Meeting Between Staff of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, and Representatives from the Securities Industry and Financial Markets Association (SIFMA) and its Asset Management Group of SIFMA (SIFMA AMG) and Member Banking Organizations
February 27, 2024

Participants: Lars Arnesen, Lesley Chao, Ryan Engler, Jacob Fraley, Charles Gray, Benjamin Kay, Brian Kesten, Francis Kuo, Vivien Lee, Reena Sahni, and William Treacy (Federal Reserve Board); Diosmedis Jara (Federal Reserve Bank of New York); Mark House (Federal Reserve Bank of Richmond)

Elizabeth Falloon, Andrew Felton, Dena Kessler, Julie Paris, Jacques Schillaci, Ryan Singer, Richard Starke, Kenneth Stinson, Angus Tarpley III, and Ryan Tetrick (Federal Deposit Insurance Corporation)

Carl Kaminski, JungSup Kim, Joanne Phillips, Margot Schwadron, and Andrew Tschirhart (Office of the Comptroller of the Currency)

Carter McDowell, Peter Ryan, Joe Seidel, and Guowei Zhang (SIFMA); Kevin Elrlich and Lindsey Keljo (SIFMA AMG); Anna Harrington (Charles Schwab); Felton Booker, Christopher Cafiero, and Alizeh Hussain (JP Morgan Chase); Bengt Redlinger (Bank of America); Lucy Brusco (Morgan Stanley); Caroline Kraus (Goldman Sachs); Brian Salley (HSBC); Jennifer Imler and Kevin Parker (SMBC); Michele Jones and Jeff Siegel (BNP Paribas)

Summary: Staff of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency (agencies) met with representatives of SIFMA, SIFMA AMG, and several SIFMA member banking organizations regarding the agencies' notice of proposed rulemaking on long term debt requirements (LTD proposal). The representatives discussed their views on the LTD proposal, including the proposed requirements at both the holding company and bank levels and the proposed minimum denomination requirement for long-term debt issuances.

Attachment

Long-Term Debt Proposal: Market Impacts and Recommendations

PRESENTED BY

SIFMA & SIFMA AMG

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NEW YORK 120 Broadway, 35th Floor | New York N.Y. 10271 | **WASHINGTON** 1099 New York Avenue, NW, 6th Floor | Washington, D.C. 20001

1 Executive Summary

- SIFMA and the Asset Management Group of SIFMA (SIFMA AMG) strongly support efforts to ensure there is adequate gone loss-absorbing capacity in the U.S. banking system.

- However, the long-term debt (LTD) proposal would simultaneously **impede demand** for LTD while drastically **increasing supply**. This would have significant **adverse effects on investor choice, bank funding costs, and market liquidity.**

- We recommend that the agencies fully consider the **costs and benefits** of the proposed changes and **proceed deliberatively** before finalizing the rule. More specifically, we recommend the following changes:

  - **Eliminate the Minimum Denomination Requirement:** The proposed minimum denomination requirement for newly issued eligible LTD should not be included in the final rule.

  - **Account for Interaction with the Basel Endgame and Other Proposals:** The LTD proposal should only be finalized once the Basel III Endgame and other capital proposals have been finalized. The transition period for the LTD rule should also follow the transition period for the Basel Endgame.

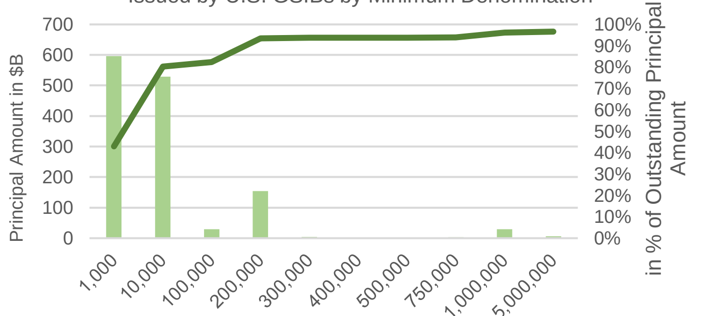
  - **Modify the Internal LTD Requirement:** Firms should have the option of complying with the LTD requirement at *either* the holding company or the IDI-level, but not both. If an internal requirement is retained, it should be recalibrated downwards and allowed to be satisfied through other secured loss-absorbing instruments. We also support the exemption from the internal requirement for U.S. GSIBs, and recommend it be extended to foreign GSIB IHCs and non-GSIB large bank retail broker-dealers.

