February 17, 2017

Via Electronic Mail

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

Re: Comment Letter on Proposed Guiding Principles on Internal TLAC – Consultative Document, dated December 16, 2016

Ladies and Gentlemen:

The Clearing House Association ("**TCH**"), the Securities Industry and Financial Markets Association ("**SIFMA**"), the American Bankers Association ("**ABA**"), the Financial Services Roundtable ("**FSR**") and the Institute of International Bankers ("**IIB**") (collectively, the "**Associations**")[1] welcome the opportunity to respond to the request of the Financial Stability Board ("**FSB**") for comment on the FSB's consultative document setting forth the FSB's proposed guiding principles on internal total loss-absorbing capacity ("**TLAC**") of global systemically important banking groups ("**G-SIB groups**") (the "**Guiding Principles**").[2] The stated purpose of the proposed Guiding Principles is "to support the implementation of the internal TLAC requirement" in the FSB's final international TLAC standard (the "**International TLAC Standard**").[3]

While we believe that the proposed Guiding Principles clarify a number of issues in helpful ways, we also believe that they contain a number of shortcomings and fail to address a

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1 *See* Annex A for a description of each of the Associations.

2 FSB, *Consultative Document: Guiding Principles on the Internal Total Loss-absorbing Capacity of G-SIBs ('Internal TLAC')* (Dec. 16, 2016), http://www.fsb.org/wp-content/uploads/Guiding-Principles-on-the-Internal-Total-Loss-absorbing-Capacity-of-G-SIBs.pdf.

3 *Id*. at iii; FSB, Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution: Total Loss-absorbing Capacity (TLAC) Term Sheet (Nov. 9, 2015), http://www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf.

number of important issues. In particular, they do not reflect a number of fundamental structural changes that were made by the U.S. G-SIB groups after the FSB issued its International TLAC Standard and could be made in the future by G-SIB groups headquartered in Switzerland, the United Kingdom or elsewhere that have top-tier holding company parents that are or could become the issuers of all or substantially of their external TLAC and do not have any external short-term debt or financial contracts at the parent level ("**Clean Holding Company Groups**"). We believe that the proposed Guiding Principles should be revised to reflect those fundamental changes. Both the International TLAC Standard and the final Guiding Principles should be updated from time to time to reflect all fundamental developments made in any jurisdiction.

We also believe that unless the proposed Guiding Principles include sufficient limits on the discretion of host authorities to impose excessive internal TLAC requirements on material sub-groups, they will inevitably result in a significant new impediment to the feasibility of single-point-of-entry ("**SPOE**") bail-in strategies. In particular, unless properly addressed in the final Guiding Principles, a collective action problem described more fully below will result in excessive internal TLAC and related pre-positioned assets being required and trapped in host jurisdictions. This pre-positioning of assets will reduce the amount of contributable assets available to the top-tier parents of G-SIB groups that have adopted, or are otherwise expected to be resolved under, an SPOE strategy ("**SPOE Groups**"). This reduction in contributable assets will increase the risk that the top-tier parents will not have a sufficient amount of contributable assets to recapitalize all of their material sub-groups if the distribution of internal TLAC does not match the distribution of losses in an actual financial distress scenario. If home authorities respond to this misallocation risk by requiring SPOE Groups to hold a substantial buffer of external TLAC, the cost of SPOE strategies will be substantially and unnecessarily higher than it would have been without the excessive internal TLAC requirements.

The fundamental developments referred to above include the fact that all but one of the U.S. G-SIB groups have now publicly adopted SPOE bail-in strategies as their preferred resolution strategies under the U.S. Bankruptcy Code and are otherwise expected to be resolved with an SPOE strategy under Title II of the Dodd-Frank Act. SPOE bail-in strategies have in fact gained significant buy-in from the U.S. regulators, including from both the Federal Reserve and the FDIC, who have publicly acknowledged the viability of the SPOE strategy in the resolution planning context.[4] The FDIC has also indicated that the SPOE bail-in strategy is the FDIC's preferred strategy for resolving the U.S. G-SIBs under Title II of the Dodd-Frank Act.[5]

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4 See 2016 Feedback Letter to Citigroup (Apr. 12, 2016), *available at* https://www.federalreserve.gov/newsevents/press/bcreg/citi-letter-20160413.pdf (the Federal Reserve and the FDIC found no deficiencies with Citigroup's SPOE strategy); Joint Press Release of the Federal Reserve and the FDIC (Dec. 13, 2016), *available at* https://www.federalreserve.gov/newsevents/press/bcreg/20161213a.htm (the Federal Reserve and the FDIC determined that Bank of America, JPMorgan Chase and State Street had adequately remedied the deficiencies associated with their SPOE strategies and that the Bank of New York Mellon had remedied the deficiencies associated with its 2015 resolution plan by adopting an SPOE strategy and taking other actions).

5 *See, e.g.*, Martin J. Gruenberg, Chairman of the FDIC, Remarks at the Eurofi High Level Seminar 2016 (Amsterdam, The Netherlands, Apr. 21, 2016); Martin J. Gruenberg, Chairman of the FDIC, *A Progress*

In addition, the Federal Reserve and the FDIC have undertaken a broad set of actions to facilitate the successful implementation of SPOE bail-in strategies, including the Federal Reserve's final TLAC rule and both of their proposed rules on stays of qualified financial contracts.[6]

Perhaps most significantly, the U.S. G-SIB groups have entered into, or have announced that they are considering entering into, secured support agreements. These agreements impose or would impose a legally binding, secured obligation on the top-tier holding company parents of the U.S. G-SIB groups to use their contributable assets to provide capital support to all of their material sub-groups, including individual material subsidiaries. The obligations are secured or would be secured by the very contributable assets the top-tier parents are required to use to recapitalize their material sub-groups. These agreements obligate the top-tier parents to provide capital support to their material sub-groups during periods of financial distress before the material sub-group reaches its point of non-viability ("**PONV**"). They also obligate the parents to provide capital support to all material sub-groups once either of the respective ratios of the G-SIB group's capital and liquidity resources to the projected capital or liquidity needs of its material subsidiaries during its projected SPOE resolution period falls to a level that is close to one. This latter trigger is designed to occur before the top-tier parent would become balance-sheet insolvent or unable to pay its debts when due, the most common traditional definitions of PONV.[7]

The rest of this comment letter explains how the proposed Guiding Principles should be revised to reflect these fundamental developments and to otherwise avoid creating any new impediments to the successful implementation of SPOE bail-in strategies. While it focuses primarily on SPOE bail-in strategies by Clean Holding Company Groups, many of our comments apply to other SPOE Groups and even G-SIB groups that have adopted, or are expected to be resolved under, multiple-point-of-entry ("**MPOE**") resolution strategies.

Report on the Resolution of Systemically Important Financial Institutions, Speech at the Peterson Institute for International Economics (Washington, D.C., May 12, 2015); *see also* Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy, 78 Fed. Reg. 76,614 (Dec. 18, 2013).

6 See Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations, 82 Fed. Reg. 8266 (Jan. 24, 2017); Restrictions on Qualified Financial Contracts of Systemically Important U.S. Banking Organizations and the U.S. Operations of Systemically Important Foreign Banking Organizations; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions, 81 Fed. Reg. 29,169 (proposed May 11, 2016) (the Federal Reserve's proposal); Mandatory Contractual Stay Requirements for Qualified Financial Contracts, 81 Fed. Reg. 55,381 (proposed Aug. 19, 2016) (the Office of the Comptroller of the Currency's proposal); Restrictions on Qualified Financial Contracts of Certain FDIC-Supervised Institutions; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions, 81 Fed. Reg. 74,326 (proposed Oct. 26, 2016) (the FDIC's proposal).

7 See the public executive summaries of the 2015 resolution plans of Bank of America Corporation, Bank of New York Mellon Corporation, Citigroup Inc., Goldman Sachs Group, Inc., JPMorgan Chase & Co., Morgan Stanley and State Street Corporation, as updated by their October 2016 submissions, if any, which are available for download at https://www.fdic.gov/regulations/reform/resplans/.

