

Federal Reserve's Final Rule on Total Loss-Absorbing Capacity and Eligible Long-Term Debt



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I. Introduction and Key Changes from Proposal

Overview of Final Rule on TLAC and Eligible LTD

- The Federal Reserve has issued a final rule (available [here](#)) that is intended to further improve the resiliency and resolvability of certain U.S. banking organizations through new enhanced prudential standards that will impose:
 - **Total loss-absorbing capacity (TLAC)** requirements (where TLAC generally consists of Tier 1 capital and eligible long-term debt);
 - Separate **eligible long-term debt (LTD)** requirements; and
 - **Clean holding company requirements** that will limit or prohibit a covered BHC or covered IHC (defined below) from incurring certain liabilities and entering into certain arrangements on or after the effective date of January 1, 2019.
- These enhanced prudential standards will apply to:
 - Top-tier U.S. bank holding companies identified by the Federal Reserve as U.S. **global systemically important banking organizations (G-SIBs) (covered BHCs)**; and
 - U.S. **intermediate holding companies (covered IHCs)** of foreign G-SIBs with at least \$50 billion in U.S. non-branch assets.
- The final rule does **not** address the **regulatory capital treatment** of investments in unsecured debt issued by covered BHCs. The Federal Reserve intends to re-propose such requirements through an interagency rulemaking with the OCC and FDIC.
- Covered BHCs and covered IHCs must comply with the final requirements by **January 1, 2019**. There is no phase-in period to January 1, 2022, as had been proposed for the risk-based ratio component of the TLAC requirements.

The Federal Reserve estimated that covered BHCs would be required to raise an aggregate of \$70 billion in new eligible LTD to comply with the final rule. This estimate was down from an aggregate of \$120 billion at the time of the proposed rule because of the amount of new LTD raised between the dates of the proposed and final rules and the grandfathering provisions in the final rule.

Applicability of Final Rule on TLAC and Eligible LTD

Requirement	Covered BHCs	Resolution covered IHCs	Non-resolution covered IHCs
Minimum external TLAC and external LTD, plus covered BHC or covered IHC external TLAC buffer	✓	✓ (Can issue any combination of external and internal TLAC and LTD to satisfy requirements)	Cannot issue external TLAC and LTD to satisfy requirements
Minimum internal TLAC and internal LTD, plus covered IHC internal TLAC buffer	N/A (but future rulemaking on such requirements is possible)	(Can issue any combination of external and internal TLAC and LTD to satisfy requirements)	✓
Clean holding company requirements	✓	✓	✓

- **Covered BHCs.** Any U.S. bank holding company that is identified as a G-SIB.
 - Bank of America, Bank of New York Mellon, Citigroup, Goldman Sachs, JPMorgan Chase, Morgan Stanley, State Street and Wells Fargo.
- **Covered IHCs.** U.S. IHCs of foreign G-SIBs required to form such IHCs under the Federal Reserve's enhanced prudential standards rule (see [here](#) for our visual memo on the IHC requirement), including Barclays, BNP Paribas, Deutsche Bank, Credit Suisse, HSBC, MUFG, Société Générale and UBS.
 - **Resolution covered IHC:** A covered IHC whose top-tier foreign parent adopts a multiple-point-of-entry (**MPOE**) strategy, under which the U.S. IHC or its subsidiaries would enter into a bankruptcy or other similar proceeding in the U.S. apart from its foreign parent.
 - **Non-resolution covered IHC:** A covered IHC whose top-tier foreign parent adopts a single-point-of-entry (**SPOE**) strategy, under which the U.S. IHC would not enter into its own bankruptcy or other similar proceeding.

Key Changes from the Proposal

Topic	Key Changes
<p>Quantitative requirements for covered BHCs</p>	<ul style="list-style-type: none"> ■ Division of leverage-based TLAC ratio into minimum plus buffer <ul style="list-style-type: none"> ■ The final rule reduced the minimum leverage-based TLAC ratio for covered BHCs from 9.5% to 7.5%, but added a 2.0% leverage-based TLAC buffer, leaving the effective total requirement unchanged. This restructuring is consistent with the Federal Reserve’s approach to the enhanced SLR requirements in its capital rules, under which covered BHCs will be subject to a minimum SLR requirement of 3% and an enhanced SLR requirement of 5%, with the incremental 2% SLR requirement being in the form of a buffer that functions in the same way as the capital conservation buffer.
<p>Quantitative requirements for covered IHCs</p>	<ul style="list-style-type: none"> ■ External TLAC and LTD for resolution covered IHCs of MPOE firms <ul style="list-style-type: none"> ■ Under the proposal, covered IHCs would have been permitted to satisfy minimum TLAC and LTD requirements solely with internal TLAC and internal LTD. ■ Under the final rule, a resolution covered IHC (defined on pages 4 and 27) may satisfy its TLAC and LTD requirements with any combination of internal and external TLAC and internal and external LTD. ■ Reduced minimum eligible LTD requirements <ul style="list-style-type: none"> ■ The three minimum eligible LTD ratios for covered IHCs were reduced to 6% of total RWAs (from 7%), 2.5% of total leverage exposure (from 3%) and 3.5% of average total consolidated on-balance sheet assets (from 4%) in response to industry comments on the need to reflect assumed balance-sheet depletion (as for covered BHCs).
<p>Haircut methodology for eligible LTD</p>	<ul style="list-style-type: none"> ■ Haircut methodology for eligible LTD <ul style="list-style-type: none"> ■ Under the proposal, haircuts were applied to the total unpaid principal of eligible debt securities based on the final maturity of the instrument. Under the final rule, principal payments on eligible debt securities are individually allocated to haircut categories based on the date when such payments are due. Whether this change will have any practical impact on outstanding internal or external LTD depends on whether any such LTD has any principal payments due before maturity.

Key Changes from the Proposal

Topic	Key Changes
<p>Compliance timing</p>	<ul style="list-style-type: none"> ■ No phase-in period <ul style="list-style-type: none"> ■ Under the proposal, compliance with the minimum risk-based TLAC ratio requirements would have been phased in through January 1, 2022. Under the final rule, covered BHCs and covered IHCs must comply with all requirements (except the resolution strategy certification requirement for covered IHCs) by January 1, 2019. ■ Resolution strategy certification by June 30, 2017 for covered IHCs <ul style="list-style-type: none"> ■ The top-tier foreign parent of each covered IHC must provide a certification to the Federal Reserve by June 30, 2017 as to whether its home-country resolution strategy is an SPOE or MPOE strategy, for purposes of determining whether each covered IHC is a resolution or non-resolution covered IHC.
<p>Grandfathering</p>	<ul style="list-style-type: none"> ■ Grandfathering from the definition of eligible debt security for external debt <ul style="list-style-type: none"> ■ The proposal would not have provided any grandfathering for legacy LTD instruments. The final rule provides permanent grandfathering for external LTD instruments issued prior to December 31, 2016 that would be eligible LTD but for impermissible acceleration clauses or being governed by foreign law. ■ Prospective application of clean holding company requirements <ul style="list-style-type: none"> ■ The final rule clarifies that the clean holding company prohibitions, including the prohibition on parent guarantees of subsidiary liabilities with impermissible cross-defaults, apply prospectively only. ■ By providing permanent grandfathering for LTD instruments issued prior to December 31, 2016 that would be eligible LTD but for impermissible acceleration clauses or being governed by foreign law, the final rule implicitly grandfathers such instruments from the 5% cap on unrelated liabilities.

Key Changes from the Proposal

Topic	Key Changes
<p>Definition of eligible external LTD securities</p>	<ul style="list-style-type: none"> ■ Acceleration clauses <ul style="list-style-type: none"> ■ Under the final rule, acceleration rights are permissible in eligible external LTD securities issued by a covered BHC or a resolution covered IHC on or after December 31, 2016 only if they are exercisable (1) on one or more specified dates, (2) in the event of insolvency of the covered BHC or resolution covered IHC, as the case may be, or (3) upon a payment default. In a change from the proposal, acceleration clauses relating to a failure to pay either interest or principal are permissible only if they include a cure period of at least 30 days. ■ Structured notes <ul style="list-style-type: none"> ■ The final rule text clarifies that the definition of structured note does not include an instrument solely because it (1) is denominated in a foreign currency or (2) has interest payments based on an interest rate index. ■ Trust preferred securities (TruPS) <ul style="list-style-type: none"> ■ The preamble to the final rule provides that TruPS do not qualify as eligible external LTD.
<p>Definition of eligible internal LTD securities</p>	<ul style="list-style-type: none"> ■ Can be issued to wholly-owned subsidiaries of foreign G-SIB parent <ul style="list-style-type: none"> ■ The proposal would have required eligible internal LTD securities to be issued to and held by a foreign parent that controls the covered IHC. Under the final rule, eligible internal LTD securities must be issued to, and remain held by, a foreign parent that controls the covered IHC or a wholly-owned subsidiary of the foreign G-SIB parent. ■ No contractual subordination requirement <ul style="list-style-type: none"> ■ The proposal would have required eligible internal LTD securities to represent the most subordinated debt claim in a bankruptcy or similar proceeding of the covered IHC. The preamble to the proposal suggested that this would require that eligible internal LTD securities be contractually subordinated to all third-party liabilities of the covered IHC. The final rule removes the contractual subordination requirement and allows covered IHCs to rely on structural subordination subject to the 5% cap on unrelated liabilities (see page 44).

Key Changes from the Proposal

Topic	Key Changes
<p>Exclusion from eligible LTD amount</p>	<ul style="list-style-type: none"> ■ Discretion to exclude certain debt from eligible LTD amount <ul style="list-style-type: none"> ■ New provisions in the final rule allow the Federal Reserve, after notice and an opportunity for a covered BHC or covered IHC to respond, to order the covered BHC or covered IHC to exclude from its outstanding eligible LTD amount any debt with features that would “significantly impair” the debt’s ability to take losses.
<p>Internal debt conversion orders</p>	<ul style="list-style-type: none"> ■ Federal Reserve power to issue internal debt conversion orders <ul style="list-style-type: none"> ■ Under the final rule, in a response to concerns about U.S. tax treatment, the Federal Reserve no longer has the authority to cancel eligible internal debt securities of covered IHCs, but rather can only require the conversion of such debt into equity; and may convert some or all, as opposed to only all, of a covered IHC’s eligible internal debt. ■ In a change from the proposal, the Federal Reserve may issue internal debt conversion orders if the home country supervisor of a covered IHC’s foreign parent does not object within 24, as opposed to 48, hours.
<p>Resolution strategy certification for covered IHCs</p>	<ul style="list-style-type: none"> ■ Responsibility shifted from foreign regulators to foreign G-SIBs <ul style="list-style-type: none"> ■ The final rule requires each foreign G-SIB to certify to the Federal Reserve whether it has adopted an MPOE or SPOE resolution strategy in order to determine whether its covered IHC is a resolution or non-resolution covered IHC. The proposal would have required the home country resolution authority for each foreign G-SIB to provide such a certification on the foreign G-SIB’s resolution strategy.

Key Changes from the Proposal

Topic	Key Changes
<p>Clean holding company requirements – 5% cap on unrelated liabilities</p>	<ul style="list-style-type: none"> ■ Applicable to covered IHCs <ul style="list-style-type: none"> ■ Because the final rule does not require eligible internal debt securities to be contractually subordinated and allows resolution covered IHCs to issue eligible external debt securities, the 5% cap on unrelated liabilities applies to covered IHCs in the final rule, unlike the proposal. ■ Contractual subordination alternative <ul style="list-style-type: none"> ■ The final rule clarifies that in the event a covered BHC or covered IHC chooses to contractually subordinate <u>all</u> of its eligible LTD securities to third-party claims, there is no cap on the amount of its unrelated liabilities. ■ Scope of unrelated liabilities for covered IHCs <ul style="list-style-type: none"> ■ Under the final rule, for non-resolution covered IHCs, unrelated liabilities means non-contingent liabilities to third parties, but for resolution covered IHCs, unrelated liabilities means non-contingent liabilities owed to “a person that is not a subsidiary” of the resolution covered IHC, i.e., parents, sister affiliates and third parties.