  - **Other Issues:** The proposed changes to the existing TLAC rule not be adopted or at least grandfathered in; the definition of a "covered debt instrument" should be clarified; changes should be made to the QFC provisions and scope of the clean holding company requirements; and the agencies should recognize the differing levels of risks posed by different types of uninsured deposits.

2 Minimum Denomination Requirement

- **Direct investment by retail investors in U.S. banks' LTD is already extremely low.**
  - Fed data show that 1% of individuals hold bonds directly. These investors tend to be more sophisticated as bond transactions require a broker and are subject to disclosure requirements.
  - Investors may also hold bonds in professionally managed accounts. These investors tend to be higher net-worth individuals. Recommendations and advice are subject to Reg BI or Investment Adviser fiduciary obligations.
  - Retail investors generally only have exposure to bonds indirectly through pooled investment funds such as mutual funds and ETFs.
- **A $400k denomination would limit participation from a wide swathe of institutional investors.**
  - Institutional investors rely on smaller denominations to manage position sizes and liquidity needs.
  - We estimate that it would be impractical for over half of the mutual funds and ETFs that track the U.S. Aggregate Bond index to invest in LTD with a $400k denomination.
- **A $400k denomination would hurt liquidity and likely increase the cost of LTD funding for banks.**
  - The proposal would exclude 90% of the existing eligible LTD issued by the U.S. GSIBs (see Figure 1).
  - Most trade sizes are less than $400k; a larger denomination would hurt secondary market liquidity (see Figure 2).

Figure 1: Outstanding Principal Amount of Debt Securities Issued by U.S. GSIBs by Minimum Denomination



Source: TRACE

Figure 2: Number of Trades of Debt Securities issued of US GSIB Holding Companies over 4 Weeks by Trade Size

Source: TRACE

3 Interaction with Basel Endgame and Other Proposals

- The proposal and its estimates do not consider the impact of the **Basel III Endgame and the GSIB surcharge proposals** on the amount of new LTD that will need to be issued and the cost of that issuance for banking organizations.

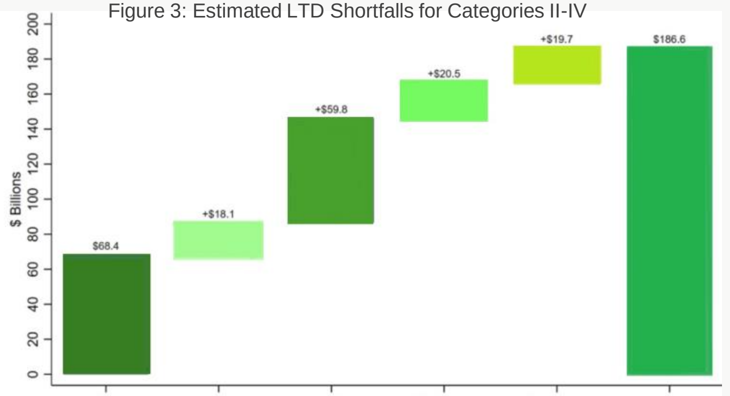
- The proposals would **significantly increase RWAs** for large banking organizations.
  - Estimates indicate there would be a **$50.3bn increase** in LTD requirements for the 8 U.S. GSIBs and a **$20.5bn** increase in LTD requirements for Categories II-IV firms owing solely to Basel-related RWA capital increases.
  - This would come on top of the **increased TLAC requirement** for the 8 U.S. GSIBs resulting from the Basel Endgame, which is estimated to be **$322.6bn**.
  - In addition, the proposed changes to the GSIB surcharge could impact the calculation and calibration of the external LTD requirement for U.S. GSIBs under the TLAC rule.

- As such, we recommend that the LTD proposal should be:
  - **Finalized only once the Basel III Endgame and other capital proposals are also finalized** so that the total amount and cost of LTD – and therefore its impacts – can be fully understood.
  - **Implemented following the implementation of the Basel Endgame**. This would help to facilitate the accretion of capital at banking organizations and minimize negative impacts on borrowers. It would also ensure the market can absorb the large volume of new LTD issuances.