Part I contains a discussion of certain fundamental principles and terminology issues that will help frame our specific comments. Part II contains a principle-by-principle discussion of any of the proposed Guiding Principles that might foster or allow a material impediment to the operational feasibility or credibility of any bail-in strategy, focusing mainly on SPOE bail-in strategies.

I. Framing Our Comments

A. Fundamental Principles of SPOE Resolution

In an SPOE resolution, only the top-tier parent enters into a bankruptcy or special resolution proceeding. In the case of a Clean Holding Company Group, as with all the U.S. and Swiss G-SIB groups and perhaps others in the future, the cash, intercompany receivables and other contributable assets owned or controlled by the parent holding company would be used to recapitalize the group's bank, broker-dealer and other operating subsidiaries, preserve their going-concern values and keep them out of their own insolvency proceedings. The operating subsidiaries would then be wound down in an orderly fashion, sold to third parties or continued in their recapitalized form. The residual value of those subsidiaries would be distributed to the holders of external TLAC and anyone else with claims against the failed holding company in accordance with the priority of their claims in satisfaction of their claims.

One way in which this distribution of residual value can take place is for the operating subsidiaries to be transferred to a bridge holding company and for the claims of the holders of the holding company's external TLAC to be exchanged for shares of the bridge holding company or their value in cash or a mixture of cash and shares. At least in the United States, this method is typically called an indirect bail-in or a two-entity bail-in.[8] It is the only way in which bail-in can occur under Title II of the Dodd-Frank Act and is how the distribution of value is expected to take place pursuant to the resolution plans under the U.S. Bankruptcy Code of five of the eight U.S. G-SIB groups.[9]

Another way in which this distribution can take place is for the failed holding company to retain ownership of the operating subsidiaries and have the claims of the holders of the external TLAC written down *in reverse order of the priority of their claims* until the sum of their written-down claims equals the aggregate residual value of the failed company or have the claims of debt holders converted into equity securities in the failed holding company in a manner that sufficiently dilutes pre-existing equity holders to reflect the fact that their interests are junior to the claims of the debt holders. These methods of distributing residual value are typically called

8 Thomas H. Jackson, Building on Bankruptcy: A Revised Chapter 14 Proposal for the Recapitalization, Reorganization, or Liquidation of Large Financial Institutions, in MAKING FAILURE FEASIBLE: HOW BANKRUPTCY REFORM CAN END "TOO BIG TO FAIL" 19–20 (Kenneth E. Scott, Thomas H. Jackson & John B. Taylor, eds., Hoover Institution 2015).

9 See the public executive summaries of the 2015 resolution plans of Bank of America Corporation, Bank of New York Mellon Corporation, Citigroup Inc., JPMorgan Chase & Co. and State Street Corporation, as updated by their October 2016 submissions, if any, which are available for download at https://www.fdic.gov/regulations/reform/resplans/.

direct bail-in, one-entity bail-in or just plain bail-in.[10] It is the dominant way in which the distribution of value is expected to take place in most European resolution proceedings, including those in Switzerland and the United Kingdom, and is how the distribution of value is expected to take place pursuant to the resolution plans under the U.S. Bankruptcy Code of two of the eight U.S. G-SIB groups.[11]

B. Collective Action Problems Associated with Internal TLAC Requirements

In order for an SPOE resolution of a Clean Holding Company Group to work, the top-tier parent must have a sufficient amount of external TLAC that is properly subordinated to the claims of the group's short-term debt holders. In contrast, there is no reason to require a material sub-group, including an individual subsidiary, to have any minimum internal TLAC in excess of its regulatory capital requirements or going-concern capital, unless the host authority reasonably believes that the holding company or its home authority will be unwilling or unable to use the holding company's contributable assets to recapitalize the material sub-group at or prior to the material sub-group's PONV. We refer to the difference between a material sub-group's internal TLAC and its required regulatory capital as its internal gone-concern loss-absorbing capacity ("**internal GLAC**").

More than being unnecessary, such internal GLAC requirements could lead to a misallocation of pre-positioned resources in subsidiaries irrespective of their needs during resolution and are likely to substantially increase the cost of SPOE strategies. They are thus likely to create a substantial new impediment to the feasibility of cross-border SPOE strategies, which depend on the top-tier parent having sufficient contributable assets to recapitalize its material sub-groups as, when and where needed.

This significant new impediment arises because if host authority A believes that one or more other host authorities will require otherwise contributable assets to be pre-positioned and trapped in those other jurisdictions—making them unavailable to operating subsidiaries in host jurisdiction A—host authority A will have a strong incentive to require otherwise contributable assets to be similarly pre-positioned and locked up in host jurisdiction A. Indeed, all host authorities will have an incentive to do the same thing if they believe that any other host authority will do so. This will reduce the amount of contributable assets available to be used to recapitalize material sub-groups, trapping them in various host jurisdictions. This might induce the home authority to require the top-tier parent to hold an additional amount of external TLAC at the top-tier parent level to be sure it has sufficient contributable assets to recapitalize its operating subsidiaries as, when and where needed.[12] This dynamic has the effect of a classic

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10 Jackson, *supra* note 8, at 19–20.

11 *See* the public executive summaries of the 2015 resolution plans of Goldman Sachs Group, Inc. and Morgan Stanley, which are available for download at https://www.fdic.gov/regulations/reform/resplans/.

12 The proposed Guiding Principles not only recognize this possibility, but actually seem to encourage home authorities to impose additional external TLAC requirements on G-SIBs that have adopted or are expected to be resolved with SPOE strategies. For example, proposed Guiding Principle 6 currently states that "if the sum of internal TLAC requirements . . . exceed[s] external TLAC, then—absent any downward

"collective action" problem,[13] discussed more fully below, that the proposed Guiding Principles do not attempt to address. If not checked by the final Guiding Principles, it is likely to increase the cost of SPOE strategies, creating a substantial new impediment to the feasibility of SPOE strategies.

If a G-SIB group's host authorities all had confidence that the top-tier parent's contributable assets could and would be used to recapitalize its material sub-groups, including individual subsidiaries, at or prior to any sub-group's PONV, there would be no collective action problem. In such a scenario, the home and host authorities would all agree that the most efficient distribution of assets would be to maximize the percentage of the G-SIB group's assets that are positioned as contributable assets at the parent level and minimize the percentage of the G-SIB group's assets that are pre-positioned at the material sub-group level. The contributable assets could then be used to recapitalize material sub-groups as, when and where needed, a significantly more efficient outcome.

C. Minimizing the Harm of Internal TLAC Requirements

To the extent that internal TLAC requirements are adopted, four conditions could reduce the inefficiencies arising from the collective action problem described above. First, internal GLAC should not be required for material sub-groups unless the host authority determines that the sub-group is systemically important in the host jurisdiction.

Second, internal TLAC requirements should be limited to the low end of the FSB's 75–90% range of the amount of external TLAC requirements applicable to similarly situated resolution entities in the host jurisdiction. In fact, we believe that the FSB should consider recalibrating the permissible internal TLAC range from 75–90% of external TLAC by using different metrics altogether to reflect the major developments described above, such as the development of secured support agreements and recapitalization triggers based on the G-SIB group's projected capital and liquidity levels and needs during its entire projected SPOE resolution period. For example, we do not believe that a denominator based on the external TLAC requirements of similarly situated resolution entities is even relevant in light of the existence of secured support, as described above. Nor do we believe that a static range such as 75–90% of whatever denominator is used is appropriate in light of these dynamic recapitalization triggers.

Third, the GLAC component of any internal TLAC requirements should be suspended at or before the time a material sub-group's parent enters into a bankruptcy or special resolution proceeding through the time its SPOE resolution strategy has been completed (the "**resolution**

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adjustment from host authorities and taking into account consolidation effects—the home authority should take action to ensure the G-SIB has sufficient external TLAC."

13 As discussed more fully below, the collective action problem that gives rise to these incentives to optimize individual host country self-interest over the optimal outcome for the home and host countries as a single group is similar to the collective action problem that gives all depositors in a bank an incentive to run if they believe other depositors will run. *See* Douglas W. Diamond & Philip H. Dybvig, *Bank Runs, Deposit Insurance, and Liquidity*, 91 J. POL. ECON. 401 (1983).

period"). Finally, the GLAC component of any internal TLAC requirements should be able to be satisfied by secured support agreements or other collateralized guarantee arrangements that impose a legally binding obligation on the parent and, if applicable, any intermediate holding company ("**IHC**") or dedicated funding vehicle, to recapitalize the material sub-group at or prior to the sub-group's PONV.

