FEDERAL RESERVE SYSTEM

12 CFR Parts 217 and 252

[Regulations Q and YY; Docket No. R–1523]

RIN 7100–AE37

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; Regulatory Capital Deduction for Investments in Certain Unsecured Debt of Systemically Important U.S. Bank Holding Companies

AGENCY: Board of Governors of the Federal Reserve System (Board).

ACTION: Notice of proposed rulemaking.

SUMMARY: The Board is inviting comment on a proposed rule to promote financial stability by improving the resolvability and resiliency of large, interconnected U.S. bank holding companies and the U.S. operations of large, interconnected foreign banking organizations pursuant to section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) and related deduction requirements for all banking organizations subject to the Board's capital rules. Under the proposed rule, a U.S. top-tier bank holding company identified by the Board as a global systemically important banking organization (covered BHC) would be required to maintain outstanding a minimum amount of loss-absorbing instruments, including a minimum amount of unsecured long-term debt, and related buffer. Similarly, the proposed rule would require the top-tier U.S. intermediate holding company of a global systemically important foreign banking organization with $50 billion or more in U.S. non-branch assets (covered IHC) to maintain outstanding a minimum amount of intra-group loss-absorbing instruments, including a minimum amount of unsecured long-term debt, and related buffer. The proposed rule would also impose restrictions on the other liabilities that a covered BHC or covered IHC may have outstanding. Finally, the proposed rule would require state member banks, bank holding companies, and savings and loan holding companies that are subject to the Board's capital rules to apply a regulatory capital deduction treatment to their investments in unsecured debt issued by covered BHCs.

DATES: Comments should be received by February 1, 2016.

ADDRESSES: You may submit comments, identified by Docket No. R–1523 and RIN 7100 AE–37, by any of the following methods:

- *Agency Web site: http://www.federalreserve.gov*. Follow the instructions for submitting comments at *http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm*.
- *Federal eRulemaking Portal: http://www.regulations.gov*. Follow the instructions for submitting comments.
- *Email: regs.comments@federalreserve.gov*. Include the docket number in the subject line of the message.
- *Fax:* (202) 452–3819 or (202) 452–3102.
- *Mail:* Robert deV. Frierson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue NW., Washington, DC 20551.

All public comments will be made available on the Board's Web site at *http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm* as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper form in Room 3515, 1801 K Street (between 18th and 19th Streets NW.) Washington, DC 20006 between 9:00 a.m. and 5:00 p.m. on weekdays.

FOR FURTHER INFORMATION CONTACT: Constance M. Horsley, Assistant Director, (202) 452–5239, Thomas Boemio, Senior Project Manager, (202) 452–2982, Juan C. Climent, Manager, (202) 872–7526, Felton Booker, Senior Supervisory Financial Analyst, (202) 912–4651, Sean Healey, Senior Financial Analyst, (202) 912–4611, or Mark Savignac, Senior Financial Analyst, (202) 475–7606, Division of Banking Supervision and Regulation; or Laurie Schaffer, Associate General Counsel, (202) 452–2272, Benjamin McDonough, Special Counsel, (202) 452–2036, Jay Schwarz, Senior Counsel, (202) 452–2970, Will Giles, Counsel, (202) 452–3351, Mark Buresh, Senior Attorney, (202) 452–5270, or Greg Frischmann, Senior Attorney, (202) 452–2803, Legal Division, Board of Governors of the Federal Reserve System, 20th and C Streets NW., Washington, DC 20551. For the hearing impaired only, Telecommunications Device for the Deaf (TDD) users may contact (202) 263–4869.

SUPPLEMENTARY INFORMATION:

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I. Introduction

A. Addressing Too-Big-to-Fail

An important objective of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) [1] is to mitigate risks to the financial stability of the United States that could arise from the material financial distress or failure of large, interconnected financial companies, including by ending market perceptions that certain financial companies are ''too big to fail'' and would therefore receive extraordinary government support to prevent their failure. Such perceptions reduce the

[1] The Dodd-Frank Act was enacted on July 21, 2010 (Pub. L. 111– 203).

incentives of the shareholders, creditors, and counterparties of such a company to discipline excessive risk-taking by the company. Such perceptions also tend to fuel further growth by the largest financial companies, making them even more systemically important and leading to more financial sector concentration than would exist in the absence of market expectations of government support. Finally, such perceptions can produce competitive distortions by allowing the largest, most interconnected financial companies to fund themselves more cheaply than their smaller competitors can. These distortions are unfair to smaller companies and detrimental to competition.

The Dodd-Frank Act establishes a framework to address the financial stability risks associated with major financial companies. The Act seeks to enhance financial stability through two approaches. First, the Act seeks to reduce major financial companies' probability of failure by requiring the Board to subject them to enhanced capital, liquidity, and other prudential requirements and to heightened supervision.[2] Second, the Act seeks to reduce the risk that such a company's failure, were it to occur, would pose to the financial stability of the United States through resolution-planning requirements and a new statutory resolution framework for major financial companies.[3] These approaches have also been followed in international regulatory reform efforts since the 2007–2009 financial crisis, which have been coordinated through the Basel Committee on Banking Supervision (BCBS)[4] and the Financial Stability Board (FSB),[5] at the direction of the Heads of State of the Group of Twenty (G20 Leaders).[6]

The Board has made considerable progress in implementing the first approach by reducing the probability that a major financial company will fail. Along with the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC), the Board has implemented stronger capital standards[7] and a new liquidity standard called the liquidity coverage ratio.[8] The Board also has adopted leverage and risk-based capital surcharges for U.S. global systemically important banking organizations (GSIBs),[9] established a robust stress testing framework for large banking organizations,[10] and created a Large Institution Supervision Coordinating Committee to strengthen the supervision of the most systemically important financial institutions operating in the United States.[11]

To further enhance firm-specific resiliency during periods of severe stress, the Board has also issued guidance on recovery planning to the most systemically important U.S. banking organizations.[12] In addition, the Board has implemented a broad set of other enhanced prudential standards for bank holding companies and foreign banking organizations with total consolidated assets of $50 billion or more.[13] Internationally, the BCBS has adopted a substantial set of post-crisis reforms, developed with significant participation from the Board and other U.S. bank regulatory agencies, which align well with the bank regulatory reforms implemented in the United States.

U.S. regulators have also made substantial progress with respect to the second approach by implementing the Dodd-Frank Act's framework for resolution-planning for major financial companies. The Dodd-Frank Act provides significant new authorities to the FDIC and the Board to address the failure of large, interconnected financial companies.[14] First, Section 165(d) of the Dodd-Frank Act requires bank holding companies with total consolidated assets of at least $50 billion and nonbank financial companies designated for supervision by the Board to prepare resolution plans, also known as ''living wills,'' that describe how they could be resolved in an orderly manner under the U.S. Bankruptcy Code if they were to fail.[15] The Board and the FDIC have established resolution-planning requirements to implement section 165(d).[16]

Second, Title II of the Dodd-Frank Act (Title II) establishes an alternative resolution framework for the largest financial companies, the Orderly Liquidation Authority. In general, if a major U.S. bank holding company or non-bank financial company were to fail, it would be resolved under the U.S. Bankruptcy Code.[17] Congress recognized, however, that such a company might fail under extraordinary circumstances that would prevent it from being resolved in bankruptcy without serious adverse effects on the financial stability of the United States.[18] Title II therefore provides the Secretary of the Treasury, upon recommendation from other government agencies, with the authority to place a major financial company into an FDIC receivership, rather than bankruptcy.[19] The set of resolution powers created by Title II form a critical post-crisis toolkit for mitigating the negative effects that could follow from the failure of a systemically important financial institution.

Since 2012, the largest bank holding companies and foreign banking organizations with U.S. operations have submitted annual resolution plans to the

[2] *See* 12 U.S.C. 5365(a)(1)(A).

[3] *See* 12 U.S.C. 5381–5394.

[4] The BCBS is a committee of banking supervisory authorities established by the central bank governors of the Group of Ten countries in 1975. The committee's membership consists of senior representatives of bank supervisory authorities and central banks from Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. The BCBS usually meets at the Bank for International Settlements (BIS) in Basel, Switzerland, where its permanent Secretariat is located.

[5] The FSB was established in 2009 to coordinate at the international level the work of national financial authorities and international standard-setting bodies and to develop and promote the implementation of effective regulatory, supervisory, and other financial sector policies in the interest of financial stability. The FSB brings together national authorities responsible for financial stability in 24 countries and jurisdictions, as well as international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts. *See generally* Financial Stability Board, available at *http://www.financialstabilityboard.org.*

[6] The Group of Twenty was established in 1999 to bring together industrialized and developing economies to discuss key issues in the global economy. Members include finance ministers and central bank governors from Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, Republic of Korea, Turkey, the United Kingdom, and the United States and the European Union.

[7] The Board and the OCC issued a joint final rule on October 11, 2013 (78 FR 62018) and the FDIC issued a substantially identical interim final rule on September 10, 2013 (78 FR 55340). The FDIC adopted the interim final rule as a final rule with no substantive changes on April 14, 2014. 79 FR 20754.

[8] 79 FR 61440 (October 10, 2014).

[9] *See* 80 FR 49082 (Aug. 14, 2015) (GSIB risk-based capital surcharge); 79 FR 24528 (May 1, 2014) (enhanced supplementary leverage ratio). The eight firms currently identified as U.S. GSIBs are Bank of America Corporation, The Bank of New York Mellon Corporation, Citigroup Inc., Goldman Sachs Group, Inc., JP Morgan Chase & Co., Morgan Stanley, State Street Corporation, and Wells Fargo & Company.

[10] 12 CFR 252.32 and 252.35.

[11] *See* Large Institution Supervision Coordinating Committee, available at *http://www.federalreserve.gov/bankinforeg/large-institution-supervision.htm.*

[12] *See* Supervision and Regulation Letter 14–8, ''Consolidated Recovery Planning for Certain Large Domestic Bank Holding Companies'' (September 25, 2014).

[13] 79 FR 17240 (March 27, 2014).

[14] 12 U.S.C. 5365, 5384, and 5385.

[15] 12 U.S.C. 5365(d).

[16] 76 FR 67323 (November 1, 2011).

[17] *See, e.g.,* 12 U.S.C. 5382(c), 5383(a)(2)(F) and (b)(4). Insurance companies, depository institutions, and broker dealers are resolved under different resolution mechanisms.

[18] *See* 12 U.S.C. 5384.

[19] *See* 12 U.S.C. 5383(b).

Board and the FDIC as required by section 165(d). The Board and the FDIC review the resolution plans, provide feedback on their shortcomings, and set expectations for subsequent iterations of the plans that are intended to improve the organizations' resolvability. Each annual plan review cycle has yielded valuable information that is being used to assess and mitigate potential obstacles to orderly resolution under the U.S. Bankruptcy Code and to plan for the contingency of a resolution under Title II. The Board and the FDIC also consult regularly on regulatory actions intended to improve GSIB resolvability, including this proposed rule.

B. Approaches to Resolution

Resolution of large financial firms will involve either a single-point-of-entry (SPOE) resolution strategy or a multiple-point-of-entry (MPOE) resolution strategy.[20] Most of the U.S. GSIBs are developing plans that facilitate an SPOE approach, including in their 2015 resolution plans.

In an SPOE resolution of a banking organization, only the top-tier bank holding company would enter a resolution proceeding. The losses that caused the banking organization to fail would be passed up from the subsidiaries that incurred the losses and would then be imposed on the equity holders and unsecured creditors of the holding company, which would have the effect of recapitalizing the subsidiaries of the banking organization. An SPOE resolution could avoid losses to the third-party creditors of the subsidiaries and could thereby allow the subsidiaries to continue normal operations, without entering resolution or taking actions (such as asset firesales) that could pose a risk to the financial stability of the United States. The expectation that the holding company's equity holders and unsecured creditors would absorb the banking organization's losses in the event of its failure would also help to maintain the confidence of the operating subsidiaries' creditors and counterparties, reducing their incentive to engage in potentially destabilizing funding runs. An SPOE resolution would avoid the need for separate proceedings for separate legal entities run by separate authorities across multiple jurisdictions and the associated destabilizing complexity.[21]

Certain structural features of the U.S. GSIBs facilitate SPOE resolution. In the United States, the top-tier parent company of a large banking organization generally does not itself engage in material operations. Rather, it generally acts primarily as a holding company, by, for example, measuring and managing the consolidated risks of the organization, undertaking capital and liquidity planning, coordinating the operations of its subsidiaries, and raising equity capital and long-term debt to fund those operations. Its assets therefore consist largely of cash, liquid securities, and equity and debt investments in its subsidiaries. As a result of this organizational structure, in the context of SPOE resolution the liabilities of the parent holding company are generally ''structurally subordinated'' to the liabilities of the operating subsidiaries.[22] Strengthening the loss-absorbing capacity of the parent holding company therefore improves the resiliency of the banking organization as a whole.

The alternative to an SPOE resolution is a multiple-point-of-entry (MPOE) resolution. An MPOE resolution would entail separate resolutions of different legal entities within the financial firm and could potentially be executed by multiple resolution authorities across multiple jurisdictions. The SPOE approach to resolution appears to offer substantial advantages, because it facilitates the continued operations of subsidiaries of a GSIB, reducing the material risk that the failure of the organization could have on U.S. financial stability. U.S. regulators nevertheless are cognizant of the need to prepare for other plausible contingencies, including the MPOE resolution of a GSIB. While this proposal is primarily focused on implementing the SPOE resolution strategy, it would also substantially improve the prospects for a successful MPOE resolution of a GSIB by requiring U.S. GSIBs and the IHCs of foreign GSIBs to maintain substantially more loss-absorbing capacity.

C. Overview of the Proposal

The Board is inviting comment on this notice of proposed rulemaking to improve the resolvability and resiliency of U.S. banking organizations. The proposal would require the parent holding companies of U.S. GSIBs to maintain outstanding minimum levels of total loss-absorbing capacity and long-term unsecured debt, and a related buffer. The proposal would also require the top-tier U.S. intermediate holding companies of foreign GSIBs to maintain outstanding minimum levels of total loss-absorbing capacity and long-term unsecured debt instruments issued to their foreign parent company, and related buffer. The proposal would subject the operations of the parent holding companies of U.S. GSIBs and the top-tier U.S. intermediate holding companies of foreign GSIBs to ''clean holding company'' limitations to further improve their resolvability and the resiliency of their operating subsidiaries. Finally, the proposal would require banking organizations subject to the Board's capital requirements to make certain deductions from capital.

This proposal would further the goals of improving the resiliency and resolvability of GSIBs. Separately, the Board and the FDIC are continuing to work to mitigate the resolvability risks related to potential disorderly unwinds of financial contracts. Other actions for consideration include ensuring the adequacy of ''internal bail-in'' mechanisms through which operating subsidiaries can pass losses up to their parent holding company and the holding company can recapitalize the subsidiaries.

1. External Total Loss-Absorbing Capacity and Long-Term Debt Requirements for Covered U.S. Bank Holding Companies

Under this proposal, a ''covered BHC'' would be required to maintain outstanding minimum levels of eligible external total loss-absorbing capacity (external TLAC requirement) and eligible external long-term debt (external LTD requirement). The term ''external'' refers to the fact that the requirement would apply to loss-absorbing instruments issued by the covered BHC to third-party investors, and the instrument would be used to pass losses from the banking organization to those investors in case of failure. This is in contrast to ''internal'' loss-absorbing capacity, which could be used to transfer losses among legal entities within a banking organization (for instance, from the operating subsidiaries to the parent holding company).

The term ''covered BHC'' would be defined to include any U.S. top-tier bank holding company identified as a GSIB under the Board's rule establishing risk-based capital surcharges for GSIBs (''GSIB surcharge rule'').[23] Under the external TLAC requirement, a covered

[20] *See* FDIC, ''Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy'' (6741–01–P) (December 10, 2013), available at *http://www.fdic.gov/news/board/2013/2013-12-10_notice_dis-b_fr.pdf.*

[21] *See* 78 FR 76614 (December 18, 2013).

[22] Generally, in an insolvency proceeding, direct third-party claims on a parent holding company's subsidiaries would be superior to the parent holding company's equity claims on the subsidiaries.

[23] 12 CFR 217.402; 80 FR 49106 (August 14, 2015).

BHC would be required to maintain outstanding eligible external total loss-absorbing capacity (''eligible external TLAC'') in an amount not less than the greater of 18 percent of the covered BHC's total risk-weighted assets and 9.5 percent of the covered BHC's total leverage exposure.[24] An external TLAC buffer that is similar to the capital conservation buffer in the Board's Regulation Q would apply in addition to the risk-weighted assets component of the external TLAC requirement.

Under the external LTD requirement, a covered BHC would be required to maintain outstanding eligible external long-term debt instruments (''eligible external LTD'') in an amount not less than the greater of 6 percent plus the surcharge applicable under the GSIB surcharge rule (expressed as a percentage) of total risk-weighted assets and 4.5 percent of total leverage exposure.[25]

A covered BHC's eligible external TLAC would be defined to be the sum of (a) the tier 1 regulatory capital of the covered BHC issued directly by the covered BHC and (b) the covered BHC's eligible external LTD, as defined below.

A covered BHC's eligible external LTD would generally be defined to be debt that is issued directly by the covered BHC, is unsecured, is ''plain vanilla,'' [26] and is governed by U.S. law. Eligible external LTD with a remaining maturity of between one and two years would be subject to a 50 percent haircut for purposes of the external LTD requirement, and eligible external LTD with a remaining maturity of less than one year would not count toward the external LTD requirement.

2. Internal Total Loss-Absorbing Capacity and Long-Term Debt Requirements for Covered U.S. Intermediate Holding Companies

Under this proposal, a ''covered IHC'' would be required to maintain outstanding minimum levels of eligible internal total loss-absorbing capacity (''internal TLAC requirement'') and eligible internal long-term debt (''internal LTD requirement''). The term ''internal'' refers to the fact that these instruments would be required to be issued internally within the foreign banking organization, from the covered IHC to a foreign parent entity. The term ''covered IHC'' would be defined to include any U.S. intermediate holding company that (a) is required to be formed under the Board's enhanced prudential standards rule [27] and (b) is controlled by a foreign banking organization that would be designated as a GSIB under the Board's capital rules if it were subject to the Board's GSIB surcharge on a consolidated basis (''foreign GSIB'').

Under the internal TLAC requirement, the amount of eligible internal total loss-absorbing capacity (''eligible internal TLAC'') that a covered IHC would be required to maintain outstanding would depend on whether the covered IHC (or any of its subsidiaries) is expected to go into resolution in a failure scenario, rather than being maintained as a going concern while a foreign parent entity is instead resolved. In general, this means that the stringency of the internal TLAC and LTD requirements for a given covered IHC would be a function of whether the foreign GSIB parent of the covered IHC has an SPOE or an MPOE resolution strategy.

Covered IHCs that are not expected to enter resolution themselves would be required to maintain eligible internal TLAC in an amount not less than the greater of: (a) 16 percent of the covered IHC's total risk-weighted assets; [28] (b) for covered IHCs that are subject to the supplementary leverage ratio,[29] 6 percent of the covered IHC's total leverage exposure; and (c) 8 percent of the covered IHC's average total consolidated assets, as computed for purposes of the U.S. tier 1 leverage ratio.[30]

Covered IHCs that are expected to enter resolution themselves would be required to maintain outstanding eligible internal TLAC in an amount not less than the greater of: (a) 18 percent of the covered IHC's total risk-weighted assets; [31] (b) 6.75 percent of the covered IHC's total leverage exposure (if applicable); and (c) 9 percent of the covered IHC's average total consolidated assets, as computed for purposes of the U.S. tier 1 leverage ratio.

For all covered IHCs, an internal TLAC buffer that is similar to the capital conservation buffer in the Board's Regulation Q would apply in addition to the risk-weighted assets component of the internal TLAC requirement.

Under the internal LTD requirement, a covered IHC would be required to maintain outstanding eligible internal long-term debt instruments (''eligible internal LTD'') in an amount not less than the greater of: (a) 7 percent of total risk-weighted assets; (b) 3 percent of the total leverage exposure (if applicable); and (c) 4 percent of average total consolidated assets, as computed for purposes of the U.S. tier 1 leverage ratio.

A covered IHC's eligible internal TLAC would generally be defined to be the sum of (a) the tier 1 regulatory capital issued from the covered IHC to a foreign parent entity that controls the covered IHC and (b) the covered IHC's eligible internal LTD, as defined below.

A covered IHC's eligible internal LTD would generally be subject to the same requirements as would apply to eligible external LTD: It would be required to be debt that is issued directly from the covered IHC, is unsecured, is plain vanilla, and is governed by U.S. law. Eligible internal LTD with a remaining maturity of between one and two years would be subject to a 50 percent haircut for purposes of the internal LTD requirement, and eligible internal LTD with a remaining maturity of less than one year would not count toward the internal LTD requirement.

However, several features distinguish eligible internal LTD from eligible external LTD: It would be required to be issued to a parent foreign entity that controls the covered IHC, to be contractually subordinated to all third-party liabilities of the covered IHC, and to include a contractual trigger pursuant

[24] The risk-weighted assets component of the external TLAC requirement would be phased in as follows: It would be equal to 16 percent of the covered BHC's risk-weighted assets beginning on January 1, 2019, and would be equal to 18 percent of the covered BHC's risk-weighted assets beginning on January 1, 2022.

[25] Total leverage exposure is defined in 12 CFR 217.10(c)(4)(ii).

[26] The term ''plain vanilla'' is defined in detail in section II.E.3 and excludes structured notes and most instruments that contain derivative-linked features.

[27] The Board's enhanced prudential standards rule generally requires any foreign banking organization with total consolidated non-branch U.S. assets of $50 billion or more to form a single U.S. intermediate holding company over its U.S. subsidiaries. 12 CFR 252.153; 79 FR 17329 (May 27, 2014).

[28] The risk-weighted assets component of the internal TLAC requirement would be phased in as follows: It would be equal to 14 percent of the covered IHC's risk-weighted assets beginning on January 1, 2019, and would be equal to 16 percent of the covered IHC's risk-weighted assets beginning on January 1, 2022.

[29] Under the IHC rule, U.S. intermediate holding companies with total consolidated assets of $250 billion or more or on-balance sheet foreign exposure equal to $10 billion or more are required to meet a minimum supplementary leverage ratio of 3 percent. 12 CFR 252.153(e)(2); 79 FR 17329 (March 27, 2014).

[30] The final rule imposes the same leverage capital requirements on U.S. intermediate holding companies as it does on U.S. bank holding companies. 12 CFR 252.153(e)(2); 79 FR 17329 (March 27, 2014). These leverage capital requirements include the generally-applicable leverage ratio and the supplementary leverage ratio for U.S. intermediate holding companies that meet the scope of application for that ratio.

[31] The risk-weighted assets component of the internal TLAC requirement for covered IHCs of MPOE firms would be phased in as follows: It would be equal to 16 percent of the covered IHC's risk-weighted assets beginning on January 1, 2019, and would be equal to 18 percent of the covered IHC's risk-weighted assets beginning on January 1, 2022.

to which the Board could require the covered IHC to cancel the eligible internal LTD or convert or exchange it into tier 1 common equity on a going-concern basis (that is, without the covered IHC's entry into a resolution proceeding) if: (a) The Board determines that the covered IHC is ''in default or in danger of default''; and (b) any of the following circumstances apply (i) the top-tier foreign banking organization or any subsidiary outside the United States is placed into resolution proceedings, (ii) the home country supervisory authority consents to the cancellation, exchange, or conversion, or does not object to the cancellation, exchange, or conversion following 48 hours' notice, or (iii) the Board has made a written recommendation to the Secretary of the Treasury that the FDIC should be appointed as receiver of the covered IHC.

3. Clean Holding Company Requirements

The Board is proposing to prohibit or limit covered BHCs from directly entering into certain financial arrangements that could impede an entity's orderly resolution. In an SPOE resolution of a U.S. GSIB, the covered BHC will go into a resolution proceeding while its subsidiaries continue their normal operations. These prohibitions and limitations would support the orderly resolution of a covered BHC, whether in an SPOE resolution or in an MPOE resolution involving the resolution of the covered BHC. The proposed requirements would also enhance the resiliency of the U.S. GSIB by reducing the covered BHC's complexity and reliance on short-term funding.

Under the Board's clean holding company proposal, a covered BHC would be prohibited from issuing short-term debt instruments to third parties (including deposits); entering into ''qualified financial contracts'' (QFCs) with third parties; having liabilities that are subject to ''upstream guarantees'' from the covered BHC's subsidiaries or that are subject to contractual offset rights for its subsidiaries' creditors; or issuing guarantees of its subsidiaries' liabilities, if the issuance of the guarantee would result in the covered BHC's insolvency or entry into resolution operating as a default event on the part of the subsidiary. Additionally, the proposal would cap the value of a covered BHC's liabilities (other than those related to eligible external TLAC and eligible external LTD) that can be pari passu with or junior to its eligible external LTD at 5 percent of the value of its eligible external TLAC. Finally, the proposal would require covered BHCs to make certain public disclosures of the fact that their unsecured debt would be expected to absorb losses ahead of other liabilities, including the liabilities of the covered BHC's subsidiaries, in a failure scenario.

An SPOE resolution of a foreign GSIB in its home jurisdiction would allow the GSIB's covered IHC to continue operating without itself entering into a resolution proceeding. However, to prepare for a scenario in which a covered IHC would enter U.S. resolution proceedings, the Board is proposing to prohibit covered IHCs from entering into certain financial arrangements that can impede such a resolution.

4. Consideration of Domestic Internal TLAC Requirement

The SPOE resolution strategy assumes (a) that losses will be passed up from the subsidiaries that initially incur them to the covered BHC or covered IHC and (b) that they then will be passed on to either the external TLAC holders (in the case of a covered BHC) or a foreign parent entity (in the case of a covered IHC). This proposal would work to satisfy the second of these assumptions, but it does not address the first. As discussed further below, however, the Board is seeking comment on whether, and if so how, the Board should regulate the mechanisms used by a covered BHC or covered IHC to transfer losses up from the operating subsidiaries that incur them to the covered BHC or covered IHC.

5. Regulatory Capital Deduction for Investments in the Unsecured Debt of Covered BHCs

To limit the potential for financial sector contagion in the event of the failure of a covered BHC, state member banks, certain bank holding companies and savings and loan holding companies with total consolidated assets of at least $1 billion, and intermediate holding companies formed pursuant to the Board's enhanced prudential standards for foreign banking organizations would be required to apply a regulatory capital deduction treatment to any investments in unsecured debt instruments issued by covered BHCs (including unsecured debt instruments that do not qualify as eligible external LTD).

D. Consultation With the FDIC, the Council, and Foreign Authorities

In developing this proposal, the Board consulted with the FDIC, the Financial Stability Oversight Council (Council), and other U.S. financial regulatory agencies. The proposal reflects input that the Board received during this consultation process. The Board also intends to consult with the FDIC, the Council, and other financial regulatory agencies after it reviews comments on the proposal. Furthermore, the Board has consulted with, and expects to continue to consult with, foreign financial regulatory authorities regarding this proposal and the establishment of other standards that would maximize the prospects for the cooperative and orderly cross-border resolution of failed GSIBs.

