



July 1, 2016

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Robert deV. Frierson, Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, N.W.
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Re: 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 Unsecured Debt of Systemically Important U.S. Bank Holding Companies

Ladies and Gentlemen:

The Institute of International Bankers (the “IIB”), the Securities Industry and Financial Markets Association (“SIFMA”) and The Clearing House Association (“TCH” and together with IIB and SIFMA, the “Associations”) appreciate the opportunity to provide supplemental comments on the recent proposal (the “Proposed Rules”) by the Board of Governors of the Federal Reserve System (the “Board”) regarding total loss-absorbing capacity (“TLAC”), long-term debt (“LTD”) and clean holding company requirements for systemically important U.S. bank holding companies (“Covered BHCs”) and the intermediate holding companies (“Covered IHCs”) of systemically important foreign banking organizations (“FBOs”).¹ This letter supplements the IIB’s previous comment letter in respect of the Proposed Rules dated February 19, 2016 (the “IIB Letter”) and the letter submitted by SIFMA, TCH and other trade associations dated February 19, 2016 (the “Joint Trades Letter”).²

¹ 80 Fed. Reg. 74926 (November 30, 2015).

² The comments and recommendations included in this letter are limited to the specific facts and circumstances presented by a Covered IHC issuing internal LTD to a foreign parent. We have not considered and are not in this letter commenting on any tax or other issues that may or may not arise in connection with the internal issuance of TLAC debt instruments by domestic subsidiaries of a Covered IHC or Covered BHC.

As discussed in the IIB Letter and the Joint Trades Letter, the Associations support the work that the Board and other authorities have done to develop credible strategies for the orderly resolution of global systemically important banks, and we recognize the utility of a TLAC framework as a mechanism to facilitate the execution of those strategies on a cross-border basis. However, various aspects of the Proposed Rules are not necessary to achieve these ends and would impose onerous costs on Covered IHCs that Covered BHCs would not have to bear and place Covered IHCs at a significant competitive disadvantage compared with comparably sized non-G-SIB U.S. bank holding companies, many of which are direct competitors of Covered IHCs.

Among those aspects are the eligibility requirements applicable only to internal LTD. The Proposed Rules would require that internal LTD, but not external LTD:

- (a) Contain a contractual conversion provision that would allow the Board to cancel internal LTD or convert it into equity, in both cases on a going-concern basis outside of resolution proceedings (the “Conversion Requirement”);
- (b) Be contractually subordinated to all other liabilities of the Covered IHC (the “Subordination Requirement”); and
- (c) Exclude any acceleration clauses (the “Acceleration Prohibition”).

As noted in the IIB Letter, the proposed imposition of these requirements appears to have been based on the incorrect assumption that a Covered IHC would have more flexibility than a Covered BHC to price its LTD because the pricing would not need to reflect market demand or pricing. Contrary to this assumption, Covered IHCs and their non-U.S. affiliates transact on arm’s-length terms. As a result, features that would increase the cost of instruments issued to third parties would also increase the cost of instruments issued to affiliates.

In addition to increasing the cost of internal LTD, the Conversion Requirement as proposed raises a substantial risk that internal LTD would be characterized as equity, rather than debt, for U.S. tax purposes. Notwithstanding such a characterization under U.S. tax law, we understand that coupon payments on internal LTD are likely to be treated as debt in FBOs’ home jurisdictions. The overall result would therefore be the incurrence by FBOs of tax costs in respect of internal LTD substantially in excess of those that would arise from either conventional debt or conventional equity.

In Section I, this letter describes amendments that could be made to the Proposed Rules that we believe should make it possible to treat internal LTD as debt for U.S. federal income tax purposes under current law. A mark-up of the Proposed Rules implementing these amendments is attached as Exhibit A. However, since debt-equity characterization is inherently fact-specific, and internal LTD even modified as we propose below would have terms that have never been approved by the Internal Revenue Service (the “IRS”) or the courts as consistent with debt characterization, any conclusions by tax advisors regarding debt characterization would be highly reasoned. While a number of leading law firms have reviewed our proposal and agree with our approach, the tax analysis of the final rules will depend on their actual terms. It is not

certain that every tax advisor would conclude that internal LTD modified as proposed should be treated as debt for tax purposes, or that every FBO would be prepared to go forward on the basis of a reasoned “should” opinion. Because of the substantial amount of internal LTD that Covered IHCs would be required to issue under the Proposed Rules and the correspondingly substantial adverse tax consequences of equity characterization, which are summarized in Exhibit B, it is likely that—as a practical matter—the characterization of internal LTD as debt would need ratification by the IRS and U.S. Department of the Treasury (“Treasury”). It is our understanding that the IRS and Treasury are likely to provide such ratification only if the Conversion Requirement is modified to address the issues described below in Section I.A.

