need for the TLAC issued from such a resolution entity itself to be contractually or statutorily subordinated.</li> </ul> <p>The requirement specified in the preceding paragraph of this Section 13 may not apply in those jurisdictions in which all Type I excluded liabilities are statutorily excluded from the scope of the bail-in tool and therefore cannot legally be written down or converted to equity in a bail-in resolution. In this case, liabilities that rank alongside them and are included in scope of the bail-in tool and meet the eligibility criteria for TLAC would in fact be able to absorb losses in resolution and</p>

	<p>qualify for TLAC. If this option is used, authorities must ensure that this would not give rise to material risk of successful legal challenge or valid compensation claims, and that the terms of the TLAC eligible liabilities specify that they are subject to bail-in.</p> <p>In those jurisdictions where the resolution authority may, under exceptional circumstances specified in the applicable resolution law, exclude or partially exclude from bail-in all of the Type I excluded liabilities, the relevant authorities may permit liabilities that would otherwise be eligible to count as external TLAC but which rank alongside those Type I excluded liabilities in the insolvency creditor hierarchy to contribute a quantum equivalent of up to 2.5% RWA or more if the final calibration of the common Pillar 1 Minimum TLAC requirement exceeds 16% RWA of the resolution entity's Pillar 1 Minimum TLAC requirement. If this option is used, authorities must ensure that the capacity to exclude or partially exclude liabilities from bail-in would not give rise to material risk of successful legal challenge or valid compensation claims.</p>
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