E. The FSB's Proposal on Total Loss-Absorbing Capacity for GSIBs

In 2013, the G20 Leaders called on the FSB to develop proposals on the adequacy of the loss-absorbing capacity of global systemically important financial institutions (''SIFIs'').[32] In November 2014, the FSB published for consultation a set of principles and a term sheet to implement those principles in the form of an internationally negotiated minimum standard for the total loss-absorbing capacity (''TLAC'') of GSIBs.[33] Under the FSB's proposed standard, GSIBs would be subject to a TLAC requirement equal to the greater of (a) a figure between 16 percent and 20 percent of a banking organization's risk-weighted assets (with the specific figure within that range to be agreed upon later) and (b) twice the Basel III tier 1 leverage ratio requirement. The FSB's proposed standard also contains an expectation that a GSIB would meet at least one-third of its TLAC requirement with eligible long-term debt (''LTD'') rather than equity.

This proposal is generally consistent with the FSB's proposed standard, although it includes a required LTD component that is more stringent than the expectation in the FSB's proposed standard.

The Board considered whether to structure this proposal solely as a TLAC requirement—that is, as a single minimum requirement that could be satisfied by any mixture of capital and eligible LTD—without a specific LTD requirement. In the absence of an LTD requirement, a TLAC requirement would permit each covered firm to reduce its expected systemic impact

[32] The Group of 20, ''G20 Leaders' Declaration'' (September 2013), available at *https://g20.org/wp-content/uploads/2014/12/Saint_Petersburg_Declaration_ENG_0.pdf*.

[33] *See* ''Adequacy of loss-absorbing capacity of global systemically important banks in resolution'' (November 10, 2014), available at *http://www.financialstabilityboard.org/wp-content/uploads/TLAC-Condoc-6-Nov-2014-FINAL.pdf*.

either by reducing its probability of default through increased going-concern capital or by reducing the harm it would cause if it were to fail through increased gone-concern LTD.[34]

This proposal includes a separate LTD requirement in order to address the too-big-to-fail problem. Unlike existing equity, LTD can be used as a fresh source of capital subsequent to failure. Imposing an LTD requirement would help to ensure that a covered firm would have a known and observable quantity of loss-absorbing capacity at the point of failure. Unlike common equity, that loss-absorbing capacity would not be at substantial risk of volatility or depletion before the covered BHC is placed into a resolution proceeding. Thus, the proposed LTD requirements would more assuredly enhance the prospects for the successful resolution of a failed GSIB and thereby better address the too-big-to-fail problem than would TLAC requirements alone.

F. Overview of Statutory Authority

The Board is issuing this proposal under the authority provided by section 165 of the Dodd-Frank Act.[35] Section 165 instructs the Board to impose enhanced prudential standards on bank holding companies with total consolidated assets of $50 billion or more ''[i]n order to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected financial institutions.'' [36] These enhanced prudential standards must increase in stringency based on the systemic footprint and risk characteristics of individual covered firms.[37] In addition to requiring the Board to impose enhanced prudential standards of several specified types, section 165 authorizes the Board to establish ''such other prudential standards as the Board of Governors, on its own or pursuant to a recommendation made by the Council, determines are appropriate.'' [38]

The enhanced prudential standards in this proposal are appropriate because they are intended to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress, failure, or ongoing activities of a GSIB. In particular, the proposed requirements would improve the resolvability of U.S. GSIBs under either the U.S. Bankruptcy Code or Title II and improve their resiliency. The proposed requirements would also improve the resiliency of covered IHCs and their subsidiaries, and thereby increase the likelihood that a failed foreign GSIB with significant U.S. operations would be successfully resolved under an SPOE approach without the failure of the U.S. subsidiaries or, failing that, that the foreign GSIB's U.S. operations could be separately resolved in an orderly manner.

In addition to the authority identified above, section 165 of the Dodd-Frank Act also authorizes the Board to establish ''enhanced public disclosures'' and ''short-term debt limits.'' [39] The proposal includes disclosure requirements and limits on the ability of covered BHCs and covered IHCs to issue short-term debt.

Finally, the Board has tailored this proposal to apply only to those companies whose disorderly resolution would likely pose the greatest risk to the financial stability of the United States: The U.S. GSIBs and the U.S. intermediate holding companies of foreign GSIBs.[40]

Question 1: The Board invites comment on all aspects of this section.

II. External TLAC and LTD Requirements for U.S. GSIBs

A. Scope of Application (Section 252.60 of the Proposed Rule)

The proposed rule would apply to all ''covered BHCs.'' The term ''covered BHC'' would be defined to include any U.S. top-tier bank holding company identified as a GSIB under the Board's GSIB surcharge rule.[41] Under the GSIB surcharge rule, a U.S. top-tier bank holding company subject to the advanced approaches rule must determine whether it is a GSIB by applying a multifactor methodology established by the Board.[42] This methodology evaluates a banking organization's systemic importance on the basis of its attributes in five broad categories: Size, interconnectedness, cross-jurisdictional activity, substitutability, and complexity.

Accordingly, the methodology provides a tool for identifying as GSIBs those banking organizations that pose elevated risks. The proposal's focus on GSIBs is in keeping with the Dodd-Frank Act's mandate that more stringent prudential standards be applied to the most systemically important bank holding companies.[43]

Under the GSIB surcharge rule's methodology, eight U.S. bank holding companies would currently be identified as GSIBs. Those eight top-tier bank holding companies would therefore be covered BHCs under this proposal.[44] In addition, because the GSIB surcharge methodology is dynamic, other banking organizations could become subject to the proposed rule in the future.

Question 2: The Board invites comment on alternative approaches for determining the scope of application of the proposed external TLAC and LTD requirements.

B. Calibration of the External TLAC and LTD Requirements (Sections 252.62 and 252.63 of the Proposed Rule)

Under the proposal's external TLAC requirement, a covered BHC would be required to maintain outstanding eligible external TLAC in an amount not less than the greater of 18 percent of the covered BHC's total risk-weighted assets [45] and 9.5 percent of the covered BHC's total leverage exposure under the supplementary leverage ratio rule. As described below, an external TLAC buffer would apply in addition to the risk-weighted assets component of the external TLAC requirement.

Under the proposal's external LTD requirement, a covered BHC would be required to maintain outstanding eligible external LTD in an amount not less than the greater of 6 percent plus the surcharge applicable under the GSIB

[34] *See* ''Calibrating the GSIB Surcharge'' at 3 (July 20, 2015), available at *www.federalreserve.gov/aboutthefed/boardmeetings/gsib-methodology-paper-20150720.pdf.*

[35] 12 U.S.C. 5365.

[36] 12 U.S.C. 5365(a)(1).

[37] 12 U.S.C. 5365(a)(1)(B), (b)(3)(A)–(D).

[38] 12 U.S.C. 5365(b)(1)(B)(iv).

[39] 12 U.S.C. 5365(b)(1)(B)(ii) and (iii).

[40] 12 U.S.C. 5365(a)(1)(B).

[41] 12 CFR 217.402; 80 FR 49106 (August 14, 2015).

[42] 12 CFR part 217, subpart E.

[43] 12 U.S.C. 5365(a)(1)(B).

[44] The eight firms currently identified as U.S. GSIBs are Bank of America Corporation, The Bank of New York Mellon Corporation, Citigroup Inc., Goldman Sachs Group, Inc., JP Morgan Chase & Co., Morgan Stanley, State Street Corporation, and Wells Fargo & Company.

[45] A covered BHC would calculate risk-weighted assets for purposes of the external TLAC requirement using the same methodology it uses to calculate risk-weighted assets under the Board's regulatory capital rules. See 12 CFR part 217, subparts D and E. The Board's regulatory capital rules require an advanced approaches banking organization (generally, a banking organization with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance sheet foreign exposure) that has successfully completed its parallel run to calculate each of its risk-based capital ratios using the standardized approach and the advanced approaches, and directs the banking organization to use the lower of each ratio as its governing ratio. *See* 12 CFR 217.10.

The risk-weighted assets component of the external TLAC requirement would be phased in as follows: It would be equal to 16 percent of the covered BHC's risk-weighted assets beginning on January 1, 2019, and would be equal to 18 percent of the covered BHC's risk-weighted assets beginning on January 1, 2022.

surcharge rule (expressed as a percentage) of total risk-weighted assets and 4.5 percent of total leverage exposure. Covered BHCs would be prohibited from redeeming or repurchasing eligible external LTD prior to its stated maturity date without obtaining prior approval from the Board where the redemption or repurchase would cause the covered BHC's eligible external LTD to fall below its external LTD requirement.

The calibration of the proposed external TLAC requirement is based in part on an analysis of the historical loss experience of major financial institutions during financial crises. First, a targeted analysis of losses of U.S. financial firms during the 2007–2009 financial crisis was performed. The analysis considered the loss experiences of the 19 bank holding companies that participated in the Supervisory Capital Assessment Program (SCAP).[46] This analysis combined the losses actually sustained by those firms during the 2007–2008 period with their 2009 SCAP loss projections [47] and the government recapitalization support that they received in order to estimate the level of losses that would likely have been sustained in the absence of extraordinary government intervention in the financial system, which likely prevented substantial losses that each firm would otherwise have incurred as a result of the material financial distress or failure of major counterparties. The purpose of a TLAC requirement is to ensure that GSIBs have sufficient loss-absorbing capacity to absorb significant losses and then be recapitalized to the level necessary for them to face the market on a going-concern basis without public-sector support. Therefore, the sum of losses and public-sector recapitalization provides a good comparator for a TLAC requirement.

The analysis found that the bank holding company with the most severe loss experience incurred estimated losses and recapitalization needs of roughly 19 percent of risk-weighted assets. The risk-weighted assets component of the proposed external TLAC requirement is consistent with this high-water mark from the global financial crisis. This historical analysis provides further confirmation of the appropriateness of the proposed calibration.

Additionally, a quantitative study of the experiences of 13 U.S. and foreign GSIBs and other major financial firms that incurred substantial losses during the 2007–2009 financial crisis and the Japanese financial crisis of the 1990s was conducted. With respect to each firm, the study considered both the peak losses incurred by the firm (measured in terms of total comprehensive income) over the loss period and public-sector capital support, incorporating both direct capital injections and asset relief transactions.

The study examined losses and recapitalization in terms of both risk-weighted assets and total assets, which is relevant to the total leverage exposure component of the external TLAC requirement. The proposed calibration of the external TLAC requirement is consistent with the findings of this historical survey. The risk-weighted assets component of the proposed requirement exceeds a substantial majority of the loss-and-recapitalization experiences surveyed, while the total leverage exposure component of the proposed requirement is slightly higher than the most severe experience surveyed. These are appropriate results in light of the Dodd-Frank Act's focus on the mitigation of risks that could arise from the material financial distress or failure of the largest, most systemic financial institutions.

The proposed external LTD requirement was calibrated primarily on the basis of a ''capital refill'' framework. According to the capital refill framework, the objective of the external LTD requirement is to ensure that each covered BHC has a minimum amount of eligible external LTD such that, if the covered BHC's going-concern capital is depleted and the covered BHC fails and enters resolution, the eligible external LTD will be sufficient to absorb losses and fully recapitalize the covered BHC by replenishing its going-concern capital. Fulfilling this objective is vital to the use of eligible external LTD to facilitate the orderly resolution of a covered BHC, because it is a prerequisite to an orderly SPOE resolution that the resolved firm have sufficient going-concern capital post-resolution to maintain market confidence in its solvency so that other market participants continue to do business with it.

The proposed external LTD requirement was calibrated in accordance with this framework. In terms of risk-weighted assets, a covered BHC's common equity tier 1 capital level is an amount equal to a minimum requirement of 4.5 percent of risk-weighted assets plus a capital conservation buffer, which is itself equal to 2.5 percent plus a firm-specific surcharge determined under the GSIB surcharge rule (expressed as a percentage) of risk-weighted assets.[48] Thus, a covered BHC with a GSIB surcharge of 2 percent would have a common equity tier 1 capital minimum plus buffers of 9 percent.

Under the proposal, a covered BHC would be subject to an external LTD requirement equal to 7 percent of risk-weighted assets plus the applicable GSIB surcharge minus a 1 percentage point allowance for balance-sheet depletion. This results in a requirement of 6 percent plus the applicable GSIB surcharge (expressed as a percentage) of risk-weighted assets. Without the 1 percentage point allowance for balance-sheet depletion, the risk-weighted assets component of a covered BHC's external LTD requirement would require it to maintain outstanding an amount of eligible external LTD equal to its common equity tier 1 capital minimum requirement plus buffers. The 1 percentage point allowance for balance-sheet depletion is appropriate under the capital refill theory because the losses that the covered BHC incurs leading to its failure will deplete its risk-weighted assets as well as its capital. Accordingly, the pre-failure losses would result in a smaller balance sheet for the covered BHC at the point of failure, meaning that a smaller dollar amount of capital would be required to restore the covered BHC's pre-stress capital level. Although the specific amount of eligible external LTD necessary to restore a covered BHC's pre-stress capital level in light of the diminished size of its post-failure balance sheet will vary slightly in light of the varying GSIB surcharges applicable to the covered BHCs, the Board is proposing to apply a uniform 1 percentage point allowance for balance-sheet depletion so as to avoid undue regulatory complexity.

The application of the capital refill framework to the leverage ratio component of the external LTD requirement is analogous. Under the enhanced supplementary leverage ratio applicable to U.S. GSIBs, a covered BHC's tier 1 leverage ratio minimum plus buffer is 5 percent of its total

[46] *See* Press Release, ''Federal Reserve, OCC, and FDIC release results of the Supervisory Capital Assessment Program'' (May 7, 2009), available at *http://www.federalreserve.gov/newsevents/press/bcreg/20090507a.htm.*

[47] *See* ''The Supervisory Capital Assessment Program: Overview of Results'' (May 7, 2009), available at *http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20090507a1.pdf.*

[48] Under the Board's capital rules, the capital conservation buffer can be increased by an additional 2.5 percent of risk-weighted assets through the activation of a countercyclical capital buffer. The proposed external LTD requirement does not incorporate any countercyclical capital buffer because it is likely that no such buffer would be active under the economic circumstances most likely to be associated with the failure and resolution of a covered BHC.

leverage exposure. Under the proposal, a covered BHC would be subject to an external LTD requirement equal to 4.5 percent of its total leverage exposure. This requirement, which incorporates a balance-sheet depletion allowance of 0.5 percentage points, is appropriate to ensure that a covered BHC that has depleted its tier 1 capital and failed will be able to refill its leverage ratio minimum requirement and buffer through the cancellation or the exchange or conversion into equity of its eligible external LTD.

The proposed calibration of the external LTD requirement was also informed by an analysis of the extreme loss tail of the distribution of income for large U.S. bank holding companies over the past several decades. This analysis closely resembled the analysis that informed the calibration of the minimum risk-based capital requirements in the revised capital framework, but it involved looking farther into the tail of the income distribution.

Question 3: The Board invites comment on all aspects of the calibration of the proposed external TLAC and LTD requirements. In particular, the Board invites comment on the probable impact of the proposed requirements on covered BHCs and on markets for senior unsecured debt instruments.

C. Core Features of Eligible External TLAC (Section 252.63(b) of the Proposed Rule)

Under the proposal, a covered BHC's eligible external TLAC would be defined to be the sum of (a) the tier 1 regulatory capital (common equity tier 1 capital and additional tier 1 capital, excluding any tier 1 minority interests) issued directly by the covered BHC and (b) the covered BHC's eligible external LTD, as defined below.[49] Tier 2 capital that meets the definition of eligible external LTD would count toward the external TLAC requirement.

The requirement that regulatory capital be issued out of the covered BHC itself (rather than by a subsidiary) is intended to ensure that the total required amount of loss-absorbing capacity would be available to absorb losses incurred anywhere in the banking organization (through downstreaming of resources from the BHC to the subsidiary that has incurred the losses, if necessary). Regulatory capital that is issued by a subsidiary lacks this key feature of being available to flexibly absorb losses incurred by other subsidiaries.

Question 4: The Board invites comment on all aspects of the proposed definition of eligible external TLAC.

Question 5: In particular, the Board invites comment on the proposed requirement that regulatory capital be issued directly by the covered BHC in order to count as eligible external TLAC. Should the definition of eligible external TLAC be broadened to include minority interests?

Question 6: Should eligible external LTD with a remaining maturity between one and two years be subject to a 50 percent haircut for purposes of the external TLAC requirement, by analogy to the treatment of such eligible external LTD for purposes of the external LTD requirement?

Question 7: Do covered BHCs have outstanding tier 2 capital instruments that would not count as eligible external LTD? What features of such tier 2 capital instruments are inconsistent with the definition of eligible external LTD? Should such tier 2 capital instruments count as eligible external TLAC?

D. External TLAC Buffer (Section 252.63(c) of the Proposed Rule)

An external TLAC buffer would apply in addition to the risk-weighted assets component of the external TLAC requirement. A covered BHC's external TLAC buffer would be equal to the sum of 2.5 percent plus the GSIB surcharge applicable to the covered BHC under method 1 of the GSIB surcharge rule[50] plus any applicable countercyclical capital buffer. The external TLAC buffer would be required to be filled solely with common equity tier 1 capital, and a covered BHC's breach of its external TLAC buffer would subject it to limits on capital distributions and discretionary bonus payments in accordance with Table 1. Thus, the external TLAC buffer would be analogous to the capital conservation buffer applicable under the Board's Regulation Q, except that it would apply in addition to the external TLAC requirement rather than in addition to minimum risk-based capital requirements under Regulation Q and would incorporate only the applicable method 1 GSIB surcharge (rather than the greater of the applicable method 1 GSIB surcharge and the applicable method 2 GSIB surcharge).

TABLE 1—CALCULATION OF MAXIMUM EXTERNAL TLAC PAYOUT AMOUNT

External TLAC buffer level	Maximum external TLAC payout ratio (as a percentage of eligible retained income)
Greater than the external TLAC buffer	No payout ratio limitation applies.
Less than or equal to the external TLAC buffer, *and* greater than 75 percent of the external TLAC buffer.	60 percent.
Less than or equal to 75 percent of the external TLAC buffer, *and* greater than 50 percent of the external TLAC buffer.	40 percent.
Less than or equal to 50 percent of the external TLAC buffer, *and* greater 25 percent of the external TLAC buffer.	20 percent.
Less than or equal to 25 percent of the external TLAC buffer	0 percent.

In order to determine whether it has met the external TLAC requirement and the external TLAC buffer, a covered BHC would calculate an outstanding TLAC amount and an external TLAC buffer level. In keeping with the definition of eligible external TLAC, a covered BHC's outstanding TLAC amount would be equal to the sum of its common equity tier 1 capital, its additional tier 1 capital, and its eligible external LTD. The covered BHC's external TLAC buffer level would be equal to the sum of its common equity tier 1 capital ratio minus that portion (if any) of its common equity tier 1 capital ratio (expressed as a percentage) that is used to meet the risk-weighted assets

[49] Although eligible external LTD with a remaining maturity between one and two years would be subject to a 50 percent haircut for purposes of the external LTD requirement, such eligible external LTD would continue to count at full value for purposes of the external TLAC requirement. As discussed below, eligible external LTD with a remaining maturity of less than one year would not count toward either the external TLAC requirement or the external LTD requirement.

[50] 80 FR 49082 (Aug. 14, 2015).

component of the external TLAC requirement. To calculate its external TLAC buffer level, a covered BHC would subtract from its common equity tier 1 capital ratio the greater of 0 percent and the following figure: The risk-weighted assets component of the covered BHC's external TLAC requirement minus the ratio of its additional tier 1 capital to its risk-weighted assets (additional tier 1 capital ratio) and minus its eligible external LTD.

In order to comply with the external TLAC requirement, the covered BHC would need to have an outstanding TLAC amount sufficient to meet both the risk-weighted assets component and the total leverage exposure component. In order to avoid limitations on capital distributions and discretionary bonus payments pursuant to Table 1, the covered BHC would also have to have an external TLAC buffer level in excess of its external TLAC buffer.

For example, suppose that a covered BHC called ''BHC A'' has a common equity tier 1 capital ratio of 10 percent, an additional tier 1 capital ratio of 2 percent, and an eligible external LTD amount equal to 8 percent of its risk-weighted assets. Suppose further that BHC A is subject to an external TLAC requirement of 18 percent and an external TLAC buffer of 5 percent of risk-weighted assets. BHC A would meet its external TLAC requirement because the sum of its common equity tier 1 capital ratio, its additional tier 1 capital ratio, and the ratio of its eligible external TLAC to risk-weighted assets would be equal to 20, which is greater than 18. Moreover, BHC A would have an external TLAC buffer level equal to $10 - (18 - 2 - 8) = 2$. Because 2 is less than 50 percent and more than 25 percent of the applicable 5 percent external TLAC buffer, BHC A would be subject to a maximum external TLAC payout ratio of 20 percent of eligible retained income.

Although the proposed external TLAC buffer must be met only with common equity tier 1 capital, under the proposal, any covered BHC that meets existing capital requirements and the existing capital conservation buffer would not need to increase its common equity tier 1 capital to meet its external TLAC requirement and its external TLAC buffer. This is because (a) a covered BHC could meet its external TLAC requirement solely through the issuance of eligible external LTD, (b) a covered BHC could use the same common equity tier 1 capital that it uses to meet existing minimum capital requirements and the existing capital conservation buffer to meet the proposed external TLAC requirement and external TLAC buffer, and (c) a covered BHC's external TLAC buffer would always be less than or equal to its existing capital conservation buffer.[51] A covered BHC could thus use its existing common equity tier 1 capital to meet the external TLAC buffer while issuing eligible external LTD as necessary to meet its external TLAC requirement.

The rationale for the external TLAC buffer is similar to the rationale for the capital conservation buffer established by the Board's Regulation Q. During the 2007–2009 financial crisis, some banking organizations continued to pay dividends and substantial discretionary bonuses even as their financial condition weakened. These capital distributions weakened the financial system and exacerbated the crisis. The external TLAC buffer would be intended to encourage covered BHCs to practice sound capital conservation and thus to enhance the resilience of covered BHCs and of the financial system as a whole. The external TLAC buffer would pursue this goal by providing covered BHCs with incentives to hold sufficient capital to reduce the risk that their eligible external TLAC would fall below the minimum external TLAC requirement during a period of financial stress.

Question 8: The Board invites comment on the organization and placement of the external TLAC buffer. For example, would the external TLAC buffer be easier to understand if it were incorporated directly into the Board's regulatory capital rules (Regulation Q)?

Question 9: The Board invites comment on an alternative calibration of the total leverage exposure component of the proposed external TLAC requirement pursuant to which covered BHCs would be subject to an external TLAC requirement equal to 7.5 percent of total leverage exposure and a capital conservation buffer equal to 2 percent of total leverage exposure would apply in addition to that external TLAC requirement, by analogy to the enhanced supplementary leverage ratio.

E. Core Features of Eligible External LTD (Section 252.61 of the Proposed Rule)

Under the proposal, a covered BHC's eligible external LTD would be defined to be debt that is paid in and issued directly by the covered BHC, is unsecured, has a maturity of greater than one year from the date of issuance, is ''plain vanilla,'' and is governed by U.S. law. Eligible external LTD with a remaining maturity of between one and two years would be subject to a 50 percent haircut for purposes of the external LTD requirement, and eligible external LTD with a remaining maturity of less than one year would not count toward the external LTD requirement.

As discussed below, the general purpose of these requirements is to ensure the adequacy of eligible external LTD instruments to absorb losses in a resolution of the covered BHC.

1. Issuance by the Covered BHC

Eligible external LTD would be required to be paid in and issued directly by the covered BHC itself—that is, by the banking organization's top-tier holding company. Thus, debt instruments issued by a subsidiary would not qualify as eligible external LTD, even if they do qualify as regulatory capital.

This restriction would serve two purposes. First, as with the requirement that regulatory capital be issued directly by the covered BHC in order to count as eligible external TLAC, this restriction helps to ensure that eligible external LTD can be used to absorb losses incurred anywhere in the banking organization. By contrast, loss-absorbing debt issued by a subsidiary would lack this flexibility and would generally be available only to absorb losses incurred by that particular subsidiary.

Second, issuance directly from the covered BHC would enable the use of the eligible external LTD in an SPOE resolution of the covered BHC. Under the SPOE approach, only the covered BHC itself would enter resolution. The covered BHC's eligible external LTD would be used to absorb losses incurred throughout the banking organization, enabling the recapitalization of operating subsidiaries that had incurred losses and enabling those subsidiaries to continue operating on a going-concern basis. For this approach to be implemented successfully, the eligible external LTD must be issued directly by the covered BHC. Debt issued by a subsidiary generally cannot be used to absorb losses even at the issuing subsidiary itself unless that subsidiary enters a resolution proceeding, which would be contrary to the SPOE approach and, in the case of a material operating subsidiary of a covered BHC, would likely present risks to financial stability.

Question 10: The Board invites comment on the benefits or drawbacks

[51] This is because, as discussed above, the external TLAC buffer and the existing capital conservation buffer would have the same components except that the external TLAC buffer would include only the applicable method 1 GSIB surcharge, while the existing capital conservation buffer includes the greater of the applicable method 1 GSIB surcharge and the applicable method 2 GSIB surcharge.

of permitting long-term debt issued by a subsidiary of a covered BHC to count as eligible external LTD and on whether there are other means to ensure that the debt be available to absorb losses incurred anywhere within the banking organization.

2. Unsecured

Eligible external LTD would be required to be unsecured, not guaranteed by the covered BHC or a subsidiary of the covered BHC, and not subject to any other arrangement that legally or economically enhances the seniority of the instrument (such as a credit enhancement provided by an affiliate). The primary rationale for this restriction is to ensure that eligible external LTD can serve its intended purpose of absorbing losses incurred by the banking organization in resolution. To the extent that a creditor is secured, it can avoid suffering losses by seizing the collateral that secures the debt. This would thwart the purpose of eligible external LTD by leaving losses with the covered BHC (which would lose the collateral) rather than imposing them on the eligible external LTD creditor (which could take the collateral).

A secondary purpose of the restriction is to prevent eligible external LTD from contributing to the asset firesales that can occur when a financial institution fails and its secured creditors seize and liquidate collateral. Asset firesales can drive down the value of the assets being sold, which can undermine financial stability by transmitting contagion from the failed firm to other entities that hold similar assets.

Finally, the requirement that eligible external LTD be unsecured ensures that losses can be imposed on that debt in resolution in accordance with the standard creditor hierarchy in bankruptcy, under which secured creditors are paid ahead of unsecured creditors.

Question 11: The Board invites comment on whether eligible external LTD should be required to be contractually subordinated to the general unsecured liabilities of the covered BHC (such as senior unsecured debt). If so, should the subordination requirement apply to all or only to some portion of the debt used to satisfy the external LTD requirement?

3. ''Plain Vanilla''

Eligible external LTD instruments would be required to be ''plain-vanilla'' instruments. The purpose of this requirement is to ensure that eligible external LTD can be effectively used to absorb losses in resolution by prohibiting exotic features that could create complexity and thereby diminish the prospects for an orderly resolution.

These prohibitions would help to ensure that a covered BHC's eligible external LTD represents loss-absorbing capacity with a definite value that can be quickly determined in resolution. In a resolution proceeding, claims represented by such plain-vanilla debt instruments are more easily ascertainable and relatively certain compared to more complex and volatile instruments. Permitting these features could engender uncertainty as to the level of the covered BHC's loss-absorbing capacity and could increase the complexity of the resolution proceeding, both of which could undermine market participants' confidence in an SPOE resolution and potentially result in a disorderly resolution. This could occur, for instance, if creditors and counterparties of the covered BHC's subsidiaries decided to reduce their exposures to the subsidiaries of the failed covered BHC by engaging in a funding run.