Key Changes from the Proposal

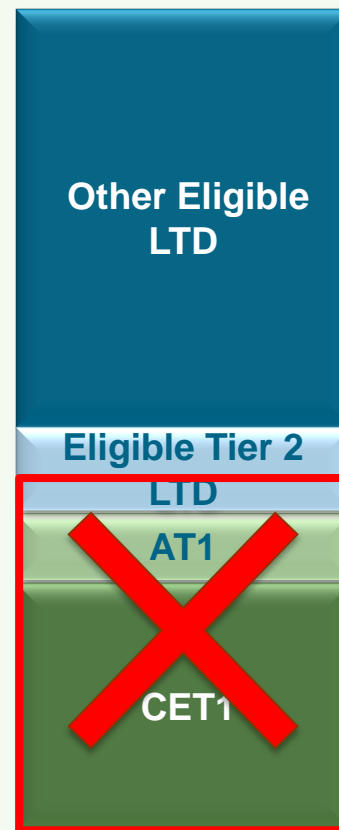
Topic	Key Changes
<p>Clean holding company requirements – flat prohibitions</p>	<ul style="list-style-type: none"> ■ Guarantees with cross-defaults <ul style="list-style-type: none"> ■ The proposal’s flat prohibition on cross-defaults still applies to guarantees of subsidiary liabilities under the final rule, except for guarantees of subsidiary liabilities under qualified financial contracts (QFCs) that are subject to one of the banking agencies’ QFC stay rules. ■ Third-party QFCs <ul style="list-style-type: none"> ■ The final rule prohibits covered BHCs and covered IHCs from entering into QFCs with third parties, other than credit enhancements such as parent guarantees. Accordingly, neither a covered BHC nor a covered IHC is prohibited from guaranteeing or otherwise providing a credit enhancement for QFCs between a subsidiary and a third party, so long as any cross-default is otherwise consistent with the final rule. ■ Short-term debt <ul style="list-style-type: none"> ■ The preamble to the final rule states that the Federal Reserve does not expect the prohibition on third-party short-term debt to interfere with the provision of secured liquidity from the FDIC as part of an orderly resolution under Title II of the Dodd-Frank Act or with other forms of governmental liquidity support, although there are no relevant changes to the rule text to make this clear.
<p>Capital deductions for investments in unsecured debt of covered BHCs</p>	<ul style="list-style-type: none"> ■ Deferred for later joint rulemaking <ul style="list-style-type: none"> ■ The Federal Reserve did not adopt any of its proposed regulatory capital deductions for investments in certain unsecured debt of covered BHCs. ■ The Federal Reserve intends to address the regulatory capital treatment of such investments jointly with the OCC and FDIC, taking into consideration the Basel Committee’s final standard on TLAC holdings.
<p>Domestic internal TLAC</p>	<ul style="list-style-type: none"> ■ No proposal <ul style="list-style-type: none"> ■ The Federal Reserve did not propose domestic internal TLAC requirements for covered BHCs or covered IHCs. The preamble to the final rule continues to leave open the possibility of a future proposal.

II. TLAC and LTD Requirements for Covered BHCs

External TLAC and Eligible External LTD Requirements Supports SPOE Resolution Strategy

- The centerpieces of the final rule for covered BHCs are the external TLAC and eligible external LTD requirements.
- The purpose of the external TLAC and eligible external LTD requirements is to enhance the resiliency and resolvability of a covered BHC.
- In a **single point-of-entry (SPOE)** resolution, only the covered BHC would enter into a bankruptcy or Title II proceeding, allowing operating subsidiaries to be recapitalized by pushing losses up to the BHC, transferring the subsidiaries to a new initially debt-free bridge BHC and keeping the subsidiaries out of insolvency proceedings. See **Appendix A** for a step-by-step illustration of an SPOE resolution.
- The covered BHC must have a sufficient amount of equity and properly subordinated LTD to absorb losses in the BHC's bankruptcy or Title II proceeding without fostering runs on the short-term debt of its operating subsidiaries, which could destabilize the financial system if the runs spread to other institutions.
- To be properly subordinated, LTD must be subordinated by structure, contract or statute to the banking group's short-term debt.

Covered BHC



Losses incurred by operating subsidiaries would be pushed up to the covered BHC and be absorbed by its equity and LTD...

Bridge BHC

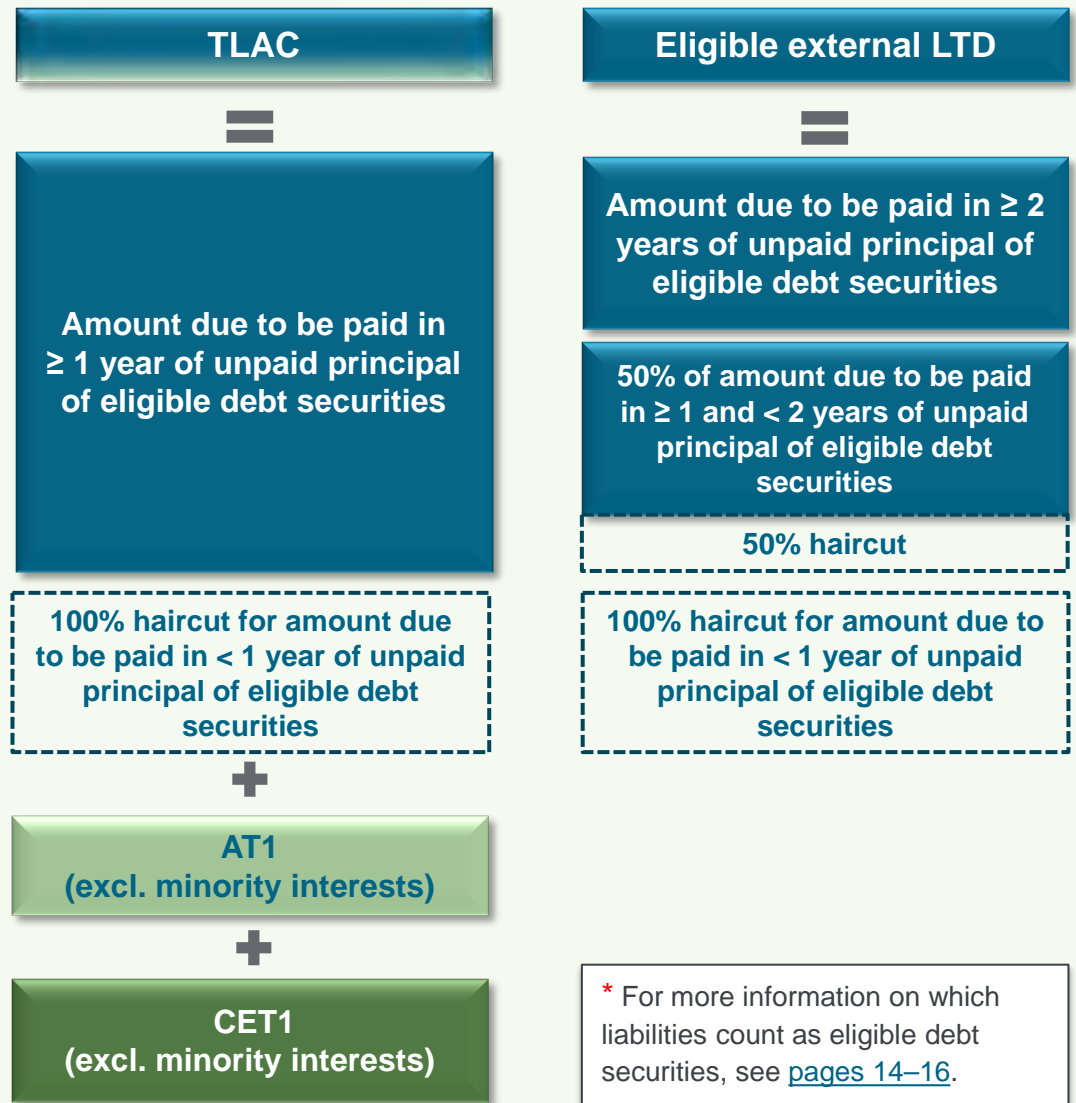
...and any residual LTD would be exchanged for equity and possibly new LTD in a new bridge BHC to which its subsidiaries would be transferred...



...thus recapitalizing the business transferred to the bridge BHC.

External TLAC and Eligible External LTD Requirements Measurement

- The final rule will require covered BHCs to maintain minimum ratios of TLAC and eligible LTD, plus TLAC buffers composed of high-quality equity capital. See [pages 17–24](#) for details on the TLAC and eligible LTD requirements.
- TLAC** consists of (1) Tier 1 capital other than minority interests and (2) the unpaid principal of **eligible debt securities**,* subject to haircuts for amounts due to be paid within 1 year.
 - For purposes of the TLAC requirements, eligible debt securities are subject to a 100% haircut for amounts due to be paid within 1 year.
- Eligible external LTD** consists of the unpaid principal of **eligible debt securities**,* subject to haircuts for amounts due to be paid within 2 years.
 - For purposes of the eligible external LTD requirements, eligible debt securities are subject to a 50% haircut for amounts due to be paid in more than 1 year but less than 2 years, and a 100% haircut for amounts due to be paid within 1 year.
- A covered BHC may not redeem or repurchase eligible debt securities before their maturity without the Federal Reserve’s prior approval if doing so would cause the covered BHC to fall below its TLAC or eligible external LTD requirements.



External TLAC and Eligible External LTD Requirements

Eligible Debt Securities

Eligible debt securities are debt instruments that:

- Are **paid in** and **issued by the covered BHC**;
- Are **not secured**, are **not guaranteed** by the covered BHC or any of its subsidiaries, and are **not** subject to other arrangements that legally or economically **enhance the seniority** of the instruments;
- Have a maturity of **greater than or equal to one year** from the date of issuance;
- Are governed by **U.S. state or federal law**; and
- Are **plain vanilla**, meaning that they:
 - Do **not** provide the holder with a **contractual right to accelerate** payment of principal or interest, **except** a right that is exercisable on one or more **specified dates**, in the **event of insolvency** of the covered BHC or upon a **payment default** that continues for **30 days** or more;
 - Do **not** have a **credit-sensitive feature** (e.g., interest rate step-ups or other resets based in whole or part on the covered BHC's credit quality), except that they may have an interest rate that is adjusted periodically independent of the covered BHC's credit quality, in relation to general market interest rates or similar adjustments (e.g., ordinary interest rate step-ups or step-downs not based on the covered BHC's credit quality);
 - Are **not structured notes** (see [page 16](#)); and
 - Have **no contractual provision** that permits the instruments to be **converted** into or **exchanged** for equity of the covered BHC.

Grandfathering. The final rule **permanently grandfathers** as eligible debt securities debt instruments issued **prior to December 31, 2016** that would be eligible debt securities but for (1) having **impermissible acceleration clauses** or (2) being **governed by foreign law**. There is no additional grandfathering from the definition of eligible debt security, including for long-term structured notes, convertible or exchangeable instruments or TruPS.

Anti-evasion. After providing notice and an opportunity for the covered BHC to respond, the Federal Reserve may order a covered BHC to exclude from its outstanding eligible external LTD amount any debt with features that would “significantly impair” the debt’s ability to absorb losses.

External TLAC and Eligible External LTD Requirements

Eligible Debt Securities – Puts/Calls and Remedies for Nonpayment

- **Put rights.** Otherwise eligible debt securities that give the investor a **put right** exercisable on a date certain **1 year or more** after the date of issuance will qualify as eligible debt securities, but their maturity date will be deemed to be the first date on which the put right may be exercised for purposes of the remaining maturity requirements of the final rule.
- **Issuer call rights.** The final rule does **not** exclude from eligible debt securities any otherwise eligible securities solely because they contain **call rights** that are **exercisable at the option of the issuer**.
- **Remedies for nonpayment.** The restriction on acceleration rights does **not** prevent a covered BHC from continuing to include **covenants** and events of default based on a breach of those covenants that give holders a **right to sue** the covered BHC for the **payment of principal and interest then due and payable**, provided that they are not given the contractual right to accelerate the debt upon such breach.

The preamble to the final rule clarifies that a debt security with a **survivor put** that is **immediately exercisable** upon the contingent future death of a particular person is treated as having matured on the date of issuance—i.e., as if the contingent future death event had already occurred and the survivor put been exercised—and thus does not qualify as an eligible debt security, which must have a maturity equal to or greater than one year.

Such debt securities will still be subject to the requirement in the final rule that a covered BHC not redeem or repurchase any eligible external LTD **without the prior approval** of the Federal Reserve if doing so would cause the covered BHC to fall below its external LTD or TLAC requirement.

Not only does this freedom include covenants to pay principal or interest when due, but the preamble to the final rule clarifies that a covered BHC is **not required to have a 30-day cure period** for the failure to pay principal or interest, **except to the extent it includes an acceleration right for such breach**. In other words, a covered BHC may include a covenant that allows a holder to sue upon a breach of a covenant to pay principal or interest when due, without providing a cure period, as long as that right does not include a contractual right to accelerate payment.

External TLAC and Eligible External LTD Requirements

Structured Notes

The final rule defines a **structured note** as a debt instrument that:

- 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;
- Has an embedded derivative or similar embedded feature that is linked to one or more equity securities, commodities, assets, or entities;
- Does not specify a minimum principal amount that becomes due upon acceleration or early termination; **or**
- Is not classified as debt under GAAP.

“Assets” would include loans, debt securities and other financial instruments.

