January 16, 2024

Chief Counsel's Office
Attention: Comment Processing (Docket ID OCC–2023–0011)
Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E–218
Washington, DC 20219

Ann E. Misback, Secretary
Attention: Docket No. R–1815; RIN 7100–AG66
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

James P. Sheesley, Assistant Executive Secretary
Attention: Comments/Legal OES (RIN 3064–AF86)
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Re: Long-Term Debt Requirements for Large Bank Holding Companies, Certain Intermediate Holding Companies of Foreign Banking Organizations, and Large Insured Depository Institutions; OCC Docket ID OCC–2023–001; Board Docket No. R–1815; RIN 7100–AG66; FDIC RIN 3064–AF86; 88 FR 64524 (Sept. 19, 2023)

Dear Ladies and Gentlemen:

Better Markets[1] appreciates the opportunity to comment on the above-captioned guidance ("Proposal") issued by the Office of the Comptroller of the Currency ("OCC"), Board of Governors of the Federal Reserve System ("Fed"), and the Federal Deposit Insurance Corporation ("FDIC"), collectively ("the Agencies").[2] The Proposal would require large depository institution

[1] Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies – including many in finance – to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

[2] Long-Term Debt Requirements for Large Bank Holding Companies, Certain Intermediate Holding Companies of Foreign Banking Organizations, and Large Insured Depository Institutions; OCC Docket ID OCC–2023–0011; Board Docket No. R–1815; RIN 7100–AG66; FDIC RIN 3064–AF86; 88 FED. REG. 64524 (Sept. 19, 2023), https://www.federalregister.gov/documents/2023/09/19/2023-19265/long-term-debt-requirements-for-large-bank-holding-companies-certain-intermediate-holding-companies.

holding companies, U.S. intermediate holding companies of foreign banking organizations, and certain insured depository institutions, ("covered firms") to issue and maintain outstanding a minimum amount of long-term debt ("LTD") for the purpose of improving resolvability of these firms as well as reducing the cost of a failure to the FDIC's Deposit Insurance Fund ("DIF"). While we strongly support the overall goals of improving financial stability, promoting better bank resolvability, and shifting the burden of failed institutions away from the public, the Proposal misses the mark by relying on LTD instruments that are unlikely to perform as intended when a large bank fails. We urge the Agencies to withdraw the Proposal, for the reasons we set forth below. In addition, should the Agencies decide to finalize the Proposal, we recommend a number of changes that will at least make it stronger.

The Proposal follows an advance notice of proposed rulemaking ("ANPR") on the topic of resolution-related resources for large banks, issued by the Fed and FDIC in late 2022.[3] Better Markets commented on this ANPR,[4] explaining that substituting LTD for capital is a fundamentally flawed approach and will not achieve the goals of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). The Proposal acknowledges Better Markets' comment but dismisses it in pursuit of a different goal—reducing the burden and cost of failures for the FDIC's DIF. As we explain throughout this letter, the Agencies should reconsider the Proposal through the Dodd-Frank Act lens and in light of promoting financial stability and protecting consumers, rather than prioritizing management of the cost of bank failures to the DIF.

The current Proposal complements the rule that requires global systemically important bank ("GSIB") holding companies to hold minimum amounts of LTD.[5] Better Markets also commented on this rule,[6] citing the same deficiencies that exist with the current Proposal—contagion risk, increased burden on individual retail investors, and the likelihood for political

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[3] Resolution-Related Resource Requirements for Large Banking Organizations; Board Docket No. R–1786 & RIN 7100–AG44; FDIC RIN 3064–AF86; 87 FED. REG. 64170 (Oct. 24, 2022), https://www.federalregister.gov/documents/2022/10/24/2022-23003/resolution-related-resource-requirements-for-large-banking-organizations.

[4] Better Markets Comment Letter, *Advance Notice of Proposed Rulemaking and Request for Comment Regarding Resolution-Related Resource Requirements for Large Banking Organizations* (Jan. 23, 2023), https://bettermarkets.org/wp-content/uploads/2023/01/Better_Markets_Comment_Letter_Resolution_Related_Resource_Requirements_Large_Banking_Organizations.pdf.

[5] 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; Board Docket No. R-1523; 82 FED. REG. 8266 (Jan. 24, 2017), https://www.federalregister.gov/documents/2017/01/24/2017-00431/total-loss-absorbing-capacity-long-term-debt-and-clean-holding-company-requirements-for-systemically.