Eligible external LTD instruments also would be prohibited from: (a) Being structured notes; (b) having a credit-sensitive feature; (c) including a contractual provision for conversion into or exchange for equity in the covered BHC; or (d) including a provision that gives the holder a contractual right to accelerate payment (including automatic acceleration), other than a right that is exercisable on a one or more dates specified in the instrument, in the event of the insolvency of the covered BHC, or the covered BHC's failure to make a payment on the instrument when due.[52]

For purposes of this proposal, a ''structured note'' is a debt instrument that (a) has a principal amount, redemption amount, or stated maturity that is subject to reduction based on the performance of any asset,[53] entity, index, or embedded derivative or similar embedded feature; (b) has an embedded derivative or similar embedded feature that is linked to one or more equity securities, commodities, assets, or entities; (c) does not specify a minimum principal amount due upon acceleration or early termination; or (d) is not classified as debt under U.S. generally accepted accounting principles. The proposed definition of a structured note is not intended to include non-dollar-denominated instruments or instruments whose interest payments are linked to an interest rate index (for example, a floating-rate note linked to the federal funds rate or to LIBOR) that satisfy the proposed requirements in all other respects.

Structured notes would not count as eligible external LTD because they contain features that could make their valuation uncertain, volatile, or unduly complex, and because they are typically customer liabilities (as opposed to investor liabilities). To promote resiliency and market discipline, it is important that covered BHCs have a minimum amount of loss-absorbing capacity whose value is easily ascertainable at any given time. Moreover, in an orderly resolution of a covered BHC, debt instruments that will be subjected to losses must be able to be valued accurately and with minimal risk of dispute. The requirement that eligible external LTD not contain the features associated with structured notes advances these goals.

Eligible external LTD would be prohibited from including contractual provisions for conversion into or exchange for equity prior to the covered BHC's resolution because the fundamental objective of the external LTD requirement is to ensure that covered BHCs will have at least a fixed minimum amount of loss-absorbing capacity available to absorb losses upon the covered BHC's entry into resolution. Debt instruments that could convert into equity prior to resolution may not serve this goal, since by doing so they would reduce the amount of debt that will be available to absorb losses in resolution.

Finally, eligible external LTD would be prohibited from having a credit-sensitive feature or giving the holder of the instrument a contractual right to the acceleration of payment of principal or interest at any time prior to the instrument's stated maturity (an ''acceleration clause''), other than upon the occurrence of either an insolvency event or a payment default event, except that eligible external LTD instruments would be permitted to give the holder a put right as of a future date certain, subject to the remaining maturity provisions discussed below. This proposed prohibition is similar to but moderately less stringent than the analogous restriction on tier 2 regulatory capital. The main difference between eligible external LTD and tier 2 capital in this regard is that tier 2 capital is also prohibited from containing payment default event acceleration clauses.[54]

[52] This restriction would be subject to an exception that would permit eligible external LTD instruments to give the holder a future put right as of a date certain, subject to the remaining maturity provisions discussed below.

[53] Assets would include loans, debt securities, and other financial instruments.

[54] *See* 12 CFR 217.20(d)(1)(vi).

However, the Board is considering whether to instead impose a restriction on eligible external LTD that is identical to the one applicable to tier 2 capital by also prohibiting eligible external LTD from containing payment default event clauses.

This proposed restriction serves the same purpose as several of the other proposed restrictions discussed above: to ensure that the required amount of loss-absorbing capacity will indeed be available to absorb losses in resolution if the covered BHC fails. Early acceleration clauses, including cross-acceleration clauses, may undermine this prerequisite to orderly resolution by triggering and forcing the covered BHC to make payments prior to its entry into resolution, potentially depleting the covered BHC's eligible external LTD immediately prior to resolution. This concern does not apply to acceleration clauses that are triggered by an insolvency event, however, because the insolvency that triggers the clause would generally occur concurrently with the covered BHC's entry into a resolution proceeding, in which case the payment obligations would generally be stayed and the debt would remain available to absorb losses.

Senior debt instruments issued by covered BHCs commonly also include payment default event clauses. These clauses provide the holder with a contractual right to accelerate payment upon the occurrence of a ''payment default event''—that is, a failure by the covered BHC to make a required payment when due. Payment default event clauses, which are prohibited from tier 2 regulatory capital, raise more concerns than insolvency event clauses because a payment default event may occur (triggering acceleration) before the institution has entered a resolution proceeding and a stay has been imposed. Such a pre-resolution payment default event could cause a decline in the covered BHC's loss-absorbing capacity.

Nonetheless, the proposal would permit eligible external LTD to be subject to payment default event acceleration rights for two reasons. First, default or acceleration rights upon a borrower's default on its direct payment obligations are a standard feature of senior debt instruments, such that a prohibition on such rights could be unduly disruptive to the potential market for eligible external LTD. Second, the payment default of a covered BHC on an eligible external LTD instrument would likely be a credit event of such significance that whatever diminished capacity led to the payment default event would also be a sufficient trigger for an insolvency event acceleration clause, in which case a prohibition on payment default event acceleration clauses would have little or no practical effect.

Question 12: The Board invites comment on the proposed definition of eligible external LTD, including whether such debt securities should be allowed to include any of the features discussed above. The Board also invites comment as to the impact that the proposed restrictions would have on the bindingness of the proposal for covered BHCs or on the markets for senior unsecured debt instruments of covered BHCs. Please provide data supporting your answer.

Question 13: The Board invites comment on whether its proposed definition of eligible external LTD should exclude debt that is subject to a guarantee from any affiliate of the global systemically important BHC.

Question 14: The Board invites comment on whether additional restrictions should be imposed on instruments that qualify as eligible external LTD in order to enhance the usefulness of eligible external LTD in an orderly resolution of the covered BHC.

Question 15: Would an orderly resolution of a covered BHC be facilitated by additional requirements intended to facilitate the process of imposing losses on the claims of holders of eligible external LTD? If so, what additional requirements (e.g., requiring eligible external LTD to be held through a securities settlement system, requiring internal data systems to facilitate the claims process) are appropriate?

Question 16: The Board invites comment on whether currently outstanding instruments that meet all other requirements should be allowed to count as eligible external LTD despite containing features that would be prohibited under the proposal. What is the amount of debt instruments now outstanding that would fall into this category, and what is the remaining maturity of those debt instruments? How burdensome would it be for covered BHCs to modify the terms of any such instruments to eliminate features that would be prohibited under the proposal?

Question 17: The Board invites comment on whether eligible external LTD should be permitted to include acceleration clauses that relate to payment default events. The Board also invites comment on the impact of excluding instruments with such acceleration clauses from the definition of eligible external LTD, including any impact on debt markets for senior unsecured debt instruments.

Question 18: The Board invites comment on whether debt instruments that are convertible into equity (with or without a regulatory conversion triggers) should be permitted to count as eligible external TLAC even if they are excluded from eligible external LTD and on whether such instruments would advance the objectives of an orderly resolution of a covered BHC.

4. Minimum Remaining Maturity and Amortization (Section 252.62(b) of the Proposed Rule)

Eligible external LTD with a remaining maturity of between one and two years would be subject to a 50 percent haircut for purposes of the external LTD requirement, and eligible external LTD with a remaining maturity of less than one year would not count toward the external LTD requirement.

The purpose of this restriction is to limit the debt that would fill the external LTD requirement to debt that will be reliably available to absorb losses in the event that the covered BHC fails and enters resolution. Debt with a remaining maturity of less than one year does not adequately serve this purpose because of the relatively high likelihood that the debt will mature during the period between the time when the covered BHC begins to experience extreme stress and the time when it enters a resolution proceeding. If the debt matures during that period, then the creditor will likely be unwilling to maintain its exposure to the covered BHC and will therefore refuse to roll over the debt or extend new credit and the distressed covered BHC will likely be unable to replace the debt with new long-term debt that would be available to absorb losses in resolution. This run-off dynamic could result in the covered BHC's entering resolution with materially less loss-absorbing capacity than would be required to recapitalize its subsidiaries, potentially resulting in a disorderly resolution. To protect against this outcome, eligible external LTD would cease to count toward the external LTD requirement upon falling below one year of remaining maturity so that the full required amount of loss-absorbing capacity would be available in resolution even if the resolution period were preceded by a year-long stress period.[55]

For analogous reasons, eligible external LTD with a remaining maturity of less than two years would be subject to a 50 percent haircut for purposes of the external LTD requirement, meaning

[55] This requirement also accords with market convention, which generally defines ''long-term debt'' as debt with maturity in excess of one year.

that only 50 percent of the value of its principal amount would count toward the external LTD requirement.[56] This amortization provision is intended to protect a covered BHC's loss-absorbing capacity against a run-off period in excess of one year (as might occur during a financial crisis or other protracted stress period) in two ways. First, it requires covered BHCs that rely on eligible external LTD that is vulnerable to such a run-off period (because it has a remaining maturity of less than two years) to maintain additional loss-absorbing capacity. Second, it incentivizes covered BHCs to reduce or eliminate their reliance on loss-absorbing capacity with a remaining maturity of less than two years, since by doing so they avoid being required to issue additional eligible external LTD in order to account for the haircut. A covered BHC could reduce its reliance on eligible external LTD with a remaining maturity of less than two years by staggering its issuance, by issuing eligible external LTD with a relatively long initial maturity, or by redeeming and replacing eligible external LTD once its remaining maturity falls below two years.

The proposal also provides similar treatment for eligible external LTD that could become subject to a ''put'' right—that is, a right of the holder to require the issuer to redeem the debt on demand—prior to reaching its stated maturity. Such an instrument would be treated as if it were going to mature on the day on which it first became subject to the put right, since on that day the creditor would be capable of demanding payment and thereby subtracting the value of the instrument from the covered BHC's loss-absorbing capacity.[57]

Question 19: The Board invites comment on whether the proposed treatment of eligible external LTD with a remaining maturity of less than two years is appropriate. How would a different remaining maturity requirement or amortization schedule better achieve the objectives of the proposal?

Question 20: The Board invites comment on whether a specific eligible external LTD issuance schedule or similar requirement should be imposed on covered BHCs by regulation. If so, how should the requirement be structured to maximize benefits and minimize costs?

Question 21: The Board invites comment on the proposed treatment of debt instruments that could become subject to put rights in the future. Should such instruments be excluded entirely from the definition of eligible external LTD? If so, what impact would such a prohibition have on markets for senior unsecured debt of covered BHCs?

5. Governing Law

Eligible long-term debt instruments should consist only of liabilities that can be effectively used to absorb losses during the resolution of a covered BHC under the U.S. Bankruptcy Code or Title II without giving rise to material risk of successful legal challenge. To this end, eligible external LTD must be governed by U.S. law, including the U.S. Bankruptcy Code and Title II.

Question 22: The Board invites comment on the proposed governing law requirement, including whether such a requirement is necessary or appropriate. Should the proposed definition of eligible external LTD permit instruments to be governed by or subject to non-U.S. law in any respects? If so, how would that be consistent the purposes of the proposed rule?

6. Contractual Subordination

The Board considered whether to require eligible external LTD instruments to be contractually subordinated to the claims of general creditors of a covered BHC. A contractual subordination requirement could improve the market discipline imposed on a covered BHC by increasing the clarity of treatment for eligible external LTD holders relative to other creditors.

The proposal does not include a contractual subordination requirement for several reasons. First, as discussed above, the structural subordination of a covered BHC's creditors to the creditors and counterparties of the covered BHC's subsidiaries already generally ensures that the covered BHC's creditors would absorb losses ahead of the creditors of the covered BHC's subsidiaries in an SPOE resolution of the covered BHC.[58] Second, the Board is proposing to subject covered BHCs to clean holding company provisions that would limit the amount of non- TLAC instruments that could be pari passu with or junior to eligible external LTD, which will further address any concerns with covered BHCs' unsecured creditor hierarchies.

By limiting the criteria for eligible external LTD to those necessary to achieve the objectives of the proposal, the proposal seeks to retain the broadest possible market for eligible external LTD instruments. Allowing covered BHCs to retain the flexibility to satisfy the external LTD requirement with either senior or subordinated debt instruments should allow covered BHCs to comply with the requirement efficiently, to adapt to debt investors' risk preferences, and to avoid re-issuances of outstanding long-term senior debt instruments that would otherwise meet the criteria for eligible external LTD.

Question 23: Should the Board require that eligible external LTD be contractually subordinated to the general unsecured liabilities of the covered BHC.

F. Costs and Benefits

An analysis of the potential costs and benefits of the external TLAC and LTD requirements was conducted. To evaluate the costs attributable to the proposed requirements, this analysis estimated (a) the extent by which the covered BHCs' required capital and currently outstanding long-term debt fall short of the proposed requirements, (b) the increase in each U.S. GSIB's ongoing cost of funding that would result from meeting the proposed requirements, (c) the expected increase in the interest rates that the U.S. GSIBs would charge to borrowers to make up for their higher funding costs, and (d) any decline in the gross domestic product (GDP) of the United States that would result from these increased lending rates.

The following components relevant to the benefits of the proposed requirements were evaluated: (a) The probability of a financial crisis occurring in a given year, (b) the cumulative economic cost that a financial crisis would impose if it were to occur, and (c) the extent to which the proposed requirements would decrease the likelihood and cost of a financial crisis.

The analysis concluded that the estimated benefits would outweigh the estimated costs and that the proposed external TLAC and LTD requirements would yield a substantial net benefit for the U.S. economy.

[56] As discussed above, the proposed amoritization would apply only to eligible external LTD, not to eligible external TLAC. Thus, an eligible external LTD instrument that counts for only half value toward the external LTD requirement because of the 50 percent amortization provision would continue to count for full value toward the external TLAC requirement, although debt with a remaining maturity of less than one year would not count toward either requirement.

[57] The remaining maturity would be calculated from the date the put right would first be exerciseable regardless of whether the put right would only be exerciseable on that date if another event occurred (*e.g.,* a credit rating downgrade).

[58] As discussed above, in an insolvency proceeding, direct third-party claims on a parent holding company's subsidiaries would be superior to the parent holding company's equity claims on the subsidiaries.

1. Shortfall Analysis

To evaluate the U.S. GSIBs' shortfalls relative to the proposed external TLAC and LTD requirements, information was collected on the long-term debt that covered BHCs had outstanding as of year-end 2014.

Several assumptions were made for purposes of the shortfall analysis. First, to provide an accurate estimate of shortfalls relative to the proposed requirements using 2014 data, it was assumed that the covered BHCs were already compliant with the other capital requirements (including capital conservation buffers) that will be in effect as of 2019, when the proposed external TLAC and LTD requirements would begin to take effect. This assumption was necessary to ensure that the analysis would attribute to the proposed external TLAC and LTD requirements only those costs that would result from those requirements, as distinct from other requirements that the Board has imposed but that were not fully phased in as of year-end 2014. As a result of this assumption, a certain amount of ''capital catch-up'' was allocated to five of the U.S. GSIBs to bring their capital levels into alignment with the rules that will be in effect as of 2019.

Second, for purposes of this analysis, all of the U.S. GSIB debt that met the primary attributes of eligible external LTD was treated as eligible LTD, including issuance directly from the covered BHC, remaining maturity of at least one year, and the absence of derivative-linked features. Although these instruments may not meet every one of the other proposed elements of eligible external LTD, it appears that the cost of meeting any remaining elements would be relatively minor.

Under the proposal, covered BHCs would have an aggregate external LTD requirement of approximately $680 billion. This amounts to approximately 9.6 percent of aggregate risk-weighted assets and 4.9 percent of aggregate total leverage exposure for the covered BHCs. The covered BHCs' aggregate shortfall relative to the proposed external TLAC requirement was approximately $100 billion. The covered BHCs' aggregate shortfall relative to the proposed external LTD requirement was approximately $90 billion. For four of the covered BHCs, the risk-weighted assets component of the external LTD requirement was binding; for the other four covered BHCs, the supplementary leverage exposure component was binding.

The covered BHCs' overall aggregate shortfall from the two proposed requirements was approximately $120 billion, or 1.7 percent of aggregate risk-weighted assets.[59] The proposed external TLAC requirement was the binding requirement for three of the covered BHCs, while the proposed external LTD requirement was the binding requirement for the other five covered BHCs. Two of the covered BHCs had no shortfall under either requirement, while the largest overall shortfall for any covered BHC amounted to 3.2 percent of its risk-weighted assets.

2. Cost-of-Funding Analysis

The analysis also considered the effect that filling the $120 billion shortfall through the issuance of additional eligible external LTD would have on the covered BHCs' cost of funding. This analysis relied on additional information about the amounts and costs of funding of the debt that the covered BHCs and their subsidiaries currently have outstanding.

Several additional assumptions were made at this stage of the analysis. First, it was assumed that covered BHCs would fill their shortfalls by replacing existing, ineligible debt with eligible external LTD during the period prior to the effective date of the proposed requirements, rather than by expanding their balance sheets by issuing the new debt while maintaining existing liabilities outstanding. Second, it was assumed that covered BHCs would minimize the cost associated with meeting the proposed external TLAC and LTD requirements by first replacing with eligible external LTD their ''near-eligible debt''—that is, their outstanding debt that comes closest to meeting all requirements for eligible external LTD (and that therefore entails a cost of funding almost as high as that associated with eligible external LTD)—and by proceeding in this cost-minimizing fashion until the proposed requirements were met. Thus, the marginal cost of each additional dollar of eligible external LTD was assumed to be the surplus of the funding cost associated with eligible external LTD over the funding cost of the covered BHC's highest-cost remaining ineligible debt. Finally, if total near-eligible liabilities were insufficient to fill the shortfall, it was assumed that the covered BHC proceeded to replace more senior, short-term liabilities, such as deposits, with eligible external LTD.

Roughly $65 billion of the aggregate $120 billion shortfall could be filled through the issuance of eligible external LTD in the place of existing near-eligible debt, most of which takes the form of long-term bonds issued by the covered BHCs' bank subsidiaries.[60] Based on market data, it was estimated that the spread between this near-eligible debt and eligible external LTD is between 20 and 30 basis points. The remaining $55 billion shortfall could then be filled through the issuance of eligible external LTD in the place of existing deposits or other lower-cost liabilities. It was estimated that the spread between these liabilities and eligible external LTD is approximately equal to the spread between the risk-free interest rate and the eligible external LTD rate, which is estimated to be between 100 and 150 basis points.

The figures at the low ends of these ranges—20 basis points for replacing near-eligible debt and 100 basis points for replacing lower-cost liabilities such as deposits—result in an aggregate increased cost of funding for the covered BHCs of $680 million per year.

A more conservative estimate was produced using figures at the high ends of these ranges and then further adjusted them upward to reflect a potential supply effect of 30 basis points (that is, an increase in the interest rate on eligible external LTD caused by the increase in the supply of eligible external LT as a result of the proposed external LTD requirement). The aggregate shortfall in eligible LTD amounts to approximately 20 percent of the covered BHCs' current eligible LTD, implying that the covered BHCs in the aggregate would need to increase their outstanding eligible external LTD by 3 to 4 percent each year through 2022, when the proposed requirements would be fully phased in. On the basis of both internal analysis and an international survey of market participants in which Board staff participated, it is estimated that this increase in supply would increase spreads of covered BHCs'

[59] This figure is less than the sum of the separate aggregate shortfalls for the external TLAC requirement and the external LTD requirement because of substantial overlap between the two requirements (that is, because eligible external LTD would also count toward the external TLAC requirement).

[60] For purposes of this analysis, structured notes were not treated as near-eligible debt. Structured notes could be viewed as near-eligible debt, but in many cases structured notes serve different purposes than debt that was treated as near-eligible (such as plain-vanilla bonds issued by covered BHCs' bank subsidiaries). As a result, the analysis assumed that covered BHCs would not replace their outstanding structured notes with eligible external LTD. On the assumption that covered BHCs would indeed replace their outstanding structured notes with eligible external LTD, covered BHCs would be able to meet roughly $100 billion of the aggregate $120 billion shortfall by replacing near-eligible debt with eligible external LTD, which would result in a lower estimated cost impact from the proposed requirements.

eligible external LTD by approximately 30 basis points.

Using the resulting, higher figures—60 basis points for replacing near-eligible debt and 200 basis points for replacing lower-cost liabilities—resulted in an estimated aggregate increased cost of funding for the covered BHCs of approximately $1.5 billion per year.

Thus, the aggregate increased cost of funding attributable to the proposed external TLAC and LTD requirement are estimated to be in the range of $680 million to $1.5 billion annually.

3. Increased Lending Rate Analysis

To arrive at a conservative estimate of the effect of the proposed external TLAC and LTD requirements on lending rates, it was next assumed that the U.S. GSIBs would maintain their current return-on-equity levels by passing all of their increased funding costs on to borrowers, holding constant their level of lending activity. The increased lending rates that the U.S. GSIBs would charge to borrowers were calculated by dividing both the low-end and the high-end estimated cost-of-funding increases by the U.S. GSIBs' aggregate outstanding loans of roughly $3.2 trillion. Under this analysis, covered BHCs would employ an increased lending rate of 1.3 to 3.1 basis points as a result of the proposed external TLAC and LTD requirements.

4. Macroeconomic Costs Analysis

In prior assessments of the economic impact of regulations on banking organizations, increases in lending rates have been assumed to produce a drag on GDP growth. However, the very modest lending rate increases estimated above—from 1.3 to 3.1 basis points—do not rise to the level of increase that could be expected to meaningfully affect GDP. Thus, from the standpoint of the economy as a whole, it appears that the costs associated with the proposed external TLAC and LTD requirements would be minimal.

5. Macroeconomic Benefits Analysis

To estimate the benefits of the proposed requirements, the analysis built on the framework considered in a recent study titled ''An assessment of the long-term economic impact of stronger capital and liquidity requirements'' (''LEI report'').[61] The LEI report estimated that, prior to the regulatory reforms undertaken since 2009, the probability of a financial crisis occurring in a given year was between 3.5 percent and 5.2 percent and the cumulative cost was between 20 percent and 100 percent of annual economic output. Even assuming that the lower ends of these ranges are accurate, these estimates reflect the well-understood fact that financial crises impose very substantial costs on the real economy. And the disorderly failures of major financial institutions play a major role in causing and deepening financial crises, as Congress recognized in enacting section 165 of the Dodd-Frank Act.

This proposal would materially reduce the risk that the failure of a covered BHC would pose to the financial stability of the United States by enhancing the prospects for the orderly resolution of such a firm. Moreover, by ensuring that the losses caused by the failure of such a firm are borne by private-sector investors and creditors (the holders of the covered BHC's eligible external TLAC), this proposal would materially reduce the probability that a covered BHC would fail in the first place by giving the firm's shareholders and creditors stronger incentives to discipline its excessive risk-taking. Both of these reductions would promote financial stability and concomitantly materially reduce the probability that a financial crisis would occur in any given year. The proposed rule would therefore advance a key objective of the Dodd-Frank Act and help protect the American economy from the substantial potential losses associated with a higher probability of financial crises.

Question 24: The Board invites comment on all aspects of the foregoing evaluation of costs and benefits.

III. Internal TLAC and LTD Requirements for U.S. Intermediate Holding Companies of Foreign Banking Organizations

A. Scope of Application (Section 252.160 of the Proposed Rule)

The proposed rule would apply to all ''covered IHCs.'' The term ''covered IHC'' would be defined to include any U.S. intermediate holding company that (a) is required to be formed under the Board's enhanced prudential standards rule (IHC rule) and (b) is controlled by a foreign banking organization that would be designated as a GSIB under either the Board's capital rules if it were subject to the Board's GSIB surcharge on a consolidated basis or the BCBS assessment methodology (foreign GSIB).

The purpose of these criteria is to identify those foreign banking organizations that are global systemically important banking organizations and that have substantial operations in the United States. The Board's IHC rule identifies foreign banking organizations with a substantial U.S. presence and requires them to form a single U.S. intermediate holding company over their U.S. subsidiaries.[62] Thus, the fact that a foreign banking organization is required to form a U.S. intermediate holding company is an indicator of whether its U.S. presence is substantial.

The Board's GSIB surcharge rule identifies the most systemically important banking organizations. As discussed above with respect to covered BHCs, its methodology evaluates a banking organization's systemic importance on the basis of its size, interconnectedness, cross-jurisdictional activity, substitutability, and complexity. The firms that score the highest on these attributes are classified as GSIBs. While the GSIB surcharge rule itself applies only to U.S. BHCs, its methodology is equally well-suited to evaluating the systemic importance of foreign banking organizations. The Board's methodology for identifying GSIBs is aligned with that of the assessment methodology for the GSIB surcharge framework developed by the BCBS. Moreover, foreign jurisdictions collect information from banking organizations in connection with that framework that parallels the information collected by the Board for purposes of the Board's GSIB surcharge rule.

Under the proposal, a foreign banking organization that controls a U.S. intermediate holding company would be required to determine whether it is a GSIB under that BCBS assessment methodology if the foreign banking organization already prepares or reports, for any purpose, the information necessary to determine whether it is a GSIB under the BCBS assessment methodology. A foreign banking organization that determines under this requirement that it is a GSIB would be a foreign GSIB under the proposal.

A foreign banking organization that controls a U.S. intermediate holding company also would be a foreign GSIB under the proposal if the Board determines that the foreign banking organization has the characteristics of a GSIB under the BCBS assessment methodology or the Board's methodology for determining whether U.S. bank holding companies are GSIBs for purposes of the Board's capital rules,

[61] Basel Committee on Banking Supervision, ''An assessment of the long-term economic impact of stronger capital and liquidity requirements'' (August 2010), available at *http://www.bis.org/publ/bcbs173.pdf*.

[62] The IHC rule generally requires any foreign banking organization with total consolidated non-branch U.S. assets of $50 billion or more to form a single U.S. intermediate holding company over its U.S. subsidiaries. 12 CFR 252.153; 79 FR 17329 (May 27, 2014).

or if the Board determines that the U.S. intermediate holding company would itself be a GSIB under the Board's methodology. The proposal would therefore require each top-tier foreign banking organization that controls an U.S. intermediate holding company to notify the Board by January first of each year whether its home country supervisor (or other appropriate home country regulatory authority) has adopted standards consistent with the BCBS assessment methodology, whether the organization prepares or reports the indicators used by the BCBS assessment methodology, and if it does prepare or report such indicators, whether the organization has determined that it has the characteristics of a global systemically important banking organization under the BCBS assessment methodology.[63]

As with covered BHCs, the proposal's focus on GSIBs is in keeping with the Dodd-Frank Act's mandate that more stringent prudential standards be applied to the most systemically important bank holding companies.[64] Furthermore, the use of the GSIB surcharge rule to identify foreign GSIBs as well as U.S. GSIBs (and thus to identify both covered BHCs and covered IHCs) promotes a level playing field between U.S. and foreign banking organizations.

Question 25: The Board invites comment on alternative approaches for determining the scope of application of the proposed internal TLAC and LTD requirements. Should the Board apply the proposed internal TLAC and LTD requirements to all U.S. intermediate holding companies required to be formed under the IHC rule rather than limiting it to U.S. intermediate holding companies that are controlled by foreign GSIBs?

Question 26: Is the proposed method for determining whether a foreign banking organization is a foreign GSIB—application of the relevant portion of the Board's GSIB surcharge rule to the foreign banking organization's balance sheet—an appropriate method for making that determination? Would an alternative method for identifying foreign GSIBs—such as looking to whether the foreign banking organization has been classified as a GSIB by its home supervisory authority or by the FSB—be more appropriate?