The rule also provides that an instrument is not a structured note solely because it is:

- **Denominated in a foreign currency; or**
- An instrument with interest payments that are **linked to an interest rate index** (such as the federal funds rate or LIBOR).

Principal-protected structured notes. Structured notes do not qualify as eligible LTD, even if they have an original maturity of one year or more and specify a minimum principal amount payable upon acceleration or early termination (i.e., they are principal protected).

Required External TLAC and External LTD Ratios

- Covered BHCs will be required to maintain minimum ratios of **TLAC** and **eligible LTD**, each as a percentage of both risk-weighted assets (risk-based ratio requirements) and total leverage exposure (supplementary leverage ratio, or **SLR**, requirements).
- In addition, covered BHCs will be required to maintain a **risk-based TLAC buffer** (comprised solely of CET1 capital*) and, in a change from the proposal, a **TLAC SLR buffer** (composed solely of Tier 1 capital*), on top of the minimum external TLAC ratios, in order to avoid restrictions on capital distributions and discretionary bonus payments to senior executives.

	Requirement Type	Risk-Based Requirements (RWA denominator)	SLR Requirements (total leverage exposure denominator)
TLAC	Minimum	18%	7.5%
	Buffer	2.5% + Method 1 G-SIB surcharge** + countercyclical buffer (if any)	2.0%
	Buffer Composition	Buffer must be composed of CET1 capital	Buffer must be composed of Tier 1 capital
	Comparison to Proposal	Unchanged	Effectively unchanged (2% shifted from minimum to buffer)
Eligible LTD	Minimum	6% + Greater of Method 1 and 2 G-SIB surcharges**	4.5%
	Comparison to Proposal	Unchanged	Unchanged

The denominator in the risk-based ratio requirements is **risk-weighted assets** (RWAs). RWAs are determined under the final rule based on the greater of total standardized RWAs and total advanced approaches RWAs, as determined under the existing U.S. Basel III capital rules.

The denominator used in the SLR requirements is **total leverage exposure**. Total leverage exposure, which is defined by the Federal Reserve's U.S. Basel III capital rule, includes both on-balance sheet assets and off-balance sheet exposures such as those related to OTC derivatives, cleared derivatives, and repo-style transactions.

* The requirement that the risk-based TLAC buffer be composed solely of CET1 is redundant with existing capital buffer requirements. Similarly, the requirement that the TLAC SLR buffer be composed solely of Tier 1 capital is redundant with the enhanced SLR 2% buffer requirement that will become effective on January 1, 2018.

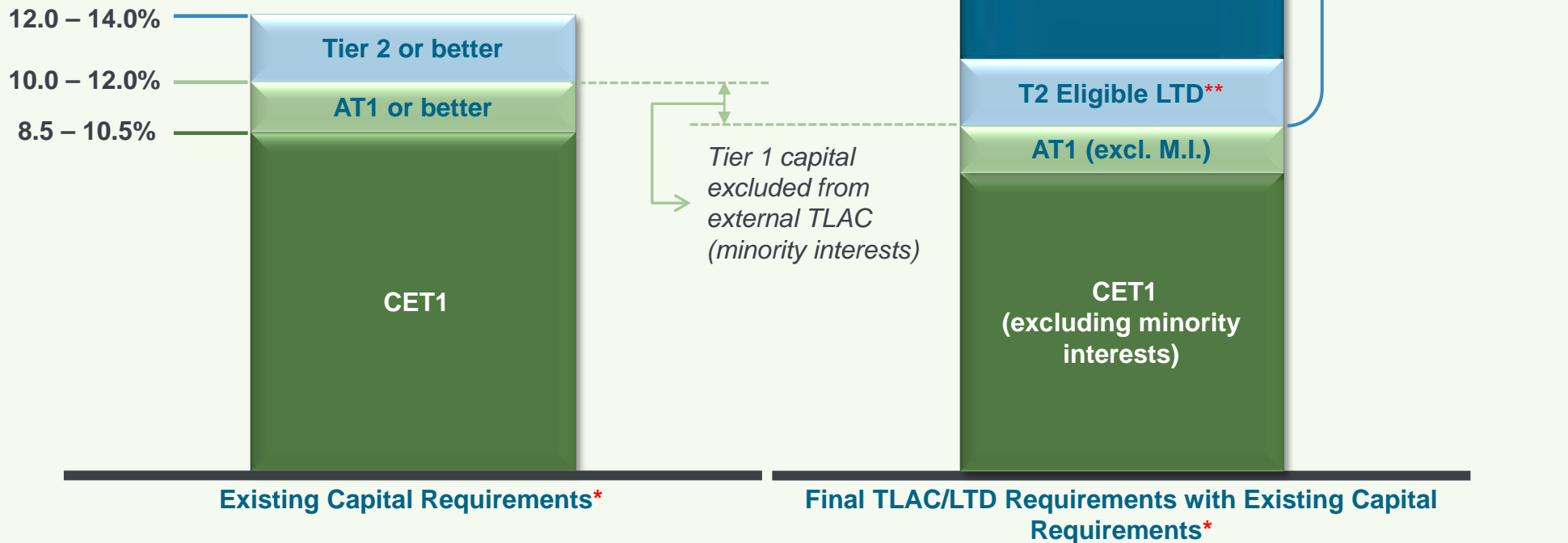
** Under the Federal Reserve's **G-SIB surcharge** final rule, the surcharge for each covered BHC is equal to the greater of the surcharge as determined under two methods: **Method 1** and **Method 2**. Typically, **Method 2** will result in a higher surcharge. For the covered BHCs, Method 2 surcharges currently range between 1.5% and 3.5%, while Method 1 surcharges currently range between 1.0% and 2.5%.

Required External TLAC and External LTD Ratios

Risk-Based Ratios and Their Relationship with Existing Capital Requirements

The final risk-based TLAC and eligible LTD requirements will complement existing U.S. Basel III capital requirements.

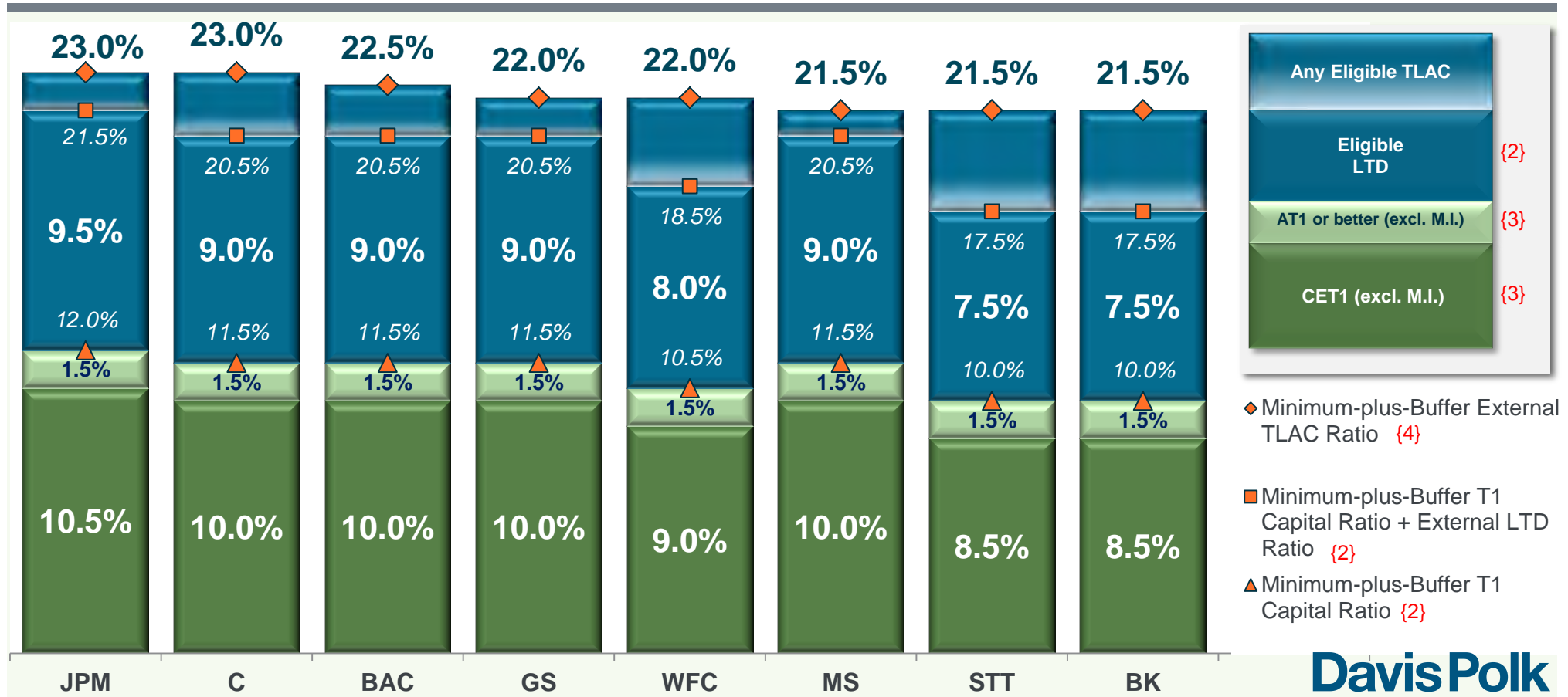
- Tier 1 capital, excluding minority instruments, will count toward TLAC.
- Tier 2 capital instruments meeting the definition of eligible debt securities will count toward TLAC and eligible LTD, subject to haircuts for amounts due to be paid within 1 year (for TLAC) or 2 years (for LTD).
- Any shortfall in required minimum TLAC not met by the sum of Tier 1 capital used to satisfy the U.S. Basel III capital rules (excluding minority interests) and modified eligible LTD will need to be met with additional TLAC.



* Ratio requirements include fully phased-in capital conservation buffers and publicly disclosed G-SIB surcharges and exclude any countercyclical buffer.
 ** Subject to different haircuts for purposes of the TLAC and eligible LTD requirements.

Required External TLAC and External LTD Ratios

Estimated Fully Phased-in Risk-Based Requirements by Covered BHC^{1}



^{1} This chart does not depict any higher amount of TLAC or eligible LTD that could be required under the final TLAC SLR and eligible LTD SLR requirements. Nor does it reflect capital that would be needed to maintain applicable minimum requirements on a stressed basis.

^{2} Includes each covered BHC's method 2 G-SIB surcharge—which is applied to the minimum eligible LTD risk-based ratio and the CET1 capital buffers—based on public disclosures.

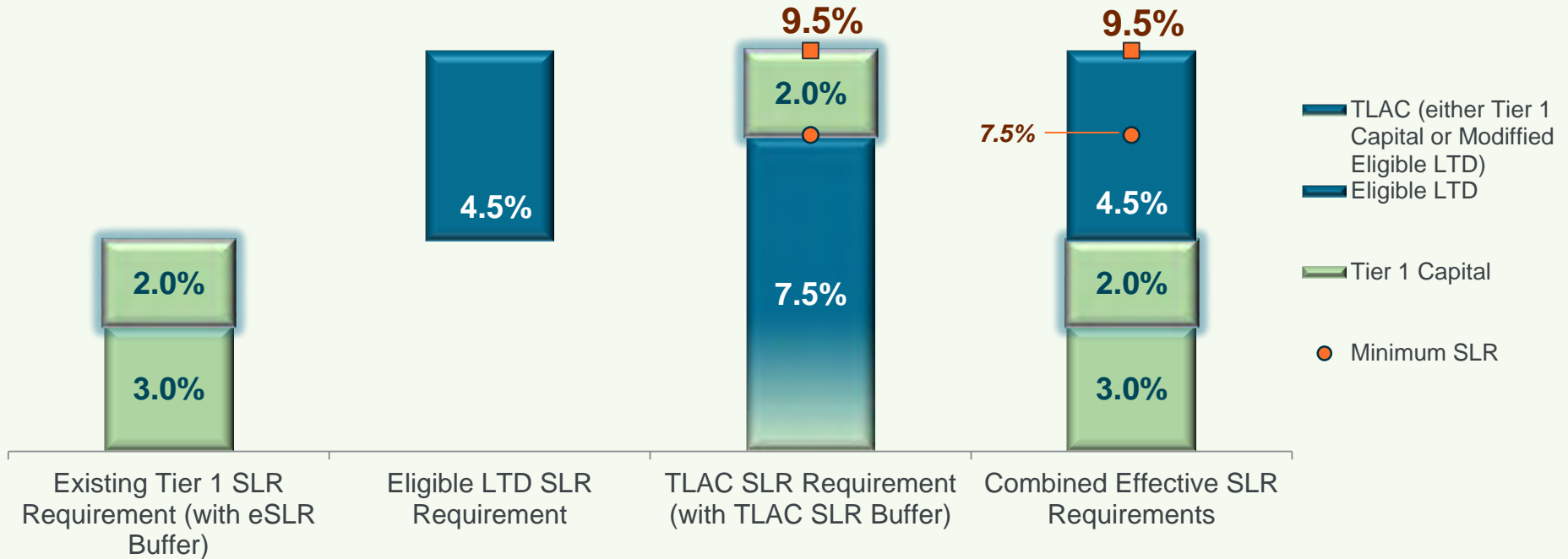
^{3} Although minority interests are excluded from TLAC, we have not adjusted minimum capital ratios and capital buffers to correct for the fact that these amounts are not similarly excluded from capital. Thus, we assume for purposes of this chart that minority interests recognized in T1 capital are de minimis.