The principal reason internal TLAC requirements should not become an excessive impediment to SPOE strategies if the four conditions outlined above are satisfied is that, at least in the case of Clean Holding Company Groups, the operating subsidiaries are already likely to have substantial amounts of internal GLAC, in addition to going-concern capital, in the ordinary course of business. Clean Holding Company Groups continually transfer cash and other assets back and forth between the top-tier parent and its operating subsidiaries in the ordinary course. For example, when the top-tier parent believes that its operating subsidiaries need more capital or funding for a particular business opportunity, it will issue debt or equity securities in the markets or sell assets, and downstream the proceeds in return for debt or equity instruments issued by the operating subsidiaries (i.e., internal TLAC). The top-tier parent funds its own obligations both by raising funds in the markets and by receiving a stream of dividends, interest and principal payments from its operating subsidiaries. Thus, even without binding internal TLAC requirements in excess of required regulatory capital, material sub-groups in a Clean Holding Company Group are likely to have significant amounts of internal GLAC in addition to required regulatory (i.e., going-concern) capital as a practical matter in the ordinary course of business.

Moreover, we believe the four conditions outlined above are important to promoting a workable approach to internal TLAC requirements for all SPOE Groups. For example, the third requirement is necessary because unless the GLAC component of any internal TLAC requirement is suspended immediately before and during the parent's resolution period, the internal GLAC amount will not be fully available to restore the material sub-group's going-concern capital at or prior to the sub-group's PONV by writing down the sub-group's internal and external TLAC instruments in reverse order of their priority or by converting TLAC debt instruments to equity, defeating the purpose of having internal GLAC. If the GLAC component of any internal TLAC requirements were not suspended in this manner, it would be like the proverbial last taxi at the train station: When a weary traveler asks the taxi driver to take her to her destination, the driver tells her she cannot do so because of a local rule requiring at least one taxi to be at the station at all times.[14]

The proposed Guiding Principles seem to recognize the need for the third requirement, since proposed Guiding Principle 19 states that the "host authority will . . . need to propose to write-down and/or convert into equity a sufficient amount of internal TLAC so that the material sub-group will meet the jurisdiction's regulatory capital requirements," thus distinguishing between total internal TLAC and its required regulatory capital component. It also states that "[i]f the triggering of internal TLAC results in the material sub-group no longer meeting its internal TLAC requirement, the host authority should provide a grace period, and may choose to

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14 Charles Goodhart, *Liquidity Risk Management* 3–4 (LSE Financial Markets Group Paper Series, Special Paper 175, Oct. 2007).

allow the material sub-group up to 24 months to come back into compliance with the internal TLAC requirement." The final Guiding Principles should recommend that the grace period be mandatory rather than discretionary until the completion of the relevant SPOE resolution strategy, which is likely to be as long as 24 months and possibly longer. The other three conditions outlined above are just as important to a workable internal TLAC approach for the reasons discussed in greater detail below in response to proposed Guiding Principles 1, 5 and 9.

D. The Critical Importance of Transparent Terminology

It can be obfuscating rather than illuminating to use terminology such as external or internal TLAC, which are defined as the sum of equity capital and certain debt instruments that appear exclusively on the right side of the balance sheets of the various legal entities that make up a G-SIB group, rather than using the terms contributable or pre-positioned assets, which refer to the corresponding assets on the left side of their balance sheets. For SPOE Groups, internal TLAC, whether referring to required internal regulatory capital or internal GLAC, is always approximately matched by assets pre-positioned at the material sub-group in the host country. Similarly, external TLAC at the top-tier parent level is always approximately matched by contributable assets and equity in subsidiaries at the parent level. The same internal TLAC instrument may be treated as an asset or a liability depending on the relevant entity. For example, an operating subsidiary's obligations under a debt instrument issued in return for a cash advance from its parent will be a liability on the subsidiary's balance sheet. But the parent's right to receive repayment under the same debt instrument will be an asset on the parent's balance sheet.

To improve clarity, we often use the terms "contributable assets" and "pre-positioned assets" in this comment letter instead of external or internal TLAC. Contributable assets include the intercompany receivables of the top-tier parent represented by debt instruments that count as internal TLAC for a material sub-group. One way to contribute any contributable assets in the form of intercompany receivables is to forgive or convert to equity the receivable from the operating subsidiary. Pre-positioned assets include the proceeds that were transferred to the subsidiary in return for internal TLAC instruments.

We also use the term "internal GLAC" or "the GLAC component of internal TLAC" to refer to the difference between internal TLAC and a material sub-group's required regulatory capital. This helps shine light on the portion of any internal TLAC requirements that could become an important new impediment to SPOE resolution strategies unless the four conditions discussed above are satisfied.

E. Continuing Developments in Resolution Strategies and Mechanisms to Make Them Operationally Feasible

As noted above, the U.S. G-SIBs have taken or are required to consider taking a variety of actions that should make host authorities highly confident that the top-tier parent of each U.S. G-SIB group will be legally bound to use its contributable assets to recapitalize its material sub-groups during periods of material financial distress before the material sub-group reaches its PONV. Those actions include pre-positioning cash and other contributable assets at IHCs or dedicated funding vehicles that can be used to recapitalize any material sub-group during periods of material financial distress before the material sub-group reaches its PONV. They also include entering into secured support agreements pursuant to which the top-tier parent and any of its IHCs or funding vehicles incur legally binding, fully secured obligations to use their contributable assets to provide capital support to all of the group's material sub-groups under the firm's internal policies during periods of material financial distress before any of the material sub-groups reach their PONV. These agreements also obligate the parents to provide capital support to all material sub-groups when the top-tier parent reaches its PONV.

In addition, the PONV of the top-tier parent of a U.S. G-SIB group is no longer defined by traditional definitions such as balance sheet insolvency or the inability to pay debts when due. Instead, the U.S. G-SIBs are required to define, and have now defined, PONV by early, forward-looking, dynamic criteria based on the respective ratios of the group's capital and liquidity resources to the projected capital or liquidity needs of its operating subsidiaries during the projected stabilization and resolution period under the group's SPOE resolution strategy. Once either ratio approaches one, the agreement would obligate the top-tier parent to use its assets to provide capital support to all of its material subsidiaries, and the material subsidiaries would have a legal right to enforce the agreement and seize any collateral if the parent did not voluntarily honor its secured obligations. These triggers are virtually certain to occur before the top-tier parent runs out of liquidity or becomes balance sheet insolvent.

II. Comments on the Proposed Guiding Principles – Principle-by-Principle

Our comments in this section recommend changes only to the proposed Guiding Principles that we believe need to be improved or clarified; where we do not have any substantial objections to a Guiding Principle as proposed, we have not addressed the principle in this letter. Annex B includes a chart mapping the specific questions asked in the FSB's consultative document to the relevant answers provided in this letter.

A. Proposed Guiding Principle 1: Material sub-group identification

1. The material sub-group identification process should be standardized across all jurisdictions.

The material sub-group identification process should follow a standardized designation process across all jurisdictions and be subject to clear standards. This process should also be aligned with the process for identifying material subsidiaries—such as material entities in the United States—within the resolution and recovery planning process of the home jurisdiction.

2. The final Guiding Principles should confirm that host country branches of a G-SIB legal entity are not identifiable as material sub-groups or subject to any internal TLAC requirements.

This principle was included in the FSB's International TLAC Standard but should be reconfirmed in the FSB's final Guiding Principles.

B. Proposed Guiding Principle 2: Material sub-group composition and distribution of internal TLAC

1. Internal TLAC requirements should be imposed only on the top-tier parent of the material sub-group, if a single top-tier parent exists, or separately on the top-tier parent companies of the material sub-group, if a single parent does not exist, in the relevant host jurisdiction.