Question 27: What additional modifications, if any, would be appropriate to the definition ''top-tier foreign banking organization'' to sufficiently explain the types of entities that may be considered top-tier foreign banking organizations under the proposal?

B. Calibration of the Internal TLAC and LTD Requirements (Sections 252.162 and 252.164 of the Proposed Rule)

Under the internal TLAC requirement, the amount of eligible internal total loss-absorbing capacity (''eligible internal TLAC'') that a covered IHC would be required to maintain outstanding would depend on whether the covered IHC (or any of its subsidiaries) is expected to enter resolution if a foreign parent entity fails, rather than being maintained as a going concern while a foreign parent entity is resolved. If the home country resolution authority for the parent foreign banking organization of the covered IHC provides a certification to the Board indicating that the authority's planned resolution strategy for the foreign banking organization does not involve the covered IHC or any subsidiary of the covered IHC entering a resolution proceeding in the United States, then the covered IHC would be considered a ''non-resolution entity.'' [65]

Covered IHCs that are non-resolution entities would be required to maintain outstanding eligible internal TLAC in an amount not less than the greater of: (a) 16 percent of the covered IHC's total risk-weighted assets; [66] (b) for covered IHCs that are subject to the supplementary leverage ratio,[67] 6 percent of the covered IHC's total leverage exposure; and (c) 8 percent of the covered IHC's average total consolidated assets, as computed for purposes of the U.S. tier 1 leverage ratio.[68] All other covered IHCs would be required to maintain outstanding eligible internal TLAC in an amount not less than the greater of: (a) 18 percent of the covered IHC's total risk-weighted assets; [69] (b) 6.75 percent of the covered IHC's total leverage exposure (if applicable); and (c) 9 percent of the covered IHC's average total consolidated assets, as computed for purposes of the U.S. tier 1 leverage ratio.

As described below, an internal TLAC buffer would apply to all covered IHCs in addition to the applicable risk-weighted assets component of the internal TLAC requirement.

Under the internal LTD requirement, a covered IHC would be required to maintain outstanding eligible internal long-term debt instruments (''eligible internal LTD'') in an amount not less than the greater of: (a) 7 percent of total risk-weighted assets; (b) 3 percent of the total leverage exposure (if applicable); and (c) 4 percent of average total consolidated assets, as computed for purposes of the U.S. tier 1 leverage ratio. Covered IHCs would be prohibited from redeeming eligible internal LTD prior to its stated maturity date without obtaining prior approval from the Board where such redemption would cause the covered IHC's eligible internal LTD to fall below its internal LTD requirement.

The rationale for the proposed internal TLAC and LTD requirements is generally parallel to the rationale for the proposed external TLAC and LTD requirements, which is discussed above. Covered IHCs, other than those that are non-resolution entities, would be subject to an internal TLAC requirement with a risk-weighted assets component identical to the risk-weighted assets component of the proposed external TLAC requirement. They would be subject to a supplementary leverage ratio component (if applicable) that is lower than the supplementary leverage ratio component of the proposed

[63] Under the proposal, these notice and determination requirements would apply to the ''top-tier foreign banking organization.'' The proposal defines top-tier foreign banking organization, with respect to a foreign bank, as the top-tier entity that controls the foreign bank (if any) unless the Board specifies a subsidiary of such entity as the ''top-tier foreign banking organization.'' Thus, the definition would include the top-tier entity that controls a foreign bank, which would be the foreign bank if no entity controls the foreign bank, or the entity specified by the Board that is a subsidiary of the top-tier entity.

[64] 12 U.S.C. 5365(a)(1)(B).

[65] If the home country resolution authority for the foreign banking organization that controls the covered IHC subsequently indicates that its planned resolution strategy for the foreign banking organization does involve the covered IHC or its subsidiaries being separately resolved in the United States, the covered IHC would cease to be a non-resolution entity one year after the Board provides the covered IHC with notice of the change.

[66] The risk-weighted assets component of the internal TLAC requirement would be phased in as follows: It would be equal to 14 percent of the covered IHC's risk-weighted assets beginning on January 1, 2019, and would be equal to 16 percent of the covered IHC's risk-weighted assets beginning on January 1, 2022.

[67] Under the IHC rule, U.S. intermediate holding companies with total consolidated assets of $250 billion or more or on-balance sheet foreign exposure equal to $10 billion or more are required to meet a minimum supplementary leverage ratio of 3 percent. 12 CFR 252.153(e)(2); 79 FR 17329 (March 27, 2014).

[68] The final rule imposes the same leverage capital requirements on U.S. intermediate holding companies as it does on U.S. bank holding companies. 12 CFR 252.153(e)(2); 79 FR 17329 (March 27, 2014). These leverage capital requirements include the generally-applicable leverage ratio and the supplementary leverage ratio for U.S. intermediate holding companies that meet the scope of application for that ratio.

[69] The risk-weighted assets component of the internal TLAC requirement for covered IHCs of MPOE firms would be phased in as follows: It would be equal to 16 percent of the covered IHC's risk-weighted assets beginning on January 1, 2019, and would be equal to 18 percent of the covered IHC's risk-weighted assets beginning on January 1, 2022.

external TLAC requirement in recognition of the fact that covered IHCs are not U.S. GSIBs and so would not be subject to the enhanced supplementary leverage ratio that applies to U.S. GSIBs. Finally, because some covered IHCs may not be subject to the supplementary leverage ratio, a third component based on the U.S. tier 1 leverage ratio was added to the internal LTD requirement. The proposed calibration of this component is consistent with the proposed calibration of the supplementary leverage ratio component.[70]

Covered IHCs that are non-resolution entities would be subject to a slightly lower internal TLAC requirement. Most foreign GSIBs are expected to be resolved by their home jurisdiction resolution authorities through an SPOE resolution and are therefore expected to be non-resolution entities under the proposal. Were such an SPOE resolution to succeed, the covered IHC would avoid entering resolution and would continue as a going concern, with its eligible internal TLAC and eligible internal LTD used to pass up the covered IHC's going-concern losses to the parent foreign GSIB, to the extent necessary. However, the Board also recognizes the need to plan for the contingency in which the covered IHC enters a U.S. resolution proceeding. The proposed calibration for such a covered IHC is based on the desirability of providing support for the preferred SPOE resolution of the foreign GSIB, which requires that the foreign GSIB be allowed to have some internal loss-absorbing capacity at the parent level that can be freely allocated to whichever subsidiaries have incurred the greatest losses (including non-U.S. subsidiaries), balanced with the need to ensure that sufficient loss-absorbing capacity is prepositioned with the covered IHC to ensure that it can be kept operating as a going concern or subjected to an orderly resolution in the United States if the foreign GSIB is not subjected to an SPOE resolution.

By contrast, covered IHCs that are not designated as non-resolution entities are more analogous to covered BHCs, which are themselves resolution entities. For these covered IHCs, there is no need to apply a diminished eligible internal TLAC requirement in order to support an SPOE resolution of the parent foreign GSIB. These covered IHCs would therefore be subject to eligible internal TLAC requirements in line with the eligible external TLAC requirements that would apply to covered BHCs, as discussed above.

The proposed internal LTD requirements are based on the capital refill framework discussed above with respect to the proposed external LTD requirements. Because covered IHCs are not U.S. GSIBs and are therefore not subject to a GSIB surcharge or to the enhanced supplementary leverage ratio, a covered IHC is subject to a common equity tier 1 capital level of 7 percent of risk-weighted assets (4.5 percent plus a 2.5 percent capital conservation buffer) and, if the supplementary leverage ratio applies to the covered IHC, to a tier 1 capital supplementary leverage ratio requirement of 3 percent of total leverage exposure. Because some covered IHCs may not be subject to the supplementary leverage ratio, a third component based on the U.S. tier 1 leverage ratio was added to the internal LTD requirement. The applicable requirement under that leverage ratio is 4 percent of on-balance sheet assets. The calibration of the proposed internal LTD requirements derives from the application of the capital refill framework described above to these requirements.

Question 28: The Board invites comment on all aspects of the proposed calibration of the internal TLAC and LTD requirements, including any impact on the internal funding structures of the covered IHC's parent foreign bank.

Question 29: The Board invites comment on its proposed method for identifying covered IHCs that are non-resolution entities.

Question 30: The Board invites comment on whether, instead of being subject to differing internal TLAC requirements on the basis of whether or not they are non-resolution entities, all covered IHCs should be subject to either the lower proposed internal TLAC requirement or to the higher proposed internal TLAC requirement.

Question 31: The Board invites comment on whether to eliminate the proposed internal TLAC requirement and subject covered IHCs to the proposed internal LTD requirement only.

C. Core Features of Eligible Internal TLAC (Section 252.164 of the Proposed Rule)

The definition of eligible internal TLAC is similar to the definition of eligible external TLAC. A covered IHC's eligible internal TLAC would be defined to be the sum of (a) the tier 1 regulatory capital (common equity tier 1 capital and additional tier 1 capital) issued from the covered IHC to a foreign entity that directly or indirectly controls the covered IHC (''foreign parent entity'') and (b) the covered IHC's eligible internal LTD, as defined below.[71] Similar to the definition of eligible external TLAC, tier 2 capital that meets the definition of eligible internal LTD would count toward the internal TLAC requirement.

The rationale for the requirement that regulatory capital be issued directly by the covered IHC, rather than by a subsidiary of the IHC, in order to count as eligible internal TLAC is identical to the rationale for the analogous requirement for eligible external TLAC: To ensure that the required quantity of loss-absorbing capacity will be available to absorb losses incurred anywhere by any subsidiary of the IHC. Regulatory capital that is issued by one subsidiary of the covered IHC would not necessarily be available to absorb losses incurred by another subsidiary.

Regulatory capital must meet one additional requirements in order to count as eligible internal TLAC: It must be issued to a foreign parent entity of the covered IHC. The requirement of issuance to a foreign parent, rather than to a U.S. affiliate or to third parties, would ensure that losses incurred by the U.S. intermediate holding company of a foreign GSIB would be upstreamed to a foreign parent rather than being transferred to other U.S. entities. This requirement would minimize the risk that such losses pose to the financial stability of the United States, regardless of whether the covered IHC enters a resolution proceeding.

The requirement of issuance to a foreign parent that controls the covered IHC, rather than to another foreign entity within the foreign GSIB or to a third party, would prevent the conversion of eligible internal TLAC into equity from effecting a change in

[70] Generally, a bank holding company is subject to a 4 percent on-balance sheet leverage ratio requirement and a 3 percent supplementary leverage ratio requirement (if the supplementary leverage ratio applies to the bank holding company). The proposed calibration of the on-balance sheet leverage ratio component of the proposed internal TLAC requirement, 8 percent, is twice the 4 percent requirement because the proposed calibration of the supplementary leverage ratio requirement, 6 percent, is twice the 3 percent requirement. The aim was to ensure that covered IHCs that are not subject to the supplementary leverage ratio would be subject to a roughly analogous component under the internal TLAC requirement.

[71] Although eligible internal LTD with a remaining maturity between one and two years would be subject to a 50 percent haircut for purposes of the internal LTD requirement, such eligible internal LTD would continue to count at full value for purposes of the internal TLAC requirement. As discussed below, eligible internal LTD with a remaining maturity of less than one year would not count toward either the internal TLAC requirement or the internal LTD requirement.

control over the covered IHC. A change in control could create additional and undesirable regulatory and management complexity during a failure scenario and would severely disrupt an SPOE resolution strategy.

Question 32: The Board invites comment on all aspects of the proposed definition of eligible internal TLAC.

Question 33: Should eligible internal LTD with a remaining maturity between one and two years be subject to a 50 percent haircut for purposes of the internal TLAC requirement, by analogy to the treatment of such eligible internal LTD for purposes of the internal LTD requirement?

D. Internal TLAC Buffer

An internal TLAC buffer would apply in addition to the risk-weighted assets component of the internal TLAC requirement. The internal TLAC buffer would be generally analogous to the proposed external TLAC buffer described above, although the internal TLAC buffer would not include a GSIB surcharge component because covered IHCs are not subject to the GSIB surcharge rule. A covered IHC's internal TLAC buffer would thus be equal to the sum of 2.5 percent plus any applicable countercyclical capital buffer.

The internal TLAC buffer would be required to be filled solely with common equity tier 1 capital, and a covered IHC's breach of its internal TLAC buffer would subject it to limits on capital distributions and discretionary bonus payments in accordance with Table 2. Thus, the internal TLAC buffer would be analogous to the capital conservation buffer applicable under the Board's Regulation Q, except that it would apply in addition to the internal TLAC requirement rather than in addition to minimum risk-based capital requirements under Regulation Q.

As discussed above with respect to the external TLAC buffer, a covered IHC that already meets the applicable capital requirements and the existing capital conservation buffer would not need to increase its common equity tier 1 capital to meet its internal TLAC requirement and its internal TLAC buffer.

TABLE 2—CALCULATION OF MAXIMUM INTERNAL TLAC PAYOUT AMOUNT

Internal TLAC buffer level	Maximum internal TLAC payout ratio (as a percentage of eligible retained income)
Greater than the internal TLAC buffer	No payout ratio limitation applies.
Less than or equal to the internal TLAC buffer, *and* greater than 75 percent of the internal TLAC buffer.	60 percent.
Less than or equal to 75 percent of the internal TLAC buffer, *and* greater than 50 percent of the internal TLAC buffer.	40 percent.
Less than or equal to 50 percent of the internal TLAC buffer, *and* greater than 25 percent of the internal TLAC buffer.	20 percent.
Less than or equal to 25 percent of the internal TLAC buffer	0 percent.

E. Core Features of Eligible Internal LTD (Section 252.161 of the Proposed Rule)

A covered IHC's eligible internal LTD would generally be subject to the same requirements as would apply to eligible external LTD: It would be required to be debt that is paid in and issued directly from the covered IHC, is unsecured, has a maturity of greater than one year from the date of issuance, is ''plain vanilla,'' and is governed by U.S. law. Eligible internal LTD with a remaining maturity of between one and two years would be subject to a 50 percent haircut for purposes of the internal LTD requirement, and eligible internal LTD with a remaining maturity of less than one year would not count toward the internal LTD requirement. The proposal would treat an instrument that could become subject to a put right in the future as if the first day on which the put right could be exercised were the instrument's stated maturity date. The rationales for these proposed provisions are generally the same as the rationales for the identical provisions in the context of eligible external LTD, which are discussed above.[72]

However, several additional requirements would apply to eligible internal LTD. Eligible internal LTD would be required to be issued to a foreign parent entity of the covered IHC, to be contractually subordinated to all third-party liabilities of the covered IHC, and to include a contractual trigger pursuant to which the Board could require the covered IHC to cancel the eligible internal LTD or convert or exchange it into tier 1 common equity on a going-concern basis under certain specified conditions.

Question 34: The Board invites comment on the appropriateness of subjecting eligible internal LTD to the same requirements as apply to eligible external LTD.

Question 35: The Board invites comment on the requirement that eligible internal LTD instruments be governed by U.S. law. Is this requirement adequate to ensure that losses can be imposed on such instruments under the U.S. Bankruptcy Code or Title II without undue legal risk? Are additional requirements appropriate? In particular, would a requirement that such instruments be subject to the contract law of one or more States be appropriate? Is it appropriate to permit such instruments to be governed by non-U.S. laws in any respects?

1. Issuance to a Foreign Parent Entity That Controls the Covered IHC

Eligible internal LTD would be required to be paid in and issued to a foreign parent entity that controls the covered IHC. The rationale for this requirement is the same as the rationale for the identical requirement with respect to regulatory capital that counts as eligible internal TLAC, which is discussed above.

Question 36: The Board invites comment on all aspects of the requirement that eligible internal LTD be issued to a foreign parent entity that controls the covered IHC. In particular, the Board invites comment with respect to whether covered IHCs that are expected to enter resolution themselves in a failure scenario should be permitted to issue eligible internal LTD to third parties, as covered BHCs would. Should internal LTD be required to be issued to the top-tier foreign parent of the covered IHC?

2. Contractual Subordination

Eligible internal LTD would be required to be contractually

[72] In addition, the proposal requires that eligible internal LTD be governed by U.S. law in order to clarify that the conversion, exchange, and cancellation provisions of these instruments, which would be held by foreign companies, are enforceable under U.S. law.

subordinated to all third-party liabilities of the covered IHC, with the exception of liabilities that are related to eligible internal TLAC. The exception for liabilities that are related to eligible internal TLAC applies to instruments that were eligible internal TLAC when issued and have ceased to be eligible solely because their remaining maturity is less than one year, because they have become subject to a put right, or because they could become subject to a put right within one year, as well as to payables (such as dividend- or interest-related payables) that are associated with such liabilities.

The proposed contractual subordination requirement would ensure that the foreign parent generally would absorb the covered IHC's losses ahead of the third-party creditors and counterparties of the covered IHC and its subsidiaries. Such a requirement should reduce the risk of third-party challenges to the recapitalization of the covered IHC and reduce the risk that a change in control could result from the recapitalization of the covered IHC. Both legal challenges to the recapitalization and a change in control over the covered IHC could create obstacles to an orderly resolution.

This requirement is more stringent than the requirements for eligible external LTD, which is allowed to be senior unsecured debt and to be senior to a limited amount of a capped amount of liabilities of the covered BHC that do not count as eligible external LTD. The Board is proposing to apply this more stringent requirement to eligible internal LTD because the costs of doing so are likely to be less than the costs of imposing an identical requirement on eligible external LTD and are likely to be outweighed by the benefits described above. In particular, the cost of imposing this contractual subordination requirement on covered IHCs should be substantially lower than the cost of imposing the same requirement on covered BHCs because a covered BHC must issue its long-term debt to third-party market participants, some of which do not invest in contractually subordinated debt instruments, whereas a covered IHC would issue its long-term debt to a parent entity in an internal transaction.[73]

Question 37: The Board invites comment on the appropriateness of the proposed contractual subordination requirement for eligible internal LTD.

3. Contractual Conversion Trigger

Eligible internal LTD would be required to include a contractual trigger pursuant to which the Board could require the covered IHC to cancel the eligible internal LTD or convert or exchange it into tier 1 common equity on a going-concern basis (that is, without the covered IHC's entry into a resolution proceeding) if: (a) the Board determines that the covered IHC is ''in default or in danger of default''; [74] and (b) any of the following circumstances apply (i) the top-tier foreign banking organization or any subsidiary outside of the United States is placed into resolution proceedings, (ii) the home country supervisory authority consents to the cancellation, exchange, or conversion, or does not object to the cancellation, exchange, or conversion following 48 hours' notice, or (iii) the Board has made a written recommendation to the Secretary of the Treasury that the FDIC should be appointed as receiver of the covered IHC under Title II.[75] The terms in the debt instrument would have to be approved by the Board.

The principal purpose of this requirement is to ensure that losses incurred by the covered IHC are shifted to a foreign parent without the covered IHC's having to enter a resolution proceeding. If the covered IHC's eligible internal LTD is sufficient to recapitalize the covered IHC in light of the losses that the covered IHC has incurred, this goal could be achieved through conversion of the eligible internal LTD into equity upon the occurrence of the trigger conditions. The covered IHC's entry into a resolution proceeding could pose a risk to the financial stability of the United States, and so avoiding the need for such a resolution proceeding would advance the Dodd-Frank Act's goal of ''mitigat[ing] risks to the financial stability of the United States that could arise from the material financial distress'' of the covered IHC.[76]

The proposed trigger conditions represent a compromise between the interests of home and host regulators. From the perspective of a host regulator, it is desirable to have the power to impose losses on eligible internal LTD quickly and easily upon a determination that the hosted subsidiary is in danger of default, in order to remove those losses from the host jurisdiction's financial system and thereby promote financial stability in the host jurisdiction. The proposed trigger conditions advance this interest by giving the Board the power to do so upon a determination that the covered IHC is in danger of default where the home jurisdiction supervisory authority either consents or fails to object within 48 hours or where the home jurisdiction resolution authority has placed the parent foreign banking organization into resolution proceedings. At the same time, from the perspective of a home regulator, it is desirable that host regulators not impose losses on the top-tier parent entity except where doing so is appropriate to prevent the failure of the hosted subsidiary, since doing so drains loss-absorbing capacity from the top-tier parent entity that may be needed to support other subsidiaries in the home jurisdiction or in another host jurisdiction. The proposed trigger conditions advance this interest by giving the home jurisdiction supervisory authority the right to object to the triggering decision within 48 hours, except where the home jurisdiction resolution authority has placed the parent foreign banking entity into resolution proceedings. The United States is home to numerous U.S. GSIBs and also hosts substantial operations of numerous foreign GSIBs, making both considerations relevant to U.S. interests. U.S. financial regulatory agencies are discussing the application of similar standards by foreign regulatory authorities in jurisdictions that host the operations of U.S. GSIBs.

Question 38: The Board invites comment on all aspects of the contractual conversion trigger requirement, including the appropriateness of the requirement for foreign GSIBs with SPOE and MPOE resolution strategies, whether an alternative to the ''in default or in danger of default'' standard would be more appropriate, and any legal risks associated with the Board's conversion of eligible internal LTD into equity in order to recapitalize the covered IHC.

[73] While the Board does not propose to subject covered BHCs to this contractual subordination requirement, it does propose to impose a cap on the value of a covered BHC's non-eligible external LTD-related liabilities that can be pari passu with or junior to its eligible long-term debt. This aspect of the proposal is discussed below.

[74] The phrase ''in default or in danger of default'' would be defined consistently with the standard provided by section 203(c)(4) of Title II of the Dodd-Frank Act. *See* 12 U.S.C. 5383. Consistent with section 203's definition of the phrase, a covered IHC would be considered to be in default or in danger of default upon a determination by the Board that (A) a case has been, or likely will promptly be, commenced with respect to the [covered IHC] under the U.S. Bankruptcy Code; (B) the covered IHC has incurred, or is likely to incur, losses that will deplete all or substantially all of its capital, and there is no reasonable prospect for the company to avoid such depletion; (C) the assets of the [covered IHC] are, or are likely to be, less than its obligations to creditors and others; or (D) the [covered IHC] is, or is likely to be, unable to pay its obligations (other than those subject to a bona fide dispute) in the normal course of business.

[75] *See* 12 U.S.C. 5383.

[76] 12 U.S.C. 5365(a)(1).

Question 39: The Board invites comment on its proposed method to identify the home jurisdiction supervisory authority of a foreign GSIB for purposes of issuing an internal debt conversion order.

Question 40: The Board invites comment on whether the conversion condition that refers to the placement of a foreign banking organization that controls the covered IHC or any subsidiary of the top-tier-foreign banking organization being placed into resolution in its home country is appropriate in scope.

IV. Clean Holding Company Requirements (sections 252.64 and 252.165 of the proposed rule)

To further facilitate the resolution of a covered BHC, a covered IHC, or a foreign parent entity of a covered IHC, the Board proposes to prohibit both covered BHCs and covered IHCs (together, ''covered holding companies'') from engaging in certain classes of transactions that could pose an obstacle to the orderly SPOE resolution of a covered holding company or increase the risk that financial market contagion would result from the resolution of a covered holding company.

In particular, the Board proposes to prohibit covered holding companies from having outstanding liabilities in the following categories: Third-party debt instruments with an original maturity of less than one year, including deposits (''short-term debt''); qualified financial contracts with a third party (''third-party QFCs''); guarantees of a subsidiary's liabilities if the covered holding company's insolvency or entry into a resolution proceeding would create default rights for a counterparty of the subsidiary; and liabilities that are guaranteed by a subsidiary of the covered holding company (''upstream guarantees'') or are subject to rights that would allow a third party to offset its debt to a subsidiary upon the covered holding company's default on an obligation owed to the third party.

Additionally, the Board proposes to cap the total value of each covered BHC's non-TLAC-related third-party liabilities that are either pari passu with or subordinated to any eligible external TLAC to 5 percent of the value of the covered BHC's eligible external TLAC. (As discussed above, the Board proposes to prohibit covered IHCs from having any non-TLAC-related third-party liabilities that are pari passu with or subordinated to eligible internal LTD by requiring that eligible internal LTD be contractually subordinated to all third-party debt claims. Therefore, the proposed cap is not relevant to covered IHCs.)

The proposed prohibitions and cap would apply only to the corporate practices and liabilities of the covered holding company itself. They would not directly restrict the corporate practices and liabilities of the subsidiaries of the covered holding company.

These proposed clean holding company provisions would advance three related goals of SPOE resolution. First, a successful SPOE resolution proceeding requires the ability to impose losses on the creditors of the covered holding company without causing material disruption to the financial system. The proposed clean holding company restrictions would advance this goal by minimizing the risk of short-term funding runs, asset firesales, and severe losses to other large financial firms that might otherwise be associated with an SPOE resolution of a covered holding company.

Second, the clean holding company provisions would limit the extent to which the subsidiaries of a covered holding company would experience losses as a result of the failure of the covered holding company. In particular, the prohibition on holding company liabilities that are subject to upstream guarantees or offset rights would prevent a failed covered holding company's creditors from passing their losses on to the covered holding company's subsidiaries. This would serve SPOE resolution's goal of ensuring that the failed holding company's operating subsidiaries are able to continue their normal operations throughout the resolution of the failed holding company by protecting those subsidiaries from losses that might threaten their viability.

Third, SPOE resolution seeks to achieve the rapid recapitalization of the material subsidiaries of a covered holding company with minimal interruption to the ordinary operations of those subsidiaries. An entity's complexity can pose a major obstacle to rapid and orderly resolution. Limitations on the types of transactions that a covered holding company may enter into serve to limit its legal and operational complexity and thereby facilitate a prompt resolution and recapitalization with minimal uncertainty and delay.

The proposed clean holding company provisions would also enhance the overall resiliency of covered holding companies by removing complexity from their balance sheets and limiting their reliance on short-term funding.

A. Third-Party Short-Term Debt Instruments (Sections 252.64(a)(1) and 252.165(a) of the Proposed Rule)

The Board proposes to prohibit covered holding companies from issuing debt instruments with an original maturity of less than one year to a third party (as opposed to an affiliate of the covered holding company). Such a liability would be considered to have an original maturity of less than one year if it would provide the creditor with the option to receive repayment within one year of the creation of the liability, or if it would create such an option or an automatic obligation to pay upon the occurrence of an event that could occur within one year of the creation of the liability (other than an event related to the covered holding company's insolvency). The proposed prohibition would also cover short-term and demand deposits at the covered holding company.[77]

One objective of SPOE resolution is to mitigate the risk of destabilizing funding runs. A funding run occurs when the short-term creditors of a financial company observe stress at that institution and seek to minimize their exposures to it by refusing to roll over its debts. The resulting liquidity stress can hasten the company's failure, including by forcing it to engage in asset firesales to come up with the liquidity to pay the short-term creditors. Because they reduce the value of similar assets held by other firms, asset firesales are a key channel for the propagation of stress throughout the financial system. The short-term creditors of a failing GSIB may also run on other counterparties that are similar to the failing firm in certain respects, weakening those firms and forcing further firesales. And depositors, who generally have the ability to demand their funds on short notice, present analogous issues.