^{4} Includes each covered BHC's method 1 G-SIB surcharge—which is applied to the minimum-plus-buffer external TLAC risk-based ratio—based on the Financial Stability Board's November 2016 update.

Required External TLAC and External LTD Ratios

SLR Requirements

- The external TLAC SLR requirement is a 7.5% minimum with a 2.0% buffer, for an effective requirement of 9.5%. Failure to maintain the full 2.0% TLAC SLR buffer will result in graduated restrictions on capital distributions and discretionary bonus payments.
 - The 2.0% TLAC SLR buffer must be composed entirely of Tier 1 capital. This is effectively redundant with the existing 2.0% enhanced SLR (**eSLR**) requirement that will apply to the covered BHCs from January 1, 2018. Thus, the 9.5% total TLAC SLR requirement can be fulfilled by maintaining compliance with the applicable SLR requirement of 5.0% under the capital rules and the final eligible LTD SLR of 4.5%.
- Consistent with the proposal, the eligible LTD SLR requirement is a 4.5% minimum with no buffer.



Required External TLAC and External LTD Ratios

Calibration Method for External LTD Requirements

- The Federal Reserve stated in the preamble to the final rule that it calibrated the external LTD requirements based on a “capital refill” framework.
 - Under the capital refill framework, a covered BHC’s external LTD requirements are linked to the covered BHC’s capital requirements—including the capital conservation buffer and applicable G-SIB surcharge but excluding the countercyclical capital buffer—as adjusted to allow for a reasonable amount of balance-sheet depletion.
 - For example, the risk-based external LTD requirement was calibrated to equal (1) the covered BHC’s fully phased-in CET1 capital requirements, including the capital conservation buffer and applicable G-SIB surcharge, minus (2) a 1% allowance for balance-sheet depletion.
 - **Example.** A covered BHC with a G-SIB surcharge of 2% has an all-in, non-cyclical CET1 capital requirement of 9% (4.5% minimum + 2.5% capital conservation buffer + 2% G-SIB surcharge). Under the final rule and the capital refill framework, the covered BHC would face a risk-based external LTD requirement of 8%—i.e., 1% less than its all-in, non-cyclical CET1 capital requirement.
- The Federal Reserve also stated that, to the extent the capital requirements are adjusted over time, it would “expect to consider updating the associated external LTD requirement in an effort to preserve the general alignment” between the capital rules and the external LTD requirements.

Balance-sheet depletion recognizes that when a bank fails it suffers losses that reduce its total assets; as a result, it does not need as much capital to achieve the required ratios of capital to assets.

External TLAC Buffer Requirements

- The final rule imposes a **risk-based TLAC buffer**, which must be composed solely of CET1 capital,* and a **TLAC SLR buffer**, which must be composed solely of Tier 1 capital,* above the minimum risk-based and SLR external TLAC requirements.

**Risk-based TLAC buffer requirement =
2.5% + method 1 G-SIB surcharge + countercyclical buffer (if any)**

TLAC SLR buffer requirement = 2.0%

- The TLAC buffers will operate in the same way as the capital conservation buffer and G-SIB surcharge under the U.S. Basel III capital rules. They must be maintained to avoid:
 - Limitations on capital distributions (e.g., repurchases of capital instruments or dividend or interest payments on capital instruments); and
 - Limitations on discretionary bonus payments to executive officers such as the CEO, president, CFO, CIO, CLO and heads of major lines of business.
- As a covered BHC dips further below the full required amount of its external TLAC buffers, it will be subject to increasingly stringent limitations on capital distributions and discretionary bonus payments, according to the table below. Any limitations on capital distributions and bonus payments will be based on the more restrictive of the two buffers.

Ratio of External TLAC Buffer Level to Requirement	Maximum Payout Ratio (as a % of eligible retained income)
> 100%	No payout limitation applies
> 75% and ≤ 100%	60%
> 50% and ≤ 75%	40%
> 25% and ≤ 50%	20%
≤ 25%	No capital distributions or discretionary bonus payments allowed

The payout limitation schedule is identical to the limitation schedule for breaches of the capital buffers under the U.S. Basel III capital rules.

* The requirement that the external TLAC buffers be composed solely of CET1 and Tier 1 capital, respectively, is redundant in view of the capital buffer requirement.

External TLAC Buffer Requirements

Calculation of Risk-Based TLAC Buffer Level

- Each covered BHC's **risk-based TLAC buffer level** will be based on its risk-based capital and eligible LTD ratios, relative to the minimum required TLAC risk-based ratio. It will be calculated using the following formula:

$$\text{Risk-Based TLAC Buffer Level} = \text{CET1 risk-based ratio} \text{ minus the greater of:}$$

- zero and
- [18% – AT1 (less Tier 1 minority interests) risk-based ratio – eligible LTD risk-based ratio*]

- The formula would effectively prevent CET1 capital used to meet the minimum required TLAC risk-based ratio from being included in the risk-based TLAC buffer.
- Step 1:** The formula first subtracts the amounts of the firm's AT1 (less Tier 1 minority interests) and eligible LTD from the applicable minimum requirement, each as a percentage of RWAs:

$$\text{18\%} - \text{AT1} - \text{LTD} = \text{Remainder of minimum required external risk-based TLAC to be met with CET1}$$

- Step 2:** If a firm has enough AT1 (less Tier 1 minority interests) and eligible LTD to meet the minimum required risk-based TLAC ratio without any CET1, then the risk-based TLAC buffer level equals the firm's full amount of CET1:

$$\text{Risk-Based TLAC Buffer Level} = \text{CET1}$$

- Step 3:** Otherwise, the risk-based TLAC buffer level equals the amount of the firm's CET1 remaining after applying CET1 toward the remainder from Step 1:

$$\text{Risk-Based TLAC Buffer Level} = \text{CET1} - \{ \text{18\%} - \text{AT1} - \text{LTD} \}$$

* Section 252.63(c)(3) (defining a covered BHC's risk-based TLAC buffer level) uses the term "outstanding eligible external long-term debt amount" without adding to that amount, as in Section 252.63(b)(3) (the definition of "outstanding eligible total loss-absorbing capacity amount"), 50% of the amount due to be paid of unpaid principal of outstanding eligible debt securities in one to two years. This may be an inadvertent omission in the text of the rule.

External TLAC Buffer Requirements

Calculation of External TLAC SLR Buffer Level

- Each covered BHC's **TLAC SLR buffer level** will be based on its Tier 1 SLR and eligible LTD SLR ratios, relative to the minimum required TLAC SLR ratio. It will be calculated using the following formula:

$$\text{TLAC SLR Buffer Level} = \text{SLR minus the greater of:}$$

- zero and
- [7.5% – eligible LTD SLR*]

- Step 1:** The formula first subtracts the amount of the firm's eligible LTD SLR from the applicable minimum requirement:

$$\text{7.5\%} - \text{LTD} = \text{Remainder of minimum required eligible SLR TLAC to be met with Tier 1}$$

- Step 2:** If a firm has enough eligible LTD to meet the minimum required TLAC SLR ratio without any Tier 1 capital, then the TLAC buffer level equals the firm's full amount of CET1:

$$\text{TLAC SLR Buffer Level} = \text{Tier 1}$$

- Step 3:** Otherwise, the TLAC SLR buffer level equals the amount of the firm's Tier 1 capital remaining after applying Tier 1 capital toward the remainder from Step 1:

$$\text{TLAC SLR Buffer Level} = \text{Tier 1} - \{ \text{7.5\%} - \text{LTD} \}$$

* Section 252.63(c)(5)(iii) (defining a covered BHC's TLAC SLR buffer level) uses the term "outstanding eligible external long-term debt amount" without adding to that amount, as in Section 252.63(b)(3) (the definition of "outstanding eligible total loss-absorbing capacity amount"), 50% of the amount due to be paid of unpaid principal of outstanding eligible debt securities in one to two years. This may be an inadvertent omission in the text of the rule.

Disclosure Requirements

- Covered BHCs are required to publicly disclose a description of the **financial consequences** to unsecured debtholders if the covered BHC were to enter into a bankruptcy or similar proceeding in which it is the only entity subject to the proceeding.
 - This disclosure is required to be included in the **offering documents** for all of the covered BHC's eligible debt securities.
 - The disclosure is **also** required to be provided publicly in one of the following ways:
 - By posting the disclosure on the covered BHC's **public website**; or
 - By including the disclosure in two or more **public financial reports or regulatory reports**, provided that the covered BHC publicly provides a **summary table** specifically **indicating the location(s) of the disclosure**.
- The final rule does not require the public disclosure of the amount or priority of TLAC or eligible LTD, though the preamble to the final rule leaves open the possibility of a future proposal on such disclosure.

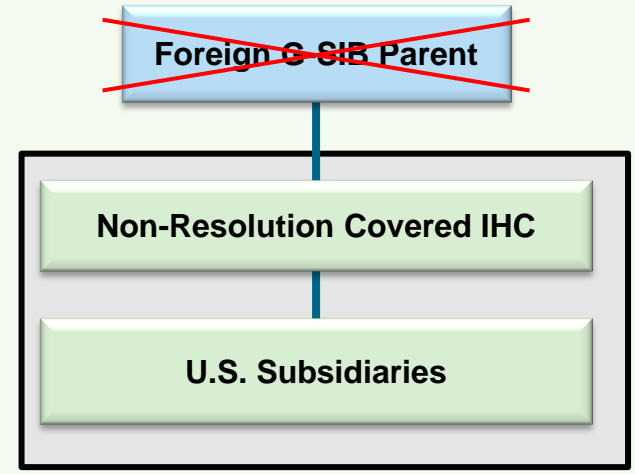
Resolution covered IHCs that issue eligible debt securities externally are subject to the disclosure requirements applicable to covered BHCs with respect to such instruments. See [page 31](#).

III. TLAC and LTD Requirements for Covered IHCs

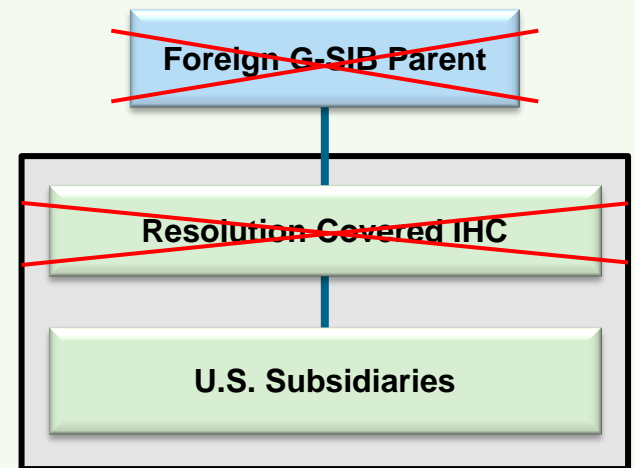
TLAC and Eligible LTD Requirements

Effect of Foreign Parent's Resolution Strategy

- The final rule amends the Federal Reserve's enhanced prudential standards applicable to **foreign banking organizations (FBOs)** to impose TLAC, LTD and clean holding company requirements on covered IHCs, i.e., all U.S. IHCs that are (1) required to be formed under the enhanced prudential standards **and** (2) controlled by a global systemically important FBO (**foreign G-SIB**).
- The TLAC and LTD requirements differ under the final rule depending on the resolution strategy adopted by the foreign G-SIB parent of the covered IHC.
 - If the foreign G-SIB parent adopts an SPOE strategy, under which the U.S. IHC would not enter into its own bankruptcy or similar proceeding, the U.S. IHC is called a **non-resolution covered IHC**.
 - If the foreign G-SIB parent adopts an MPOE strategy, under which the U.S. IHC or its subsidiaries would enter into a bankruptcy or similar proceeding in the United States apart from its foreign parent, the U.S. IHC is called a **resolution covered IHC**.
 - A major difference between the two sets of requirements is that resolution covered IHCs are allowed to meet their TLAC and LTD requirements with any combination of internal or external TLAC or LTD, whereas non-resolution covered IHCs must do so exclusively with internal TLAC and LTD.
- Each foreign G-SIB parent must **certify** to the Federal Reserve whether its planned resolution strategy is an SPOE or MPOE strategy. See [page 29](#).