If internal TLAC and related pre-positioned asset requirements were imposed on each of the members of a material sub-group in addition to its top-tier parent or parents, host authorities would risk creating additional impediments to cross-border SPOE resolution strategies by further balkanizing and trapping assets in the host jurisdiction. Internal TLAC requirements should be set at the top-tier parent or parents within the jurisdiction of the material sub-group. Any holding companies further up the ownership chain that are located in a different jurisdiction should also not be considered when determining material sub-groups. Just as it is inefficient and ultimately counterproductive to require excessive amounts of internal TLAC and related pre-positioned assets in host jurisdictions, it is even more inefficient and counterproductive for such internal TLAC and pre-positioned assets to be further balkanized within host jurisdictions. Neither lack of trust among host authorities, if there is more than one such authority within the single jurisdiction in which the material sub-group is located, nor any operational or legal barriers in the host jurisdiction to the availability of internal TLAC to recapitalize other members of the material sub-group, should be considered a sufficient justification for such balkanization under the International TLAC Standard. It is reasonable to assume that host authorities can solve their internal coordination, operational or legal impediments on their own, without creating any additional legal or operational impediments to cross-border SPOE resolution strategies.

2. Sister companies located within the relevant host jurisdiction should not be grouped together as a material sub-group if they do not already form a sub-consolidation group for accounting purposes in the host jurisdiction.

Absent such a limitation, internal TLAC requirements could result in a resolution-related sub-consolidation where none otherwise exists for accounting purposes in the host jurisdiction. G-SIBs would be required to create phantom combined balance sheets for the sister companies to calculate the combined assets of the phantom group of sister subsidiaries. Worse, host jurisdictions could require actual, structural sub-consolidation changes based on geography. These requirements would directly contravene efforts of the G-SIB groups to reduce the number of their legal entities and to align corporate structures with business lines for operational and resolution purposes. Rather, in such a case, each company should be tested on its own against the materiality criteria.

C. Proposed Guiding Principle 3: Multi-jurisdictional material sub-groups

1. Material sub-groups should only consist of entities in more than one jurisdiction where there is a single resolution regime covering those jurisdictions. We do not believe that this principle should be extended to jurisdictions where there is merely cooperation and coordination among multiple resolution authorities.

We believe that the benefits of extending proposed Guiding Principle 3 to jurisdictions where there is merely cooperation and coordination among multiple resolution authorities, but not a single resolution regime, are outweighed by the costs of doing so in terms of legal uncertainty. For example, intermediate holding companies in jurisdictions other than the host jurisdiction should not be included in a sub-group unless there is a single resolution regime for both jurisdictions.

D. Proposed Guiding Principle 4: Regulated or unregulated non-bank entities

1. Regulated or unregulated non-bank entities, such as shared service companies or commercial companies, should not be designated as or included in material sub-groups or subject to internal TLAC requirements, unless they conduct critical operations or provide critical services *and* continuity of those operations or services cannot be achieved through alternative arrangements.

A G-SIB group may have a number of regulated or unregulated non-bank entities, such as shared service companies, insurance companies or commercial company subsidiaries. There is no reason to impose internal TLAC requirements on such companies unless they conduct operations that are critical to financial stability or provide services that are critical to the operations of the G-SIB group. If they do not conduct critical operations or provide critical services, they can be allowed to fail without destabilizing the financial system or creating a material impediment to the G-SIB group's SPOE resolution strategy.

Moreover, even if a regulated or unregulated non-bank entity conducts a critical operation or provides a critical service, there is no need to impose internal TLAC requirements on it if the continuity of those operations or services can be achieved through alternative arrangements and those arrangements are in place. In the case of a shared service subsidiary, which typically does not require much capital, alternative arrangements might include having available liquidity for a six-month period and ensuring service-level agreements are predictable, transparent and set on an arm's length basis.[15] Under such an alternative arrangement, for

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15 The U.S. regulators are requiring this kind of arrangement through the resolution planning process. *See* FDIC and Federal Reserve, *Guidance for 2017 §165(d) Annual Resolution Plan Submissions By Domestic Covered Companies that Submitted Resolution Plans in July 2015* at 14 (Apr. 13, 2016) ("[T]he firm should ensure the financial resilience of internal shared service providers by maintaining working capital for six months (or through the period of stabilization as required in the firm's preferred strategy) in such entities sufficient to cover contract costs, consistent with the preferred resolution strategy."). The PRA has outlined similar expectations for U.K. firms. *See* Bank of England, Prudential Regulation Authority,

example, the shared service company can be expected to continue to provide such services as long as it is paid on a cost-plus basis.

E. Proposed Guiding Principle 5: The role of the host authority

1. This proposed Guiding Principle should be rewritten to state that host authorities should comply with appropriate limits on the imposition of internal TLAC requirements on material sub-groups.

If such limits are not agreed to, internal TLAC requirements will inevitably become a substantial new impediment to the operational feasibility of cross-border SPOE strategies, because of a collective action problem that gives host authorities a powerful incentive, if they expect one or more other host jurisdictions to do so, to require and trap excessive amounts of internal TLAC and pre-positioned assets in their jurisdictions. Trapping excessive amounts of internal TLAC and pre-positioned assets in host jurisdictions has the inefficient effect of reducing the amount of contributable assets at the top-tier parent level of at least Clean Holding Company Groups that would otherwise be available to recapitalize material sub-groups as, when and where needed.

This balkanization of pre-positioned assets will increase the risk that the top-tier parent will not have a sufficient amount of contributable assets to recapitalize all of its material sub-groups if the distribution of internal TLAC does not match the distribution of losses in an actual financial distress scenario. If the home authority responds to this misallocation risk by requiring the G-SIB group to hold a substantial buffer of external TLAC, the cost of its SPOE strategy will be substantially higher than it would have been without the excessive internal TLAC requirements, creating a substantial new and wholly unnecessary impediment to the feasibility of SPOE strategies.

The collective action problem that gives rise to these incentives to take self-protective measures is similar to the collective action problem that gives all depositors in a bank engaged in maturity or liquidity transformation an incentive to run if they believe other depositors will run. As described in the classic article by Douglas Diamond and Philip Dybvig,[16] depositors in banks that fund themselves with demand deposits or other short-term borrowings and invest in illiquid assets are engaged in a coordination game that has multiple Nash equilibria,[17] one of which is a bank run on the bank's demand deposits and other short-term debt. If depositors believe that

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Ensuring operational continuity in resolution – SS9/16 at 8 (July 7, 2016) ("[T]he PRA expects that, as a minimum, the critical services provider within a group . . . should be supported by liquidity resources equivalent to at least 50% of annual fixed overheads of the critical services provided by the critical services provider.").

[16] *See* Diamond & Dybvig, *supra* note 13.

[17] The term "Nash equilibrium" is used in the game theory branch of economics and refers to an outcome that is in the individual self-interest of both players in a two-player game based on the actual or expected self-interested behavior of the other player, even if both parties would have been better off if they had cooperated instead of engaging in self-interested behavior under conditions of uncertainty and distrust about the possible self-interested actions of the other player.

enough other depositors will run, they will find it in their individual self-interest to run, even if the bank is indisputably solvent, lest the process of selling the bank's illiquid assets at fire sale prices to meet withdrawal demands under demand deposit or other short-term debt instruments renders the indisputably solvent bank insolvent, leaving any depositors who did not run to bear all the losses.[18]

The dynamic is the same with host authorities and excessive internal TLAC requirements. If just one host authority imposes excessive internal TLAC and related pre-positioned asset requirements on a material sub-group in its jurisdiction (e.g., at the high end of the FSB's 75–90% range of the amount of external TLAC requirements applicable to similarly situated resolution entities in the host jurisdiction), the pool of contributable assets at the top-tier parent will be reduced by a corresponding amount. This reduction in contributable assets increases the risk that the G-SIB group's top-tier parent might not have enough contributable assets to recapitalize material sub-groups in other host jurisdictions. To mitigate this risk, other host authorities have a powerful incentive to impose similarly excessive internal TLAC and pre-positioned asset requirements in their jurisdictions. Just as all depositors find it in their individual self-interest to run to protect themselves against losses if they believe enough other depositors will run, so host authorities face a powerful incentive to impose excessive internal TLAC and pre-positioned asset requirements on material sub-groups in their jurisdictions if they observe or believe that other host authorities will do so.