The Board's proposal seeks to mitigate these risks in two complementary ways. First, although the operating subsidiaries of covered holding companies rely on short-term funding, in an SPOE resolution, their short-term creditors would not bear losses incurred by the subsidiaries because those losses would instead be borne by the external TLAC holders of the covered holding company. To the extent that market participants view SPOE resolution as workable, the subsidiaries' short-term creditors should have reduced incentives to run because their direct counterparty will not default in such a resolution. Second, the covered holding

[77] For purposes of the proposal, deposits would include those that are captured in line item 11 of schedule PC of FR Y–9LP.

companies themselves—which would (or, in the case of a covered IHC, might) enter into resolution and default on certain of their debts in a failure scenario—would be prohibited from relying on short-term funding, reducing the run risk associated with the failure of such an entity. This is a particularly important objective in light of the likely liquidity needs of a GSIB during SPOE resolution, because a short-term funding run on a covered holding company would drain liquidity that might be needed to support the group's operating subsidiaries.

The proposed prohibition applies to both secured and unsecured short-term borrowings. Although secured creditors are less likely to take losses in resolution than unsecured creditors, secured creditors may nonetheless be unwilling to maintain their exposures to a covered holding company that comes under stress. In particular, if the covered holding company were to enter into a resolution proceeding, the collateral used to secure the debt would be subject to a stay, preventing the creditor from liquidating it immediately. (Qualified financial contracts, which are not subject to a stay under the U.S. Bankruptcy Code but which present other potential difficulties for SPOE resolution, are discussed below.) The creditor would therefore face two risks: The risk that the value of the collateral would decline before it could be liquidated and the liquidity risk attributable to the fact that the creditor would be stayed from liquidating the collateral for some time. Knowing this, secured short-term creditors may well decide to withdraw funding from a covered holding company that comes under stress.

Additionally, many short-term lenders to GSIBs are themselves maturity-transforming financial firms that are vulnerable to runs (for instance, money market mutual funds). If such firms incur losses, then they may be unable to meet their obligations to their own investors and counterparties, which would cause further losses throughout the financial system. Because SPOE resolution relies on imposing losses on the covered holding company's creditors while protecting the creditors and counterparties of its material operating subsidiaries, it is desirable that the holding company's creditors be limited to those entities that can be exposed to losses without materially affecting financial stability. This proposal seeks to further enhance the credibility of the SPOE approach by removing undue complexity from the resolution of a covered holding company.

Finally, the proposed prohibition on short-term debt instruments would promote the resiliency of covered holding companies as well as their resolvability. As discussed above, reliance on short-term funding creates the risk of a short-term funding run that could destabilize the covered holding company by draining its liquidity and forcing it to engage in capital-depleting asset firesales. The increase in covered holding company resiliency yielded by the proposed prohibition provides a secondary justification for the proposal.

Question 41: The Board invites comment on whether the proposed prohibition would advance SPOE resolution by helping to minimize the run risk and potential negative externalities associated with issuance of short-term debt by covered holding companies. In particular, the Board invites comment on the appropriate scope of the proposed prohibition and whether the prohibition is sufficiently clear.

Question 42: The Board invites comment on whether the purpose of the proposed prohibition would be served by a further requirement that covered holding companies not redeem or buy back their liabilities without prior regulatory approval, to prevent covered holding companies from doing so to preserve their franchise in response to creditor requests, which could hasten a failure by draining liquidity or requiring asset firesales.

Question 43: The Board invites comment on the appropriate treatment of pre-existing notes that would require redemption or create a put right upon the occurrence of an event that could (but might not) occur within one year of issuance.

B. Qualified Financial Contracts with Third Parties (Sections 252.64(a)(3) and 252.165(c) of the Proposed Rule)

Under the proposal, covered BHCs could only enter into qualified financial contracts (QFCs) with their subsidiaries and covered IHCs could only enter into QFCs with their affiliates. The proposal defines QFCs by reference to Title II of the Dodd-Frank Act, which defines QFCs to include securities contracts, commodities contracts, forward contracts, repurchase agreements, and swap agreements.[78]

The failure of a large financial organization that is a party to a material amount of third-party QFCs could pose a substantial risk to the stability of the financial system. Specifically, it is likely that many of that institution's QFC counterparties would respond to the institution's default by immediately liquidating their collateral and seeking replacement trades with other dealers, which could cause firesale effects and propagate financial stress to other firms that hold similar assets by depressing asset prices.

The proposed restriction on third-party QFCs would mitigate this threat to financial stability by two means. First, covered holding companies' operating subsidiaries, which are parties to large quantities of QFCs, should remain solvent and not fail to meet any ordinary course payment or delivery obligations during a successful SPOE resolution. Therefore, assuming that the cross-default provisions of the QFCs engaged in by the operating subsidiaries of covered holding companies are appropriately structured, their QFC counterparties generally would have no contractual right to terminate or liquidate collateral on the basis of the covered holding company's entry into resolution proceedings.[79] Second, the covered holding companies themselves would have no QFCs with external counterparties, and so their entry into resolution proceedings would not result in QFC terminations and related firesales. The proposed restriction on third-party QFCs would therefore materially diminish the firesale risk and contagion effects associated with the failure of a covered holding company.

Question 44: The Board invites comment with respect to whether the prohibition on third-party QFCs should be subject to an exception for derivatives contracts that are intended to hedge the exposures of the covered holding company and, if so, the appropriate scope of any such exception. The Board also invites comment on whether the definition of ''qualified financial contracts'' provides an appropriate scope for this prohibition and, in particular, whether the scope should be narrowed to permit covered holding companies to enter into certain third-party QFCs or broadened to prohibit additional classes of transactions.

Question 45: The Board invites comment on the appropriate treatment of pre-existing third-party QFCs, some of which may be long-dated. Should some or all pre-existing third-party QFCs be included in the proposed restriction? Commenters are invited to provide information on the characteristics of existing third-party QFCs to which a covered holding company is a party.

[78] 12 U.S.C. 5390(c)(8)(D).

[79] *See* International Swaps and Derivatives Association's (''ISDA'') 2014 Resolution Stay Protocol (November 4, 2014).

C. Guarantees that Are Subject to Cross-Defaults (Sections 252.64(a)(4) and 252.165(d) of the Proposed Rule)

The proposal would prohibit a covered holding company from guaranteeing (including by providing credit support) with respect to any liability between a direct or indirect subsidiary of the covered holding company and an external counterparty if the covered holding company's insolvency or entry into resolution (other than resolution under Title II of the Dodd-Frank Act) would directly or indirectly provide the subsidiary's counterparty with a default right.[80] Guarantees by covered holding companies of liabilities that are not subject to such cross-default rights would be unaffected by the proposal.

The proposed prohibition would advance the key SPOE resolution goal of ensuring that a covered holding company's subsidiaries would continue to operate normally upon the covered holding company's entry into resolution. This goal would be jeopardized if the covered holding company's entry into resolution or insolvency operated as a default by the subsidiary and empowered the subsidiary's counterparties to take default-related actions, such as ceasing to perform under the contract or liquidating collateral. Were the counterparty to take such actions, the subsidiary could face liquidity, reputational, or other stress that could undermine its ability to continue operating normally, for instance by prompting a short-term funding run on the subsidiary. The proposed prohibition would be a complement to other work that has been done or is underway to facilitate SPOE resolution through the stay of cross-defaults, including the ISDA 2014 Resolution Stay Protocol.[81]

Question 46: The Board invites comment on the appropriate definition of ''default right'' in the proposed regulations, and on whether the definition of this term should specifically exclude contracts that provide for termination on demand. The Board also invites comment on whether, for the purposes of this proposal, contractual provisions that require the parties to negotiate new terms (*e.g., Annex III (Term Loans) of the Global Master Securities Lending Agreement) should be treated the same as a right to terminate on demand.*

Question 47: The Board invites comment on whether a covered holding company should be permitted to guarantee the liabilities of its subsidiaries if such liabilities permit a person to terminate the contract on demand or at its option at a specified time, or from time to time, without the need to show cause. Should a covered holding company be permitted to guarantee any particular class or classes of liabilities of its subsidiaries that include such provisions?

Question 48: The Board invites comment on whether a covered IHC should be permitted to guarantee liabilities of affiliates of the covered IHC that are not subsidiaries of the *covered IHC, and whether any prohibition should distinguish between the foreign banking organization's non-U.S. operations and its U.S. branches and agencies.*

Question 49: The Board invites comment on whether additional limitations or exceptions for guarantees by covered holding companies are necessary or appropriate.

D. Upstream Guarantees and Offset Rights (Sections 252.64(a)(2), (5) and 252.165(b)(e) of the Proposed Rule)

The Board proposes to prohibit covered holding companies from having outstanding liabilities that are subject to a guarantee from any direct or indirect subsidiary of the holding company. SPOE resolution relies on imposing all losses incurred by the group on the covered holding company's eligible external TLAC holders while ensuring that its operating subsidiaries continue to operate normally. This arrangement could be undermined if a liability of the covered holding company is subject to an upstream guarantee, because the effect of such a guarantee is to subject the guaranteeing subsidiary (and, ultimately, its creditors) to the losses that would otherwise be imposed on the holding company's creditors. A prohibition on upstream guarantees would facilitate the SPOE resolution strategy by increasing the certainty that the covered holding company's eligible external TLAC holders will be exposed to loss ahead of the creditors of its subsidiaries.

Upstream guarantees do not appear to be common among covered holding companies. Section 23A of the Federal Reserve Act already limits the ability of a U.S. insured depository institution to issue guarantees on behalf of its parent holding company.[82] The principal effect of the proposed prohibition would therefore be to prevent the future issuance of such guarantees by material non-bank subsidiaries.

For analogous reasons, the Board also proposes to prohibit covered holding companies from issuing an instrument if the holder of the instrument has a contractual right to offset its or its affiliates' liabilities to the covered holding company's subsidiaries against the covered holding company's liability under the instrument.[83] The prohibition would include all such offset rights regardless of whether the right is provided in the instrument itself. Such offset rights are another device by which losses that should flow to the covered holding company's external TLAC holders in an SPOE resolution could instead be imposed on operating subsidiaries and their creditors.

Question 50: The Board invites comment on the appropriate scope of the ''upstream guarantee'' prohibition and on whether any exceptions to the proposed prohibition on such guarantees are necessary or appropriate. The Board also invites comment on the appropriate scope of the offset rights prohibition, including whether the proposed prohibition is adequate to achieve the goals expressed above. For example, should this provision be limited to debt instruments that provide contractual offset rights? The Board invites comment with respect to whether any exceptions or limitations to the proposed restrictions on such rights, such as a limitation of the restriction to eligible external TLAC instruments, are necessary or appropriate.

Question 51: The Board invites comment on the types of instruments that provide contractual offset rights and the amount of such instruments issued by covered BHCs.

Question 52: The Board invites comment on whether arrangements other than upstream guarantees and offset rights could also have the effect of forcing the creditors of material operating subsidiaries to take losses before holding company creditors (for instance, a subsidiary's entry into a credit default swap referencing the debt of the covered holding company) and, if so, whether they should also be restricted by regulation. Finally, the Board invites comment on whether the prohibition should be limited to certain material operating subsidiaries rather than covering all subsidiaries of a covered holding company and, if so, the

[80] The proposal defines the term ''default right'' broadly.

[81] *See* ISDA 2014 Resolution Stay Protocol.

[82] Transactions subject to the quantitative limits of section 23A of the Federal Reserve Act and Regulation W include guarantees issued by a bank on behalf of an affiliate. *See* 12 U.S.C. 371c(b)(7); 12 CFR 223.3(h).

[83] The prohibition for covered IHCs also would include contractual rights to offset against the covered IHC because the covered IHC itself may not enter resolution or insolvency proceedings.

appropriate scope of the limitation on the types of subsidiaries.

E. Cap on Other Third-Party Liabilities (section 252.64(b) of the proposed rule)

Finally, the Board proposes to limit the total value of certain other liabilities of covered BHCs that could create obstacles to orderly resolution to 5 percent of the value of the covered BHC's eligible external TLAC. The cap would apply to non-contingent liabilities to third parties (*i.e.,* persons that are not affiliates of the covered BHC) that would rank either pari passu with or junior to the covered BHC's eligible LTD in the priority scheme of either the U.S. Bankruptcy Code or Title II.[84] The cap would not apply to eligible external TLAC; to instruments that were eligible external TLAC when issued and have ceased to be eligible (because their remaining maturity is less than one year) as long as the holder of the instrument does not have a currently exercisable put right; or to payables (such as dividend- or interest-related payables) that are associated with such liabilities.

Because the Board proposes to require that a covered IHC's eligible internal LTD be contractually subordinated to all of the covered IHC's third-party liabilities, this proposed cap would have no relevance to those firms. The Board accordingly does not propose to apply the cap to covered IHCs.

Liabilities that would be expected to be subject to the cap include debt instruments with derivative-linked features (*i.e.,* structured notes); external vendor and operating liabilities, such as for utilities, rent, fees for services, and obligations to employees; and liabilities arising other than through a contract (*e.g.,* liabilities created by a court judgment).

The liabilities subject to the cap fall into two groups: Those that could be subjected to losses alongside eligible external TLAC without potentially undermining SPOE resolution or financial stability, and those that potentially could not.

The first group includes structured notes. The proposal defines structured notes so as to avoid capturing debt instruments that pay interest based on the performance of a single index but to otherwise capture all debt instruments that have a principal amount, redemption amount, or stated maturity, that is subject to reduction based on the performance of any asset, entity, index, or embedded derivative or similar embedded feature.[85] Such liabilities could be subjected to losses in resolution alongside eligible external TLAC, but the proposal would cap them in light of their greater complexity relative to the plain-vanilla debt that qualifies as external TLAC. In an orderly resolution of a covered BHC, debt instruments that will be subjected to losses should be able to be valued accurately and with minimal risk of dispute. Structured notes contain features that could make their valuation uncertain, volatile, or unduly complex. Additionally, structured notes are often customer products sold to purchasers who are primarily seeking exposure to a particular asset class and not seeking credit exposure to the covered BHC, and the need to impose losses on a financial institution's customers in resolution may create obstacles to orderly resolution. The proposed cap on structured notes would promote the resolvability of covered BHCs by limiting their issuance of instruments that present these issues. The cap would not limit a covered BHC's ability to issue structured notes out of subsidiaries.

The second group includes, for example, vendor liabilities and obligations to employees. Successful resolution may require that the covered BHC continue to perform on certain of its unsecured liabilities in order to ensure that it is not cut off from vital services and resources. If these vital liabilities were pari passu with eligible external LTD, protecting these vital liabilities from loss would entail treating these liabilities differently from eligible external LTD of the same priority, which could present both operational and legal risk. The operational risk flows from the need to identify such liabilities quickly in the context of a complex resolution proceeding, reducing the covered holding company's complexity by capping the amount of these liabilities that it can have outstanding mitigates this risk. The legal risk flows from the no-creditor-worse-off principle, according to which each creditor of a firm that enters resolution is entitled to recover at least as much as it would have if the firm had simply been liquidated under chapter 7 of the U.S. Bankruptcy Code.[86] As creditors of a given priority receive special treatment (that is, as they are paid in full to ensure that the firm maintains access to vital external services and resources), the pool of resources available to other creditors of the same priority shrinks, making it more likely that those creditors will recover less than they would have in liquidation. Thus, imposing a cap on the total value of liabilities that are pari passu with or junior to eligible external TLAC but that might need to receive special treatment in resolution mitigates this no-creditor-worse-off risk.

The rationale for calibrating the proposed cap to 5 percent of a covered BHC's eligible TLAC is as follows. The Board collected data from the U.S. GSIBs and determined that covered BHCs have outstanding certain third-party operational liabilities that may rank pari passu with eligible LTD and that could not be eliminated without substantial cost and complexity. These liabilities include (among other things) tax payables, compensation payables, and accrued benefit plan obligations. For the eight current U.S. GSIBs, the value of these operating liabilities ranges from 1 percent to 4 percent of the sum of the covered BHC's equity and long-term debt, which provides a reasonable proxy for the amount of eligible external TLAC it would have under this proposal. The cap was calibrated to allow these existing operational liabilities while limiting the excessive growth of these and other liabilities at the covered BHC so that the problems discussed in the preceding paragraphs may be avoided. In particular, several covered BHCs may need to limit the value of structured notes that they have outstanding. This result would be consistent with the rationale for the clean holding company requirements because, as noted above, such structured notes are customer liabilities rather than vital operating liabilities and because their presence at the holding company could create undue complexity during resolution.

By subjecting the total value of a covered BHC's liabilities of both types to a single cap, the Board's proposal gives covered BHCs greater discretion to manage their own affairs than would a proposal that applied separate, smaller caps to the two types of liability.

Question 53: The Board invites comment on the appropriate definition of ''structured notes,'' and whether the provisions of the definition are adequate to achieve the goals expressed above. The Board invites comment on use and scope of the term ''assets'' as used in the definition of structured note, and whether a different term would be more appropriate in this context.

[84] *See* 11 U.S.C. 507; 12 U.S.C. 5390(b).

[85] In addition, the definition captures debt instruments that have more than one embedded derivative (or similar embedded feature) or are not treated as debt under generally accepted accounting principles.

[86] *See, e.g.,* 11 U.S.C. 1129(a)(7); 12 U.S.C. 5390(d)(2).

Question 54: Should liabilities subject to the proposed cap on certain third-party liabilities be netted against reserves held with respect to such liabilities for purposes of determining compliance with the proposed cap?

Question 55: The Board invites comment on the appropriate size of the proposed cap. The Board also invites comment as to the appropriate scope of the cap, including the liabilities excluded from the cap and the formulation of the proposed exemption for certain liabilities associated with eligible external TLAC.

Question 56: The Board invites comment regarding whether a grandfather of existing liabilities that would be subject to the proposed cap would be appropriate. In particular, the Board invites comment on the appropriate design of such a grandfather and the likely impact on covered BHCs and debt markets of the failure to include such a grandfather. Please support your response with data.

Question 57: The Board invites comment on the appropriate accounting treatment to be used in determining the total value of the liabilities subject to the cap, including whether and to what extent guarantees by the resolution entity of the liabilities of its subsidiaries should be subject to the cap.

Question 58: The Board invites comment on whether secured liabilities and liabilities that otherwise represent a claim that would be senior to eligible debt securities under bankruptcy proceedings or a Title II resolution should be subject to the limit on unrelated liabilities of the covered BHC.

Question 59: The Board invites comment on what, if any, additional restrictions on corporate practices or operations of covered BHCs would be appropriate.

F. Disclosure Requirements (Section 252.65 of the Proposed Rule)

The Board proposes to require each covered BHC to publicly disclose a description of the financial consequences to unsecured debtholders of the covered BHC's entry into a resolution proceeding in which the covered BHC is the only entity that would enter resolution.

Consistent with the disclosure requirements imposed by the Board's capital regulations, the covered BHC would be permitted to make this disclosure on its Web site or in more than one public financial report or other public regulatory report, provided that the covered BHC publicly provides a summary table specifically indicating the location(s) of this disclosure.[87] Because the disclosure requirement is primarily intended to inform holders of a covered BHC's eligible external LTD that they are subject to loss ahead of other creditors of the covered BHC or its subsidiaries, the proposal would also require the covered BHC to disclose the required information in the offering documents for all of its eligible external LTD.

The Board has long supported meaningful public disclosure by banking organizations, with the objective of improving market discipline and encouraging sound risk-management practices.[88] By helping holders of eligible external LTD and other unsecured debt issued by a covered BHC to understand that they will be allowed to suffer losses in a resolution and generally will absorb losses ahead of the creditors of the covered BHC's subsidiaries, the proposed disclosure requirement should encourage potential investors to carefully assess the covered BHC's risk profile when making investment decisions. This careful assessment should lead to an improvement in the market pricing of the unsecured debt of covered BHCs, including eligible external LTD, providing supervisors and market participants with more accurate market signals about the financial condition and risk profile of the covered BHC.

Question 60: The Board invites comment on the proposed disclosure requirements, including whether additional disclosures would further advance the goals of this proposal. In particular, the Board invites comment on whether a covered BHC should be required to disclose that the public section of its most recent resolution plan is available online.

Question 61: The Board invites comment on whether the proposed methods for a covered BHC to make the required disclosures are appropriate and on whether covered BHCs should be permitted to use additional methods to make the required disclosures.

Question 62: Should the Board require covered BHCs to provide specific disclosure language that is designed to notify potential investors of the resolution-related risks of investing in unsecured debt instruments issued by covered BHCs? If so, what language would be appropriate?

[87] *See* 12 CFR 217.62(a), 12 CFR 217.172(c)(1).

[88] *See, e.g.,* 78 FR 62018, 62128–29 (October 11, 2013).

V. Consideration of Public Reporting Requirements for Eligible External and Internal TLAC and LTD

The Board intends to propose for a comment a requirement that covered BHCs and covered IHCs report publicly their amounts of eligible external TLAC and LTD and eligible internal TLAC and LTD, respectively, on a regular basis. By rendering each covered holding company's loss-absorbing capacity transparent to regulators and market participants, public reporting requirements would promote both supervision and market discipline, which could be expected to disincentivize excessive risk-taking by covered BHCs and covered IHCs and thereby mitigate risks to the financial stability of the United States.

Question 63: The Board invites comment on its plan to propose a reporting requirement for eligible external TLAC and LTD and eligible internal TLAC and LTD.

VI. Consideration of Domestic Internal TLAC Requirement

Under the SPOE resolution strategy, severe losses must be passed up from the operating subsidiaries that initially incur them to the covered holding company, and then on to the eligible external TLAC holders (in the case of a covered BHC) or the foreign parent (in the case of a covered IHC). Both steps are necessary to achieve the key goal of the SPOE resolution strategy: Allowing material operating subsidiaries to continue to operate normally by ensuring that losses that would otherwise fall on their creditors (potentially sparking contagious runs and other generators of financial instability) will instead be borne by the holders of the TLAC issued by the covered holding company. The proposed rule is intended to ensure that covered holding companies issue a sufficient amount of loss-absorbing resources to absorb such losses, but the proposed rule does not ensure that firms have in place adequate mechanisms for transferring severe losses up from their operating subsidiaries to the covered holding company—that is, domestic internal total loss-absorbing capacity (''domestic internal TLAC'').

The Board is therefore considering the costs and benefits of imposing domestic internal TLAC requirements between covered holding companies and their subsidiaries. Such requirements could complement this proposed rule and could enhance the prospects for a successful SPOE resolution of a covered BHC or of the parent foreign GSIB of a covered IHC.

The domestic internal TLAC framework that the Board is considering would require identification of covered holding companies' material operating subsidiaries (''covered subsidiaries''). The framework would then subject each covered holding company to a domestic internal TLAC requirement with respect to each of its covered subsidiaries. The size of the requirement with respect to a given covered subsidiary would depend on the subsidiary's total risk-weighted assets, its total leverage exposure, or both.[89]

Under the framework that the Board is considering, domestic internal TLAC would be divided into two categories: ''contributable resources'' and ''prepositioned resources.'' Contributable resources would be assets that are held by the covered holding company and would enable the covered holding company to make contributions to covered subsidiaries that incur severe losses, which would have the effect of recapitalizing those subsidiaries. The principal benefit of contributable resources is that they avoid the ''misallocation risk'' associated with prepositioned resources: Whereas an investment that has been prepositioned with a particular subsidiary cannot easily be used to recapitalize a different subsidiary that incurs unexpectedly high losses, contributable resources can be flexibly allocated among subsidiaries in light of the losses they suffer. The rationale for requiring that contributable resources be held by the covered holding company (rather than allowing them to be held at its subsidiaries) would be that it could help to avoid operational risks and other potential limitations on the firm's ability to move the assets to the parts of the organization that need them most.

To ensure that the contributable resources would retain sufficient value to recapitalize a subsidiary, including under conditions of severe market stress, a domestic internal TLAC framework could require that the contributable resources requirement be met entirely or substantially with assets that would qualify as high-quality liquid assets (HQLA) under the U.S. liquidity coverage ratio rule.[90] Requiring a firm's contributable resources to be made up of HQLA, rather than a broader set of high-quality assets, would have two further advantages beyond helping to ensure that the assets remain valuable during a stress period. First, the contribution of such assets to a subsidiary would provide the subsidiary with additional liquidity as well as capital. Second, some subsidiaries are subject to limitations on the kinds of assets they are permitted to hold (for example, U.S. banks generally cannot hold equities).[91] If a firm's contributable resources consist of HQLA, then these limitations should not pose an obstacle to recapitalization because the firm will be able to convert the assets into cash and then contribute the cash to its subsidiaries.

Prepositioned resources would be a covered holding company's debt and equity investments in a covered subsidiary (including investments made indirectly through lower-tier parent entities of the covered subsidiary). A covered holding company's equity investment in a subsidiary would transfer losses from the subsidiary to the holding company automatically, while a holding company's debt investment could be used to absorb losses incurred by the subsidiary through forgiveness of the debt, conversion of the debt into equity, or another economically similar procedure. To qualify as prepositioned resources, debt could be required to be unsecured, be plain vanilla, have a remaining maturity of at least one year, and be of lower priority than all third-party claims on the subsidiary. The rationale for these restrictions would be to ensure that the loss-absorbing capacity will indeed be available if and when it is needed, to reduce operational risk by eliminating unnecessary complexity, and to mitigate possible legal risk associated with insolvency law.

Question 64: The Board invites comment on all aspects of this potential domestic internal TLAC framework. In particular, the Board invites comment on whether the Board should impose domestic internal TLAC requirements on covered holding companies. If so, how should the Board regulate the following key elements: The definition of ''covered subsidiary''; the calibration of the domestic internal TLAC requirement with respect to each covered subsidiary; the division of domestic internal TLAC between ''contributable resources'' and ''prepositioned resources''; the definition of ''contributable resources,'' including whether certain non-HQLA resources should be allowed to count toward the requirement; the definition of ''prepositioned resources,'' including any minimum maturity and subordination requirements; and the legal risks associated with passing losses from a subsidiary to a holding company by means of the mechanisms described above in the context of SPOE resolution, including risks under insolvency law, as well as potential mitigants for these risks.

Question 65: The Board also seeks comment on whether, in a domestic internal TLAC framework, contributable resources and prepositioned debt should be required to be subject to a capital contribution agreement that would impose upon the covered holding company a legal obligation to recapitalize the subsidiary upon the occurrence of a trigger outside the firm's discretion (such as the current or projected insolvency of the subsidiary, or a government order), and on the appropriate design of such a trigger. Finally, the Board invites comment on whether any domestic internal TLAC framework proposed by the Board should treat foreign subsidiaries of covered holding companies differently from their domestic subsidiaries.

VII. Regulatory Capital Deduction for Investments in the Unsecured Debt of Covered BHCs

Background

The Board's regulatory capital rules (Regulation Q) impose minimum capital requirements on all state member banks, as well as on certain bank holding companies, and certain savings and loan holding companies (''Board-regulated institutions'').[92] These minimum requirements take the form of minimum ratios of various forms of regulatory capital to different measures of assets.[93] The risk-based ratios are the common equity tier 1 ratio, the tier 1 risk-based capital ratio, and the total risk-based capital ratio.[94] Regulation Q also includes a leverage ratio that measures the proportion of a Board-regulated institution's tier 1 capital to its total

[89] *See generally* 12 CFR 217.10.

[90] 79 FR 61440 (October 10, 2014).

[91] *See* 12 U.S.C. 24(7).

[92] *See* 12 CFR 217.1(c). Savings and loan holding companies that are substantially engaged in insurance underwriting or commercial activities are exempt temporarily from Regulation Q. *See* 12 CFR 217.1(c)(1)(iii); and 12 CFR 217.2, definition of ''Covered savings and loan holding company.'' In addition, any bank holding company that is subject to the Board's Small Bank Holding Company Policy Statement (12 CFR part 225, appendix C) is exempt from Regulation Q. *See* 12 CFR 217.1(c)(1)(ii). In addition, any savings and loan holding company that meets the requirements of the Small Bank Holding Company Policy Statement ''as if the savings and loan holding company were a bank holding company and the savings association were a bank'' is exempt from Regulation Q. *See* 12 CFR 217.1(c)(1)(iii).