SPOE: the U.S. IHC does not enter its own bankruptcy or similar proceeding.



MPOE: the U.S. IHC enters its own bankruptcy or similar proceeding apart from its foreign parent.

TLAC and Eligible LTD Requirements

Scope of Covered IHCs

- **Determination of Foreign G-SIB Status:** Under the final rule, a **top-tier FBO*** that controls a **U.S. IHC** is a foreign G-SIB if:
 - The top-tier FBO determines that it has the characteristics of a foreign G-SIB under the assessment methodology and higher loss absorbency requirement for global systemically important banks issued by the Basel Committee on Banking Supervision (**BCBS methodology**); **or**
 - The Federal Reserve, using any information available to it, determines that:
 - The top-tier FBO would be a G-SIB under the BCBS methodology;
 - The top-tier FBO would be identified as a G-SIB BHC under the Federal Reserve’s G-SIB surcharge rule; **or**
 - The U.S. IHC would be identified as a G-SIB BHC under the Federal Reserve’s G-SIB surcharge rule if the G-SIB surcharge applied the U.S. IHC.
- **Notice Regarding G-SIB Status:** Each top-tier FBO will be required to notify the Federal Reserve through its U.S. IHC by January 1 of each year:
 - Whether its home country supervisor or other appropriate home country regulatory authority has adopted standards consistent with the BCBS methodology; **and**
 - Whether the top-tier FBO prepares or reports the indicators used by the BCBS methodology to identify a banking organization as a G-SIB and, if it does, whether the top-tier FBO has determined that it has the characteristics of a G-SIB under the BCBS methodology using such indicators.
- **Initial Application of Requirements for New Covered IHCs:** Any new covered IHC will be subject to the requirements of the final rule three years after the earlier of (1) the date on which the U.S. non-branch assets of the G-SIB FBO that controls the covered IHC equal or exceed \$50 billion and (2) the date on which the FBO that controls the covered IHC first became a G-SIB.**

The top-tier FBO is required to conduct this assessment to the extent that it prepares or reports for any purpose the indicator amounts necessary to determine whether an FBO is a G-SIB under the BCBS methodology.

* Under the final rule, a “top-tier foreign banking organization” is the top-tier entity that is or controls a foreign bank that (i) operates a branch, agency, or commercial lending company subsidiary in the United States, (ii) controls a bank in the United States, or (iii) controls an Edge corporation acquired after March 5, 1987, or the entity specified by the Federal Reserve that is a subsidiary of the top-tier entity.

** This provision is unclear as currently drafted. Prong (1) seems to refer to the date on which an FBO that is already a G-SIB first triggers the requirement to form an IHC rather than the date on which the FBO actually forms an IHC. Prong (2) seems to refer to the date on which an FBO with an existing IHC first becomes a G-SIB. In addition, while the rule text states that compliance is required three years after the *earlier* of the dates, an explanation of the provision in the preamble to the final rule refers to the *later* of the dates.

TLAC and Eligible LTD Requirements

Resolution Strategy Certification

■ **Certification of resolution status:**

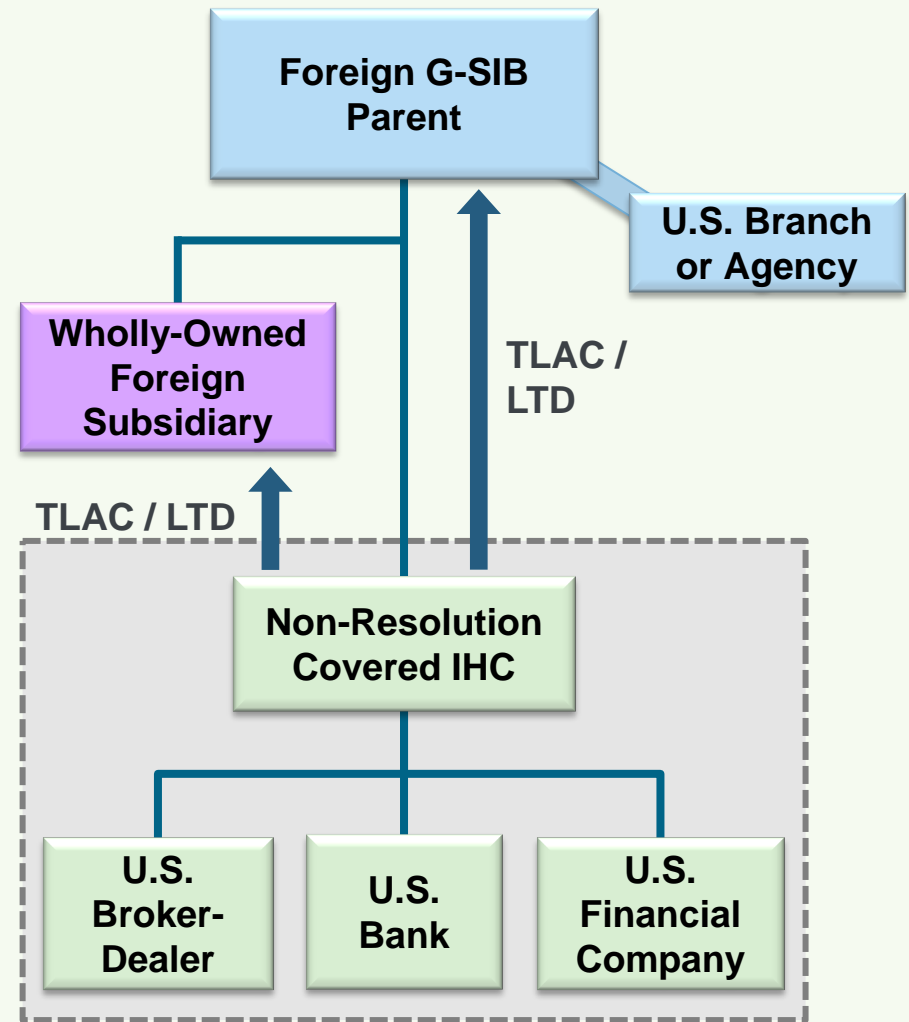
- Each foreign G-SIB with U.S. non-branch assets that equal or exceed \$50 billion must **certify** to the Federal Reserve whether its planned resolution strategy is an SPOE or MPOE strategy and update the Federal Reserve upon any change in its resolution strategy described in the original certification.
 - The initial certification is required by the later of (1) **June 30, 2017** and (2) one year prior to becoming subject to the requirements of the final rule.
 - A Covered IHC must comply with the requirements applicable to a resolution or non-resolution covered IHC within one year after being identified as or determined to be a resolution or non-resolution covered IHC, unless such time period is extended by the Federal Reserve in its discretion.
- **Federal Reserve discretion.** The Federal Reserve reserves the authority to **designate** covered IHCs to be resolution or non-resolution covered IHCs at its discretion.
- **Change in resolution strategy.** A foreign G-SIB with an IHC required to be formed under the Federal Reserve's enhanced prudential standards must update this certification if its planned resolution strategy changes. The covered IHC would have one year after the date of identification or designation as a resolution covered IHC or a non-resolution covered IHC to comply with any new applicable requirements as a result of the transition.

TLAC and Eligible LTD Requirements

Eligible Securities for Non-Resolution Covered IHCs

- For a **non-resolution covered IHC**, minimum amounts of **internal LTD** must be issued to, and remain held by:
 - A **foreign G-SIB parent entity** that directly or indirectly controls the non-resolution covered IHC; or
 - A **wholly-owned subsidiary*** of its foreign G-SIB parent.
- Minimum amounts of **internal TLAC** must be issued to, and remain held by, a foreign G-SIB parent entity, except to the extent that internal LTD satisfying the internal TLAC requirements is held by a wholly-owned subsidiary of its foreign parent.

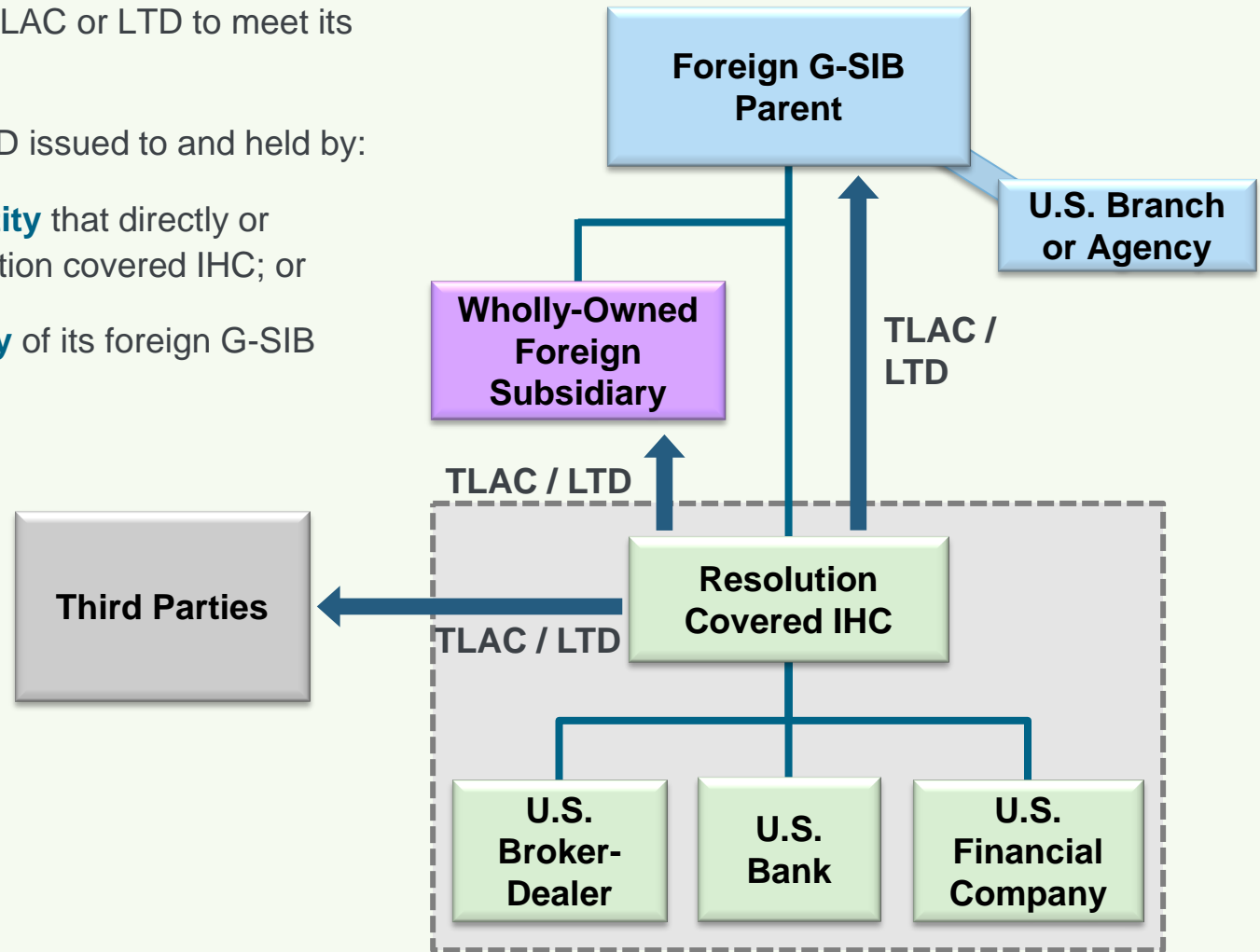
* **Wholly-owned subsidiary** means an entity, all of the outstanding ownership interests of which are owned directly or indirectly by a foreign G-SIB parent that directly or indirectly controls a covered IHC, **except** that **0.5%** of the entity's outstanding ownership interests may be held by a third party if the ownership interest is acquired or retained by the third party for the purpose of establishing corporate separateness or to address bankruptcy, insolvency or other similar concerns.



TLAC and Eligible LTD Requirements

Eligible Securities for Resolution Covered IHCs

- A **resolution covered IHC** may issue any combination of internal TLAC or LTD or external TLAC or LTD to meet its required minimums.
- **Internal TLAC / LTD** is TLAC / LTD issued to and held by:
 - A **foreign G-SIB parent entity** that directly or indirectly controls the resolution covered IHC; or
 - A **wholly-owned subsidiary** of its foreign G-SIB parent.
- **External TLAC** and **external LTD** are issued to **third parties**.
- Resolution covered IHCs that issue **external** eligible debt securities are subject to the **disclosure requirements** applicable to covered BHCs (see [page 25](#)) with respect to such instruments.