Only cooperative behavior among home and host authorities, or agreed-upon limits on the imposition of excessive internal TLAC and related pre-positioned asset requirements, will avoid this excessive and wholly unnecessary new cost. Surely, it is reasonable for the FSB to expect home and host authorities to voluntarily cooperate rather than compete with each other or to agree to appropriate limits in advance for the sake of the overall public good.

The only way to prevent the dynamic described above from creating a substantial new impediment to cross-border SPOE strategies is for the FSB's final Guiding Principles to be rewritten to state that host jurisdictions should comply with appropriate limits on such inefficient behavior. This would remove the incentive for other host jurisdictions to race to impose their own requirements, thereby solving the collective action problem.

2. **To prevent internal TLAC requirements from becoming an excessive impediment to cross-border SPOE strategies, the FSB should revise its proposed Guiding Principle 5 to provide that internal TLAC requirements should not be imposed on material sub-groups by host authorities unless:**

    a. **the host authority determines that the material sub-group is systemically important in the host jurisdiction;**

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[18] Diamond & Dybvig, *supra* note 13. Morgan Ricks has described this "bank game" as a version of the classic "stag hunt game" in which the socially optimal outcome is not a Nash equilibrium, but instead various suboptimal outcomes are the Nash equilibria. Morgan Ricks, THE MONEY PROBLEM: RETHINKING FINANCIAL REGULATION 62–70 (Univ. of Chi. Press 2016).

b. **the internal TLAC requirements are limited to the low end of the FSB's 75–90% range of the amount of external TLAC requirements applicable to similarly situated resolution entities in the host jurisdiction;**

c. **the GLAC component of any internal TLAC requirements is suspended at or before the time the top-tier parent of a G-SIB group enters into a bankruptcy or special resolution proceeding and through the time its SPOE resolution strategy has been completed; and**

d. **the GLAC component of any internal TLAC requirements is permitted to be satisfied by secured support agreements or other collateralized guarantee arrangements that impose a legally binding obligation on the parent, an IHC or a dedicated funding vehicle to recapitalize the material sub-group at or prior to the sub-group's PONV.**

We believe that the FSB should also consider recalibrating the permissible internal TLAC range from 75–90% of external TLAC by using different metrics altogether to reflect the major developments described above, such as the development of secured support agreements and recapitalization triggers based on the G-SIB group's projected capital and liquidity levels and needs during its entire projected SPOE resolution period. For example, we do not believe that a denominator based on the external TLAC requirements of similarly situated resolution entities is even relevant in light of the existence of secured support agreements, described above. Nor do we believe that a static range such as 75–90% of whatever denominator is used is appropriate in light of these dynamic recapitalization triggers.

3. **The FSB should also strike the statement, "there is no presumption that host authorities would apply a lower internal TLAC requirement if the sum of internal TLAC requirements exceeds the resolution entity's external TLAC" and replace it with the following new statement:**

   If the sum of a G-SIB's internal TLAC requirements exceeds the top-tier parent's external TLAC, host jurisdictions are expected to reduce their internal TLAC requirements on a pro-rata basis until they fall within the range of 75–90% of the top-tier parent's external TLAC requirements.

We believe that the current statement quoted above is inconsistent with the letter and spirit of the FSB's International TLAC Standard and that the new statement is more consistent with the International TLAC Standard and the other changes to Guiding Principle 5 proposed above.

4. **For the reasons stated in our February 2015 comment letter to the FSB,[19] final Guiding Principle 5 should state that host authorities should exclude a material sub-group's assets consisting of obligations of its top-tier parent or other affiliates when calibrating the sub-group's internal TLAC requirement.**

In other words, when calculating its internal TLAC requirements, the sub-group should not be required to issue internal TLAC against assets on its balance sheet that correspond to liabilities on the balance sheets of its top-tier parent or other affiliates. Allowing host authorities to count such assets towards a material sub-group's internal TLAC requirement would amount to unnecessary double-counting. Exposures at the material sub-group level that represent external risks are consolidated at the resolution entity level and are factored into the resolution entity's required external TLAC. 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 and especially where the issuing entity is already carrying internal TLAC of its own to protect the claims on its balance sheet from other affiliates. To require internal TLAC at both the issuing and receiving ends of an intragroup transaction causes double counting, which can exacerbate the misallocation risk described above.

F. Proposed Guiding Principle 6: The role of the home authority

1. **Paragraph (ii) describing the role of the home authority should be replaced in its entirety with the following new paragraph (ii):**

   "it would be beneficial to maximize the percentage of the group's assets that are positioned as contributable assets at the parent level and minimize the percentage of the group's assets that are pre-positioned at the material sub-group level, consistent with the regulatory capital requirements to which the material sub-groups are subject; and"

This change is necessary to make final Guiding Principle 6 consistent with the limits described in our recommended revisions to proposed Guiding Principle 5 to which host authorities should be required to agree for the reasons set forth above in our recommended revisions to proposed Guiding Principle 5.

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19 Joint Comment Letter of TCH, SIFMA, the ABA and the FSR on the FSB's Consultative Document on Adequacy of Loss-Absorbing Capacity of Global Systemically Important Banking Groups in Resolution (Feb. 2, 2015), *available at* https://www.theclearinghouse.org/-/media/files/association%20related%20documents/20150202%20joint%20comment%20letter%20on%20fsb%20tlac%20proposal.pdf?la=en [hereinafter "February 2015 Comment Letter"], at 40.

2. **Paragraph (iii) describing the role of the home authority should be amended to add the words "75–90% of" in front of the phrase "the resolution entity's external TLAC."**

This change would make final Guiding Principle 6 more consistent with the FSB's International TLAC Standard and with the limits described above and in our recommended revisions to proposed Guiding Principle 5, which are appropriate for the reasons set forth above.

3. **The penultimate paragraph under proposed Guiding Principle 6 should be deleted.**

It is inconsistent with our recommended revisions to proposed Guiding Principle 5. The sum of a G-SIB group's internal TLAC requirements should ***never*** be required to exceed the amount of the top-tier parent's external TLAC recommended under the FSB's International TLAC Standard.

G. Proposed Guiding Principle 7: Surplus TLAC

1. **Proposed Guiding Principle 7 is beyond the scope of the proposed Guiding Principles, which are supposed to be limited to *internal* TLAC, but if kept, proposed Guiding Principle 7 should be revised to eliminate the suggestion in the related commentary to this proposed Guiding Principle that any contributable assets positioned at the top-tier parent level should be limited to liquid assets.**

Proposed Guiding Principle 7 states that "[i]n cases where there is TLAC at the [top-tier parent level] that is not distributed to material sub-groups . . . ***home*** authorities should consider the characteristics of the correspond[ing] assets of such surplus [external] TLAC to ensure that it is readily available to recapitalize any direct or indirect subsidiary, as required by Section 18 of the TLAC term sheet." (Emphasis added.) The commentary elaborates on this proposed Guiding Principle by stating that "***home*** authorities may consider it appropriate for [the corresponding assets of] surplus [external] TLAC to be held in the form of assets that can be promptly and easily valued, and which are likely to retain sufficient value in times of market-wide distress." (Emphasis added.) This elaboration seems to be referring to liquid assets, perhaps even high-quality liquid assets ("**HQLA**").

We believe that proposed Guiding Principle 7 is beyond the scope of the proposed Guiding Principles, which are supposed to be limited to ***internal*** TLAC. Instead, the proposed Guiding Principle relates to the assets positioned at the top-tier parent level that correspond to any surplus ***external*** TLAC. Accordingly, we believe it should be deleted as beyond scope.

But even if proposed Guiding Principle 7 were somehow within the scope of the proposed Guiding Principles, we believe it should be revised to eliminate any suggestion that contributable assets at the top-tier parent level should be limited to HQLA. The purpose of external and internal TLAC is to provide resources that can be used to ***recapitalize*** the top-tier parent and material sub-groups of a G-SIB group. TLAC was not designed to provide ***liquidity*** to a G-SIB group. There is a fundamental difference between capital and liquidity.[20] Liquidity needs are addressed by various separate mechanisms, such as cash reserve requirements, HQLA requirements imposed by the liquidity coverage ratio ("**LCR**") and lender-of-last-resort facilities.