In addition, the IRS and Treasury recently proposed regulations under section 385 of the Internal Revenue Code (the “385 Proposal”) addressing debt-equity characterization for related party debt in a more comprehensive manner.³ Those proposed regulations would override current law and, we think, make it virtually impossible to be sure that internal LTD would be treated as debt for U.S. tax purposes. We are engaged in separate discussions with Treasury on the 385 Proposal and its treatment of internal LTD and we believe the IRS and Treasury will need to modify the proposal to exclude such instruments from the requirements of any final regulations. In its comment letter to Treasury in response to the 385 Proposal, the IIB has proposed such a safe harbor.

In Section II, this letter quantifies the increased cost to Covered IHCs (but not Covered BHCs) of certain of the eligibility criteria for internal LTD that do not apply to external LTD.

I. Addressing the Tax Consequences of the Conversion Requirement

Below, we set out the primary reasons why the Conversion Requirement as proposed makes it difficult to conclude that internal LTD will be treated as debt for U.S. tax purposes. We then describe how the changes we propose in Exhibit A should address these concerns while continuing to ensure that a Covered IHC may be recapitalized and its losses shifted to its foreign parent without the commencement of insolvency proceedings.⁴

A. Tax Concerns Raised by the Conversion Provision

There is no statutory or regulatory test for determining whether a given instrument is debt instead of equity for purposes of U.S. tax law. Instead, courts and the IRS have historically been guided by certain principles. These principles include: (1) debt must have an unqualified obligation by the issuer to repay a sum certain within a specified reasonable time frame, or on demand; and (2) debt holders must have adequate legal remedies if payment is not made when due. Conversely, (3) debt may not share in the economic risks (particularly

³ Internal Revenue Service, Treatment of Certain Interests in Corporations as Stock or Indebtedness (REG-108060-15), 81 Fed. Reg. 20,912 (Apr. 8, 2016).

⁴ As discussed in the IIB Letter and the Joint Trades Letter, it is our view that neither an internal LTD requirement nor a Conversion Requirement is consistent with the purposes of internal TLAC. We continue to maintain this view for the reasons articulated by the Associations and other commenters. The changes proposed in Exhibit A would only be necessary if the Board, notwithstanding such arguments, imposed an internal LTD requirement and required such LTD to be convertible into equity outside of insolvency proceedings.

downside risks) of the enterprise, and therefore, among other matters, must be expected to be repaid when it is issued and must be senior to equity.⁵

Debt-equity tax law is concerned primarily with the application of these principles to related party debt, since third parties generally are assumed to negotiate at arm's length for adequate legal protections to their interests. The fact that the internal LTD rules require that LTD be issued to a foreign parent rather than permitting issuance to third parties is in and of itself an "equity" characteristic weighing against debt characterization.

More generally, various aspects of the Conversion Requirement as proposed are directly in conflict with the principles described above.

1. *Priority*

It is a fundamental principle of U.S. tax law that debt must be senior to equity. As proposed, the Conversion Requirement is inconsistent with this principle for two reasons. First, under the Conversion Requirement, internal LTD would need to "provide for . . . the cancellation of the instrument" upon the Board's issuance of an internal debt conversion order.⁶ Such a cancellation provision would be inconsistent with the principle that debt is senior to equity because a cancellation of internal LTD would result in the subordination of the LTD to existing equity: The LTD would bear losses, while the existing equity retains and indeed increases in value.

Second, under the Conversion Requirement as proposed, internal LTD would be subject to conversion into common equity tier 1 ("CET1") while existing CET1 and other classes of equity remain outstanding. Such a conversion would result in internal LTD being *pari passu* with, rather than senior to, existing CET1 and potentially subordinated to other classes of equity (e.g., preferred shares).