TLAC and Eligible LTD Requirements

Eligible External Debt Securities and Grandfathering

Only resolution covered IHCs are permitted to use external debt securities to satisfy their minimum LTD and TLAC requirements. The definition of eligible external debt securities applicable to resolution covered IHCs tracks the definition of eligible debt securities applicable to covered BHCs.

Eligible external debt securities are debt instruments that:

- Are **paid in** and issued by the resolution covered IHC to, and remain held by, a person that does not directly or indirectly control the resolution covered IHC and is not a wholly-owned subsidiary of the foreign G-SIB parent;
- Are **not secured**, are **not guaranteed** by the resolution covered IHC or any of its subsidiaries, and are **not** subject to other arrangements that legally or economically **enhance the seniority** of the instruments;
- Have a maturity of **greater than or equal to one year** from the date of issuance;
- Are governed by **U.S. state or federal law**; and

(continued on following page)

Put rights. Otherwise eligible debt securities that give the investor a **put right** exercisable on a date certain **1 year or more** after the date of issuance will qualify as eligible external debt securities, but their maturity date will be deemed to be the first date on which the put right may be exercised for purposes of the remaining maturity requirements of the final rule. The preamble to the final rule clarifies that a debt security with a **survivor put** that is **immediately exercisable** upon the contingent future death of a particular person is treated as having matured on the date of issuance—i.e., as if the contingent future death event had already occurred and the survivor put been exercised—and thus does not qualify as an eligible external debt security, which must have a maturity equal to or greater than one year.

Grandfathering. The final rule provides **permanent grandfathering** for debt instruments issued **prior to December 31, 2016** that would be eligible external debt securities but for (1) having **impermissible acceleration clauses** or (2) being **governed by foreign law**. There is no additional grandfathering from the definition of eligible external debt security, including for long-term structured notes, convertible or exchangeable instruments or TruPS.

TLAC and Eligible LTD Requirements

Eligible External Debt Securities and Grandfathering (*cont.*)

(Continued from prior page)

- Are **plain vanilla**, meaning that they:
 - Do **not** provide the holder with a **contractual right to accelerate** payment of principal or interest, **except** a right that is exercisable on one or more **specified dates** or in the **event of insolvency** of the resolution covered IHC or upon a **payment default** that continues for **30 days** or more;
 - Do **not** have a **credit-sensitive feature** (e.g., interest rate step-ups or other resets based in whole or part on the resolution covered IHC's credit quality), except that they may have an interest rate that is adjusted periodically independent of the resolution covered IHC's credit quality, in relation to general market interest rates or similar adjustments (e.g., ordinary interest rate step-ups or step-downs not based on the resolution covered IHC's credit quality);
 - Are **not structured notes**; and
 - Have **no contractual provision** that permits the instruments to be **converted** into or **exchanged** for equity of the resolution covered IHC.

Anti-evasion. After providing notice and an opportunity for the covered IHC to respond, the Federal Reserve may order a covered IHC to exclude from its outstanding eligible LTD amount any debt with features that would “significantly impair” the debt's ability to absorb losses.

TLAC and Eligible LTD Requirements

Eligible Internal Debt Securities

- Eligible internal debt securities may be used by resolution covered IHCs and are the only debt securities that may be used by non-resolution covered IHCs to satisfy their TLAC and eligible LTD requirements.
- While the definition of eligible internal debt securities tracks the definition of eligible external debt securities in certain respects, it also includes several additional or varying requirements.
- **Eligible internal debt securities**, similar to eligible external debt securities, are debt instruments that:
 - Are **paid in** and issued by the covered IHC;
 - Are **not secured**, are **not guaranteed** by the covered IHC or any of its subsidiaries, and are **not** subject to other arrangements that legally or economically **enhance the seniority** of the instruments;
 - Have a maturity of **greater than or equal to one year** from the date of issuance;
 - Are **plain vanilla** and are **not structured notes**; and
 - Are governed by **U.S. state or federal law**.

No grandfathering. There is **no** grandfathering for eligible internal debt securities similar to that provided for eligible external debt securities.

In contrast to eligible external debt securities, there is **no requirement** that eligible internal debt securities **exclude** instruments with a **credit-sensitive feature**.

(continued on following page)

Guidance from Treasury on tax treatment. The IRS stated in [Revenue Procedure 2017-12](#) that it will treat internal TLAC (by which it means internal LTD) issued by a covered IHC pursuant to the Federal Reserve's final rule on or after December 15, 2016 as indebtedness for federal tax purposes unless and until the Federal Reserve has issued an internal debt conversion order (as described on [page 36](#)).

TLAC and Eligible LTD Requirements

Eligible Internal Debt Securities (*cont.*)

(Continued from prior page)

- Unlike eligible external debt securities, eligible internal debt securities must have the following characteristics:
 - **Issued to a foreign parent or wholly-owned subsidiary.** The debt securities must be issued to and remain held by a foreign parent entity of the covered IHC or a wholly-owned subsidiary of its foreign G-SIB parent, but cannot be issued to a U.S. affiliate or to third parties.
 - **Contractual trigger.** Eligible internal debt securities must include a contractual provision approved by the Federal Reserve that provides for the **immediate conversion or exchange** of the instrument into Common Equity Tier 1 of the covered IHC upon the Federal Reserve's issuance of an **internal debt conversion order**, which can only be issued if certain strict conditions are satisfied (see [page 36](#)).

Eligible internal debt securities are **not** required to be issued to the foreign G-SIB parent, and instead can be issued to any foreign parent entity that directly or indirectly controls the covered IHC, or any wholly owned subsidiary of the foreign G-SIB parent that falls outside of the ownership chain running between the covered IHC and its foreign G-SIB parent.

This requirement would prevent the conversion of eligible internal TLAC into equity from effecting a change in control over the covered IHC and would ensure that a covered IHC's foreign parent, rather than U.S. affiliates, would absorb losses and recapitalize a covered IHC's subsidiaries.

Anti-avoidance. After providing notice and an opportunity for the covered IHC to respond, the Federal Reserve may order a covered IHC to exclude from its outstanding eligible LTD amount any debt with features that would "significantly impair" the debt's ability to absorb losses.

TLAC and Eligible LTD Requirements

Internal Debt Conversion Order

- The contractual trigger requirement in internal eligible debt securities is intended to ensure that losses incurred by the covered IHC are pushed to a foreign parent or foreign sister and the covered IHC does not have to enter into a bankruptcy or similar proceeding.
- The Federal Reserve is permitted to issue an **internal debt conversion order**, activating the contractual trigger, if the following conditions are met:
 - The Federal Reserve has determined that the covered IHC is in **default or in danger of default**; **and**
 - **Any** of the following circumstances apply:
 - An FBO that directly or indirectly controls the covered IHC or any subsidiary of the covered IHC's top-tier FBO parent has been **placed into bankruptcy or similar proceedings**, including the application of statutory resolution powers, in its home country;
 - The home country supervisor of the top-tier FBO parent has **consented or** has **not objected within 24 hours** of notification by the Federal Reserve to the conversion or exchange of the covered IHC's eligible internal debt securities; **or**
 - The Federal Reserve has made a **written recommendation** to the Secretary of the Treasury that **the FDIC should be appointed as receiver** of the covered IHC under Title II of the Dodd-Frank Act.
- The Federal Reserve may require the conversion or exchange of internal debt securities for CET1 capital, but not their cancellation.

Consistent with the standard provided by section 203(c)(4) to trigger the Orderly Liquidation Authority under Title II of the Dodd-Frank Act, a covered IHC is in **default or in danger of default** if:

- A case has been, or likely will promptly be, commenced with respect to the covered IHC under the Bankruptcy Code;
- 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;
- The covered IHC's assets are, or are likely to be, less than its obligations to creditors and others; **or**
- 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.

Required TLAC and LTD Ratios

Required TLAC Ratios and Buffer

- TLAC Minimum Ratios:** Covered IHCs will be required to maintain minimum ratios of TLAC as a percentage of RWAs (risk-based ratios), total leverage exposure (supplementary leverage ratios) and average total consolidated assets (U.S. Tier 1 leverage ratios).
- TLAC Buffer:** Covered IHCs also will be required to maintain a TLAC buffer, composed solely of CET1 capital, on top of the minimum TLAC risk-based ratio, in order to avoid restrictions on distributions and discretionary bonus payments to senior executives. Unlike the TLAC buffer for covered BHCs, the TLAC buffer applicable to covered IHCs does not include a G-SIB surcharge component (unless the covered IHC were itself a covered BHC). Unlike covered BHCs, covered IHCs are not subject to a buffer requirement on top of their TLAC SLR or Tier 1 leverage requirements.

Requirement Type (Minimum or Buffer)	Resolution Covered IHCs (MPOE Strategy) External or Internal TLAC			Non-Resolution Covered IHCs (SPOE Strategy) Internal TLAC Only		
	Risk-Based TLAC Ratio	TLAC SLR*	TLAC U.S. Tier 1 Leverage Ratio	Risk-Based TLAC Ratio	TLAC SLR*	TLAC U.S. Tier 1 Leverage Ratio
Minimum Ratio	18%	6.75%	9%	16%	6%	8%
Buffer (Composition)	2.5% + countercyclical buffer (if any) (must be composed of CET1 capital)	N/A	N/A	2.5% + countercyclical buffer (if any) (must be composed of CET1 capital)	N/A	N/A

- The denominator of each of these measures is as described on the following page.

The Federal Reserve's final minimum TLAC risk-weighted ratio for non-resolution covered IHCs is 89% of the final minimum external TLAC risk-weighted ratio for covered BHCs, which is at the high end of the 75-90% range for internal TLAC for material foreign subsidiaries established by the FSB in its final international TLAC standard.

* Apply if the covered IHC has \geq \$250 billion of total consolidated assets or \geq \$10 billion of on-balance sheet foreign exposures.

Required TLAC and LTD Ratios

Required LTD Ratios

- LTD Minimum Ratios:** Covered IHCs will be required to maintain minimum ratios of LTD as a percentage of RWAs (risk-based ratios), total leverage exposure (supplementary leverage ratios) and average total consolidated assets (U.S. Tier 1 leverage ratios).
- Prior Approval for Redemption or Repurchase:** A covered IHC will be prohibited from redeeming or repurchasing outstanding eligible LTD prior to maturity without the Federal Reserve's prior approval if the covered IHC would fall below its LTD requirement.
- No Cure Period:** The final rule does not include a cure period for any inadvertent breach of the 5% cap or address the consequences of such a breach.

Minimum Ratio or Buffer	Resolution Covered IHCs (MPOE Strategy) External or Internal LTD			Non-Resolution Covered IHCs (SPOE Strategy) Internal LTD Only		
	Risk-Based Eligible LTD Ratio	Eligible LTD SLR*	Eligible LTD U.S. Tier 1 Leverage Ratio	Risk-Based Eligible LTD Ratio	Eligible LTD SLR*	Eligible LTD U.S. Tier 1 Leverage Ratio
Minimum LTD Ratio	6%	2.5%	3.5%	6%	2.5%	3.5%

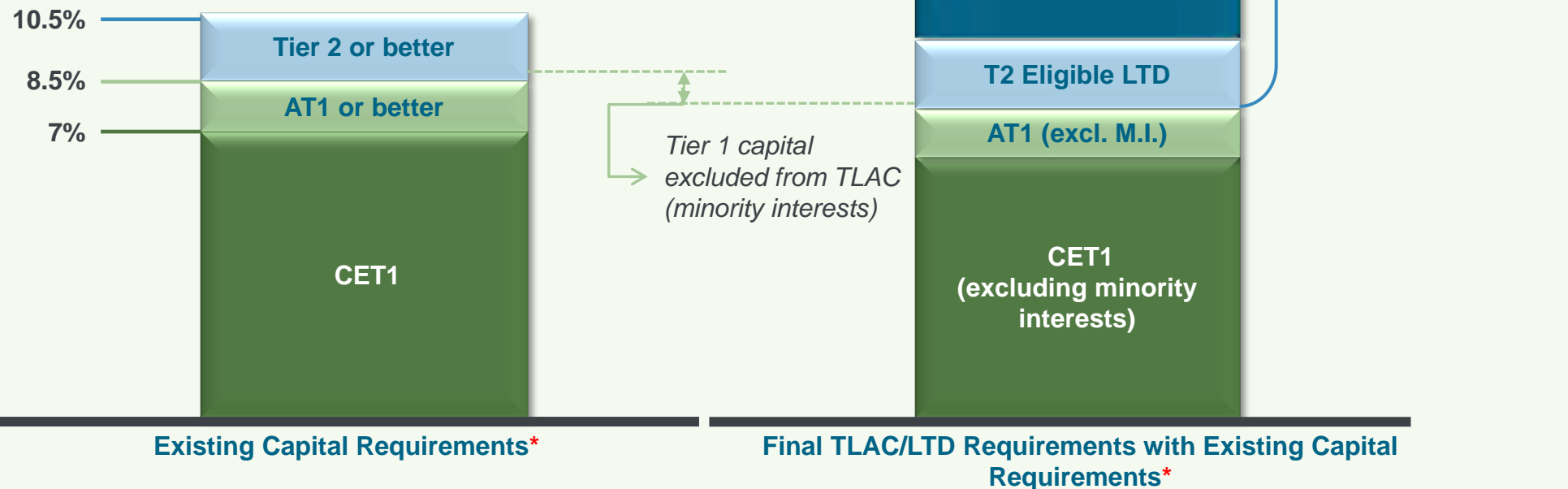
- The denominator in the risk-based ratio requirements is RWAs and is calculated using the same methodology for calculating the covered IHC's RWAs under existing regulatory capital rules.
- The denominator used in the SLR requirements is total leverage exposure, which, as defined by the Federal Reserve's SLR rule, includes both on-balance sheet assets and off-balance sheet exposures such as those related to OTC derivatives, cleared derivatives and repo-style transactions.
- The denominator in the Tier 1 leverage ratio requirements is average total consolidated assets.

