Via Electronic Submission to: regs.comments@federalreserve.gov

January 12, 2016

Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Subject: Docket No. R-1523 and RIN 7100 AE-37; Comment on Total Loss Absorbing Capacity Rule

Dear Mr. deV Frierson,

I am writing to you today on behalf of the CtW Investment Group to share our comments on the proposed Total Loss Absorbing Capacity Rule. We are pleased that the Federal Reserve is making progress in implementing the rules called for by the Dodd Frank Act; however, the proposals regarding "eligible external long term debt" raised serious questions for us. Because the proposal deters Global Systemically Important Banks and their subsidiaries from holding this debt, pension funds like my organization will likely be among the primary investors in this new form of "debt". However, we are concerned that the rule as currently written opts to privilege the interests of issuers over those of investors, exposing our funds and others like them to unnecessary risks. This seems especially unfortunate as it was, in our view, the strong preference among federal regulators for issuers over investors that enabled the accumulation of highly risky asset-backed securities and derivatives on the balance sheets of investors for whom those were inappropriate, and which in turn caused the freezing up of credit markets in 2008-2009. We urge you to consider these comments and modify the proposed rule in order to ensure that investors have the information they need to determine if these securities are appropriate for them.

The CtW Investment Group works with union-sponsored pension funds sponsored by affiliates of Change to Win to enhance long-term shareholder value through active ownership. These funds have over $250 billion in assets under management.

Need for Substantial Disclosure

As with any new financial product, adequate disclosure is essential to ensure that potential investors are fully informed of the risks they are taking on with the product. That imperative, however, is even greater here where there are several ways in which proper disclosure will apparently not be required for this debt.

In the case of contractual subordination, the proposed rule acknowledges (at CFR 74937) that explicit contractual subordination would improve market discipline, clarity, and transparency for investors. However, the rule then proposes not to include a requirement for clear and explicit subordination in the contract, in order to improve the marketability of the instrument. The assumption appears to be that investors will be more likely to purchase the product if they understand less about the associated risks and rights. Also implicit is the assumption that explicit contractual subordination will provide significant new information to investors. In such a case, we believe that the investor must receive the information, and we believe that the rule currently does not properly balance concerns about marketability and investor transparency. We urge you to require explicit contractual subordination in eligible long term debt.

In the case of acceleration clauses, the proposed rule contemplates permitting such acceleration clauses on event of payment default (CFR 74936) despite the intention to preserve eligible LTD for a resolution, on the basis that any payment default is likely to be an insolvency event. Again, marketability is cited as the reason. We believe that investors should have maximum clarity concerning the possible equity conversion or liquidation of this debt given bank insolvency and resolution. As the proposal itself acknowledges, acceleration clauses on payment default are highly likely to be unusable. Their inclusion will therefore be deceptive for investors, and they should not be permitted.

Those disclosure concerns are compounded by the current efforts to roll back investors' access to information. The disclosure review initiative at the SEC and the new accounting rule on materiality are only two examples of a broader, aggressive campaign to limit corporate disclosures. Without sufficient disclosure and a clear understanding of how this debt will operate, investors run the risk of grossly mispricing the associated risk.

To address these problems, contractual subordination should be required and made explicit, and any clauses that create the impression that this debt is likely to receive priority payment in a situation where a bank is effectively insolvent should be prohibited. In addition, the Fed should publish a clean data series with information on the spreads on this instrument relative to secured or more senior debt. Without these protections, we as investors run the risk of grossly underpricing the risk of these new instruments and perpetuating the systemic risks the rules seek to avoid.

Issue Subordinated LTD as Executive Compensation

We believe that the rule would be substantially improved by mandating that a substantial share of executive compensation for bank executives be given in the form of eligible external long term debt. Such an arrangement would properly align executives' incentives with the interests of the public and debt investors better than most compensation practices we are aware of. It would also serve as a mechanism to implement the incentive compensation reforms called for in Section 956 of the Dodd-Frank Act. Importantly, it would greatly expand the market for this debt, and reduce the likelihood that this inherently risky debt would be inappropriately marketed to pension funds and mutual funds seeking a safe long-term investment.

We Support "Gone Concern Capital" not "Going Concern Capital"

We wish also to identify our support for the explicit ban on converting eligible external long-term debt in any circumstance outside of the resolution of a failing bank. Not only would permitting conversion prior to resolution reduce the financial stability benefits of this debt, it would increase risks to investors. Similarly, we support an explicit ban on conversion of internal TLAC in any circumstance outside of an explicit decision by the Board or a clear insolvency event.

Simultaneously, however, we wish to again highlight the imperative of contractual clarity and adequate disclosure on this point. In the discussion of the calibration of the requirements, the proposed rules state, "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."[1] It is essential that the final rule be perfectly clear on the question of what will trigger the conversion of LTD. The relevant contracts and any related disclosures should also comprehensively and clearly disclose any event that could potentially lead to the conversion of LTD to equity and/or its depletion.

If you have any additional questions or would like clarification on any of these points, please reach out to Richard Clayton at richard.clayton@changetowin.org or at 202 721 6038.

Sincerely,

Dieter Waizenneger
Executive Director
CtW Investment Group

[1] Proposed rules 80 FR 74932. Available at: https://www.federalregister.gov/articles/2015/11/30/2015-29740/total-loss-absorbing-capacity-long-term-debt-and-clean-holding-company-requirements-for-systemically#p-143