At this time, the proposed capital deduction will not apply to nonbank SIFIs. Following the finalization of the regulatory capital framework applicable to one or more nonbank SIFIs, the Board would determine whether, and how, the proposed capital deduction would apply to such companies.

[93] *See* 12 CFR 217.10.

[94] *See* 12 CFR 217.10(a)(1) through (3).

assets.[95] In addition, certain internationally active Board-regulated institutions are subject to a supplementary leverage ratio, which incorporates certain off-balance sheet exposures into the measure of total assets.[96]

In calculating its capital ratios under these rules, a Board-regulated institution is required to deduct fully from regulatory capital certain assets, such as goodwill and other intangible assets.[97] Certain other assets must be deducted from regulatory capital to the extent they exceed a particular threshold, such as mortgage servicing assets and certain deferred tax assets.[98]

The regulatory capital rules include two broad categories of deductions related to investments in capital instruments. First, Regulation Q requires that a Board-regulated institution fully deduct any investment in its own regulatory capital instruments and investments in regulatory capital instruments held reciprocally with another financial institution.[99] Second, Regulation Q requires that a Board-regulated institution deduct investments in capital instruments issued by other financial institutions that would be regulatory capital if issued by the Board-regulated institution.[100] In this second case, a Board-regulated institution may be required to fully deduct the investment or may be required to deduct the investment above a particular threshold, depending on the circumstances.[101] In both cases, the Board-regulated institution is required to make the deduction from the category of regulatory capital for which the instrument qualifies or would qualify if issued by the Board-regulated institution.[102] Thus, a Board-regulated institution that purchases its own subordinated debt instrument that qualifies as tier 2 capital must deduct the debt instrument from its tier 2 capital. Similarly, a Board-regulated institution that owns less than 10 percent of the common equity of an unaffiliated bank must deduct from its common equity the amount, if any, by which the Board-regulated institution's investment exceeds 10 percent of the Board-regulated institution's common equity.

Proposed deductions from regulatory capital

To address the potential contagion stemming from the failure of a GSIB, the proposal would amend Regulation Q to require a Board-regulated institution to deduct from its regulatory capital the amount of any investment in, or exposure to, unsecured debt issued by a covered BHC. In particular, for purposes of the deductions, a Board-regulated institution would be required to treat unsecured debt issued by a covered BHC in a similar manner to an investment in a tier 2 capital instrument.[103] The form and amount of the deduction would depend on the type of investment and various other factors, as described below.

Analysis conducted by Board staff has not indicated that Board-regulated institutions currently own a substantial amount of unsecured debt issued by covered BHCs. The proposed deduction requirement would substantially reduce the incentive of a Board-regulated institution to invest in unsecured debt issued by a covered BHC, thereby increasing the prospects for an orderly resolution of a covered BHC by reducing the risk of contagion spreading to other Board-regulated institutions.

To implement the proposed deduction requirements for investments in covered debt instruments, the proposal would add or amend certain definitions in Regulation Q. The proposal would add new definitions of ''covered debt instrument'' and ''investment in a covered debt instrument'' to § 217.2 of Regulation Q. A ''covered debt instrument'' would be defined as any unsecured debt security issued by a global systemically important BHC, excluding any instrument that qualifies as tier 2 capital. An ''investment in a covered debt instrument'' would be defined as a net long position in a covered debt instrument, including direct, indirect, and synthetic exposures to a covered debt instrument. This definition would exclude underwriting positions held for five or fewer business days for purposes of certain deductions. In addition, the proposal would amend the definitions of ''indirect exposure'' and ''synthetic exposure'' in Regulation Q to add exposures to covered debt instruments. Further, the definition of ''investment in the capital of an unconsolidated financial institution'' would be amended to correct a typographical error.

In addition, as discussed more fully in the following section, the proposal would revise § 217.22(c), (f), and (h) of Regulation Q to incorporate the proposed deductions for investments in covered debt instruments. The proposed revisions to Regulation Q would take effect on January 1, 2019, consistent with the other aspects of the proposal; provided that the proposed correction to the definition of ''investment in the capital of an unconsolidated financial institution'' would take effect on April 1, 2016.

To be most effective, the proposed deduction approach for investments in unsecured debt instruments of a covered BHC would apply to all depository institution holding companies and insured depository institutions covered by the capital rules issued by the Board, OCC, and FDIC. The Board intends to consult with the OCC and FDIC on the proposed deductions for covered debt instruments in Regulation Q regarding consistent treatment among all banking organizations subject to the regulatory capital rules.

Section-by-Section Discussion of the Proposed Deductions for Covered Debt Instruments

Under the Board's current regulatory capital rules, a Board-regulated institution must deduct any investment in its own capital instruments and any investment in the capital of other financial institutions that it holds reciprocally under § 217.22(c)(1) and (3) of Regulation Q.[104] The proposal would amend § 217.22(c)(1) and (3) of Regulation Q to require, respectively, a covered BHC to deduct from its tier 2 capital any investment in its own unsecured debt instruments that are not tier 2 capital and the carrying value of any investment in the unsecured debt issued by a covered BHC that is held reciprocally with the covered BHC.

Under § 217.22(c)(4) and (5) of Regulation Q, a Board-regulated institution must deduct certain investments in the capital of unconsolidated financial institutions.[105] The amount of the deduction depends on whether or not the Board-regulated institution has a ''significant'' investment in the unconsolidated financial institution, with ''significant'' defined as ownership of more than 10

[95] *See* 12 CFR 217.10(a)(4).

[96] *See* 12 CFR 217.10(a)(5).

[97] *See* 12 CFR 217.22.

[98] *Id.*

[99] 12 CFR 217.22(c)(1).

[100] *See* 12 CFR 217.22(c)(2).

[101] *See* 12 CFR 217.22(c)(3) through (5).

[102] *See* 12 CFR 217.22(c)(1) and (2).

[103] Unsecured debt issued by a covered BHC may or may not qualify as tier 2 capital, depending on its characteristics. *See* 12 CFR 217.20(d). Similarly, unsecured debt issued by a covered BHC may or may not qualify as eligible long term debt under this proposal, depending on its characteristics. *See* Proposed 12 CFR 252.61, 252.161.

[104] 12 CFR 217.22(c)(1) and 12 CFR 217.22(c)(3). The definition of ''financial institution'' in the Board's regulatory capital rules includes bank holding companies. Therefore, each covered BHC is a ''financial institution'' for purposes of these deductions. *See* 12 CFR 217.2.

[105] 12 CFR 217.22(c)(4) and (5).

percent of the common stock of the unconsolidated financial institution.[106]

If the Board-regulated institution has a ''non-significant investment'' in an unconsolidated financial institution, the Board-regulated institution must deduct its investments in the capital of the unconsolidated financial institution to the extent that the Board-regulated institution's investment exceeds 10 percent of the Board-regulated institution's common equity tier 1 capital.[107] The proposal would amend § 217.22(c)(4) of Regulation Q to require a Board-regulated institution with a non-significant investment in a covered BHC to deduct any investment in unsecured debt issued by the covered BHC in the same manner as if the unsecured debt were tier 2 capital.

If a Board-regulated institution has a significant investment in an unconsolidated financial institution, the Board-regulated institution must fully deduct under § 217.22(c)(5) of Regulation Q any investment in the capital instruments of the unconsolidated financial institution that are not in the form of common stock.[108] The proposal would amend § 217.22(c)(5) of Regulation Q to require a Board-regulated institution with a significant investment in a covered BHC to deduct any investment in unsecured debt issued by the covered BHC in the same manner as if the unsecured debt were tier 2 capital.

For each of the proposed deductions, the same rules and standards that apply to investments in capital instruments issued by financial institutions would also apply to an investment in a covered debt instrument. For example, the proposal would amend the ''corresponding deduction approach'' in § 217.22(c)(2) of Regulation Q to specify that unsecured debt issued by a covered BHC would be treated as tier 2 capital for purposes of deductions from capital. Under the corresponding deduction approach, a Board-regulated institution must make deductions from the component of capital for which the underlying instrument would qualify if it were issued by the Board-regulated institution making the deduction.[109] If the Board-regulated institution does not have enough of the component of capital to carry out the deduction, the corresponding deduction approach provides that any amount of the investment not already deducted would be deducted from the next higher, that is, more subordinated, component of capital.[110] If the next higher level is insufficient to effect the remaining deduction and there is a higher level of capital, any amount not already deducted is deducted from the highest level.[111]

Under Regulation Q, if a Board-regulated institution has an investment in the tier 2 capital of an unconsolidated financial institution that the Board-regulated institution is required to deduct from capital, the Board-regulated institution must make the deduction from its tier 2 capital. Under the proposal, if a Board-regulated institution has a significant investment in a covered BHC and also owns unsecured debt of the covered BHC, the Board-regulated institution would be required to deduct the unsecured debt amount from its tier 2 capital. If the Board-regulated institution does not have sufficient tier 2 capital to complete this deduction, then the Board-regulated institution would be required to deduct any shortfall amount from its additional tier 1 capital. If the Board-regulated institution does not have sufficient additional tier 1 capital to complete this deduction, the institution would deduct any remaining amount of the investment from its common equity tier 1 capital.

The proposal would follow the same general approach as under the current requirements in Regulation Q regarding the calculation of the amount of any deduction and the treatment of guarantees and indirect investments for purposes of the deductions. Under Regulation Q, the amount of a Board-regulated institution's investment in its own capital instrument or in the capital instrument of an unconsolidated financial institution is the Board-regulated institution's net long position in the capital instrument as calculated under § 217.22(h) of Regulation Q.[112] Under § 217.22(h) of Regulation Q, a Board-regulated institution may net certain gross short positions in a capital instrument against a gross long position in the instrument to determine the net long position. The proposal would modify § 217.22(h) of Regulation Q such that a Board-regulated institution would follow the same procedures to determine its net long position in an exposure to its own covered debt instrument or in a covered debt instrument issued by an unconsolidated financial institution. The calculation of the net long position, under the proposal, also would take into account direct investments in unsecured debt instruments as well as indirect exposures to covered debt instruments held through investment funds in the same manner as under the regulatory capital rules.

With regard to an indirect exposure to a capital instrument in the form of, for example, a direct exposure to an investment fund, a Board-regulated institution has three options under Regulation Q to measure its gross long position in the capital instrument.[113] The proposal would amend § 217.22(h)(2)(ii) of Regulation Q to provide the same three options to determine the gross long position in the form of an indirect fund investment in a covered debt instrument.

The first option would be to deduct the entire carrying value of the investment. The second option would be, with the prior approval of the Board, for the Board-regulated institution to use a conservative estimate of the amount of the investment in the unsecured debt instrument held through a fund. The third option would be to multiply the carrying value of the Board-regulated institution's investment in a fund by either the exact percentage of the unsecured debt issued by a covered BHC held by the investment fund or by the highest stated prospectus limit for such investments held by the investment fund. In each case, the amount of the gross long position may be reduced by the Board-regulated institution's qualified short positions to reach the net long position.[114]

An investment in the unsecured debt of a covered BHC would be defined in § 217.2 of Regulation Q to include synthetic exposures to covered debt instruments, including, for example, the issuance a guarantee of such debt or selling a credit default swap referencing such debt.[115] For purposes of any deduction required for a Board-regulated institution's investment in the capital of an unconsolidated financial institution, the amount of unsecured debt issued by a covered BHC would include any contractual obligations of the Board-regulated institution to purchase such instruments, but would exclude positions held in a bona fide underwriting capacity for five or fewer business days.[116]

Question 66: The Board invites comment on the appropriateness of the proposed deduction for investments in a

[106] 12 CFR 217.2, (''significant investment in the capital of an unconsolidated financial institution'').

[107] *See* 12 CFR 217.22(c)(4).

[108] *See* 12 CFR 217.22(c)(5).

[109] *See* 12 CFR 217.22(c)(2).

[110] *See* 12 CFR 217.22(c)(2); 12 CFR 217.22(f).

[111] *See* 12 CFR 217.22(f).

[112] *See* 12 CFR 217.22(h).

[113] *See* 12 CFR 217.22(h)(2).

[114] 12 CFR 217.22(h)(1).

[115] *See* 12 CFR 217.2 (''investment in the capital of an unconsolidated financial institution'' and ''investment in the Board-regulated institution's own capital instrument'').

[116] *See* 12 CFR 217.2 (''investment in the capital of an unconsolidated financial institution'').

covered BHC's unsecured debt instruments from regulatory capital, including (a) its implementation through amendment of the Board's regulatory capital rules and (b) whether such an approach would impact underwriting and market making for unsecured debt instruments of covered BHCs.

Question 67: The Board invites comment on whether holdings of a covered BHC's debt instruments that result from dealing or market-making activities should be exempt from the proposed deduction, including costs and benefits of such an exemption.

Question 68: The Board invites comment on all aspects of the proposed capital deduction treatment for investments by banking organizations in debt instruments of a covered BHC, specifically, whether the debt instruments required to be deducted should be all unsecured debt directly issued by a covered BHC or only eligible long-term debt? If the long-term debt instruments required to be deducted were limited to eligible long-term debt, how best to identify eligible long-term debt for the purposes of the deduction?

Questions 69: The Board invites comment on alternatives to the proposed deduction approach, including a stringent risk-weighting approach, integrating eligible long-term debt into the Basel III threshold deduction system as a new class of regulatory capital, or an outright prohibition of bank ownership of covered BHC's unsecured debt instruments.

Question 70: The Board invites comment on whether to expand the proposed capital deduction treatment to cover investments by banking organizations in debt instruments issued by nonbank financial companies supervised by the Board and non-U.S. GSIBs.

VIII. Transition Periods

The Board proposes to generally require firms that are covered BHCs as of the date on which the final rule is issued to achieve compliance with the rule as of January 1, 2019. However, the Board proposes to phase in the risk-weighted assets component of the external TLAC requirement in two stages. A 16 percent requirement would apply as of January 1, 2019. The requirement would then increase to 18 percent as of January 1, 2022. The purpose of the proposed transition period is to minimize the effect of the implementation of the proposal on credit availability and credit costs in the U.S. economy.

Firms that become covered BHCs after the date on which the final rule is issued would be required to comply by the later of three years after becoming covered BHCs and the effective date applicable to firms that are covered BHCs as of the date on which the final rule is issued.

Foreign GSIBs that are required to form U.S. intermediate holding companies as of the date on which the final rule is issued would similarly be required to achieve compliance as of January 1, 2019. However, the Board proposes to phase in the risk-weighted assets component of the internal TLAC requirement applicable to covered IHCs that are expected to enter resolution in a failure scenario in two stages. A 16 percent requirement would apply as of January 1, 2019. The requirement would then increase to 18 percent as of January 1, 2022.

Where a foreign banking organization becomes subject to a requirement to form a covered IHC after the date on which the final rule is issued,[117] that covered IHC would be required to comply with the rule's requirements by the later of three years after the date on which the foreign banking organization first becomes subject to the requirement to form the U.S. intermediate holding company and the effective date applicable to foreign GSIBs that are required to form U.S. intermediate holding companies as of the date on which the final rule is issued. The Board may accelerate or extend this transition period in writing.

Board-regulated institutions would be required to comply with the proposed regulatory capital deduction for investments in the unsecured debt of a covered BHC as of January 1, 2019.

Question 71: The Board invites comments on all aspects of the transition period, including whether the proposed phase-in period for the risk-weighted assets components of the proposed external and internal TLAC requirements is appropriate. Would it be appropriate to instead require compliance with those higher requirements as of January 1, 2019?

Question 72: The Board invites comment with respect to whether a grandfather provision is necessary or appropriate for any existing instruments. What types and volumes of outstanding long-term debt instruments of covered BHCs would fail to meet the proposed requirements for eligible external or internal LTD? How burdensome would it be for covered holding companies to modify the terms of such instruments to align with the proposed requirements?

[117] This could occur where a foreign banking organization that is already required to form a U.S. intermediate holding company becomes a foreign GSIB (rendering its U.S. intermediate holding company a covered IHC) or where a foreign GSIB first becomes required to form a U.S. intermediate holding company (which would be a covered IHC upon formation).

IX. Regulatory Analysis

A. Paperwork Reduction Act

Certain provisions of the proposed rule contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501 through 3521). The Board reviewed the proposed rule under the authority delegated to the Board by OMB. The disclosure requirements are found in § 252.65 and the reporting requirements are found in § 252.153(b)(5). These information collection requirements would implement section 165 of the Dodd Frank Act, as described in the Abstract below. In accordance with the requirements of the PRA, the Board may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number.

The proposed rule would revise the Reporting, Recordkeeping, and Disclosure Requirements Associated with Enhanced Prudential Standards (Regulation YY) (Reg YY; OMB No. 7100–0350). In addition, as permitted by the PRA, the Board proposes to extend for three years, with revision, the Reporting, Recordkeeping, and Disclosure Requirements Associated with Enhanced Prudential Standards (Regulation YY) (Reg YY; OMB No. 7100–0350).

Comments are invited on:

(a) Whether the collections of information are necessary for the proper performance of the Board's functions, including whether the information has practical utility;

(b) The accuracy of the Board's estimates of the burden of the information collections, including the validity of the methodology and assumptions used;

(c) Ways to enhance the quality, utility, and clarity of the information to be collected;

(d) Ways to minimize the burden of information collections on respondents, including through the use of automated collection techniques or other forms of information technology; and

(e) Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

All comments will become a matter of public record. Comments on aspects of this notice that may affect reporting, recordkeeping, or disclosure requirements and burden estimates should be sent to the addresses listed in the **ADDRESSES** section. A copy of the comments may also be submitted to the OMB desk officer: By mail to U.S. Office of Management and Budget, 725 17th Street NW., #10235, Washington, DC 20503 or by facsimile to 202–395–5806, Attention, Federal Reserve Desk Officer.

Proposed Revision, With Extension, of the Following Information Collection

Title of Information Collection: Reporting, Recordkeeping, and Disclosure Requirements Associated with Enhanced Prudential Standards (Regulation YY).

Agency Form Number: Reg YY.

OMB Control Number: 7100–0350.

Frequency of Response: Annual, semiannual, quarterly, one-time, and on occasion.

Affected Public: Businesses or other for-profit.

Respondents: State member banks, U.S. bank holding companies, savings and loan holding companies, nonbank financial companies, foreign banking organizations, U.S. intermediate holding companies, foreign saving and loan holding companies, and foreign nonbank financial companies supervised by the Board.

Abstract: Section 165 of the Dodd-Frank Act requires the Board to implement enhanced prudential standards for bank holding companies with total consolidated assets of $50 billion or more, including global systemically important foreign banking organizations with $50 billion or more in U.S. non-branch assets. Section 165 of the Dodd-Frank Act also permits the Board to establish such other prudential standards for such banking organizations as the Board determines are appropriate.

Disclosure Requirements

Section 252.65 of the proposed rule would require a global systemically important BHC to publicly disclose a description of the financial consequences to unsecured debtholders of the global systemically important BHC entering into a resolution proceeding in which the global systemically important BHC is the only entity that would be subject to the resolution proceeding. A global systemically important BHC must provide the disclosure required of this section: (1) In the offering documents for all of its eligible debt securities; and (2) either on the global systemically important BHC's Web site, or in more than one public financial report or other regulatory reports, provided that the global systemically important BHC publicly provides a summary table specifically indicating the location(s) of this disclosure.

Reporting Requirements

Section 252.153(b)(5) of the proposed rule would require each top-tier foreign banking organization that controls a U.S. intermediate holding company to submit to the Board by January 1 of each calendar year through the U.S. intermediate holding company: (1) Notice of whether the home country supervisor (or other appropriate home country regulatory authority) of the top-tier foreign banking organization of the U.S. intermediate holding company has adopted standards consistent with the BCBS assessment methodology for identifying global systemically important banking organizations; and (2) notice of whether the top-tier foreign banking organization prepares or reports the indicators used by the BCBS assessment methodology to identify a banking organization as a global systemically important banking organization and, if it does, whether the top-tier foreign banking organization has determined that it has the characteristics of a global systemically important banking organization under the BCBS assessment methodology.

Estimated Paperwork Burden for Proposed Revisions

Estimated Number of Respondents:

Disclosure Burden

Section 252.65—8 respondents.

Reporting Burden

Section 252.153(b)(5)—15 respondents.

Estimated Burden per Response:

Disclosure Burden

Section 252.65—1 hour (annual), 5 hours (one-time burden).

Reporting Burden

Section 252.153(b)(5)—1 hour (annual).

Total estimated one-time burden: 40 hours.

Current estimated annual burden for Reporting, Recordkeeping, and Disclosure Requirements Associated with Enhanced Prudential Standards (Regulation YY): 118,546 hours.

Proposed revisions estimated annual burden: 23 hours.

Total estimated annual burden: 118,609 hours.

B. Regulatory Flexibility Act

The Board is providing an initial regulatory flexibility analysis with respect to this proposed rule. The Regulatory Flexibility Act, 5 U.S.C. 601 *et seq.* (RFA), generally requires that an agency prepare and make available an initial regulatory flexibility analysis in connection with a notice of proposed rulemaking. Under regulations issued by the Small Business Administration, a small entity includes a depository institution, bank holding company, or savings and loan holding company with assets of $550 million or less (small banking organizations).[118] As of June 30, 2015, there were 628 small state member banks. As of June 30, 2015, there were approximately 180 small savings and loan holding companies and 3,351 small bank holding companies.

This proposed rule is designed to improve the resolvability of covered BHCs and covered IHCs by requiring such institutions maintain outstanding a minimum amount of loss-absorbing instruments, including a minimum amount of unsecured long-term debt, and imposing restrictions on the corporate practices and liabilities of such organizations. The proposed rule is also designed to help reduce the potential contagion stemming from the failure of a GSIB by requiring state member banks, bank holding companies, savings and loan holding companies, and intermediate holding companies subject to the Board's capital rules to deduct from their regulatory capital investments in unsecured debt issued by covered BHCs.

The majority of the provisions of the proposed rule would apply to a top-tier bank holding company domiciled in the United States with $50 billion or more in total consolidated assets and has been identified as a GSIB, and to a U.S. intermediate holding company of a foreign GSIB. Bank holding companies and U.S. intermediate holding companies of foreign GSIBs that are subject to the proposed rule therefore substantially exceed the $550 million asset threshold at which a banking entity would qualify as a small banking organization. However, small state member banks would be subject to the provisions of the proposed rule that impose regulatory capital deductions for investments in eligible external long-term debt of covered BHCs. The provisions of the proposed rule related

[118] *See* 13 CFR 121.201. Effective July 14, 2014, the Small Business Administration revised the size standards for banking organizations to $550 million in assets from $500 million in assets. 79 FR 33647 (June 12, 2014).

to regulatory capital deductions generally would not apply to small savings and loan holding companies and small bank holding companies.

The proposed regulatory capital deductions for investments in the unsecured debt of covered BHCs would require small state member banks to deduct holdings of unsecured debt issued by a covered BHC from regulatory capital, in a similar manner as small state member banks must deduct investments in tier 2 capital instruments from their regulatory capital, as described in Part VII. State member banks would be required to make internal reporting changes to comply with the proposed capital rules and corresponding reporting requirements. As described in Part VII, these requirements would reduce the incentives of a small state member bank to invest in the unsecured debt of a covered BHC, and thereby increase the prospect for an orderly resolution not a covered BHC.

Depository institutions do not presently report their holdings in the unsecured debt of U.S. GSIBs. However, regulatory reports filed by depository institutions provide a listing of the holdings by such institutions of ''other domestic debt,'' which would include holdings of unsecured debt issued by U.S. GSIBs. Therefore, the reported holdings of ''other domestic debt'' held by small depository institutions provides a conservative estimate of the amount of unsecured debt of GSIBs held by such institutions.

As of June 30, 2015, such institutions held ''other domestic debt'' equal to approximately 0.5 percent of their total assets. Excluding depository institutions that report no holdings of ''other domestic debt,'' such depository institutions held ''other domestic debt'' equal to only 2.2 percent of their total assets. The low level of reported holdings of ''other domestic debt'' by such institutions supports the view that the proposed regulatory capital deductions would not have a material impact on small state member banks. In addition, in light of the reported holdings of ''other domestic debt'' by small depository institutions, such institutions should be able to replace their holdings of unsecured debt by GSIBs without a material economic impact.

The proposed rule does not appear to duplicate, overlap, or conflict with any other Federal rules. In light of the foregoing, the Board does not believe that the proposed rule, if adopted in final form, would have a significant economic impact on a substantial number of small entities. Nonetheless, the Board invites comment on whether the proposed rule would impose undue burdens on, or have unintended consequences for, small organizations, and whether there are ways such potential burdens or consequences could be minimized in a manner consistent with the purpose of the proposed rule. A final regulatory flexibility analysis will be conducted after consideration of comments received during the public comment period.

C. Riegle Community Development and Regulatory Improvement Act of 1994

In determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements on state member banks, the Board is required to consider, consistent with the principles of safety and soundness and the public interest, any administrative burdens that such regulations would place on depository institutions, and the benefits of such regulations.[119] In addition, new regulations that impose additional reporting disclosures or other new requirements on insured depository institutions generally must take effect on the first day of a calendar quarter which begins on or after the date on which the regulations are published in final form.[120]

The proposed regulatory capital deductions applicable to state member banks would take effect on the first day of a calendar quarter. The proposed rule would provide state member banks a reasonable period of time to make the incremental internal reporting changes necessary to comply with the proposed revisions to the regulatory capital rules. The proposed revisions to the regulatory capital rules would also be reflected in amendments to the Board's regulatory reporting forms, and the instructions to such forms. The internal reporting changes are expected to be minimal because the banking organizations subject to the proposed rule are already required to track similar information to comply with current capital rules and reporting requirements.

As described above in Part IX.B, depository institutions do not presently report their holdings in the unsecured debt of U.S. GSIBs, but do report holdings of ''other domestic debt,'' which would include holdings of unsecured debt issued by U.S. GSIBs. Therefore, the reported holdings of ''other domestic debt'' held by depository institutions provides a conservative estimate of the amount of unsecured debt of GSIBs held by such institutions.

As of June 30, 2015, state member banks held ''other domestic debt'' equal to approximately 0.57 percent of their total assets. Excluding state member banks that report no holdings of ''other domestic debt,'' such depository institutions held ''other domestic debt'' equal to only 0.77 percent of their total assets. The reported holdings of ''other domestic debt'' by such institutions supports the view that the incremental administrative reporting burden imposed by the proposed revisions to the Board's regulatory capital rules on such institutions is expected to be minimal. These administrative burdens are offset by the safety and soundness and financial stability benefits that will accrue to the financial system as a result of the proposed rule, as described herein.

D. Solicitation of Comments on the Use of Plain Language

Section 722 of the Gramm-Leach-Bliley Act (Pub. L. 106–102, 113 Stat. 1338, 1471, 12 U.S.C. 4809) requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The Board has sought to present the proposed rule in a simple and straightforward manner, and invites comment on the use of plain language. For example:

- Have the agencies organized the material to suit your needs? If not, how could they present the proposed rule more clearly?
- Are the requirements in the proposed rule clearly stated? If not, how could the proposed rule be more clearly stated?
- Do the regulations contain technical language or jargon that is not clear? If so, which language requires clarification?
- Would a different format (grouping and order of sections, use of headings, paragraphing) make the regulation easier to understand? If so, what changes would achieve that?
- Is the section format adequate? If not, which of the sections should be changed and how?
- What other changes can the Board incorporate to make the regulation easier to understand?