[6] Better Markets Comment Letter, *Regulatory Capital Treatment for Investments in Certain Unsecured Debt Instruments of Global Systemically Important U.S. Bank Holding Companies, Certain Intermediate Holding Companies, and Global Systemically Important Foreign Banking Organizations* (June 7, 2019), https://www.bettermarkets.org/sites/default/files/Better%20Markets%20CL%20Fed%20Etc%20TLAC%20Debt%206-7-2019.pdf.

pressure that will prevent an LTD framework from working as planned, especially in periods of financial stress when more than one large bank can be expected to be struggling.

While the Proposal may be in the interest of the regulators that focus on resolution costs to the DIF, it shifts the financial burden and risk stemming from large bank failures to retail investors, pension funds, and other debtholders who may be unaware of the actual risk they have accepted with these LTD investments. Furthermore, if regulators chose to actually impose losses on debtholders in a large bank failure situation, which we believe to be highly unlikely and vulnerable to legal challenges and public outrage, the likelihood of additional contagion would rise precipitously—not decline as suggested in the Proposal—because investors would begin to fear for the health of other large banks for which they also may hold debt instruments.

We offer suggestions and alternatives that the Agencies should consider to improve the Proposal, including the most obvious—simply requiring covered firms to have more capital to reduce the likelihood of failure in the first place. The Agencies should also increase transparency for all market participants by requiring covered firms to more clearly and conspicuously disclose the risks inherent in LTD instruments. This would protect and inform individual investors about the possibility and potential size of loss associated with LTD investments. It would also promote a clear understanding of risks for all market participants to promote accurate pricing of LTD. Finally, if the Agencies decide to adopt the Proposal, they should also implement changes to the large bank pricing model for deposit insurance. Currently, the cost of deposit insurance is reduced for large banks issuing LTD. If issuing LTD becomes mandatory, large banks should not be rewarded with a reduction in deposit insurance assessments just for following the rules.

BACKGROUND

During the global financial crisis ("2008 Crash") and again in the spring of 2023, the Agencies and policymakers were repeatedly faced with complex and consequential decisions on how to resolve large, systemically important firms. A key objective of the Dodd-Frank Act was to end too-big-to-fail ("TBTF") and eliminate the need for future taxpayer-funded bailouts. Unfortunately, TBTF is alive and well, as discussed in several Better Markets reports.[7] Furthermore, the orderly resolution of a large bank is untested and likely could not or would not be implemented—either through bankruptcy or by the resolution authority—in a way that achieves

[7] *See, e.g.*, Dennis Kelleher & Frank Medina, *Ending Too-Big-to-Fail by Breathing Life into 'Living Wills'* (Jan. 2016), https://bettermarkets.org/wp-content/uploads/2021/07/Breathing-Life-Into-Living-Wills_0.pdf; *see also* Better Markets, *Banking Regulators' Pre-Thanksgiving Announcement Passing Living Wills For The Largest Banks Shows Some Progress But Falls Well Short Of Addressing Too-Big-To-Fail* (Nov. 23, 2022), https://bettermarkets.org/newsroom/banking-regulators-pre-thanksgiving-announcement-passing-living-wills-for-the-largest-banks-shows-some-progress-but-falls-well-short-of-addressing-too-big-to-fail/; Dennis Kelleher, *The Too Big to Fail Problem Is Alive, Well and Getting Worse: Presentation to the Financial Stability Board Workshop at the Federal Reserve Bank of New York*, BETTER MARKETS (Sept.16, 2019), https://bettermarkets.org/sites/default/files/documents/Better_Markets_Too-Big-To-Fail_FSB_Conference-9-16-2019.pdf; Better Markets, *Can Too Big To Fail Be Ended? And, If So, How?: 15th Anniversary Lehman Collapse Conference* (Sept. 13, 2023) https://bettermarkets.org/analysis/15th-anniversary-lehman-collapse-conference/.

the intended Dodd-Frank Act goals of eliminating contagion and the disruption of the financial system. In fact, it is unlikely to be attempted at all given the uncertain outcome and potential for disaster, which would be particularly high when orderly resolution would be most needed, during a period of broader stress when more than one large bank may be at risk of collapse. We believe that has been proved beyond doubt when not one of the three systemically significant banks that failed in the spring of 2023 was put through resolution. If a bank with $200 billion in assets was deemed systemically significant and it couldn't be resolved in an orderly fashion as the FDIC and others have prepared for since 2010, it is inconceivable that a GSIB with trillions of dollars in assets would be put through resolution by those same regulators. ***For this reason, the Agencies' primary focus should be on strengthening the financial resilience of large banks before they fail so they don't fail, by implementing the proposed higher capital requirements[8] and strengthening the Federal Reserve's stress testing program.***