2. *Unqualified Obligation to Pay*

It is also a fundamental tenet of U.S. tax law that a debt obligation must contain an unqualified promise to repay principal at a fixed time. A provision mandating the conversion

⁵ These concepts are embodied in section 1.385-2 of the 385 Proposal (the "documentation rules"). While the procedural requirements of that regulation are new, the fundamental standards—unqualified promise to pay, adequate creditor remedies and expectation of repayment—embody decades of statutory, judicial and administrative law on debt-equity tax issues.

Section 385 itself identifies five critical debt terms relevant to the debt/equity determination. Four of those are whether there is an unqualified promise to pay a sum certain at a fixed time (a debt characteristic), whether the debt is subordinated (an equity characteristic), whether the debt is convertible (an equity characteristic) and whether the debt is held by related parties (an equity characteristic). Internal LTD as proposed is on the "wrong" side of each of these factors.

⁶ 80 Fed. Reg. at 74962.

of an instrument into common equity, which legally need not receive regular payments, is by its terms in direct conflict with that requirement.⁷

It is useful to contrast a contractual conversion term with the possibility that a debt instrument might be converted into equity in a formal legal proceeding such as bankruptcy or a resolution proceeding, which is not of concern as a matter of tax law. There are a number of key differences.

First, conversion into equity in a proceeding of that kind is the result of statutory law governing all debt instruments, not a contractual term included in only a particular debt instrument. Second, conversion takes place only at a point when it is not possible for an issuer to continue operating as a going concern without restructuring its liabilities, and when creditors effectively are entitled to all or most of the real value of the issuer. Third, the issuer can take numerous measures to avoid reaching the point of insolvency or resolution, including restructuring its business, selling assets to pay down debt and raising additional debt or equity capital. Bankruptcy or resolution proceedings are intended to be a last resort when measures of this kind fail.

By contrast, under the Conversion Requirement as proposed, the internal LTD converts automatically upon the Board's issuance of the internal debt conversion order. There is no process under the Proposed Rules for holders of internal LTD to avoid that conversion, the way creditors can effect a "work out" on the eve of bankruptcy, once the Board determines that bankruptcy, resolution or restructuring of the IHC is necessary. Instead, upon the Covered IHC's approach to insolvency, the debt is unilaterally converted into equity by the Board. Moreover, the lender has agreed in advance, by contract, to this surrender of its rights to insist on payment, rather than negotiating at the time of the proceeding on the basis of its rights inherent in background law taking into account its contractual right to full payment.

Under the Conversion Requirement as proposed, internal LTD would appear to only be convertible at the point of non-viability ("PONV") because the Board could issue an internal debt conversion order only if the Covered IHC is "in default or danger of default", and the Board proposes to define this standard consistently with that contained in Section 203(c)(4) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").⁸ A conversion would therefore only be permissible if the Covered IHC were in a condition that would allow it to be placed into receivership under Title II of the Dodd-Frank Act.

Nonetheless, language in the preamble to the Proposed Rules could be construed as casting doubt on the view that LTD only converts at the PONV. In particular, the Board states that 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

⁷ Convertibility has been a principal focus of concern on Congress's part. In addition to the reference to convertibility in section 385, a separate provision of the Internal Revenue Code (section 163(l)) provides that an issuer may not deduct interest on a debt instrument that is effectively mandatorily convertible into equity, or where a holder has an option to convert the instrument if it is substantially certain that the conversion will take place.

⁸ 80 Fed. Reg. at 74943 n.74, 74963.

into resolution proceedings)".⁹ From the parenthetical language, it appears that, by "going concern", the Board means that the Covered IHC can be recapitalized without the need to initiate resolution proceedings, not that the Board can issue an internal conversion order in respect of a Covered IHC that is in a financial position to continue operating. Nonetheless, the "going concern" language could create doubt that conversion of internal LTD occurs only at the PONV.

3. *Creditor Remedies*

Lastly, an instrument is generally considered to be debt for U.S. tax purposes only if its holder has adequate legal remedies, such as acceleration rights or the right to sue, if the issuer does not pay when due. This requirement can be considered ancillary to those described above, since seniority to equity and a promise to pay a fixed sum on a stated date are meaningful only if they are enforceable.