List of Subjects in 12 CFR Part 252

12 CFR Chapter II

Administrative practice and procedure, Banks, banking, Federal

[119] *See* Section 302 of the Riegle Community Development and Regulatory Improvement Act of 1994 (RCDRIA), 12 U.S.C. 4802.

[120] 12 U.S.C. 4802(b).

Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities.

Authority and Issuance

For the reasons stated in the preamble, the Board of Governors of the Federal Reserve System proposes to amend 12 CFR parts 217 and 252 as follows:

PART 217—CAPITAL ADEQUACY OF BANK HOLDING COMPANIES, SAVINGS AND LOAN HOLDING COMPANIES, AND STATE MEMBER BANKS (REGULATION Q).

■ 1. The authority citation for part 217 continues to read as follows:

Authority: 12 U.S.C. 248(a), 321–338a, 481–486, 1462a, 1467a, 1818, 1828, 1831n, 1831o, 1831p–l, 1831w, 1835, 1844(b), 1851, 3904, 3906–3909, 4808, 5365, 5368, 5371.

■ 2. In § 217.2:
■ a. Add the definition of ''Covered debt instrument'' in alphabetical order;
■ b. Revise the definition of ''Indirect exposure'';
■ c. Add the definition of ''Investment in a covered debt instrument,'' in alphabetical order;
■ d. Revise the definition of ''Investment in the capital of an unconsolidated financial institution''; and
■ e. Revise the definition of ''Synthetic exposure;''

The additions and revisions read as follows:

§ 217.2 Definitions.

* * * * *

Covered debt instrument means an unsecured debt security issued by a global systemically important BHC, including direct, indirect, or synthetic exposures to such a debt security, other than an unsecured debt security that qualifies as tier 2 capital pursuant to § 217.20(d).

* * * * *

Indirect exposure means an exposure that arises from the Board-regulated institution's investment in an investment fund which holds an investment in the Board-regulated institution's own capital instrument, an investment in the capital of an unconsolidated financial institution, or an investment in a covered debt instrument.

* * * * *

Investment in a covered debt instrument means a Board-regulated institution's net long position calculated in accordance with § 217.22(h) in a covered debt instrument, including direct, indirect, and synthetic exposures to the debt instrument, excluding for purposes of § 217.22(c)(4) and (5) any underwriting positions held by the Board-regulated institution for five or fewer business days.

* * * * *

Investment in the capital of an unconsolidated financial institution means a net long position calculated in accordance with § 217.22(h) in an instrument that is recognized as capital for regulatory purposes by the primary supervisor of an unconsolidated regulated financial institution or in an instrument that is part of the GAAP equity of an unconsolidated unregulated financial institution, including direct, indirect, and synthetic exposures to the capital instruments, excluding underwriting positions held by the Board-regulated institution for five or fewer business days.

* * * * *

Synthetic exposure means an exposure whose value is linked to the value of an investment in the Board-regulated institution's own capital instrument, to the value of an investment in the capital of an unconsolidated financial institution, or to the value of an investment in a covered debt instrument.

* * * * *

■ 3. In § 217.22, revise paragraphs (c) and its footnotes, (f), and (h) to read as follows:

§ 217.22 Regulatory capital adjustments and deductions.

* * * * *

(c) *Deductions from regulatory capital related to investments in capital instruments* [23]—(1) *Investment in the Board-regulated institution's own capital or covered debt instruments.* A Board-regulated institution must deduct an investment in the Board-regulated institution's own capital instruments or an investment in the Board-regulated institution's own covered debt instruments as follows:

(i) A Board-regulated institution must deduct an investment in the Board-regulated institution's own common stock instruments from its common equity tier 1 capital elements to the extent such instruments are not excluded from regulatory capital under § 217.20(b)(1);

(ii) A Board-regulated institution must deduct an investment in the Board-regulated institution's own additional tier 1 capital instruments from its additional tier 1 capital elements;

(iii) A Board-regulated institution must deduct an investment in the Board-regulated institution's own tier 2 capital instruments from its tier 2 capital elements; and

(iv) A Board-regulated institution that is a global systemically important BHC must deduct an investment in the Board-regulated institution's own covered debt instruments from its tier 2 capital elements. If the Board-regulated institution does not have a sufficient amount of tier 2 capital to effect this deduction, the Board-regulated institution must deduct the shortfall amount from the next higher (that is, more subordinated) component of regulatory capital.

(2) *Corresponding deduction approach.* For purposes of subpart C of this part, the corresponding deduction approach is the methodology used for the deductions from regulatory capital related to reciprocal cross holdings (as described in paragraph (c)(3) of this section), non-significant investments in the capital of unconsolidated financial institutions (as described in paragraph (c)(4) of this section), and non-common stock significant investments in the capital of unconsolidated financial institutions (as described in paragraph (c)(5) of this section). Under the corresponding deduction approach, a Board-regulated institution must make deductions from the component of capital for which the underlying instrument would qualify if it were issued by the Board-regulated institution itself, as described in paragraphs (c)(2)(i) through (iii) of this section. If the Board-regulated institution does not have a sufficient amount of a specific component of capital to effect the required deduction, the Board-regulated institution must deduct the shortfall amount from its capital according to paragraph (f) of this section.

(i) If an investment is in the form of an instrument issued by a financial institution that is not a regulated financial institution, the Board-regulated institution must treat the instrument as:

(A) A common equity tier 1 capital instrument if it is common stock or represents the most subordinated claim in liquidation of the financial institution; and

(B) An additional tier 1 capital instrument if it is subordinated to all creditors of the financial institution and is senior in liquidation only to common shareholders.

(ii) If an investment is in the form of an instrument issued by a regulated financial institution and the instrument does not meet the criteria for common

[23] The Board-regulated institution must calculate amounts deducted under paragraphs (c) through (f) of this section after it calculates the amount of ALLL includable in tier 2 capital under § 217.20(d)(3).

equity tier 1, additional tier 1 or tier 2 capital instruments under § 217.20, the Board-regulated institution must treat the instrument as:

(A) A common equity tier 1 capital instrument if it is common stock included in GAAP equity or represents the most subordinated claim in liquidation of the financial institution;

(B) An additional tier 1 capital instrument if it is included in GAAP equity, subordinated to all creditors of the financial institution, and senior in a receivership, insolvency, liquidation, or similar proceeding only to common shareholders; and

(C) A tier 2 capital instrument if it is a covered debt instrument or if it is not included in GAAP equity but considered regulatory capital by the primary supervisor of the financial institution.

(iii) If an investment is in the form of a non-qualifying capital instrument (as defined in §217.300(c)), the Board-regulated institution must treat the instrument as:

(A) An additional tier 1 capital instrument if such instrument was included in the issuer's tier 1 capital prior to May 19, 2010; or

(B) A tier 2 capital instrument if such instrument was included in the issuer's tier 2 capital (but not includable in tier 1 capital) prior to May 19, 2010.

(3) *Reciprocal cross holdings in the capital of financial institutions.* A Board-regulated institution must deduct an investment in the capital of another financial institution that the Board-regulated institution holds reciprocally with another financial institution and an investment in any covered debt instrument that the Board-regulated institution holds reciprocally with another financial institution, where such reciprocal cross holdings result from a formal or informal arrangement to swap, exchange, or otherwise intend to hold each other's capital instruments, by applying the corresponding deduction approach in paragraph (c)(2) of this section.

(4) *Non-significant investments in the capital of unconsolidated financial institutions.* (i) If a Board-regulated institution has a non-significant investment in the capital of an unconsolidated financial institution, the Board-regulated institution must deduct any such investment and must deduct, if the unconsolidated financial institution is a global systemically important BHC, any investment in a covered debt instrument issued by the unconsolidated financial institution, to the extent that the combined amount of the investment in capital and the investment in covered debt instruments exceed 10 percent of the sum of the Board-regulated institution's common equity tier 1 capital elements minus all deductions from and adjustments to common equity tier 1 capital elements required under paragraphs (a) through (c)(3) of this section (the 10 percent threshold for non-significant investments) by applying the corresponding deduction approach in paragraph (c)(2) of this section.[24] The deductions described in this paragraph are net of associated DTLs in accordance with paragraph (e) of this section. In addition, with the prior written approval of the Board, a Board-regulated institution that underwrites a failed underwriting, for the period of time stipulated by the Board, is not required to deduct from capital a non-significant investment in the capital of an unconsolidated financial institution or an investment in a covered debt instrument pursuant to this paragraph (c)(4) to the extent the investment is related to the failed underwriting.[25]

(ii) The amount to be deducted under this section from a specific capital component is equal to:

(A) The Board-regulated institution's aggregate non-significant investments in the capital of an unconsolidated financial institution and, if applicable, any investments in a covered debt instrument subject to deduction under this paragraph (c)(4), exceeding the 10 percent threshold for non-significant investments, multiplied by

(B) The ratio of the Board-regulated institution's aggregate non-significant investments in the capital of an unconsolidated financial institution (in the form of such capital component) to the Board-regulated institution's total non-significant investments in unconsolidated financial institutions, with an investment in a covered debt instrument being treated as tier 2 capital for this purpose.

(5) *Significant investments in the capital of unconsolidated financial institutions that are not in the form of common stock.* If a Board-regulated institution has a significant investment in the capital of an unconsolidated financial institution, the Board-regulated institution must deduct from capital any such investment and any covered debt instrument issued by the unconsolidated financial institution that is held by the Board-regulated institution other than an investment in the form of common stock by applying the corresponding deduction approach in paragraph (c)(2) of this section.[26] The deductions described in this section are net of associated DTLs in accordance with paragraph (e) of this section. In addition, with the prior written approval of the Board, for the period of time stipulated by the Board, a Board-regulated institution that underwrites a failed underwriting is not required to deduct a significant investment in the capital of an unconsolidated financial institution or an investment in covered debt instruments pursuant to this paragraph (c)(5) if such investment is related to such failed underwriting.

* * * * *

(f) *Insufficient amounts of a specific regulatory capital component to effect deductions.* Under the corresponding deduction approach, if a Board-regulated institution does not have a sufficient amount of a specific component of capital to effect the full amount of any deduction from capital required under paragraph (d) of this section, the Board-regulated institution must deduct the shortfall amount from the next higher (that is, more subordinated) component of regulatory capital. Any investment by a Board-regulated institution in a covered debt instrument must be treated as an investment in the tier 2 capital of the global systemically important BHC for purposes of this paragraph.

* * * * *

(h) *Net long position.* (1) For purposes of calculating the amount of a Board-regulated institution's investment in the Board regulated institution's own capital instrument, investment in the capital of an unconsolidated financial institution, and investment in a covered debt instrument, the Board-regulated institution's net long position is its gross long position in the underlying instrument determined in accordance with paragraph (h)(2) of this section, as

[24] With the prior written approval of the Board, for the period of time stipulated by the Board, a Board-regulated institution is not required to deduct a non-significant investment in the capital instrument of an unconsolidated financial institution or an investment in a covered debt instrument pursuant to this paragraph if the financial institution is in distress and if such investment is made for the purpose of providing financial support to the financial institution, as determined by the Board.

[25] Any non-significant investment in the capital of an unconsolidated financial institution or any investment in a covered debt instrument that is not required to be deducted under this paragraph (c)(4) or otherwise under this section must be assigned the appropriate risk weight under subparts D, E, or F of this part, as applicable.

[26] With prior written approval of the Board, for the period of time stipulated by the Board, a Board-regulated institution is not required to deduct a significant investment in the capital of an unconsolidated financial institution or an investment in a covered debt instrument under this paragraph (c)(5) or otherwise under this section if such investment is made for the purpose of providing financial support to the financial institution as determined by the Board.

adjusted to recognize any short position by the Board-regulated institution in the same instrument subject to paragraph (h)(3) of this section.

(2) *Gross long position.* A gross long position is determined as follows:

(i) For an equity exposure that is held directly by the Board-regulated institution, the adjusted carrying value of the exposure as that term is defined in §217.51(b);

(ii) For an exposure that is held directly and that is not an equity exposure or a securitization exposure, the exposure amount as that term is defined in §217.2; and

(iii) For each indirect exposure, the Board-regulated institution's carrying value of its investment in an investment fund or, alternatively:

(A) A Board-regulated institution may, with the prior approval of the Board, use a conservative estimate of the amount of its indirect investment in the Board-regulated institution's own capital instruments, its indirect investment in the capital of an unconsolidated financial institution, or its indirect investment in a covered debt instrument held through a position in an index, as applicable; or

(B) A Board-regulated institution may calculate the gross long position for an indirect exposure by multiplying the Board-regulated institution's carrying value of its investment in the investment fund by either:

(*1*) The highest stated investment limit (in percent) for an investment in the Board-regulated institution's own capital instruments, an investment in the capital of an unconsolidated financial institution, or an investment in a covered debt instrument, as applicable, as stated in the prospectus, partnership agreement, or similar contract defining permissible investments of the investment fund; or

(*2*) The investment fund's actual holdings of the investment in the Board-regulated institution's own capital instruments, investment in the capital of an unconsolidated financial institution, or investment in an covered debt instrument, as applicable; and

(iv) For a synthetic exposure, the amount of the Board-regulated institution's loss on the exposure if the reference capital instrument were to have a value of zero.

(3) *Adjustments to reflect a short position.* In order to adjust the gross long position to recognize a short position in the same instrument under paragraph (h)(1) of this section, the following criteria must be met:

(i) The maturity of the short position must match the maturity of the long position, or the short position must have a residual maturity of at least one year (maturity requirement); or

(ii) For a position that is a trading asset or trading liability (whether on- or off-balance sheet) as reported on the Board-regulated institution's Call Report, for a state member bank, or FR Y–9C, for a bank holding company or savings and loan holding company, as applicable, if the Board-regulated institution has a contractual right or obligation to sell the long position at a specific point in time and the counterparty to the contract has an obligation to purchase the long position if the Board-regulated institution exercises its right to sell, this point in time may be treated as the maturity of the long position such that the maturity of the long position and short position are deemed to match for purposes of the maturity requirement, even if the maturity of the short position is less than one year; and

(iii) For an investment in a Board-regulated institution's own capital instrument under paragraph (c)(1) of this section, an investment in a capital of an unconsolidated financial institution under paragraphs (c)(4), (c)(5), and (d)(1)(iii) of this section, and an investment in a covered debt instrument under paragraphs (c)(1), (c)(4), and (c)(5) of this section:

(A) The Board-regulated institution may only net a short position against a long position in an investment in the Board-regulated institution's own capital instrument or own covered debt instrument under paragraph (c)(1) of this section if the short position involves no counterparty credit risk;

(B) A gross long position in an investment in the Board-regulated institution's own capital instrument, an investment in the capital instrument of an unconsolidated financial institution, or an investment in a covered debt instrument due to a position in an index may be netted against a short position in the same index;

(C) Long and short positions in the same index without maturity dates are considered to have matching maturities; and

(D) A short position in an index that is hedging a long cash or synthetic position in an investment in the Board-regulated institution's own capital instrument, an investment in the capital instrument of an unconsolidated financial institution, or an investment in a covered debt instrument can be decomposed to provide recognition of the hedge. More specifically, the portion of the index that is composed of the same underlying instrument that is being hedged may be used to offset the long position if both the long position being hedged and the short position in the index are reported as a trading asset or trading liability (whether on- or off-balance sheet) on the Board-regulated institution's Call Report, for a state member bank, or FR Y–9C, for a bank holding company or savings and loan holding company, as applicable, and the hedge is deemed effective by the Board-regulated institution's internal control processes, which have not been found to be inadequate by the Board.

PART 252—ENHANCED PRUDENTIAL STANDARDS (REGULATION YY).

■ 4. The authority citation for part 252 is revised to read as follows:

Authority: 12 U.S.C. 321–338a, 481–486, 1467a(g), 1818, 1828, 1831n, 1831o, 1831p–l, 1831w, 1835, 1844(b), 1844(c), 3904, 3906–3909, 4808, 5361, 5365, 5366, 5367, 5368, 5371.

■ 5. In § 252.2, redesignate paragraphs (t) through (z) as paragraphs (aa) through (gg) and redesignate paragraphs (n) through (s) as (t) through (y); and add new paragraphs (n) through (s) and (z).

The additions read as follows:

§ 252.2 Definitions.

* * * * *

(n) *Global methodology* means the assessment methodology and the higher loss absorbency requirement for global systemically important banks issued by the Basel Committee on Banking Supervision, as updated from time to time.

(o) *Global systemically important banking organization* means a global systemically important bank, as such term is defined in the global methodology.

(p) *Global systemically important foreign banking organization* means a top-tier foreign banking organization that is identified as a global systemically important foreign banking organization under § 252.153(b)(4) of this part.

(q) *Home country,* with respect to a foreign banking organization, means the country in which the foreign banking organization is chartered or incorporated.

(r) *Home country resolution authority,* with respect to a foreign banking organization, means the governmental entity or entities that under the laws of the foreign banking organization's home county has responsibility for the resolution of the top-tier foreign banking organization.

(s) *Home country supervisor,* with respect to a foreign banking organization, means the governmental entity or entities that under the laws of the foreign banking organization's home county has responsibility for the

supervision and regulation of the top-tier foreign banking organization.

* * * * *

(z) *Top-tier foreign banking organization,* with respect to a foreign bank, means the top-tier foreign banking organization or, alternatively, a subsidiary of the top-tier foreign banking organization designated by the Board.

* * * * *

■ 6. Add subpart G to read as follows:

Subpart G—External Long-term Debt Requirement, External Total Loss-absorbing Capacity Requirement and Buffer, and Restrictions on Corporate Practices for U.S. Global Systemically Important Banking Organizations

Sec.

§ 252.60 Applicability.

(a) *General applicability.* This subpart applies to any U.S. bank holding company that is identified as a global systemically important BHC.

(b) *Initial applicability.* A global systemically important BHC shall be subject to the requirements of this subpart beginning on the later of:

(1) January 1, 2019; or

(2) 1095 days (three years) after the date on which the company becomes a global systemically important BHC.

§ 252.61 Definitions.

For purposes of this subpart:

Additional tier 1 capital has the same meaning as in 12 CFR 217.20(c).

Common equity tier 1 capital has the same meaning as in 12 CFR 217.20(b).

Common equity tier 1 capital ratio has the same meaning as in 12 CFR 217.10(b)(1) and 12 CFR 217.10(c), as applicable.

Common equity tier 1 minority interest has the same meaning as in 12 CFR 217.2.

Default right (1) Means any:

(i) Right of a party, whether contractual or otherwise (including rights incorporated by reference to any other contract, agreement or document, and rights afforded by statute, civil code, regulation and common law), to liquidate, terminate, cancel, rescind, or accelerate the agreement or transactions thereunder, set off or net amounts owing in respect thereto (except rights related to same-day payment netting), exercise remedies in respect of collateral or other credit support or property related thereto (including the purchase and sale of property), demand payment or delivery thereunder or in respect thereof (other than a right or operation of a contractual provision arising solely from a change in the value of collateral or margin or a change in the amount of an economic exposure), suspend, delay or defer payment or performance thereunder, modify the obligations of a party thereunder or any similar rights; and

(ii) Right or contractual provision that alters the amount of collateral or margin that must be provided with respect to an exposure thereunder, including by altering any initial amount, threshold amount, variation margin, minimum transfer amount, the margin value of collateral or any similar amount, that entitles a party to demand the return of any collateral or margin transferred by it to the other party or a custodian or that modifies a transferee's right to reuse collateral or margin (if such right previously existed), or any similar rights, in each case, other than a right or operation of a contractual provision arising solely from a change in the value of collateral or margin or a change in the amount of an economic exposure; and

(2) Does not include any right under a contract that allows a party to terminate the contract on demand or at its option at a specified time, or from time to time, without the need to show cause.

Discretionary bonus payment has the same meaning as under 12 CFR 217.2.

Distribution has the same meaning as under 12 CFR 217.2.

Global systemically important BHC has the same meaning as in 12 CFR 217.2.

Eligible debt security means, with respect to a global systemically important BHC, a debt instrument that:

(1) Is paid in, and issued by the global systemically important BHC;

(2) Is not secured, not guaranteed by the global systemically important BHC or a subsidiary of the global systemically important BHC, and is not subject to any other arrangement that legally or economically enhances the seniority of the instrument;

(3) Has a maturity of greater than 365 days (one year) from the date of issuance;

(4) Is governed by the laws of the United States or any State thereof;

(5) Does not provide the holder of the instrument a contractual right to accelerate payment of principal or interest on the instrument, except a right that is exercisable on one or more dates that are specified in the instrument or in the event of (i) a receivership, insolvency, liquidation, or similar proceeding of the global systemically important BHC or (ii) a failure of the global systemically important BHC to pay principal or interest on the instrument when due;

(6) Does not have a credit-sensitive feature, such as an interest rate that is reset periodically based in whole or in part on the global systemically important BHC's credit quality, but may have an interest rate that is adjusted periodically independent of the global systemically important BHC's credit quality, in relation to general market interest rates or similar adjustments;

(7) Is not a structured note; and

(8) Does not provide that the instrument may be converted into or exchanged for equity of the global systemically important BHC.

External TLAC buffer means, with respect to a global systemically important BHC, the sum of 2.5 percent, any applicable countercyclical capital buffer under 12 CFR 217.11(b) (expressed as a percentage), and the global systemically important BHC's method 1 capital surcharge.

GAAP means generally accepted accounting principles as used in the United States.

GSIB surcharge has the same meaning as in 12 CFR 217.2.

Method 1 capital surcharge means, with respect to a global systemically important BHC, the most recent method 1 capital surcharge (expressed as a percentage) the global systemically important BHC was required to calculate pursuant to subpart H of Regulation Q (12 CFR 217.400 through 217.406).

Outstanding eligible external long-term debt amount is defined in § 252.62(a).

Person has the same meaning as in 12 CFR 225.2.

Qualified financial contract has the same meaning as in § 210(c)(8)(D) of Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5390(c)(8)(D)), including any ''swap'' defined in section 1a(47) of the Commodities Exchange Act (7 U.S.C. 1a(47)) and in any rules or regulations issued by the Commodity Futures Trading Commission pursuant to such section; any ''security-based swap'' defined in section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)) and in any rules or regulations issued by the Securities and Exchange Commission pursuant to such section; and any securities contract, commodity contract, forward contract, repurchase agreement, swap agreement, and any

similar agreement that the Federal Deposit Insurance Corporation determines by regulation to be a qualified financial contract as provided in 12 U.S.C. 5390(c)(8)(D)(i).

Structured note means a debt instrument that:

(1) Has a principal amount, redemption amount, or stated maturity that is subject to reduction based on the performance of any asset, entity, index, or embedded derivative or similar embedded feature;

(2) Has an embedded derivative or similar embedded feature that is linked to one or more equity securities, commodities, assets, or entities;

(3) Does not specify a minimum principal amount due upon acceleration or early termination; or

(4) Is not classified as debt under GAAP.

Tier 1 minority interest has the same meaning as in 12 CFR 217.2.

Tier 2 capital has the same meaning as in 12 CFR 217.20(d).

Total leverage exposure has the same meaning as in 12 CFR 217.10(c)(4)(ii).

Total risk-weighted assets means the greater of total risk-weighted assets as calculated under 12 CFR 217, subpart D (the standardized approach) or 12 CFR 217, subpart E (the advanced approaches).

§ 252.62 External long-term debt requirement.

(a) *External long-term debt requirement.* Except as provided under paragraph (c) of this section, a global systemically important BHC must maintain an outstanding eligible external long-term debt amount that is no less than the amount equal to the greater of:

(1) The global systemically important BHC's total risk-weighted assets multiplied by the sum of 6 percent plus the global systemically important BHC's GSIB surcharge (expressed as a percentage); and

(2) 4.5 percent of the global systemically important BHC's total leverage exposure.

(b) *Outstanding eligible external long-term debt amount.* (1) A global systemically important BHC's outstanding eligible external long-term debt amount is the sum of:

(i) One hundred (100) percent of the unpaid principal amount of the outstanding eligible debt securities issued by the global systemically important BHC that have a remaining maturity greater than or equal to 730 days (two years);

(ii) Fifty (50) percent of the unpaid principal amount of the outstanding eligible debt securities issued by the global systemically important BHC that have a remaining maturity of greater than or equal to 365 days (one year) and less than 730 days (two years); and

(iii) Zero (0) percent of the unpaid principal amount of the outstanding eligible debt securities issued by the global systemically important BHC that have a remaining maturity of less than 365 days (one year).

(2) For purposes of paragraph (b)(1) of this section, the remaining maturity of an outstanding eligible debt security is calculated from the earlier of:

(i) The final payment date of the principal, without respect to any right of the holder to accelerate payment of principal; and

(ii) The date the holder of the instrument first has the contractual right to request or require payment of principal, provided that, with respect to a right that is exercisable on one or more dates that are specified in the instrument only on the occurrence of an event (other than an event of a receivership, insolvency, liquidation, or similar proceeding of the global systemically important BHC, or a failure of the global systemically important BHC to pay principal or interest on the instrument when due), the date for the outstanding eligible debt security under this paragraph (b)(2)(ii) will be calculated as if the event has occurred.

(c) *Redemption and repurchase.* A global systemically important BHC may not redeem or repurchase any outstanding eligible debt security without the prior approval of the Board if, immediately after the redemption or repurchase, the global systemically important BHC would not meet its external long-term debt requirement under paragraph (a) of this section, or its external total loss-absorbing capacity requirement under § 252.63(a).

§ 252.63 External total loss-absorbing capacity requirement and buffer.

(a) *External total loss-absorbing capacity requirement.* A global systemically important BHC must maintain an outstanding external total loss-absorbing capacity amount that is no less than the amount equal to the greater of:

(1)(i) From January 1, 2019 through December 31, 2021, 16 percent of the global systemically important BHC's total risk-weighted assets; and

(ii) Beginning January 1, 2022, 18 percent of the global systemically important BHC's total risk-weighted assets; and

(2) 9.5 percent of the global systemically important BHC's total leverage exposure.

(b) *Outstanding external total loss-absorbing capacity amount.* A global systemically important BHC's outstanding external total loss-absorbing capacity amount is the sum of:

(1) The global systemically important BHC's common equity tier 1 capital (excluding any common equity tier 1 minority interest);

(2) The global systemically important BHC's additional tier 1 capital (excluding any tier 1 minority interest); and

(3) The global systemically important BHC's outstanding eligible external long-term debt amount plus 50 percent of the unpaid principal amount of outstanding eligible debt securities issued by the global systemically important BHC that have a remaining maturity, as calculated in § 252.62(b)(2), of greater than or equal to 365 days (one year) but less than 730 days (two years).

(c) *External TLAC buffer*—(1) *Composition of the External TLAC buffer.* The external TLAC buffer is composed solely of common equity tier 1 capital.

(2) *Definitions.* For purposes of this paragraph, the following definitions apply:

(i) *Eligible retained income.* The eligible retained income of a global systemically important BHC is the global systemically important BHC's net income for the four calendar quarters preceding the current calendar quarter, based on the global systemically important BHC's FR Y–9C, net of any distributions and associated tax effects not already reflected in net income. Net income, as reported in the FR Y–9C, reflects discretionary bonus payments and certain distributions that are expense items (and their associated tax effects).