We recognize that the Agencies believe that an LTD requirement can mitigate resolution challenges and promote financial stability. According to FDIC Chairman Gruenberg, LTD lowers the incentive for uninsured depositors to run which helps to avoid failure.[9] Gruenberg also believes that LTD reduces cost to the DIF by making the sale of a failing bank to a healthy acquirer more likely and creates additional options for the FDIC in resolution. In support of this view, Gruenberg stated,

> Since this debt is long-term, it will not be a source of liquidity pressure when problems become apparent. Unlike uninsured depositors, investors in this debt know that they will not be able to run when problems arise. This gives them a greater incentive to monitor risk in these banks and exert pressure on management to better manage risk. Finally, because these instruments are publicly traded, their prices serve as a signal of the market's view of risk in these banks.[10]

However, despite these statements, Better Markets has had a long history of concern about LTD requirements, that directly contrasts with the Agencies' support for LTD Proposal. We maintain our view that the risks and challenges that accompany LTD requirements are significant and strongly suggest that the Agencies focus on other methods of increasing financial stability, namely higher capital requirements for large banks, rather than pursuing an LTD scheme as well. Specifically, our concerns include:

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8 Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity; RIN 1557-AE78, RIN 3064-AF29, RIN 7100-AG64; 88 Fed. Reg. 64028 (Sept. 18, 2023), https://www.federalregister.gov/documents/2023/09/18/2023-19200/regulatory-capital-rule-large-banking-organizations-and-banking-organizations-with-significant#citation-468-p64169.

9 Federal Deposit Insurance Corporation, *Statement by Martin J. Gruenberg, Chairman, FDIC, On the Notice of Proposed Rulemaking on Long-Term Debt* (Aug. 29, 2023), https://www.fdic.gov/news/speeches/2023/spaug2923a.html.

10 *Id.*

(1) LTD requirements implicitly acknowledge that minimum capital requirements are not high enough to adequately protect against the potential consequences of severe stress on a banking organization's solvency. Rather than addressing this directly, which would be more expensive for banks but also far more effective at crisis prevention, the Agencies just accept the shortcomings in the current capital requirements. Instead of simply increasing capital requirements, the Agencies place unearned faith in the possibility of a smooth resolution of a failing large banking organization through the untested conversion of LTD to capital after a bank has failed.

(2) Retail investors are the most likely holders of LTD (directly or indirectly through brokerage accounts, mutual funds, and pension funds) and face the risk of large and possibly unexpected losses in the event of a large bank failure. However, the social and political pressure to avoid imposing losses from a large bank failure on these investors may be so great that the intended purpose of the LTD is nullified. The Agencies appear to recognize the contagion risk that would result from banks themselves investing in other banks' LTD. In fact, the Basel Endgame Proposal includes rules that are intended to discourage banks from investing in other banks' LTD. While the temptation of higher yields may be too great and some banks still may choose to become LTD investors, the more likely result is that retail investors will become the largest buyers of LTD instruments. This puts individual investors who have an interest in LTD through their mutual funds or pension funds directly at risk of shouldering the losses if LTD instruments are converted to equity in the face of a bank failure.

However, as bank failures in multiple European countries have demonstrated,[11] it is highly likely that there would be intense political and social pressure to not saddle individual investors with direct losses from a bank failure, therefore increasing the chance the failing bank would be bailed out ***despite*** the presence of LTD. In short, reliance on LTD either foists large and poorly understood risks onto retail investors or stands little chance of actually being relied upon during a crisis. Neither outcome is acceptable.

(3) Contagion risk can result both from uncertainty about, and actual losses on, LTD issued by a failing bank or multiple failing banks. The Agencies tout price changes on LTD in response to perceived risk for banks that issued the debt as a strength of the Proposal. We caution, though, that in a period of extreme market stress, price changes in LTD could be very large and lead to contagion risk. In other words, if there is a perceived increase in risk at one large bank, concern could quickly spread to other banks with similar risk characteristics.