Most of the assets currently positioned at the top-tier parents of Clean Holding Company Groups consist of cash and other liquid assets, receivables on debt instruments issued by subsidiaries, equity in subsidiaries and other assets. Cash and other liquid assets are necessary to provide liquidity to material sub-groups, but they are not necessary to recapitalize them. It is both operationally and legally feasible to use a wide array of other assets to recapitalize material sub-groups.

For example, there are no general operational or legal barriers to using receivables on debt instruments issued by subsidiaries to recapitalize material sub-groups, even though they are unlikely to qualify as liquid assets. Such debt instruments would be shown as liabilities on the balance sheet of the subsidiaries that issued them, and might even count as internal TLAC. The receivables on those debt instruments would be treated as assets on the balance sheet of the top-tier parent, and should count as contributable assets regardless of whether they "can be promptly and easily valued" or can be expected to "retain sufficient value in times of market-wide distress."

The simplest and most obvious way for the top-tier parent to use the receivables to recapitalize a material sub-group is for the parent to forgive all or a portion of the material sub-group's obligations on any debt securities issued by the material sub-group or exchange the receivables on such debt instruments for equity securities issued by the material sub-group. Either action will decrease the liabilities and increase the capital of the material sub-group.

Another way is for the parent to contribute a receivable from material sub-group A to material sub-group B. Alternatively, material sub-group A could distribute assets to the parent in return for forgiveness of material sub-group A's obligations on the receivable and then the parent could contribute the distributed assets to material sub-group B. The assets distributed to the parent and contributed to material sub-group B do not need to be liquid in order to be effective. Either action will increase material sub-group B's assets and therefore its capital.

2. **The first sentence of the explanation of this proposed Guiding Principle should be amended by striking the phrase "there is an expectation that not all external Minimum TLAC would be distributed to material sub-groups in the form of pre-positioned internal TLAC" and replacing it with "not all contributable assets related to external Minimum TLAC should be distributed to material sub-groups in the form of pre-positioned assets related to internal TLAC."**

This change should make final Guiding Principle 7 more comprehensible because it does not confuse assets with TLAC (i.e., regulatory capital and certain qualifying debt instruments)

20 *See* Bipartisan Policy Center, *Too Big to Fail: The Path to a Solution* (May 2013), *available at* http://bipartisanpolicy.org/wp-content/uploads/sites/default/files/TooBigToFail.pdf, at 19.

and because it is more consistent with our recommended revisions to proposed Guiding Principles 5 and 6.

H. Proposed Guiding Principle 8: Internal TLAC composition

1. **The final Guiding Principles should not state that host authorities may include any expectation that at least 33% of internal TLAC consist of debt instruments, at least for material sub-groups of a G-SIB group that have entered into a legally binding secured support agreement with their top-tier parent that includes recapitalization triggers based on the respective ratios of the group's capital or liquidity resources to the projected capital or liquidity needs of its material sub-groups.**

We do not believe that the expectation that at least 33% of a G-SIB group's eligible external TLAC consist of debt instruments is a "core feature" of eligible external TLAC as defined in the FSB's International TLAC Standard. First, the feature is only an expectation, not a requirement. If it were a core feature, it would be a requirement. Second, the final International TLAC Standard does not expressly state that the 33% expectation is a core feature, even though we had specifically requested in our comment letter on the FSB's proposed International TLAC Standard that it clarify that such an expectation would not be included in any internal TLAC requirements.[21] This silence in the face of our specific comment further supports our position that it is not a "core feature." We do not believe that the final Guiding Principles should amend or otherwise expand the International TLAC Standard to treat the 33% expectation as a core feature of eligible external TLAC and therefore as a permissible element of internal TLAC. Instead, the final Guiding Principles should be limited to clarifying what is already in the International TLAC Standard.

Moreover, the rationale underlying the expectation that at least 33% of external TLAC should consist of debt instruments does not apply to internal TLAC, at least for Clean Holding Company Groups. That rationale was to ensure that the home authority had the legal power to put resolution entities into bankruptcy or other resolution proceedings when they still had enough external TLAC to recapitalize the resolution entity. First, a material sub-group is supposed to be recapitalized by its top-tier parent, kept open and operating and kept out of its own bankruptcy or other resolution proceeding in an SPOE resolution strategy. Only the top-tier parent is supposed to enter into bankruptcy or resolution proceedings. Second, the top-tier parents of seven out of the eight U.S. G-SIB groups have entered into, or have publicly announced they are considering entering into, secured support agreements that impose or would impose a fully secured obligation on the top-tier holding company parents to use their contributable assets to recapitalize all of their material sub-groups. Finally, such secured support agreements of the U.S. G-SIB groups contain provisions that obligate the top-tier parent to provide capital support to its material sub-groups under during periods of material financial distress before any of the material sub-groups reach their PONV. They also contain provisions that would obligate the top-tier parent to provide capital support to all of its material sub-groups when either of the respective ratios of the

21 February 2015 Comment Letter, at 8, 35–36.

group's capital and liquidity resources to the projected capital or liquidity needs of its operating subsidiaries approaches one. This latter trigger is designed to occur before the top-tier parent would reach its PONV.[22]

As a result, any material sub-group that has entered into such a secured support agreement with its top-tier parent will have a legally enforceable, fully secured right to be recapitalized at or prior to its PONV, regardless of whether its internal TLAC requirement has a minimum debt component.

2. **If the final Guiding Principles retain the expectation that at least 33% of internal TLAC consist of debt instruments, they should clarify that G-SIB groups taking the daisy chain approach or other approaches to internal TLAC issuance need not meet that expectation at each level of the chain and that the composition of internal TLAC at each level of the chain need not be identical.**

The composition of internal TLAC need not be identically matching at each level of the daisy chain or of any other chain for losses to be effectively passed up from the material sub-group to the resolution entity. In addition, such a requirement may be inconsistent with a particular G-SIB group's resolution strategy, such as one that relies on a secured support agreement or collateralized guarantee approach. The G-SIB group should be permitted to retain the flexibility to determine the appropriate composition of internal TLAC at each level of the chain consistent with its resolution strategy.

3. **The final Guiding Principles should state that host authorities should not impose any restriction on the double leverage of a G-SIB group.**

Proposed Guiding Principle 8 could be read to imply that host authorities should impose restrictions on the double leverage of a G-SIB group by noting that "external TLAC in the form of debt pre-positioned at the material sub-group as internal TLAC in the form of equity could result in a scenario where the resolution entity is unable to finance its interest payments on its external TLAC debt because it has not earned sufficient dividend payments on internal TLAC instruments in the form of equity." To the extent that host authorities determine the composition of internal TLAC for the material sub-groups in their jurisdiction, they should not create restrictions on double leverage or consider the impact of double leverage as part of their determination, as such considerations are unrelated to the availability of internal TLAC to absorb losses or to the credibility of the resolution strategy. Considerations relating to double leverage should remain appropriately within the purview of the home authorities acting in their supervisory capacity with respect to each G-SIB group's top-tier parent.

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[22] In addition, other justifications for having an expectation that 33% percent of external TLAC consist of debt instruments are not applicable to internal TLAC. For example, while holders of external debt could monitor a firm and serve a market discipline function, holders of internal debt would not serve this function.