The Acceleration Prohibition is not necessarily in conflict with this principle, as long as there is no doubt that the holders of internal LTD have the right to sue and to collect on a judgment in their favor in the event of non-payment. Although nothing in the text of the Proposed Rules appears to limit such rights, language elsewhere in the preamble suggests that the Board is seeking to avoid the making of "payments prior to the [covered entity's] entry into resolution".¹⁰ This language may cast doubt as to whether internal LTD holders are permitted to exercise their rights otherwise available at law to sue in the event of nonpayment.

B. Proposals to Address the Tax Concerns

In Exhibit A, we suggest changes to the Conversion Requirement that should address the concerns raised above.¹¹ Although these changes would thereby increase the likelihood that internal LTD will be characterized as debt, they would not reduce the effectiveness of the Conversion Provision as a mechanism to ensure that a Covered IHC can be recapitalized and its losses shifted to its foreign parent without the need to commence insolvency proceedings.

The general concept behind these changes is that any conversion of internal LTD into equity should take place under conditions similar to those of a bankruptcy or resolution proceeding, notwithstanding that the conversion takes place outside such a proceeding. Thus,

⁹ 80 Fed. Reg. at 74943 (emphasis added); see also 80 Fed. Reg. at 74942 ("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.") (emphasis added).

¹⁰ 80 Fed. Reg. at 74936. Although this language concerns eligible external LTD, the Board notes that the rationales for the requirements applicable to eligible internal and external LTD "are generally the same". 80 Fed. Reg. at 74942.

¹¹ The discussion below assumes that other debt-equity factors are favorable for debt characterization, for example interest is payable at a conventional fixed or floating rate, internal LTD does not by its terms provide for a right to participate in management of the IHC and it is expected at the time of issuance of the internal LTD that it will be repaid.

conversion should be into a class of securities that respects the priority of internal LTD over existing equity, and only to the extent necessary to satisfy applicable regulatory capital requirements; conversion should not take place until the investor has exhausted whatever measures it chooses to take to recapitalize the IHC; to the extent possible, conversion should be the result of a failure to complete a separate regulatory process to the regulators' satisfaction, so that it operates in a manner broadly similar to a cross-default rather than a directly operative contractual provision; and conversion should take place only when the issuer is no longer a viable going concern.

In effect, what we are describing is analogous to a "work out" that prevents an issuer from entering a bankruptcy or resolution proceeding, except that the terms of the work-out process have been settled at the time of issuance of the LTD. There is no authority that addresses whether limiting conversion of an instrument to circumstances that are essentially the equivalent of, and an alternative to, a bankruptcy or resolution proceeding is sufficient to ensure that the instrument is treated as debt for tax purposes. However, U.S. tax law recognizes that under dire conditions an issuer's creditors may in effect have become its shareholders, after existing equity has been economically wiped out. Moreover, there is a long history of both the IRS and courts giving great deference to terms of debt instruments that are necessary in order for the debt to qualify as a capital security for regulatory purposes. While the limits of that deference have not been tested, we believe that what we propose should be sufficient for tax advisors to conclude that internal LTD should qualify as debt under current U.S. federal income tax law.

1. Priority

To address the priority concerns, we propose changes to paragraph (5) of the definition of "eligible internal debt security".¹² In particular, we suggest the deletion of the portion of that paragraph that would require internal LTD to be subject to cancellation, as such a requirement is not necessary to ensure that a Covered IHC can be recapitalized outside of insolvency proceedings; conversion alone can achieve such an end.

As discussed above, the language of paragraph (5) requiring that internal LTD convert into CET1 likewise raises challenges because a conversion of internal LTD into CET1 while any equity remains outstanding would be inconsistent with the principle of priority. However, Covered IHCs may be able to take steps, as described below, to ensure such priority is preserved by other means, without the need to further change paragraph (5). We suggest that the Board clarify in the preamble to the final rule that such "self-help" measures that preserve the priority of internal LTD while ensuring that it converts into CET1 are permissible.

The IIB has worked with members to develop mechanisms under which internal LTD could convert into CET1 without losing priority. One such mechanism (the "Equity Transfer Mechanism") would function as follows:

- All classes of equity (including preferred shares) of the Covered IHC would contain a transfer provision.