(ii) *Maximum external TLAC payout ratio.* The maximum external TLAC payout ratio is the percentage of eligible retained income that a global systemically important BHC can pay out in the form of distributions and discretionary bonus payments during the current calendar quarter. The maximum external TLAC payout ratio is based on the global systemically important BHC's external TLAC buffer level, calculated as of the last day of the previous calendar quarter, as set forth in Table 1 to § 252.63.

(iii) *Maximum external TLAC payout amount.* A global systemically important BHC's maximum external TLAC payout amount for the current calendar quarter is equal to the global systemically important BHC's eligible retained income, multiplied by the applicable maximum external TLAC

payout ratio, as set forth in Table 1 to § 252.63.

(3) *Calculation of the external TLAC buffer level.* (i) A global systemically important BHC's external TLAC buffer level is equal to the global systemically important BHC's common equity tier 1 capital ratio (expressed as a percentage) minus the greater of zero and the following amount:

(A) (*1*) From January 1, 2019 through December 31, 2021, 16 percent; and

(*2*) Beginning January 1, 2022, 18 percent; minus

(B) The ratio (expressed as a percentage) of the global systemically important BHC's additional tier 1 capital (excluding any tier 1 minority interest) to its total risk-weighted assets; and minus

(C) The ratio (expressed as a percentage) of the global systemically important BHC's eligible external long-term debt amount to total risk-weighted assets.

(ii) Notwithstanding paragraph (c)(3)(i) of this section, if the ratio (expressed as a percentage) of a global systemically important BHC's external total loss-absorbing capacity amount as calculated under paragraph (b) of this section to its risk-weighted assets is less than or equal to, from January 1, 2019, through December 31, 2021, 16 percent and beginning January 1, 2022, 18 percent, the global systemically important BHC's external TLAC buffer level is zero.

(4) *Limits on distributions and discretionary bonus payments.* (i) A global systemically important BHC shall not make distributions or discretionary bonus payments or create an obligation to make such distributions or payments during the current calendar quarter that, in the aggregate, exceed the maximum external TLAC payout amount.

(ii) A global systemically important BHC with an external TLAC buffer level that is greater than the external TLAC buffer is not subject to a maximum external TLAC payout amount.

(iii) Except as provided in paragraph (c)(4)(iv) of this section, a global systemically important BHC may not make distributions or discretionary bonus payments during the current calendar quarter if the global systemically important BHC's:

(A) Eligible retained income is negative; and

(B) External TLAC buffer level was less than the external TLAC buffer as of the end of the previous calendar quarter.

(iv) Notwithstanding the limitations in paragraphs (c)(4)(i) through (iii) of this section, the Board may permit a global systemically important BHC to make a distribution or discretionary bonus payment upon a request of the global systemically important BHC, if the Board determines that the distribution or discretionary bonus payment would not be contrary to the purposes of this section, or to the safety and soundness of the global systemically important BHC. In making such a determination, the Board will consider the nature and extent of the request and the particular circumstances giving rise to the request.

TABLE 1 TO § 252.63—CALCULATION OF MAXIMUM EXTERNAL TLAC PAYOUT AMOUNT

External TLAC buffer level	Maximum External TLAC payout ratio (as a percentage of eligible retained income)
Greater than the external TLAC buffer	No payout ratio limitation applies.
Less than or equal to the external TLAC buffer, *and* greater than 75 percent of the external TLAC buffer.	60 percent.
Less than or equal to 75 percent of the external TLAC buffer, *and* greater than 50 percent of the external TLAC buffer.	40 percent.
Less than or equal to 50 percent of the external TLAC buffer, *and* greater 25 percent of the external TLAC buffer.	20 percent.
Less than or equal to 25 percent of the external TLAC buffer	0 percent.

(v)(A) A global systemically important BHC is subject to the lowest of the maximum payout amounts as determined under 12 CFR 217.11(a)(2)(iii) and (iv) and the maximum external TLAC payout amount as determined under this paragraph.

(B) Additional limitations on distributions may apply to a global systemically important BHC under 12 CFR 225.4, 225.8, and 263.202.

§ 252.64 Restrictions on corporate practices of U.S. global systemically important banking organizations.

(a) *Prohibited corporate practices.* A global systemically important BHC may not directly:

(1) Issue any debt instrument with an original maturity of less than 365 days (one year), including short term deposits and demand deposits, to any person, unless the person is a subsidiary of the global systemically important BHC;

(2) Issue any instrument, or enter into any related contract, with respect to which the holder of the instrument has a contractual right to offset debt owed by the holder or its affiliates to a subsidiary of the global systemically important BHC against the amount, or a portion of the amount, owed by the global systemically important BHC under the instrument;

(3) Enter into a qualified financial contract with a person that is not a subsidiary of the global systemically important BHC;

(4) Guarantee a liability of a subsidiary of the global systemically important BHC if such liability permits the exercise of a default right that is related, directly or indirectly, to the global systemically important BHC becoming subject to a receivership, insolvency, liquidation, resolution, or similar proceeding other than a receivership proceeding under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5381 through 5394); or

(5) Enter into, or otherwise benefit from, any agreement that provides for its liabilities to be guaranteed by any of its subsidiaries.

(b) *Limit on unrelated liabilities.* (1) The aggregate amount, on an unconsolidated basis, of unrelated liabilities of a global systemically important BHC owed to persons that are not affiliates of the global systemically important BHC may not exceed 5 percent of the systemically important BHC's external total loss-absorbing capacity amount, as calculated under § 252.63(b).

(2) For purposes of paragraph (b)(1) of this section, an unrelated liability is any non-contingent liability of the global systemically important BHC owed to a person that is not an affiliate of the global systemically important BHC other than:

(i) The instruments that satisfy the global systemically important BHC's external total loss-absorbing capacity amount, as calculated under § 252.63(b);

(ii) Any dividend or other liability arising from the instruments that satisfy the global systemically important BHC's external total loss-absorbing capacity amount, as calculated under § 252.63(b)(2);

(iii) An eligible debt security that does not provide the holder of the instrument with a currently exercisable right to require immediate payment of the total or remaining principal amount; and

(iv) A secured liability, to the extent that it is secured, or a liability that otherwise represents a claim that would be senior to eligible debt securities in Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5390(b)) and the Bankruptcy Code (11 U.S.C. 507).

§ 252.65 Disclosure requirements.

(a) A global systemically important BHC must publicly disclose a description of the financial consequences to unsecured debtholders of the global systemically important BHC entering into a resolution proceeding in which the global systemically important BHC is the only entity that would be subject to the resolution proceeding.

(b) A global systemically important BHC must provide the disclosure required by paragraph (a) of this section:

(1) In the offering documents for all of its eligible debt securities; and

(2) Either:

(i) On the global systemically important BHC's Web site; or

(ii) In more than one public financial report or other public regulatory reports, provided that the global systemically important BHC publicly provides a summary table specifically indicating the location(s) of this disclosure.

■ 7. Add § 252.153(b)(4), (5), and (6) to read as follows:

§ 252.153 U.S. intermediate holding company requirement for foreign banking organizations with U.S. non-branch assets of $50 billion or more.

* * * * *

(b) * * *

(4) For purposes of this part, a top-tier foreign banking organization that controls a U.S. intermediate holding company is a global systemically important foreign banking organization if any of the following conditions are met:

(i) The top-tier foreign banking organization determines, pursuant to paragraph (b)(6) of this section, that the top-tier foreign banking organization has the characteristics of a global systemically important banking organization under the global methodology; or

(ii) The Board, using information reported by the top-tier foreign banking organization or its U.S. subsidiaries, information that is publicly available, and confidential supervisory information, determines:

(A) That the top-tier foreign banking organization would be a global systemically important banking organization under the global methodology;

(B) That the top-tier foreign banking organization, if it were subject to the Board's Regulation Q, would be identified as a global systemically important BHC under § 217.402 of the Board's Regulation Q; or

(C) That the U.S. intermediate holding company, if it were subject to § 217.402 of the Board's Regulation Q, would be identified as a global systemically important BHC.

(5) Each top-tier foreign banking organization that controls a U.S. intermediate holding company shall submit to the Board by January 1 of each calendar year through the U.S. intermediate holding company:

(i) Notice of whether the home country supervisor (or other appropriate home country regulatory authority) of the top-tier foreign banking organization of the U.S. intermediate holding company has adopted standards consistent with the global methodology; and

(ii) Notice of whether the top-tier foreign banking organization prepares or reports the indicators used by the global methodology to identify a banking organization as a global systemically important banking organization and, if it does, whether the top-tier foreign banking organization has determined that it has the characteristics of a global systemically important banking organization under the global methodology pursuant to paragraph (b)(6) of this section.

(6) A top-tier foreign banking organization that controls a U.S. intermediate holding company and prepares or reports for any purpose the indicator amounts necessary to determine whether the top-tier foreign banking organization is a global systemically important banking organization under the global methodology must use the data to determine whether the top-tier foreign banking organization has the characteristics of a global systemically important banking organization under the global methodology.

* * * * *

■ 8. Add subpart P to read as follows:

Subpart P—Internal Long-Term Debt Requirement, Internal Total Loss-absorbing Capacity Requirement and Buffer, and Restrictions on Corporate Practices for Intermediate Holding Companies of Global Systemic Foreign Banking Organizations

Sec.

§ 252.160 Applicability.

(a) *General applicability.* This subpart applies to a U.S. intermediate holding company that is required to be established pursuant to § 252.153 and is controlled by a global systemically important foreign banking organization (Covered IHC).

(b) *Initial applicability.* A Covered IHC is subject to the requirements of this subpart beginning on the later of:

(1) January 1, 2019; and

(2) 1095 days (three years) after the earlier of date on which a:

(i) Global systemically important foreign banking organization is required to establish a U.S. intermediate holding company pursuant to § 252.153; and

(ii) Foreign banking organization that is required to establish a U.S. intermediate holding company pursuant to § 252.153 becomes a global systemically important foreign banking organization.

§ 252.161 Definitions.

For purposes of this subpart:

Additional tier 1 capital has the same meaning as in 12 CFR 217.20(c).

Average total consolidated assets means the denominator of the leverage ratio as described in 12 CFR 217.10(b)(4).

Common equity tier 1 capital has the same meaning as in 12 CFR 217.20(b).

Common equity tier 1 capital ratio has the same meaning as in 12 CFR 217.10(b)(1) and 12 CFR 217.10(c), as applicable.

Common equity tier 1 minority interest has the same meaning as in 12 CFR 217.2.

Covered IHC is defined in § 252.160.

Default right (1) Means any:

(i) Right of a party, whether contractual or otherwise (including rights incorporated by reference to any other contract, agreement or document, and rights afforded by statute, civil code, regulation and common law), to

liquidate, terminate, cancel, rescind, or accelerate such agreement or transactions thereunder, set off or net amounts owing in respect thereto (except rights related to same-day payment netting), exercise remedies in respect of collateral or other credit support or property related thereto (including the purchase and sale of property), demand payment or delivery thereunder or in respect thereof (other than a right or operation of a contractual provision arising solely from a change in the value of collateral or margin or a change in the amount of an economic exposure), suspend, delay or defer payment or performance thereunder, modify the obligations of a party thereunder or any similar rights; and

(ii) Right or contractual provision that alters the amount of collateral or margin that must be provided with respect to an exposure thereunder, including by altering any initial amount, threshold amount, variation margin, minimum transfer amount, the margin value of collateral or any similar amount, that entitles a party to demand the return of any collateral or margin transferred by it to the other party or a custodian or that modifies a transferee's right to reuse collateral or margin (if such right previously existed), or any similar rights, in each case, other than a right or operation of a contractual provision arising solely from a change in the value of collateral or margin or a change in the amount of an economic exposure; and

(2) Does not include any right under a contract that allows a party to terminate the contract on demand or at its option at a specified time, or from time to time, without the need to show cause.

Discretionary bonus payment has the same meaning as under 12 CFR 217.2.

Distribution has the same meaning as under 12 CFR 217.2.

Eligible internal debt security means a debt instrument that:

(1) Is paid in, and issued by a Covered IHC to and remains held by a company that is incorporated or organized outside of the United States that directly or indirectly controls the Covered IHC;

(2) Is unsecured and would represent the most subordinated debt claim in a receivership, insolvency, liquidation, or similar proceeding of the Covered IHC;

(3) Has a maturity at issuance of greater than 365 days (one year) from the date of issuance;

(4) Does not provide the holder of the instrument a contractual right to accelerate payment of principal or interest on the instrument;

(5) Has a contractual provision that is approved by the Board that provides for the immediate conversion or exchange of the instrument into common equity tier 1 of the Covered IHC, or the cancellation of the instrument, in either case upon issuance by the Board of an internal debt conversion order;

(6) Is governed by the laws of the United States or any State thereof; and

(7) Is not a structured note.

GAAP means generally accepted accounting principles as used in the United States.

Internal debt conversion order, with respect to a Covered IHC, means an order by the Board to immediately convert or exchange all eligible internal debt securities of the Covered IHC to common equity tier 1 capital or immediately cancel all eligible internal debt securities of the Covered IHC.

Internal TLAC buffer means, with respect to a Covered IHC, the sum of 2.5 percent and any applicable countercyclical capital buffer under 12 CFR 217.11(b) (expressed as a percentage).

Outstanding eligible internal long-term debt amount is defined in § 252.162(b).

Person has the same meaning as in 12 CFR 225.2.

Qualified financial contract has the same meaning as in section 210(c)(8)(D) of Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5390(c)(8)(D)) including, any ''swap'' defined in section 1a(47) of the Commodities Exchange Act (7 U.S.C. 1a(47)) and in any rules or regulations issued by the Commodity Futures Trading Commission pursuant to such section; any ''security-based swap'' defined in section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)) and in any rules or regulations issued by the Securities and Exchange Commission pursuant to such section; and any securities contract, commodity contract, forward contract, repurchase agreement, swap agreement, and any similar agreement that the Federal Deposit Insurance Corporation determines by regulation to be a qualified financial contract as provided in 12 U.S.C. 5390(c)(8)(D)(i).

Standardized total risk-weighted assets has the same meaning as in 12 CFR 217.2.

Structured note means a debt instrument that:

(1) Has a principal amount, redemption amount, or stated maturity that is subject to reduction based on the performance of any asset, entity, index, or embedded derivative or similar embedded feature;

(2) Has an embedded derivative or other similar embedded feature that is linked to one or more equity securities, commodities, assets, or entities;

(3) Does not specify a minimum principal amount due upon acceleration or early termination; or

(4) Is not classified as debt under GAAP.

Supplementary leverage ratio has the same meaning as in 12 CFR 217.10(c)(4).

Tier 1 minority interest has the same meaning as in 12 CFR 217.2.

Tier 2 capital has the same meaning as in 12 CFR 217.20(d).

Total leverage exposure has the same meaning as in 12 CFR 217.10(c)(4)(ii).

Total risk-weighted assets, with respect to a Covered IHC, is equal to the Covered IHC's standardized total risk-weighted assets.

§ 252.162 Internal long-term debt requirement.

(a) *Internal long-term debt requirement.* A Covered IHC must have an outstanding eligible internal long-term debt amount that is no less than the amount equal to the greater of:

(1) 7 percent of the Covered IHC's total risk-weighted assets;

(2) If the Covered IHC is required to maintain a minimum supplementary leverage ratio, 3 percent of the Covered IHC's total leverage exposure; and

(3) 4 percent of the Covered IHC's average total consolidated assets.

(b) *Outstanding eligible internal long-term debt amount.* A Covered IHC's outstanding eligible internal long-term debt amount is the sum of:

(1) One hundred (100) percent of the unpaid principal amount of the outstanding eligible internal debt securities issued by the Covered IHC that have a remaining maturity greater than or equal to 730 days (two years); and

(2) Fifty (50) percent of the unpaid principal amount of the outstanding eligible internal debt securities issued by the Covered IHC that have a remaining maturity of greater than or equal to 365 days (one year) and less than 730 days (two years); and

(3) Zero (0) percent of the unpaid principal amount of the outstanding eligible internal debt securities issued by the Covered IHC that have a remaining maturity of less than 365 days (one year).

(c) *Redemption and repurchase.* Without the prior approval of the Board, a Covered IHC may not redeem or repurchase any outstanding eligible internal debt security if, immediately after the redemption or repurchase, the Covered IHC would not have an outstanding eligible internal long-term debt amount that is sufficient to meet its internal long-term debt requirement under paragraph (a) of this section.

§ 252.163 Internal debt conversion order.

(a) The Board may issue an internal debt conversion order if:

(1) The Board has determined that the Covered IHC is in default or danger of default; and

(2) Any of the following circumstances apply:

(i) A foreign banking organization that directly or indirectly controls the Covered IHC or any subsidiary of the top-tier foreign banking organization has been placed into resolution proceedings (including the application of statutory resolution powers) in its home country;

(ii) The home country supervisor of the top-tier foreign banking organization has consented or not promptly objected after notification by the Board to the conversion, exchange, or cancellation of the eligible internal debt securities of the Covered IHC; or

(iii) The Board has made a written recommendation to the Secretary of the Treasury pursuant to 12 U.S.C. 5383(a) regarding the Covered IHC.

(b) For purposes of paragraph (a) of this section, the Board will consider:

(1) A Covered IHC in default or danger of default if

(i) A case has been, or likely will promptly be, commenced with respect to the Covered IHC under the Bankruptcy Code (11 U.S.C. 101 *et seq.*);

(ii) The Covered IHC has incurred, or is likely to incur, losses that will deplete all or substantially all of its capital, and there is no reasonable prospect for the Covered IHC to avoid such depletion;

(iii) The assets of the Covered IHC are, or are likely to be, less than its obligations to creditors and others; or

(iv) The Covered IHC is, or is likely to be, unable to pay its obligations (other than those subject to a bona fide dispute) in the normal course of business; and

(2) An objection by the home country supervisor to the conversion, exchange or cancellation of the eligible internal debt securities to be prompt if the Board receives the objection no later than 48 hours after the Board requests such consent or non-objection from the home country supervisor.

§ 252.164 Internal total loss-absorbing capacity requirement and buffer.

(a) *Internal total loss-absorbing capacity requirement.* Except as provided in paragraph (b) of this section, a Covered IHC must have an outstanding internal total loss-absorbing capacity amount that is no less than the amount equal to the greater of:

(1) (i) From January 1, 2019 through December 31, 2021, 16 percent of the Covered IHC's total risk-weighted assets; and

(ii) Beginning January 1, 2022, 18 percent of the Covered IHC's total risk-weighted assets;

(2) If the Board requires the Covered IHC to maintain a minimum supplementary leverage ratio, 6.75 percent of the Covered IHC's total leverage exposure; and

(3) Nine (9) percent of the Covered IHC's average total consolidated assets.

(b) *Internal total loss-absorbing capacity requirement for a Covered IHCs that is a non-resolution entity.* A Covered IHC that is a non-resolution entity must have an outstanding internal total loss-absorbing capacity no less than the amount equal to the greater of:

(1) (i) From January 1, 2019 through December 31, 2021, 14 percent of the Covered IHC's total risk-weighted assets; and

(ii) Beginning January 1, 2022, 16 percent of the Covered IHC's total risk-weighted assets;

(2) If the Board requires the Covered IHC to maintain a minimum supplementary leverage ratio, 6 percent of the Covered IHC's total leverage exposure; and

(3) Eight (8) percent of the Covered IHC's average total consolidated assets.

(c) *Internal Total loss-absorbing capacity amount.* A Covered IHC's internal total loss-absorbing capacity amount is equal to the sum of:

(1) The Covered IHC's common equity tier 1 capital (excluding any common equity tier 1 minority interest) held by a company that is incorporated or organized outside of the United States and that directly or indirectly controls the Covered IHC;

(2) The Covered IHC's additional tier 1 capital (excluding any tier 1 minority interest) held by a company that is incorporated or organized outside of the United States and that directly or indirectly controls the Covered IHC; and

(3) The Covered IHC's outstanding eligible internal long-term debt amount plus 50 percent of the unpaid principal amount of outstanding eligible internal debt securities issued by the Covered IHC that have a remaining maturity of greater than or equal to 365 days (one year) but less than 730 days (two years).

(d) *Identification of non-resolution entities.* (1) A Covered IHC is a non-resolution entity for purposes of this section if the home country resolution authority for the top-tier foreign banking organization that controls the Covered IHC has certified to the Board that the authority's planned resolution strategy for the foreign banking organization does not involve the Covered IHC or the subsidiaries of the Covered IHC entering resolution, receivership, insolvency or similar proceedings in the United States.

(2) A Covered IHC will cease to be a non-resolution entity 365 days (one year) from the date the Board first provided notice to the Covered IHC that the home country resolution authority for the top-tier foreign banking organization that controls the Covered IHC has indicated that the authority's planned resolution strategy for the foreign banking organization involves the Covered IHC or one or more of the subsidiaries of the Covered IHC entering resolution, receivership, insolvency or similar proceedings in the United States.

(e) *Internal TLAC buffer.*—(1) *Composition of the internal TLAC buffer.* The internal TLAC buffer is composed solely of common equity tier 1 capital.

(2) *Definitions.* For purposes of this paragraph, the following definitions apply:

(i) *Eligible retained income.* The eligible retained income of a Covered IHC is its net income for the four calendar quarters preceding the current calendar quarter, based on the Covered IHC's FR Y–9C, or other applicable regulatory report as determined by the Board, net of any distributions and associated tax effects not already reflected in net income. Net income, as reported in the FR Y–9C, reflects discretionary bonus payments and certain distributions that are expense items (and their associated tax effects).

(ii) *Maximum internal TLAC payout ratio.* The maximum internal TLAC payout ratio is the percentage of eligible retained income that a Covered IHC can pay out in the form of distributions and discretionary bonus payments during the current calendar quarter. The maximum internal TLAC payout ratio is based on the Covered IHC's internal TLAC buffer level, calculated as of the last day of the previous calendar quarter, as set forth in Table 1 to § 252.164.

(iii) *Maximum internal TLAC payout amount.* A Covered IHC's maximum internal TLAC payout amount for the current calendar quarter is equal to the Covered IHC's eligible retained income, multiplied by the applicable maximum internal TLAC payout ratio, as set forth in Table 1 to § 252.164.

(3) *Calculation of the internal TLAC buffer level.* (i) A Covered IHC's internal TLAC buffer level is equal to the Covered IHC's common equity tier 1 capital ratio (expressed as a percentage) minus the greater of zero and the following amount:

(A) (*1*) From January 1, 2019, through December 31, 2021, 14 percent for a

Covered IHC that is a non-resolution entity, and 16 percent for all other Covered IHCs; and

(*2*) Beginning January 1, 2022, 16 percent for a Covered IHC that is a non-resolution entity, and 18 percent for all other Covered IHCs; minus

(B) The ratio (expressed as a percentage) of the Covered IHC's additional tier 1 capital (excluding any tier 1 minority interest) held by a company that is incorporated or organized outside of the United States and that directly or indirectly controls the Covered IHC to its total risk-weighted assets; and minus

(C) The ratio (expressed as a percentage) of the Covered IHC's eligible internal long-term debt to total risk-weighted assets.

(ii) (A) Except as provided in paragraph (e)(3)(ii)(B) of this section and notwithstanding paragraph (e)(3)(i) of this section, if the ratio (expressed as a percentage) of the Covered IHC's internal total loss-absorbing capacity amount, as calculated under § 252.164(a), to the Covered IHC's risk-weighted assets is less than or equal to, from January 1, 2019, through December 31, 2021, 16 percent and beginning January 1, 2022, 18 percent, the Covered IHC's internal TLAC buffer level is zero.

(B) With respect to a Covered IHC that is a non-resolution entity, notwithstanding paragraph (e)(3)(i) of this section, if the ratio (expressed as a percentage) of the Covered IHC's internal total loss-absorbing capacity amount, as calculated under § 252.164(b), to the Covered IHC's risk-weighted assets is less than or equal to, from January 1, 2019, through December 31, 2021, 14 percent and beginning January 1, 2022, 16 percent, the Covered IHC's internal TLAC buffer level is zero.

(4) *Limits on distributions and discretionary bonus payments.* (i) A Covered IHC shall not make distributions or discretionary bonus payments or create an obligation to make such distributions or payments during the current calendar quarter that, in the aggregate, exceed the maximum internal TLAC payout amount.

(ii) A Covered IHC with an internal TLAC buffer level that is greater than the internal TLAC buffer is not subject to a maximum internal TLAC payout amount.

(iii) Except as provided in paragraph (e)(4)(iv) of this section, a Covered IHC may not make distributions or discretionary bonus payments during the current calendar quarter if the Covered IHC's:

(A) Eligible retained income is negative; and

(B) Internal TLAC buffer level was less than the internal TLAC buffer as of the end of the previous calendar quarter.

(iv) Notwithstanding the limitations in paragraphs (e)(4)(i) through (iii) of this section, the Board may permit a Covered IHC to make a distribution or discretionary bonus payment upon a request of the Covered IHC, if the Board determines that the distribution or discretionary bonus payment would not be contrary to the purposes of this section, or to the safety and soundness of the Covered IHC. In making such a determination, the Board will consider the nature and extent of the request and the particular circumstances giving rise to the request.

TABLE 1 TO § 252.164—CALCULATION OF MAXIMUM INTERNAL TLAC PAYOUT AMOUNT

Internal TLAC buffer level	Maximum internal TLAC payout ratio (as a percentage of eligible retained income)
Greater than the internal TLAC buffer	No payout ratio limitation applies
Less than or equal to the internal TLAC buffer, *and* greater than 75 percent of the internal TLAC buffer.	60 percent.
Less than or equal to 75 percent of the internal TLAC buffer, *and* greater than 50 percent of the internal TLAC buffer.	40 percent.
Less than or equal to 50 percent of the internal TLAC buffer, *and* greater 25 percent of the internal TLAC buffer.	20 percent.
Less than or equal to 25 percent of the internal TLAC buffer	0 percent.

(v) (A) A Covered IHC is subject to the lowest of the maximum payout amounts as determined under 12 CFR 217.11(a)(2)(iii) and (iv) and the maximum internal TLAC payout amount as determined under this paragraph.

(B) Additional limitations on distributions may apply to a Covered IHC under 12 CFR 225.4, 225.8, and 263.202.

§ 252.165 Restrictions on corporate practices of intermediate holding companies of foreign banking organizations.

A Covered IHC may not directly:

(a) Issue any debt instrument with an original maturity of less than 365 days (one year), including short term deposits and demand deposits, to any person, unless the person is an affiliate of the covered IHC;

(b) Issue any instrument, or enter into any related contract, with respect to which the holder of the instrument has a contractual right to offset debt owed by the holder or its affiliates to the Covered IHC or a subsidiary of the Covered IHC against the amount, or a portion of the amount, owed by the Covered IHC under the instrument;

(c) Enter into a qualified financial contract with a person that is not an affiliate of the Covered IHC;

(d) Guarantee a liability of an affiliate of the Covered IHC if such liability permits the exercise of a default right that is related, directly or indirectly, to the Covered IHC becoming subject to a receivership, insolvency, liquidation, resolution, or similar proceeding other than a receivership proceeding under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5381 through 5394); or

(e) Enter into, or otherwise benefit from, any agreement that provides for its liabilities to be guaranteed by any of its subsidiaries.

By order of the Board of Governors of the Federal Reserve System, November 17, 2015.

Robert deV. Frierson,

Secretary of the Board.

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