The threat of contagion is intensified due to the evident uncertainties surrounding the pricing of LTD. Market forces on pricing can be unpredictable and may not always behave

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[11] Stephen J. Lubben & Arthur E. Wilmarth, Jr., *Too Big and Unable to Fail,* 69 FLA. L. REV. 1205, 1235–38 (2017), https://scholarship.law.ufl.edu/cgi/viewcontent.cgi?article=1386&context=flr.

as expected. To illustrate, a study[12] compared pricing for bonds with identical maturities issued by JP Morgan Chase and Exxon. The exercise was meant to examine and understand how investors viewed different risk profiles and capital backstops, and how these differences affected pricing. Despite a considerable difference in underlying equity capital on paper (JP Morgan with about 10% equity capital and Exxon with about 50% equity capital), the difference in bond yields for the two companies was very small, suggesting the market may not be as skilled at price discovery as the Agencies believe it to be during normal times. Even more troubling, the study continues to explain that ***losses to LTD holders for a bank that fails would likely be at least 50%***. In other words, a pension fund or mutual fund's bond portfolio value could lose half the value of its investment in a bank's LTD in the blink of an eye during periods of financial stress. It is hard to imagine this magnitude of loss not leading to widespread investor panic and contagion risk. To summarize, the Agencies should recognize that there will likely be a large amount of uncertainty about the value of LTD investments, especially in stressed periods, which could lead to even greater contagion risk than if there were no LTD and certainly greater systemic risk than if the banks had simply been required to have more actual loss absorbing capital in the first place.

(4) Banks that have not already issued LTD in the quantity required by the Proposal may have to issue additional LTD that they otherwise would not have, increasing outflows of debt-service payments to their debt holders. This outflow of funds to service debt will be an additional strain on banks, especially during periods of stress, and could negatively impact their liquidity and capital positions.

(5) While a greater reliance on LTD rather than short-term wholesale funding would provide liquidity-strengthening benefits, all things being equal, simply issuing greater amounts of debt, if not accompanied by a commensurate increase in capital, by definition would make these banks more highly leveraged. Increased leverage directly increases the likelihood of potential failure.

SUMMARY OF THE PROPOSAL

The Proposal requires large banks to issue and maintain minimum amounts of LTD that would be converted to capital in the event of a bank failure. The Proposal is intended to improve the resilience of the financial system and shift the cost burden of a failure to the LTD investors and away from the DIF and taxpayers. We have grave concerns about the success of such a scheme, especially during periods of financial stress, which we will explain in more detail below.

[12] Stephen J. Lubben, *The Impossibility of TLAC,* 23 N.Y.U. J. LEGIS. & PUB. POL'Y 45 (2020), https://nyujlpp.org/wp-content/uploads/2021/07/JLPP-23.1-Lubben-Final.pdf.

GSIBs are already subject to requirements to maintain a minimum amount of total loss-absorbing capacity ("TLAC"), consisting of a minimum amount of LTD and tier 1 capital.[13] This Proposal would be applicable to banks with more than $100 billion in total assets, that are not GSIBs – also known as Category II, III, and IV firms – as well as any affiliates, even if smaller than $100 billion in total assets.

Covered firms would have to maintain LTD equal to whichever of the following three calculations results in the greatest dollar amount:

- 6% of risk-weighted assets;
- 3.5% of average total consolidated assets; or
- 2.5% of total leverage exposure if the bank is subject to the supplementary leverage ratio rule.[14]

The LTD itself must have several characteristics that make it stable and resilient. It must be unsecured, have a maturity of greater than one year from the date of issuance, have "plain vanilla" features, be issued in a minimum denomination of $400,000, and be governed by U.S. law.

There is a three-year ramp-up period for institutions to comply with the rule, beginning with the date of a final rule. Institutions would be required to issue a minimum of 25% of their LTD minimum in year 1, 50% of their LTD minimum in year 2, and finally reach 100% of their full LTD minimum requirement by the end of year 3.

SUMMARY OF COMMENTS

We applaud and support the Agencies' goal of increasing financial stability, but we cannot support this Proposal because its provisions are untested, will likely be ineffective in achieving the stated objectives, and may even increase contagion risk across the financial system and make the system even more vulnerable in a crisis. In fact, in the Proposal, the Agencies summarize comments received in response to the ANPR that appear to agree with our concerns:

> While ***higher regulatory capital levels would reduce the probability of default of a covered IDI and may increase the chance that a covered entity or covered IDI would have remaining equity in the event of its failure***, regulatory capital is likely to be significantly or completely depleted in the lead up to an FDI Act resolution. ***While eligible LTD would not help a troubled IDI remain adequately capitalized***

[13] 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, *supra* note 5.

[14] *See* 12 CFR 217.10(c)(2).

> ***on a going-concern basis***, it would significantly reduce the likelihood of contagion and loss to the DIF in resolving the failed bank." [15]

We urge the Agencies to refocus on implementing higher capital requirements that would actually reduce the likelihood of bank failures in the first instance. The Agencies should also reassess the downsides of the Proposal, including the contagion risk that could stem from its implementation and the reality that in the face of large bank failures, it will never actually be implemented and therefore do nothing to reduce the risk of bailouts.