¹² 80 Fed. Reg. at 74962.

- The transfer provision would provide that, upon the conversion of internal LTD into common equity, all existing equity (other than the new common equity into which the internal LTD converted) will be transferred to the Covered IHC issuer for no consideration.¹³
- The transferred equity may then be cancelled or remain outstanding as treasury stock.

As we understand that many IHCs will be Delaware corporations or LLCs, the IIB has consulted with Delaware counsel regarding the feasibility of the Equity Transfer Mechanism as a matter of Delaware corporate law. Delaware counsel has indicated that they would be able to provide a reasoned “should” level opinion that the proposed mechanism would be valid and enforceable under Delaware law.

Based on initial diligence performed by IIB members and legal counsel, there do not appear to be any clear U.S. or home-country legal, accounting or tax impediments to the implementation of the Equity Transfer Mechanism in this or a substantially similar form. However, such diligence remains on-going, and the specifics of the mechanism may need to be adapted to take into account jurisdiction-specific issues. Further, the feasibility of the Equity Transfer Mechanism would need to be considered under applicable state law for IHCs not organized under Delaware law.

Another possible approach would be to provide for internal LTD to convert into CET1 in such a proportion that existing equity would be so massively diluted as to have practically no value (the “Equity Dilution Mechanism”). Although such a dilution would function to wipe out existing equity as a practical matter, it is unclear whether the IRS and Treasury would consider internal LTD subject to the Equity Dilution Mechanism to have priority over existing equity if such shares in fact remained outstanding.

2. *Unqualified Obligation to Pay*

As described above, a conversion that is inevitable and operates solely through a contractual trigger is incompatible with debt characterization for tax purposes. To avoid the inevitability and shift as much of the trigger mechanism as possible into the realm of regulatory action, we propose requiring Covered IHCs and their foreign parents to enter into “recapitalization agreements”. Under these agreements, a Covered IHC and its parent agree that, upon the Board’s issuance of a “recapitalization order”, the parent will submit to the Board within 48 hours a plan that would result in the recapitalization of the Covered IHC. The circumstances under which a Board could issue the recapitalization order would be the same as those under the Proposed Rules under which the Board may issue an internal debt conversion order.

¹³ To ensure that a Covered IHC would consistently have common equity outstanding, the transfer of existing CET1 (and any preferred shares) would occur either simultaneously with, or moments after, the conversion of internal LTD into common equity. To facilitate the transfer, existing common equity could be classified as Class A shares, while internal LTD, upon conversion, could be classified as Class B shares, and only Class A shares (and any preferred shares) would be subject to transfer.

Although the recapitalization agreement would permit the parent's plan to propose the recapitalization of the Covered IHC through the conversion of internal LTD into equity, the recapitalization agreement would also permit the plan to contain alternatives, such as purchases of the Covered IHC's equity or sales of the Covered IHC's assets. Because alternatives exist, the conversion of the internal LTD would not be inevitable.

However, it is not sufficient for the tax analysis that alternatives exist; they must also be realistic. We therefore propose that the "recapitalization order" permit the Covered IHC's parent at least 48 hours following the issuance of a recapitalization order to submit a recapitalization plan. Although that is a narrow window, we believe that the FBO generally will have been in discussions with the Board for weeks, if not months, regarding the deterioration of the Covered IHC, such that 48 hours would be enough time to submit a recapitalization plan. This narrow window would also not limit the ability of the Board to intervene with necessary speed, as the Board will most likely take action in respect of a failing Covered IHC on a Friday afternoon. In such circumstances, action would not need to be taken until Sunday afternoon when Asian markets open. We also note that the Proposed Rules contemplate a similar 48 hour window within which the home-country regulators of the FBO parent of a Covered IHC could object to the Board's issuance of a debt conversion order.

In order for alternatives to conversion to be realistic, it is also necessary that the recapitalization target be reasonable, rather than so onerous that FBOs will always opt for conversion. The recapitalization agreement would therefore require FBOs to submit a plan to bring Covered IHCs into compliance with applicable minimum capital requirements. (Likewise, the recapitalization target under a notice of recapitalization deficiency, described below, is also based on compliance with applicable minimum capital requirements.) Although we considered setting the recapitalization target equal to the amount of a Covered IHC's internal LTD requirement (which, under the Board's capital refill framework, would roughly equal the minimum capital requirements plus a buffer), tying the recapitalization target to a Covered IHC's internal LTD requirement would result in outcomes that diverge from those expected in a bankruptcy or resolution proceeding, and would more closely couple, rather than decouple, the recapitalization process with a conversion of internal LTD.