Required TLAC and LTD Ratios

Risk-Based Ratios and Their Relationship with Existing Capital Requirements

The final TLAC and internal LTD requirements will complement existing U.S. Basel III capital requirements applicable to covered IHCs.

- Tier 1 capital, excluding minority instruments, will generally count towards TLAC (except to the extent issued to third parties, in the case of non-resolution covered IHCs).
- Tier 2 instruments meeting the definition of eligible debt securities will count towards LTD.
- Any shortfall in required minimum TLAC not met by the sum of Tier 1 capital used to satisfy the U.S. Basel III capital rules (excluding minority interests) and LTD will need to be met with additional TLAC.



* Ratio requirements include the fully phased-in capital conservation buffer and exclude any countercyclical buffer.

IV. Clean Holding Company Requirements

Clean Holding Company Framework

Overview

The final rule establishes a **clean holding company** framework that imposes certain restrictions on the types of liabilities or arrangements that may be incurred, entered into or in some cases held by a covered BHC or covered IHC.

Prohibitions

- Covered BHCs and covered IHCs will be prohibited from issuing short-term debt, creating setoff rights against subsidiaries, entering into QFCs with third parties, issuing guarantees with certain prohibited cross-defaults or entering into or beginning to benefit from an arrangement that provides for upstream guarantees. For more details, see [page 42](#).

These prohibitions apply **prospectively** only to instruments or arrangements issued or entered into **on or after January 1, 2019**. Permitted legacy arrangements, however, may become subject to the 5% cap on January 1, 2019.

5% Capped Liabilities

- There is a 5% cap on the aggregate amount of certain non-contingent liabilities owed to any person other than an affiliate or, in the case of a resolution covered IHC, to any person (including an affiliate) other than a subsidiary. For more details, see [page 44](#).

Permissible Ineligible Liabilities

- Certain liabilities that do not qualify as eligible LTD will be permitted to remain *pari passu* or junior to eligible LTD.
- These liabilities will not count toward the 5% cap.

Subordination. This framework is designed to make eligible LTD structurally or contractually subordinate to short-term debt (including deposits) and most other ineligible liabilities, so that losses may be imposed on eligible LTD without being required to impose them pro rata on short-term unsecured debt and most other ineligible unsecured liabilities. The primary purpose of this creditor hierarchy is to reduce the risk of runs by the holders of short-term debt (including deposits) and the sort of contagion that can destabilize the U.S. financial system.

Please refer to [page 45](#) for a table providing a non-exclusive list of expected prohibited, capped and permissible liabilities.

Clean Holding Company Framework

Prohibited Liabilities and Other Arrangements

A covered BHC or covered IHC may **not**:

- **Issue** any **short-term debt instrument** (i.e., an instrument with an original maturity of less than one year, such as commercial paper), including short-term deposits and demand deposits,* to a third party;
- **Issue** any instrument, or enter into any related contract, with respect to which the holder of the instrument has a **contractual right to offset** debt owed to an affiliate of the covered BHC or covered IHC by the holder or its affiliates **against the amount owed by the covered BHC or covered IHC** under the instrument;
- **Enter into** a **QFC**, other than a **credit enhancement** such as a parent guarantee of a subsidiary QFC, with a third party;
- **Enter into** an agreement in which the covered BHC or covered IHC **guarantees** a liability of an affiliate if such liability permits the exercise of a **cross-default right** (defined on [page 43](#)) that is related, directly or indirectly, to the **covered BHC's or covered IHC's insolvency** or similar proceeding, other than a resolution proceeding under Title II of the Dodd-Frank Act, **except** for liabilities **subject to** requirements of any of the federal banking agencies restricting such default rights; or
- **Enter into**, or otherwise begin to benefit from, any agreement that provides for the covered BHC's or covered IHC's liabilities to be guaranteed by any of its subsidiaries (**upstream guarantees**).

These prohibitions apply whether or not the liabilities are secured or otherwise senior to the firm's eligible LTD securities by statute or contract.

The preamble to the final rule states that the Federal Reserve does not expect the prohibition on third-party short-term debt to interfere with the provision of secured liquidity from the FDIC as part of an orderly resolution under Title II of the Dodd-Frank Act or with other forms of governmental liquidity support.

This exception is a reference to the **QFC stay rules** proposed by the Federal Reserve, OCC and FDIC (click [here](#) for our visual memo on the Federal Reserve's proposal). These proposals have not yet been finalized as of the date of this publication. The preamble to the final rule states that liabilities would be considered "subject to" such a rule even if those liabilities were exempted from one or more of the requirements of the rule.

Clean Holding Company Framework

Definition of Default Right

- A **default right**, with respect to the prohibition on guarantees of affiliate liabilities with impermissible cross-default rights, includes:

- A right, regardless of source, including by statute, contract or common law, of a non-defaulting party to:
 - **Liquidate, terminate, cancel, rescind** or **accelerate** an agreement or transactions under a contract or agreement;
 - **Set off** or net amounts owed thereto (excluding 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** in respect thereof (other than a right or operation of a contractual provision arising solely from a change in 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.

- A 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;
 - 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
- **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.

Exclusion. The definition excludes **same-day netting** and **contractual margin requirements that arise solely from a change in value** of the collateral or the amount of an economic exposure because these rights are seen as arising out of the parties' business-as-usual interactions under a contract or agreement.

Clean Holding Company Framework

5% Capped Liabilities

The final rule imposes a cap on the aggregate amount, measured on an **unconsolidated** basis, of certain unrelated liabilities equal to 5% of the particular covered BHC's or covered IHC's eligible TLAC.

Unrelated Liabilities

≤ 5% Cap

Eligible TLAC

Unrelated liabilities means any **non-contingent** liability, in the case of a covered BHC or a non-resolution covered IHC, owed to a third party and, in the case of a resolution covered IHC, owed to any person (including an affiliate) other than a subsidiary, **except for:**

- Eligible TLAC;
- Any dividend or other liability arising from eligible TLAC;
- An instrument that is an eligible debt security with a remaining maturity of less than one year that does not provide the holder of the instrument with a currently exercisable put right; and
- A secured liability, to the extent that it is secured, or a liability that otherwise represents a claim that would be senior to eligible debt securities under Title II of the Dodd-Frank Act or the Bankruptcy Code.

The covered BHC's or covered IHC's actual **Tier 1 Capital** (excluding any Tier 1 minority interests) + **Eligible LTD** (as measured for purposes of the TLAC requirements)

- **Contractual subordination.** No cap on unrelated liabilities applies if a covered BHC or covered IHC chooses to contractually subordinate all of its eligible LTD to all external liabilities such **that all of its eligible debt securities would represent the most subordinated claim** in a receivership, insolvency, liquidation or similar proceeding of the covered BHC or covered IHC.
- **Liabilities created by a court judgment.** The preamble to the final rule states that the 5% cap on unrelated liabilities applies to liabilities arising other than through a contract, such as liabilities created by a court judgment, which would generally include all administrative penalties and court judgments for which the covered BHC has completed **any applicable appeals process**. We believe that this means that a non-contingent liability for a court judgment will **not** be deemed to exist for purposes of the final rule unless and until the covered BHC has exhausted its rights to appeal any judgment.
- **No cure period.** The final rule does **not** include a cure period for any inadvertent breach of the 5% cap or address the consequences of such a breach.

Clean Holding Company Framework

Examples of Prohibited, Capped and Permissible Liabilities and Other Arrangements

Prohibitions

- Any short-term debt instrument issued to a third party on or after the effective date, including:
 - Commercial paper
 - Short-term deposits*
 - Demand deposits*
- An instrument issued on or after the effective date under which the holder has a contractual right to offset debt owed by the holder or any of its affiliates to an affiliate of the covered BHC or covered IHC against the amount owed by the covered BHC or covered IHC under the instrument
- QFCs with a third party entered into on or after the effective date, other than credit enhancements
- Guarantees of a subsidiary liability with cross-default rights related to the covered BHC's or covered IHC's insolvency entered into on or after the effective date, unless the liability is subject to one of the federal banking agencies QFC stay rules
- Upstream guarantees on or after the effective date

These liabilities and other arrangements are all prohibited even if they are secured or otherwise made senior to eligible LTD by statute or contract. According to the preamble to the final rule, these prohibitions only apply prospectively on or after the effective date of January 1, 2019.

Capped Liabilities

- Any LTD issued to a third party after December 31, 2016 that has acceleration rights for defaults other than insolvency of the covered BHC or covered IHC or payment defaults
- Any LTD issued to a third party after December 31, 2016 governed by foreign law
- Structured notes issued to a third party, including principal protected long-term structured notes
- External vendor and operating liabilities that are non-contingent, including non-contingent liabilities for:
 - Utilities and rent
 - Fees for services
 - Obligations to employees
- Liabilities to a third party arising other than through a contract, if non-contingent, including:
 - Liabilities created by a court judgment

In each case, unless secured or otherwise made senior to eligible LTD.

Permissible Ineligible Liabilities

- Liabilities to a subsidiary, including short-term debt and QFC liabilities, whether secured or unsecured
- Debt instruments that otherwise qualify as eligible TLAC except that they have a remaining maturity of less than one year, as long as the holder does not have a currently exercisable put right
- Payables (such as dividends or interest-related payables) associated with eligible TLAC
- Liabilities that are secured or senior to eligible debt securities by statute or contract that are not prohibited liabilities, such as certain federal tax liabilities
- Contingent liabilities that are not otherwise prohibited liabilities, including:
 - A covered BHC's or covered IHC's guarantees of subsidiary liabilities that do not contain an impermissible cross-default
 - Obligations under executory contracts that are not yet payable (e.g., for future rent periods on a long-term lease)

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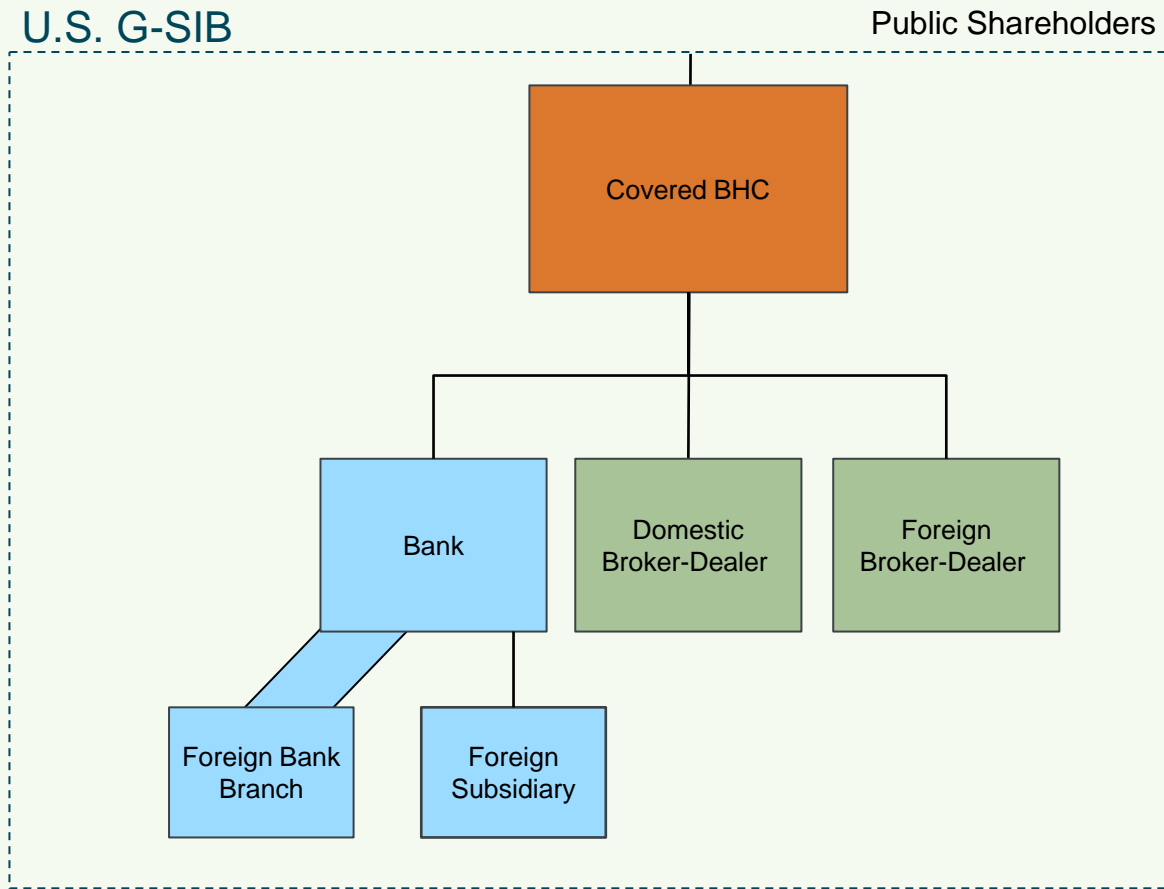
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Appendix A: Step-by-Step Illustration of an SPOE Resolution Applied to Simplified U.S. G-SIB under the Bankruptcy Code*