I. Proposed Guiding Principle 9: Collateralized guarantees

1. **Final Guiding Principle 9 should confirm that host authorities should allow the GLAC component of any internal TLAC requirements to be satisfied by fully secured support agreements or other collateralized guarantee arrangements that impose a legally binding and fully secured obligation on the top-tier parent, an IHC or a dedicated funding vehicle to recapitalize the material sub-group at or prior to the sub-group's PONV.**

This change to proposed Guiding Principle 9 is necessary to reflect the major developments recently made by seven of the eight U.S. G-SIB groups or which may be made in the future by non-U.S. G-SIB groups. As discussed above, material sub-groups of a G-SIB group that has put in place a secured support agreement or other similar collateralized guarantee already have a legally enforceable, fully secured right to be recapitalized using contributable assets from the top-tier parent, an IHC or a dedicated funding vehicle (depending on the terms of the agreement). Moreover, such secured support agreements include provisions that would obligate the top-tier parents to provide capital support to their material sub-groups during periods of material financial distress before the material sub-groups or their top-tier parent reach their PONV. They also include provisions that would obligate the top-tier parent to provide capital support to all of its material sub-groups when either of the respective ratios of the group's capital and liquidity resources to the projected capital or liquidity needs of its operating subsidiaries approaches one. This latter trigger is designed to occur before the top-tier parent would reach its PONV. Because a secured support agreement or collateralized guarantee arrangement would therefore achieve the same recapitalization goal as the GLAC component of internal TLAC and related pre-positioning requirements, the final Guiding Principles should provide that they can be used to substitute for the GLAC component of any internal TLAC requirements.

2. **For the reasons stated in our February 2015 Comment Letter,[23] the final Guiding Principles should confirm that each secured support or other collateralized guarantee obligation may be secured by the entire pool of contributable assets rather than a segregated, earmarked pool of its own collateral.**

Assuming, as we believe to be the case, that the FSB has conservatively calibrated the total amount of external TLAC needed to recapitalize all the material sub-groups of an SPOE Group and host authorities have not trapped an excessive amount of pre-positioned assets in host jurisdictions, the sum of the secured claims of all the material sub-groups should be less than or equal to the total amount of the collateral pool. Therefore, the collateral does not need to be segregated and earmarked to ensure that the claims of each material sub-group will be fully secured. Indeed, each of those individual claims is likely to be substantially oversecured. Requiring collateral to be segregated and earmarked for individual material sub-groups will create the same misallocation risk as excessive internal TLAC and related pre-positioned asset

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[23] February 2015 Comment Letter, at 36–37.

requirements since the distribution of any such segregated and earmarked collateral is unlikely to match the distribution of losses in any actual distress scenario. Thus, any segregation and earmarking requirements would defeat the purpose of allowing secured support agreements and other collateralized guarantee arrangements to substitute for internal TLAC and related pre-positioned asset requirements.

3. **The final Guiding Principles should also clarify that collateral should be considered unencumbered for purposes of internal TLAC requirements as long as any security interests over the collateral in favor of all material sub-groups are senior to any security interest in favor of anyone other than a material sub-group.**

So long as the security interests in favor of all material sub-groups are senior to any lien in favor of anyone other than a material sub-group, the collateral will be available to satisfy the claims of each material sub-group as and when needed. Having a senior lien entitles each senior lien holder, upon a default, to foreclose on the collateral and sell it free from any junior lien holder's lien. Having a senior lien also entitles each senior lien holder, in a bankruptcy or special resolution proceeding of the top-tier parent, to the value of its portion of the overall collateral pool before a junior lien holder or any unsecured creditor of the debtor. The rights of each senior lien holder to its portion of the collateral pool are thus the same as if the senior lien holders held the only security interests over the collateral pool and, therefore, it would not matter whether their secured interests in the collateral pool are the only interests over that collateral pool or one of several interests over that collateral pool, so long as the interest of each material sub-group is senior to the interests of anyone other than a material sub-group over the same collateral. Accordingly, we request that the FSB clarify that collateral will be considered unencumbered for purposes of the final Guiding Principles so long as any security interests in favor of a material sub-group are senior to any security interest in favor of anyone other than a material sub-group.

J. Proposed Guiding Principle 10: Internal TLAC issuance

1. **Each G-SIB group should be permitted (in consultation with its home authority) to determine the most appropriate internal TLAC issuance strategy for purposes of its individual funding plan and resolution strategy, taking into account tax and other concerns, and should not be limited to direct and daisy chain issuances.**

Proposed Guiding Principle 10 appropriately allows for both direct and daisy chain issuance structures. This flexibility is especially important if material sub-groups are held through a chain of intermediaries. We believe that final Guiding Principle 10 should allow additional flexibility, however, given that direct and daisy chain issuances are not the only internal TLAC issuance strategies that could support a G-SIB group's resolution strategy and the passing of losses and recapitalization needs to the resolution entity.

For example, a material sub-group might choose to issue internal TLAC to an affiliate that is not held by the top-tier parent through the same ownership chain as the material sub-group.

Where a G-SIB group can demonstrate that this approach to issuing internal TLAC adequately supports the passing of losses to the top-tier parent, the FSB should recognize this as an eligible approach to issuing internal TLAC. The Federal Reserve's final TLAC rule provides a useful example. In response to comments on the proposal, it allowed the U.S. IHC subsidiaries of non-U.S. G-SIBs to issue internal TLAC to non-U.S. affiliates that were not in the same ownership chain with the U.S. IHC subsidiaries.[24]

Proposed Guiding Principle 10 also mentions a possible deduction mechanism for solo entities relating to internal TLAC. At this stage, we believe that it would be far wiser to defer to Crisis Management Group ("**CMG**") oversight than to hardwire a new set of internal rules into the FSB framework before supervisors have had a chance to explore various group approaches and structures and develop a sense of best practices. CMGs are the right avenue to ensure that legal entity architecture is sensibly designed, and should be sufficient for that purpose.

K. Proposed Guiding Principle 12: Internal TLAC obstacles and Proposed Guiding Principle 13: Contractual trigger clauses

1. The final Guiding Principles should clarify that a contractual trigger clause should not give host authorities the right to write down any debt securities or convert them to equity unless and until the material sub-group becomes balance-sheet insolvent or unable to pay its debts when due.

Proposed Guiding Principle 12 provides that "contractual triggers for internal TLAC instruments should specify the conditions under which a write-down and/or conversion into equity is expected to take place" and that "[i]n accordance with the TLAC term sheet, this should be the point at which the material sub-group reaches PONV, as determined by the host authority." The PONV as determined by the host authority should be when a material sub-group becomes balance-sheet insolvent or unable to pay its debts when due, which is consistent with the most common traditional definitions of the PONV.

24 *See* Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations, 82 Fed. Reg. 8266, 8292–93 (Jan. 24, 2017)

2. **The final Guiding Principles should include an expectation that authorities will consider the tax consequences of their internal TLAC requirements, especially in connection with contractual trigger clauses in TLAC-eligible debt instruments that permit host authorities to write down the debt or convert it to equity (or otherwise require such write down or conversion) at the PONV outside of an insolvency or resolution proceeding.**

Proposed Guiding Principle 12 appropriately notes the issues raised by the potentially asymmetric tax treatment of internal TLAC instruments between home and host authority jurisdictions under their respective tax codes. The final Guiding Principles should go further, however. Even if the tax treatment of an instrument is symmetric (i.e., both the home and host jurisdictions treat an instrument the same way for tax purposes, or the internal TLAC is between two subsidiaries in the same jurisdiction), internal TLAC requirements can still have significant tax consequences if instruments that are debt in form are treated as equity for tax purposes. This recharacterization risk can be substantial in some jurisdictions for debt instruments that contain contractual clauses that permit host authorities to write down or convert the debt into equity (or otherwise require such write down or conversion) outside an insolvency or resolution proceeding. Asymmetric treatment only exacerbates the potential issue.

The final Guiding Principles should include an expectation that each authority will consider the tax consequences of its internal TLAC requirements, especially in connection with contractual trigger clauses in TLAC-eligible debt instruments that permit host authorities to write down the debt or convert it to equity (or otherwise require such write down or conversion) at the PONV outside of an insolvency or resolution proceeding. The Federal Reserve's final TLAC rule provides a useful example. The Federal Reserve heeded concerns regarding the tax consequences of its internal TLAC requirement for U.S. IHCs of non-U.S. G-SIBs, including by modifying certain proposed requirements and consulting in advance with the U.S. Internal Revenue Service and the U.S. Department of the Treasury regarding the U.S. tax law treatment of internal long-term debt issued pursuant to the rule,[25] which resulted in the U.S. Internal Revenue Service issuing guidance that confirmed that such internal long-term debt would be respected as debt for purposes of U.S. tax law even if the debt contained certain contractual trigger clauses.