As discussed above, the requirement under the recapitalization agreement would be for the FBO to submit a plan to recapitalize the Covered IHC, not to effect the recapitalization. The reason for this approach is that some FBOs may be subject to "solo" capital requirements, i.e., regulatory capital requirements that apply on an unconsolidated basis, in addition to consolidated capital requirements in their home jurisdictions. A contractual requirement that the FBO recapitalize its subsidiary could be considered to be an exposure of the FBO in respect of which it would need to hold additional capital. Moreover, the Board does not need FBOs to be subject to a contractual recapitalization obligation in order to require FBOs to recapitalize troubled subsidiaries. The Board already has authority under existing law to effectively require such a recapitalization.

Additionally, under our proposed modifications, if the FBO either (i) fails to submit within 48 hours a recapitalization plan that is satisfactory to the Board or (ii) following acceptance by the Board of such a plan, fails to comply with a material aspect of the plan, the Board may issue a "notice of recapitalization deficiency". In such an instance, the amount of

internal LTD specified in the notice will convert into equity. The conversion of internal LTD thus would not occur as a contractual matter but because the Covered IHC's parent either did not submit a satisfactory recapitalization plan or did not carry it to completion. Please note, however, that we have avoided characterizing such circumstances as an event of default, which could trigger cross-defaults in other agreements that might not be stayed under the applicable insolvency or resolution regime and could therefore disrupt an orderly recapitalization.

The amount of internal LTD that would be converted into equity upon the Board's issuance of a notice of recapitalization deficiency would be an amount specified by the Board, but no more than necessary to bring the Covered IHC into compliance with applicable minimum capital requirements. If the Covered IHC satisfies its minimum capital requirements, there should be no need to effect a drastic remedy such as conversion of internal LTD. For similar reasons, under the proposed modifications, a Covered IHC would not be required to submit a recapitalization plan, and a notice of recapitalization deficiency could not be issued, if the Covered IHC meets applicable minimum capital requirements. These provisions, however, would not constrain the Board's authority under applicable statutes and regulations to require Covered IHCs to increase their capital or to require FBOs to improve the safety and soundness of their U.S. operations.

Finally, as discussed above, it appears that, under the Proposed Rules, internal LTD could be converted into equity only if the Covered IHC is at the PONV. In order to clarify that this is indeed the case, we would suggest that the Board avoid characterizing the Conversion Requirement as permitting a conversion on a "going-concern" basis. Instead, the Board should clarify in the preamble to the final rule that a recapitalization order causing conversion could only be issued when the Covered IHC is in a financial condition that would permit the commencement of proceedings under the U.S. Bankruptcy Court or Title II of the Dodd-Frank Act.

3. Creditor Remedies

As discussed above, the text of the Proposed Rules does not suggest limits on the rights of holders of internal LTD to file suit in the event of non-payment or that such holders would have to waive those rights. However, in light of the Acceleration Prohibition, it would be helpful if the preamble to the final rule avoided language suggesting that creditors would not be able to exercise remedies and stated affirmatively that the limitations on acceleration clauses contained in paragraph (4) of the definition of "eligible internal debt security" do not require the holders of such securities to waive their rights to file suit to enforce their ordinary creditor remedies.

II. Increased Cost of Internal LTD Related to Eligibility Criteria

As described in the IIB Letter and the Joint Trades Letter, Covered IHCs transact with their foreign parents on an arm's-length basis. As a result, they would bear the full market costs of the Conversion Requirement, Subordination Requirement and Acceleration Prohibition. Based on data from its members, the IIB has developed the estimates provided below of the effect of the proposed Conversion Requirement and Subordination Requirement on the cost of

eligible internal LTD. Members generally reported that they were not able to separately estimate the cost of the Acceleration Prohibition at this time.

<i>(in basis points)</i>	Cost of Eligibility Criteria		
	Contractual Conversion	Subordination	Total
Max ¹⁴	85	100	185
Min ¹⁵	20	25	45
Average ¹⁶	50	59	109

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¹⁴ Represents the highest estimate provided by any member.