* For the sake of simplicity, this illustration is limited to a two-company SPOE resolution strategy under the existing Bankruptcy Code, which involves the creation of a new debt-free BHC (**New HoldCo**) to which all of the covered BHC's assets, including its operating subsidiaries, are transferred pursuant to an order from the bankruptcy court under Section 363 of the Bankruptcy Code. All SPOE strategies under Title II of the Dodd-Frank Act are limited to two-company strategies involving a bridge BHC. It is possible to do a one-company SPOE strategy under the Bankruptcy Code, but one-company strategies are less common than two-company strategies in the U.S., and the differences between one- and two-company SPOE strategies are not material to the Federal Reserve's final TLAC rule.

SPOE Resolution Applied to Simplified U.S. G-SIB

Hypothetical U.S. G-SIB Structure Before Financial Distress



Note: This is a hypothetical and greatly simplified U.S. G-SIB structure. The location of various legal entities, including whether they are in a separate legal chain or in a chain with a domestic insured bank, varies from firm to firm. Asset management entities are not shown.

SPOE Resolution Applied to Simplified U.S. G-SIB

Hypothetical U.S. G-SIB Structure Before Financial Distress (*cont.*)

Covered BHC Stand-Alone Balance Sheet (\$bn)*

Assets		Liabilities	
Cash and Other HQLAs	25	Unsecured long-term debt	100
BHC Deposits in Bank	35		
Advances to Domestic Broker-Dealer	15		
Advances to Foreign Broker-Dealer	10		
Equity of Bank	75	Unsecured short-term debt	0
Equity of Domestic Broker-Dealer	15		
Equity of Foreign Broker-Dealer	10		
Other Assets	15		
		Equity	100
Total	200	Total	200

* The figures used in this SPOE hypothetical are meant to be illustrative only.

Note: This is a hypothetical covered BHC's stand-alone balance sheet, which shows only the covered BHC's investments in OpCos, and not the OpCos' assets and liabilities. A consolidated balance sheet would show that the firm has \$850bn – \$1tn in assets.

SPOE Resolution Applied to Simplified U.S. G-SIB

Hypothetical Losses

Losses in Subs (\$bn)

Bank: \$40 Loss

- \$35 Remaining Equity

Domestic Broker-Dealer: \$5 Loss

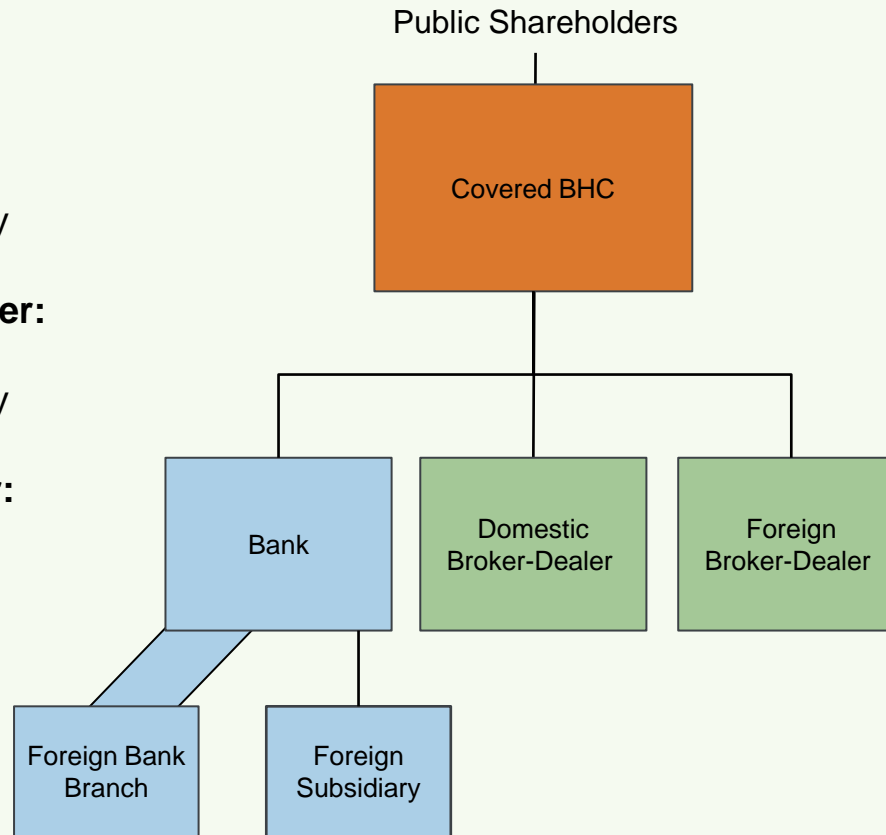
- \$10 Remaining Equity

Foreign Broker-Dealer: \$5 Loss

- \$5 Remaining Equity

Total Losses: \$50 bn

Remaining BHC Equity: \$50 bn



SPOE Resolution Applied to Simplified U.S. G-SIB

Hypothetical Losses (*cont.*)

Covered BHC Stand-Alone Balance Sheet After Losses and Before Recapitalization (\$bn)

Assets		Liabilities	
Cash and Other HQLAs	25	Unsecured long-term debt	100
BHC Deposits in Bank	35		
Advances to Domestic Broker-Dealer	15		
Advances to Foreign Broker-Dealer	10		
Equity of Bank	75→35	Unsecured short-term debt	0
Equity of Domestic Broker-Dealer	15→10		
Equity of Foreign Broker-Dealer	10→5		
Other Assets	15		
		Equity	100→50
Total	200→150	Total	200→150

SPOE Resolution Applied to Simplified U.S. G-SIB

OpCos Operating Subsidiaries Recapitalized and Provided Liquidity Prior to BHC Bankruptcy

Covered BHC Stand-Alone Balance Sheet After Recapitalization Actions (\$bn)

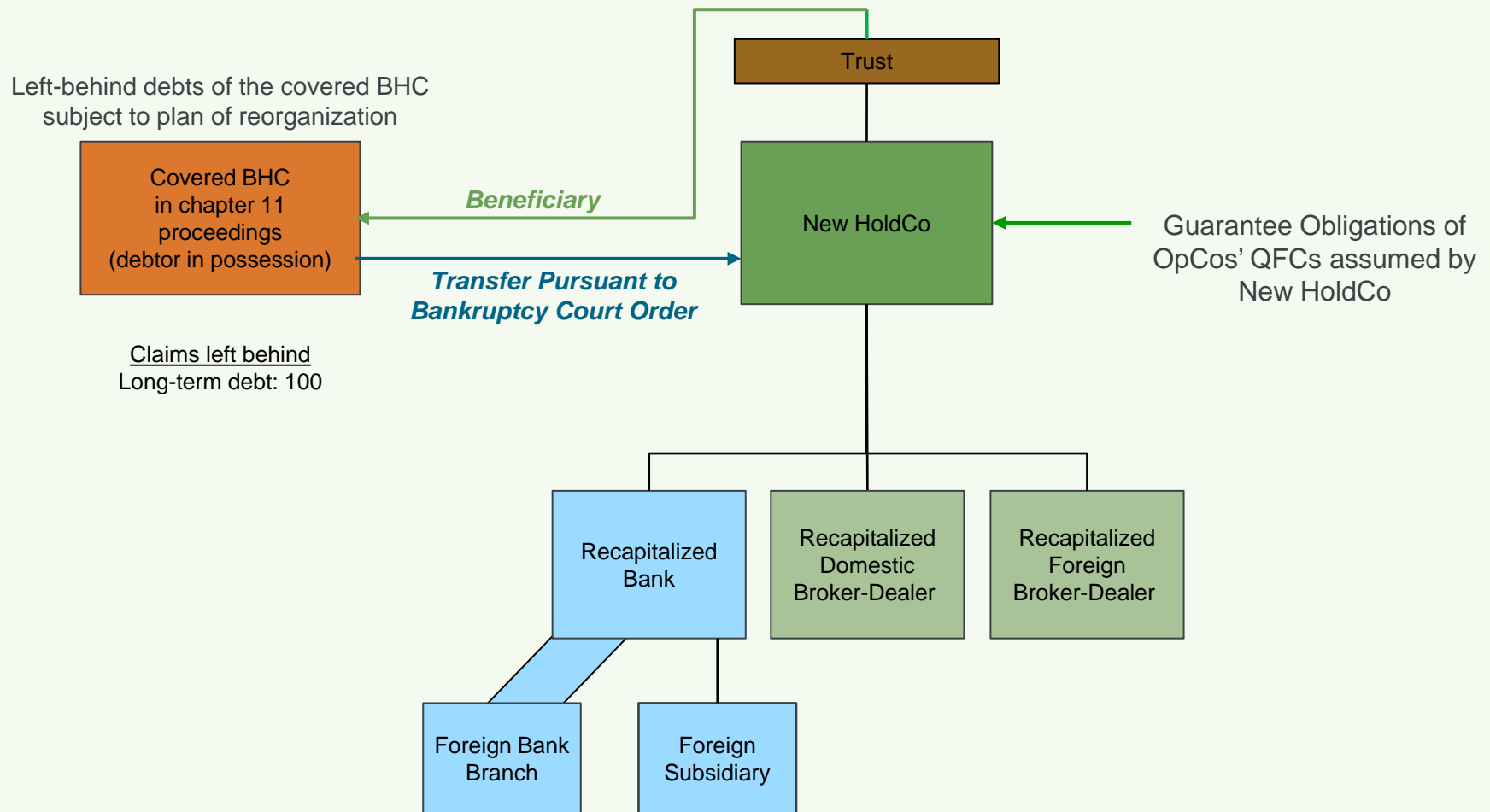
Assets		Liabilities	
Cash and Other HQLAs	25→2	Unsecured long-term debt	100
BHC Deposits in Bank	35→0		
Advances to Broker-Dealer 1	15→0		
Advances to Broker-Dealer 2	10→0		
Equity of Bank	35→93	Unsecured short-term debt	0
Equity of Broker-Dealer 1	10→25		
Equity of Broker-Dealer 2	5→15		
Other Assets	15		
		Equity	50
Total	150	Total	150

After providing capital and liquidity to its OpCos, the covered BHC commences chapter 11 proceedings and immediately files an emergency transfer motion with the bankruptcy court for an order under Section 363 of the Bankruptcy Code to transfer all of its assets, including its operating subsidiaries, to a debt-free newly incorporated BHC (New HoldCo)

SPOE Resolution Applied to Simplified U.S. G-SIB

Transfer of OpCos to Debt-Free New HoldCo Owned by Trust for Benefit of the Bankruptcy Estate of the Covered BHC

Recapitalized OpCos transferred to New HoldCo owned by Trust for benefit of the covered BHC's bankruptcy estate



SPOE Resolution Applied to Simplified U.S. G-SIB

Management of the Firm After Chapter 11 Filing

- The management of the firm will be identified and approved by the bankruptcy court in the Transfer Order.
- Depending on the firm's resolution strategy, actions after the bankruptcy filing may include:
 - Winding down certain subsidiaries (e.g., wholesale broker-dealer) and distributing any net proceeds to the holders of any claims against the bankruptcy estate;
 - Disposing of certain subsidiaries or business lines through sales and distributing any net proceeds to the holders of any claims against the bankruptcy estate; or
 - Continuing to operate subsidiaries or business lines for the benefit of the covered BHC's bankruptcy estate and distributing the shares of New HoldCo (or any proceeds from the sale thereof) to the holders of any claims against the bankruptcy estate.