We begin with the following comments that support the ***need to completely reconsider the Proposal to align with the goals of the Dodd-Frank Act***:

- Financial stability should be prioritized in policy decisions, over other goals such as reduced cost to the DIF. The Agencies should focus on raising large banks' capital levels and strengthening resolution preparedness and planning requirements rather than on untested LTD to serve as a mitigant to systemic risks associated with large bank failures.

- The Proposal shifts losses from the large banks themselves to individual retail investors. The most likely holders of LTD under the framework in the current Proposal are retail investors, via vehicles such as brokerage funds, mutual funds, or pension funds. The framework described in the Proposal saddles retail investors with losses on LTD, which could be very large. However, it is unclear and unlikely that there will be the political and social support to actually impose these losses in the event of a large failure, which makes a taxpayer-funded bailout still the most likely outcome.

- The Proposal could actually result in more contagion risk, not less, when large banks fail and debtholders experience losses. Contagion would likely result both from uncertainty about and actual losses on LTD investments issued by a failing bank or other banks with similar risk characteristics to a failing bank.

If the Proposal moves forward, ***which we do not support***, we provide the following recommendations for minimum changes that are needed to strengthen it to protect consumers and the financial system:

- Stronger requirements for transparent, timely, accessible, and plain English disclosures that explain the risks and potential losses that buyers of LTD are facing must be added. Similar to other investments, buyers of LTD must be provided with a very clear explanation of the risks and potential decline in value that the LTD may experience. These disclosures, if done correctly, could increase the yield that

[15] Long-Term Debt Requirements for Large Bank Holding Companies, Certain Intermediate Holding Companies of Foreign Banking Organizations, and Large Insured Depository Institutions, *supra* note 2, at 64531 (emphasis added).

investors demand and the cost to banks that issue the debt, potentially to the point at which a bank would choose to increase capital instead of debt.

- Additional measures of risk, beyond simply a bright-line asset size test, must be added to identify the banks that require LTD protections in the event of failure. Agencies should consider other risk factors that make a firm vulnerable to failure and incorporate these into the determination of whether a firm should be subject to the Proposal.

- The deposit insurance pricing calculation for large banks, which currently offers a discount for issuing LTD, must be adjusted to not provide covered firms with a benefit for simply complying with the rule. Within the current FDIC deposit insurance pricing rules, large banks can lower their insurance assessment rate – the price they pay each quarter to maintain deposit insurance – by issuing long-term unsecured debt that absorbs losses ahead of the FDIC and uninsured depositors if the firm fails. If this debt issuance becomes required, however, firms should no longer be rewarded with a discount on insurance premiums.

COMMENTS

I. FINANCIAL STABILITY SHOULD BE PRIORITIZED IN POLICY DECISIONS, OVER OTHER GOALS SUCH AS REDUCED COST TO THE DIF.

The Agencies should focus on raising covered firms' capital requirements and strengthening resolution planning and preparedness requirements rather than implementing an LTD requirement. Increasing capital requirements is the most direct and proven path to a more resilient banking and financial system.[16] The Proposal itself acknowledges and agrees with us on this point, although it then goes on to say that regulatory capital would likely be depleted as a firm approaches failure, "While higher regulatory capital levels would reduce the probability of default of a covered IDI and may increase the chance that a covered entity or covered IDI would have remaining equity in the event of its failure, regulatory capital is likely to be significantly or completely depleted in the lead up to an FDI Act resolution." This reinforces our assertion that capital levels must be increased to further reduce the likelihood of failure in the first place.

The Dodd-Frank Act was intended to address TBTF, first through stronger capital and liquidity requirements to lower the probability of default and, second, with better preparation for resolution. Readily available, loss absorbing capital stands between a bank and its failure during

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16 *See e.g.*, Arthur E. Wilmarth Jr., *The Financial Industry's Plan for Resolving Failed Megabanks Will Ensure Future Bailouts for Wall Street*, 50 GEORGIA L. REV. 43 (2023), https://digitalcommons.law.uga.edu/cgi/viewcontent.cgi?article=1460&context=glr; *see also* ANAT ADMATI & MARTIN HELLWIG, THE BANKERS' NEW CLOTHES: WHAT'S WRONG WITH BANKING AND WHAT TO DO ABOUT IT - NEW AND EXPANDED EDITION (Jan. 9, 2024).

times of stress or crisis. LTD, in contrast, is untested and many economists, government officials, and academics do not believe that it will work as intended when it is needed most – during a large bank failure in a stressed environment. If large banks simply had enough capital to prevent failure, LTD would not even be needed.