L. Proposed Guiding Principle 16: Options to restore material sub-group viability

1. **The GLAC component of any internal TLAC requirements should be suspended during the top-tier parent's resolution period.**

As discussed above in Section I, if the GLAC component of any internal TLAC requirement were binding during the top-tier parent's resolution period, the internal GLAC would not be available to recapitalize the material sub-group at or prior to the sub-group's

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[25] *See id.* at 8294–97.

PONV by writing down the internal TLAC instruments in reverse order of their priority or by converting internal TLAC debt instruments to equity. Thus, it would impede, rather than facilitate, the restoration of each material sub-group's going-concern capital, and so should be suspended during the resolution period.

M. Proposed Guiding Principle 19: Material sub-group recapitalization

1. **Host authorities should be required to establish the recapitalization amount (i.e., going-concern capital) that a material sub-group will be required to have during an SPOE bail-in period during business-as-usual, not at or after a bail-in of internal TLAC.**

Proposed Guiding Principle 19 contemplates that the host authority would determine the recapitalization level (i.e., going-concern capital) of a material sub-group that has reached its PONV at the time it is deciding whether to write down internal TLAC or convert it to equity. Proposed Guiding Principle 19 should be revised to provide that host authorities should determine and disclose the amount of going-concern capital that a material sub-group will be required to have during an SPOE bail-in period during business-as-usual well before bail-in occurs, not after the bail-in occurs. Otherwise, unexpected increases in the applicable capital requirements of a particular sub-group could make effective resolution of the G-SIB group more difficult. For example, absent such a limitation, a host authority could raise the recapitalization level of the material sub-group in order to capture a share of the finite amount of contributable assets remaining at the top-tier parent, even though it may be more efficient for the G-SIB group to use those excess contributable assets to recapitalize other material sub-groups.

N. Proposed Guiding Principle 20: Choice of write-down or conversion into equity

1. **Final Guiding Principle 20 should expressly provide that if any internal TLAC is written down by the host authority, it should be written down in the reverse order of the priority of its claims—e.g., ordinary shares first, preference shares second, subordinated debt third and senior debt fourth.**

Host authorities should respect the priority of claims in the context of converting or writing down internal TLAC. In particular, equity (ordinary and preference shares) should be written down first, followed by subordinated and senior debt in the reverse order of seniority. Otherwise, senior instruments would be effectively subordinated to junior instruments in the write-down or conversion process.

2. **If internal TLAC debt is converted into equity by the host authority, it should be converted at a conversion ratio that reflects the priority of claims between such TLAC debt and any junior claims or interests—e.g., pre-existing equity should be sufficiently diluted to reflect the priority of claims.**

Any internal TLAC write-down by the host authority should be conducted in accordance with the normal priority of claims.

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We thank the Financial Stability Board for its consideration of our comments. If you have any questions, please do not hesitate to contact any of the undersigned.

Sincerely,

John Court
Managing Director and Deputy General Counsel
The Clearing House Association L.L.C.

Carter McDowell
Managing Director and Associate General Counsel
Securities Industry and Financial Markets Association

Hu Benton
Vice President, Banking Policy
American Bankers Association

Rich Foster
Senior Vice President and Senior Counsel for Regulatory and Legal Affairs
Financial Services Roundtable

Richard Coffman
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ANNEX A
The Associations

The Clearing House

The Clearing House is a banking association and payments company that is owned by the largest commercial banks and dates back to 1853. The Clearing House Association L.L.C. is a nonpartisan organization that engages in research, analysis, advocacy and litigation focused on financial regulation that supports a safe, sound and competitive banking system. Its affiliate, The Clearing House Payments Company L.L.C., owns and operates core payments system infrastructure in the United States and is currently working to modernize that infrastructure by building a new, ubiquitous, real-time payment system. The Payments Company is the only private-sector ACH and wire operator in the United States, clearing and settling nearly $2 trillion in U.S. dollar payments each day, representing half of all commercial ACH and wire volume.

Securities Industry and Financial Markets Association

SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the U.S., serving clients with over $20 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. 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.

American Bankers Association

The American Bankers Association is the voice of the nation's $16 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $12 trillion in deposits and extend more than $9 trillion in loans.

Financial Services Roundtable

As *advocates for a strong financial future*™, 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.

Institute of International Bankers

IIB is the only national association devoted exclusively to representing and advancing the interests of the international banking community in the United States. Its membership is comprised of internationally headquartered banking and financial institutions from over 35 countries around the world doing business in the United States. The IIB's mission is to help resolve the many special legislative, regulatory, tax and compliance issues confronting internationally headquartered institutions that engage in banking, securities and other financial activities in the United States. Through its advocacy efforts the IIB seeks results that are consistent with the U.S. policy of national treatment and appropriately limit the extraterritorial application of U.S. laws to the global operations of its member institutions. Further information is available at www.iib.org.

ANNEX B
Responses to Specific FSB Questions

1. What factors should the relevant authorities take into account when determining the composition of material sub-groups and the distribution of internal TLAC between the entities that form the material sub-group (guiding principle 2)?

Please see our comments on proposed Guiding Principles 1, 2, 3 and 4 contained in Sections II.A to II.D of our comment letter.

2. What are your views on the treatment of regulated or unregulated non-bank entities as set out in guiding principle 4? If such entities were included within a material sub-group, how should the relevant authorities calculate an internal TLAC requirement?

Please see our comments on proposed Guiding Principle 4 contained in Section II.D of our comment letter.

3. Do you agree with the roles of home and host authorities in relation to the host authority's determination of the size of the internal TLAC requirement, as set out in guiding principles 5 and 6? What additional factors, if any, should the host authority take into account when setting the internal TLAC requirement?

Please see our comments on proposed Guiding Principles 5 and 6 contained in Sections II.E to II.F of our comment letter.

4. How should TLAC at the resolution entity that is not distributed to material subgroups ('surplus TLAC') be maintained to ensure that it is readily available to recapitalise any direct or indirect subsidiary, as required by the TLAC term sheet (guiding principle 7)?

Please see our comments on proposed Guiding Principle 7 contained in Section II.G of our comment letter.

5. What are your views on the composition of internal TLAC, as set out in guiding principle 8? In particular, should there be an expectation of the inclusion within internal TLAC of debt liabilities accounting for an amount equal to, or greater than, 33% of the material sub-group's internal TLAC?

Please see our comments on proposed Guiding Principle 8 contained in Section II.H of our comment letter.

6. What are your views on the potential benefits or drawbacks of different approaches to the issuance of internal TLAC instruments as set out in guiding principle 10, and what steps could be taken to mitigate the drawbacks that you have identified?

Please see our comments on proposed Guiding Principle 10 contained in Section II.J of our comment letter.

7. Should the FSB conduct further work on the need for a deduction mechanism for internal TLAC, as proposed in guiding principle 10?

We believe that it would be premature to specify a detailed deduction mechanism for the issuance of internal TLAC at each level of a G-SIB group's daisy chain. The FSB should defer developing a deduction mechanism for internal TLAC until the G-SIBs have developed their internal TLAC issuance strategies.

8. Do you agree with the obstacles to the implementation of internal TLAC mechanisms set out in guiding principle 12? How should G-SIBs and authorities address those obstacles and what additional obstacles, if any, might arise?

Please see our comments on proposed Guiding Principle 12 contained in Section II.K of our comment letter.

9. Do you agree with the key features of contractual trigger language for internal TLAC, as set out in guiding principle 13 and in Annex 2? Should authorities consider the use of contractual triggers for internal TLAC in the form of regulatory capital instruments, including in cases where statutory point of non-viability powers exist in relation to such instruments?

Please see our comments on proposed Guiding Principle 13 contained in Section II.K of our comment letter.

10. Do you agree with the process for triggering internal TLAC in Section V? In particular, what are your views on the timeframe for the home authority to decide whether to consent to the write-down and/or conversion into equity of internal TLAC?

Please see our comments on proposed Guiding Principles 16, 19 and 20 contained in Sections II.L to II.N of our comment letter.

11. Are there any other actions that should be taken by G-SIBs and authorities to support the implementation of the internal TLAC requirement, consistent with the TLAC term sheet?

Please see all of the comments in our comment letter, but especially those on proposed Guiding Principle 5 in Section II.E.