4 Internal LTD Requirement

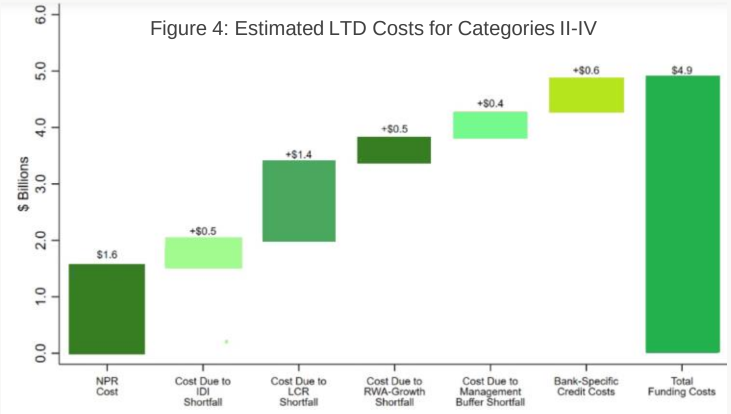
- The internal LTD requirement would create a **two-tiered requirement** for Category II-IV firms and contribute to **a significant over-calibration of LTD** for those firms**,** which will **have to be met through external issuance**.
  - This will further increase funding costs & negatively impact firms' ability to provide credit & capital markets services.
  - It will also push up the supply of LTD at a time when demand may be impeded, with negative impacts on market liquidity.
- This over-calibration of external LTD levels would occur because the firm may need to maintain a certain level of liquidity at the holding company (i.e., to meet the holding company's LCR requirement).
  - As a result, incremental internal debt will need to be financed by issuing more external debt – regardless of whether the holding company already meets the external LTD requirement.
- This will **increase the amount of LTD that will need to be issued, as well as funding costs for covered firms.**
  - **$77.9bn** of the aggregate $186.6bn LTD shortfall for Categories II-IV banking institutions can be attributed to the internal requirement (i.e., the IDI + LCR shortfall in Figure 3)
  - **$1.9bn** of the aggregate $4.9bn in funding costs for Categories II-IV firms can be attributed to the internal requirement (costs due to IDI + LCR shortfalls in Figure 4).

Figure 3: Estimated LTD Shortfalls for Categories II-IV



Source: BPI

Figure 4: Estimated LTD Costs for Categories II-IV



Source: BPI

4 Internal LTD Requirement

- The best way to avoid this over-calibration would be to permit covered holding companies to comply with the LTD requirement at **either the holding company or IDI level - but not both**.

- If retained, the internal LTD requirement should be modified to reduce its impact on the holding company's liquidity requirements/LTD issuance.
  - First, consider replacing the internal LTD requirement with a more flexible "**gone loss-absorbing capacity requirement**" that includes additional loss-absorbing instruments backed by secured support agreements.
  - Second, the internal requirement should be recalibrated **downwards to 2% of RWA** for Categories III and IV firms (with commensurate changes to the leverage-based requirements). This calibration would ensure **adequate recapitalization** of the institution (based on different – but reasonable – assumptions to those included in the proposal). It would also be consistent with the legal requirement to tailor enhanced prudential standards.

- For the reasons we discuss in our letter, we **strongly support the exemption of IDI subsidiaries of U.S. GSIBs** from the proposed internal requirement. That exemption should also be extended to:
  - The IDI subsidiaries of the **IHCs of foreign GSIBs**; and
  - The IDI subsidiaries of **non-GSIB large banking organizations that operate primarily as retail broker-dealers**.

5 Other Issues

- **Changes to the Existing TLAC Rule:**
  - The proposed changes to the calculation of TLAC should not be adopted. Modifying the TLAC calculation method, particularly when significant RWA increases are expected as a result of the Basel III Endgame, would impair firms' funding plans and business strategies without yielding any significant benefit.
  - However, if the changes are adopted, they should only apply to newly issued LTD so as not to subject firms' long-standing funding plans to sudden and disruptive changes.
- **Clean Holding Company Requirements:**
  - The proposal's limited exemptions to the prohibition on covered entity holding companies entering QFC arrangements with third parties should be expanded to cover normal course transactions that do not conflict with the agencies' underlying policy objectives.
  - The agencies should also clarify that since clean holding company requirements are primarily designed to facilitate an SPOE resolution, the same requirements should not be applied to firms with alternative resolution strategies.
- **Covered Debt Instrument Definition:**
  - The agencies should clarify that the definition of "covered debt instrument" only applies to an IDI subject to the LTD requirement.
- **Uninsured Deposits:**
  - The agencies have asked about the different types of uninsured deposits and are urged to recognize the differing levels of risks posed by different types of these deposits.