Furthermore, rather than fortifying banks' resilience to instability and crisis, issuing LTD could actually undermine financial stability. For firms whose LTD requirement is higher than the amount of debt they otherwise would have issued, the cost of servicing the additional debt could strain firms' liquidity positions.

Finally, issuing more debt without commensurate increases in capital leads to firms becoming more leveraged and increasing their risk profile, all other things being equal. If banking organizations fund themselves more than they otherwise would with debt in place of capital, those organizations will be less able to absorb losses under stressed situations, thus increasing their probability of failure – not reducing it. This point is also highlighted in the comment letter submitted by Stephen Miller and Thomas Hoenig in response to the Proposal's ANPR. Miller and Hoenig summarize,

> Adding leverage to the banking system in the expectation that it enhances financial stability is a gamble. Equity funding enhances resiliency… the focus on [LTD] undermines the main goal of the proposal, which is to foster financial stability.[17]

II. <u>THE PROPOSAL SHIFTS LOSSES FROM THE LARGE BANKS THEMSELVES TO INDIVIDUAL RETAIL INVESTORS.</u>

The most likely holders of LTD under the framework in the current Proposal are retail investors – American citizens – via exposures to brokerage funds, mutual funds, or pension funds. The Proposal anticipates that in the case of a large bank failure, debt instruments will be converted to equity. During this process, the value of these investments will likely drop precipitously and result in unsuspecting Americans potentially losing large amounts of money in accounts intended to serve other important financial goals, including a child's college education, a home purchase, or retirement.

Furthermore, it is unclear and unlikely that there will be the political and social support to actually impose these losses on American citizens in the event of a large failure, which makes a taxpayer-funded bailout still the most likely outcome. Neel Kashkari, current President of the Federal Reserve Bank of Minneapolis, and former Treasury senior official during the 2008 Crash, recalls his experience during the 2008 Crash and shares doubts about the real-world effectiveness of this Proposal in a 2016 speech: "[N]o rational policymaker would risk restructuring large firms and forcing losses on creditors and counterparties using the new tools in a risky environment, let alone in a crisis environment like we experienced in 2008. They will be forced to bail out failing

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[17] Stephen Matteo Miller & Thomas M. Hoenig, *ANPR Resolution-Related Resource Requirements For Large Banking Organizations*, Mercatus Center: George Mason University (2022), https://www.fdic.gov/resources/regulations/federal-register-publications/2022/2022-resolution-resource-large-banking-3064-af86-c-003.pdf.

institutions—as we were."[18]

Experience from large bank failures in Europe provides additional evidence of the problems with an LTD scheme and additional support for our concerns that imposing large losses on debtholders could ignite a political firestorm.[19] For example, in 2015, after consumers who held debt in regional banks in Italy were saddled with $400 million in losses after the banks failed, "debtholders' losses provoked a strong political backlash against then Prime Minister Matteo Renzi and caused many investors to dump their holdings of subordinated debt in Italian banks."[20] Similarly, bondholder losses from Portuguese bank failures led to protests, lawsuits by the bondholders, and the sale of bonds issued by other Portuguese banks.

It is nearly impossible to imagine that the Agencies and the Federal government would actually be willing to risk triggering a political, social, and economic crisis by imposing losses from a large bank failure on individual American investors. As Kashkari posited, it is far more likely that we would end up turning to a bailout option in the event of large bank failures.

III. THE PROPOSAL COULD ACTUALLY RESULT IN MORE CONTAGION RISK, NOT LESS, WHEN LARGE BANKS FAIL AND DEBTHOLDERS EXPERIENCE LOSSES.

The Proposal states that the use of LTD will limit contagion effects related to failing large banks, but we disagree. Evidence suggests that contagion risk from both uncertainty about and actual losses on LTD investments will persist.

The European experience with Credit Suisse in March 2023 illustrates these contagion risks. Credit Suisse had issued Additional Tier 1 ("AT1") debt, also known as contingent convertible bonds ("CoCos"), that were intended to function as a shock absorber in the event of a potential bank failure, similar to the proposed LTD. These bonds can be converted to capital, essentially shifting financial losses away from taxpayers if the bank fails.[21] Indeed, in March 2023, the Swiss regulator, FINMA, ordered that Credit Suisse's AT1 bonds be written down to zero as part of the takeover deal with UBS. As a result, debt took losses ahead of equity and the AT1 bondholders lost $17.5 billion.

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18 Neel Kashkari, *Lessons from the Crisis: Ending Too Big to Fail*, Federal Reserve Bank of Minneapolis: Remarks Given at Brookings Institution in Washington, D.C. (Feb. 16, 2016), https://www.minneapolisfed.org/speeches/2016/lessons-from-the-crisis-ending-too-big-to-fail.