¹⁵ Represents the lowest estimate provided by any member.

¹⁶ Represents the average of all estimates provided.

We appreciate your consideration of our comments. Please contact the undersigned (646-213-1149; smiller@iib.org) or our General Counsel, Richard Coffman (646-213-1149; rcoffman@iib.org), if we can provide any additional information.

Sincerely,



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EXHIBIT A
RECOMMENDED AMDNEDMENTS TO THE PROPOSED RULES

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

§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;¹⁷
- (5) Has a contractual provision that is approved by the Board that, upon the issuance by the Board of a notice of recapitalization deficiency in respect of the recapitalization agreement for the Covered IHC, provides for the immediate conversion or exchange of that portion of the instrument that is specified in the notice of recapitalization deficiency 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;~~¹⁸
- (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 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).

*Notice of recapitalization deficiency, with respect to a recapitalization agreement for a Covered IHC, means a notice from the Board to the parties to the recapitalization agreement that a recapitalization deficiency has occurred and that sets forth the proportion of the Covered IHC's eligible long-term debt the conversion of which the Board has determined is necessary to cause the Covered IHC to satisfy the minimum capital requirements of 12 CFR 217.10 applicable to it.*¹⁹

Outstanding eligible internal longterm debt amount is defined in § 252.162(b).

Person has the same meaning as in 12 CFR 225.2.

¹⁷ From a debt-for-tax perspective, it is important that the holder be able to enforce its rights as a creditor in some way upon non-payment, whether by accelerating the repayment obligation or by suing for the missed payment. This element of the eligibility requirements would not appear to require a holder to waive the right to sue for the missed payment, although it would be helpful to include language in the preamble to the final rule clarifying that the holder is not required to waive such rights.

¹⁸ It would be helpful from a debt-for-tax perspective for the preamble to the final rule to note that "self-help" structures that preserve the priority of eligible long-term debt over existing equity would be permitted, such as the Equity Transfer Mechanism described in Section I.B.1 above.

¹⁹ The intention of this provision is not to limit the ability of the Board to exercise other powers available to it under law.

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).

Recapitalization agreement, with respect to a Covered IHC, means an agreement between the Covered IHC and a company that is incorporated or organized outside of the United States that directly or indirectly controls the Covered IHC under which such company agrees, upon the Board issuing a recapitalization order, to submit to the Board by the time provided in the recapitalization order a plan that would result in the Covered IHC satisfying the minimum capital requirements of 12 CFR 217.10 applicable to the Covered IHC within a timeframe acceptable to the Board, including by purchasing, or causing affiliates of such company to purchase, additional equity instruments of the Covered IHC, canceling or contributing debt liabilities of the Covered IHC held by such company or affiliates of such company, causing the Covered IHC or subsidiaries of the Covered IHC to sell assets, or taking other actions acceptable to the Board. Notwithstanding the foregoing, the party to a recapitalization agreement that is incorporated or organized outside of the United States that directly or indirectly controls the Covered IHC shall not be required to submit a plan pursuant to the recapitalization agreement if the Covered IHC satisfies the minimum capital requirements of 12 CFR 217.10.

~~*Internal debt conversion order*~~*Recapitalization deficiency*, with respect to a Covered IHC, means ~~an order, following the issuance 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,~~of a recapitalization order for the Covered IHC, that the party to the recapitalization agreement for the Covered IHC that is incorporated or organized outside of the United States and that directly or indirectly controls the Covered IHC fails to:

(1) Submit to the Board a plan for the recapitalization of the Covered IHC that is acceptable to the Board by the time specified in the recapitalization order; or

(2) Comply with a material obligation under the plan submitted to the Board for the recapitalization of the Covered IHC;

provided that there shall be no such recapitalization deficiency if the Covered IHC satisfies the minimum capital requirements of 12 CFR 217.10.

Recapitalization order, with respect to a Covered IHC, means an order by the Board that requires the party to the recapitalization agreement in respect of the Covered IHC that is incorporated or organized outside of the United States and that directly or indirectly controls the Covered IHC to submit to the Board by a specified time, which shall be no earlier than 48 hours after the Board issues the recapitalization order, a plan acceptable to the Board for the recapitalization of the Covered IHC in accordance with the terms of the recapitalization agreement.