19 Too Big and Unable to Fail, *supra* note 11.

20 *Id*, at 1236.

21 *See e.g., What Are AT1 Bonds and Why Are Credit Suisse's Wiped Out*, REUTERS (Mar. 24, 2023), https://www.reuters.com/markets/why-markets-are-uproar-over-risky-bank-bond-known-at1-2023-03-24/; Alice Huang; *Buyer Beware: Credit Suisse AT1 Bond Documents Warn of Writedown*, BLOOMBERG (Mar. 20, 2023), https://www.bloomberg.com/news/articles/2023-03-20/why-is-credit-suisse-writing-down-bonds?sref=mQvUqJZj.

While the possibility of AT1 write-downs was explained in the Credit Suisse bond issuance disclosures, the reality of the losses has led to additional concern and uncertainty among AT1 investors.[22] FINMA stands by its decision to write down the AT1 bonds, but thousands of bondholders are pursuing legal action because of their belief that equity should have taken the first loss.[23] Additionally, AT1 markets more broadly have taken note of the Credit Suisse experience; a recent analysis summarized concerns of contagion risk as follows:

> Bailing in AT1 at one bank is highly likely to lead to concerns about AT1 instruments at other banks, especially in a more homogeneous banking market and a more severe systemic crisis. It can also lead to broader contagion risks across the industry, as imposing losses on domestic AT1 investors creates an immediate feedback loop in the financial system, undermining confidence at a critical time in a crisis.[24]

Furthermore, while contagion effects are not new, the emergence of social media as a contagion catalyst presents new concerns for policymakers and financial regulators. Previous research and our understanding of contagion focused on communication that spread through word of mouth and traditional physical networks, such as neighborhoods or other communities.[25] The proliferation of social media as a superhighway for communication and contagion introduces new and complex risks. In addition to spreading information about the presence of a bank run or changes in bank stock prices, social media contagion presents concerns about the viability of the LTD framework in the Proposal, particularly during bank stress periods.

Academics have already started to study the 2023 bank failures to understand the new dimensions of contagion effects. A groundbreaking study of Twitter activity surrounding the failure of Silicon Valley Bank ("SVB") and the contagion that ensued states:

> SVB's failure was preceded by a flurry of Twitter activity by apparent depositors who openly used words like "withdraw" in their tweets. The openness and speed of this coordination around a bank run is unprecedented, which led to immediate

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[22] Alice Huang, *supra* note 21.

[23] Press Release, Swiss Financial Market Supervisory Authority, FINMA Publishes Report and *Lessons Learned from the Credit Suisse Crisis* (Dec. 19, 2023), https://www.finma.ch/en/news/2023/12/20231219-mm-cs-bericht/.

[24] Australian Prudential Regulation Authority, *Enhancing bank resilience: Additional Tier 1 Capital in Australia* (Sept. 21, 2023), https://www.apra.gov.au/improving-effectiveness-of-additional-tier-1-capital-instruments.

[25] *See e.g.,* Morgan Kelly & Cormac Ó Gráda, *Market Contagion: Evidence from the Panics of 1854 and 1857*, 90 AMER. ECON. REV. 110 (Dec. 2000), https://www.aeaweb.org/articles?id=10.1257/aer.90.5.1110; Charles W. Calomiris & Joseph R. Mason, *Contagion and Bank Failures During the Great Depression: The June 1932 Chicago Banking Panic*, National Bureau of Economic Research Working Paper 4934 (Nov. 1994), https://www.nber.org/papers/w4934; Rajkamal Iyer & Manju Puri, *Understanding Bank Runs: The Importance Of Depositor-Bank Relationships And Networks*, National Bureau of Economic Research Working Paper 14280 (Aug. 2008), https://www.nber.org/system/files/working_papers/w14280/w14280.pdf.

> discussions about contagion to other banks. … Using comprehensive Twitter data, this paper shows that social media contributed to the run on SVB, ***and more importantly, social media amplified the severity of the episode for other banks.***[26]

Therefore, given the havoc that social media activity caused during spring 2023, it is reasonable to expect that it could cause similar damage to LTD investment valuations and potentially totally undermine the stability that LTD is intended to provide.

IV. IF THE PROPOSAL MOVES FORWARD, IT SHOULD INCLUDE STRONGER DISCLOSURE REQUIREMENTS, ADDITIONAL METRICS FOR TRIGGERING APPLICATION OF THE LTD FRAMEWORK, AND NO FURTHER DIF PREMIUM DISCOUNTS FOR BANKS THAT COMPLY.

A. If the Proposal moves forward, stronger requirements for transparent, plain English disclosures that explain the risks and potential losses that LTD purchasers are facing must be added.

Like required disclosures for other types of financial products, buyers of LTD must be provided with a clear explanation of the risks and potential decline in value that the LTD may experience. These explanations must not be buried in the small print of voluminous financial disclosure statements; they must be presented in a clear and understandable format to all LTD investors.

As described earlier, the most likely buyers of LTD are American citizens—also known as retail investors. The average American investor is most likely unaware of the specific risk in an LTD investment, just as the Credit Suisse investors were. To illustrate, an extensive study[27] of TLAC concludes that even if individual investors are savvy enough to know they ***should*** be aware of how a bank failure affects their investment value, it is extremely difficult to locate the proper disclosure statements that contain the information needed to make this assessment and even more difficult to understand them. The study's author states that even if an investor (1) knows to look for risk information and (2) is successful in finding it, "there is no present requirement that disclosures … must be…understood by somebody who is not either a corporate bankruptcy or bank regulation and resolution expert. Saying that certain types of investments will "absorb the losses" that result from a bankruptcy case is not quite the same thing as saying, "your investment is comparable to "junk bonds" – high-risk debt – and will lose value, perhaps all value, if the bank fails."

Therefore, if the Agencies proceed with this Proposal, they should significantly increase the disclosure requirements so that retail investors and any American citizen can easily find reliable

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26 J. Anthony Cookson, Corbin Fox, Javier Gil-Bazo, Juan Felipe Imbet, & Christoph Schiller, *Social Media as a Bank Run Catalyst,* Université Paris-Dauphine Research Paper No. 4422754 (Apr. 18, 2023), https://www.fdic.gov/analysis/cfr/bank-research-conference/annual-22nd/papers/cookson-paper.pdf.

27 Stephen J. Lubben, *The Impossibility of TLAC*, *supra* note 12.

information that clearly explains the risk that comes with an LTD investment. The current opacity is unacceptable.

B. If the proposal moves forward, additional measures of risk, beyond simply a bright-line asset size test, must be added to identify the banks that require ltd protection in the event of failure.

The current Proposal applies to Category II, III, and IV firms as well as their subsidiary insured depository institutions ("IDIs"). While it is true that these large banks present considerable risk to the financial system as a whole, the Agencies should consider other risk factors that make a firm vulnerable to failure, such as elevated levels of uninsured deposits, to ensure that the Proposal comprehensively covers firms that present potential systemic risk.

C. If the proposal moves forward, the deposit insurance pricing calculation for large banks, which currently offers a discount for issuing LTD, must be adjusted to not provide covered firms with a benefit for simply complying with the rule.

Within the current FDIC deposit insurance pricing rules, large banks can lower their insurance assessment rate – the price they pay each quarter to maintain deposit insurance – by issuing long-term unsecured debt that absorbs losses ahead of the FDIC and uninsured depositors if the firm fails. The FDIC states,[28] "long-term unsecured debt provides a cushion that can reduce the FDIC's loss in the event of failure. Because such debt absorbs losses ahead of the FDIC and uninsured depositors, the FDIC wanted to encourage reliance on this funding source." After computing an individual bank's initial risk-based assessment rate, between 5 and 32 basis points, the bank can reduce its rate by up to 5 basis points based on unsecured debt issuance.[29] If the Proposal is finalized and LTD is required, firms should no longer be rewarded with an additional discount on insurance premiums, simply for complying with the rule.

Furthermore, the DIF is currently below its statutory minimum level, because of the losses that were incurred as a result of the spring 2023 failures.[30] The DIF needs to be rebuilt, so it is in the best interest of the DIF, financial stability, and the American people to end the assessment rate reductions that historically were offered for unsecured debt issuance.

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[28] Edward Garnett, LaVaughn Henry, Daniel Hoople, & Ashley Mihalik, *A History of Risk-Based Premiums at the FDIC*, FDIC Staff Studies, Report No. 2020-01 (Jan. 2020), https://www.fdic.gov/analysis/cfr/staff-studies/2020-01.pdf.

[29] *See* FDIC, Total Base Assessment Rates (last updated Nov. 16, 2023), https://www.fdic.gov/deposit/insurance/assessments/risk.html.

[30] Restoration Plan Semiannual Update, FDIC (Nov. 16, 2023), https://www.fdic.gov/news/board-matters/2023/2023-11-16-notational-mem-e.pdf.

CONCLUSION

We hope these comments are helpful.

Sincerely,

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