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~~ Recapitalization order.

(a) The Board may issue ~~an internal debt conversion~~ a recapitalization 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~~ issuance of the recapitalization order; 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 ²⁰

(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~~ issuance of a recapitalization order to be prompt if the

²⁰ To avoid the characterization of eligible long-term debt as equity rather than debt for tax purposes, it would be helpful to clarify in the preamble that the time at which a recapitalization order can be issued is when the Covered IHC is in a near gone-concern condition—i.e., the same time as when the Covered IHC would be able to commence proceedings under the Bankruptcy Code or could be placed into receivership under the Orderly Liquidation Authority.

Board receives the objection no later than 48 hours after the Board requests such consent or non-objection from the home country supervisor.

EXHIBIT B
ESTIMATE OF INTERNAL LTD TAX COSTS FOR COVERED IHCs

Estimate of Internal LTD Tax Costs for Covered IHCs²¹

USD '000s	Non-branch consolidated assets ²²	Estimated internal LTD requirement ²³	Amount of coupon	Loss of U.S. income tax deduction ²⁴	Home income tax cost ²⁵	Total income tax cost	Effective income tax rate	All-in effective tax rate, assuming 5% w/h tax on coupons ²⁶	All-in effective tax rate, assuming 5% w/h tax on coupons and principal ²⁷
2% coupon (estimated)	\$1,618,384,322	\$66,501,402	\$1,330,028	\$500,346					
20% home jurisdiction income tax rate					\$266,006	\$766,351	58%	63%	313%
30% home jurisdiction income tax rate					\$399,008	\$899,354	68%	73%	323%
5% coupon (estimated)	\$1,618,384,322	\$66,501,402	\$3,325,070	\$1,250,864					
20% home jurisdiction income tax rate					\$665,014	\$1,915,878	58%	63%	163%
30% home jurisdiction income tax rate					\$997,521	\$2,248,385	68%	73%	173%
Actual/estimated coupon & home income tax rate²⁸	\$1,618,384,322	\$66,501,402	\$2,363,369	\$883,515	\$601,554	\$1,485,069	63%	68%	209%

²¹ Under the Board's Proposed Rules, Covered IHCs would include Barclays, BNP Paribas, Credit Suisse, Deutsche Bank, HSBC, Mitsubishi UFJ, Santander, Société Générale and UBS.

²² Estimated average consolidated assets of Covered IHCs based on consolidated U.S. non-branch assets of the FBO parents of the Covered IHCs based on the Board's Structure Data for the U.S. offices of FBOs from December, 2015, Consolidated Financial Reports from December, 2015, and Securities and Exchange Commission FOCUS reports for 2015. We understand that a number of IHCs are continuing to reduce their presence in the U.S. Therefore, average consolidated assets of Covered IHCs may be lower than these estimates.

²³ The figures reflect firms' estimations of their total LTD requirement (or where no such estimate was provided, total U.S. non-branch consolidated assets multiplied by 4%).

²⁴ The figure reflects the U.S. income tax rates that firms estimate would apply to them as a result of treating coupons as non-deductible for U.S. tax purposes (or where no such estimate was provided, a 38% income tax rate).

²⁵ We understand that internal LTD is likely to be treated as debt in FBOs' home jurisdictions, regardless of whether it is treated as equity for U.S. tax purposes. As a result, coupon payments would not be eligible for the favorable tax rules that many countries provide for dividend income from affiliates to avoid double taxation. Rather than merely shifting the jurisdiction in which tax is paid, such treatment would result in the income that funds coupon payments being taxed twice—in the U.S. because there is no deduction for the coupon and in the home jurisdiction because the coupon is treated as fully taxable interest (rather than tax-favored dividend) income. The figures in this column represent estimated home tax costs attributable to the taxation of coupon payments as interest in the home jurisdiction.

²⁶ Only certain firms would be subject to withholding tax.

²⁷ Only certain firms would be subject to withholding tax.

²⁸ This row reflects firms' estimation of actual coupons and information about actual home tax rates. Where no information was provided, an estimated coupon of 3.25% and an estimated home tax rate of 25% was used.