June 7, 2019

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Ms. Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Robert E. Feldman
Executive Secretary
ATTN: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: 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, OCC Docket ID OCC-2018-0019; Board Docket No. R-1655 and RIN 7100-AF43; FDIC RIN 3064-AE79

Dear Ladies and Gentlemen:

Better Markets[1] appreciates the opportunity to comment on the notice of proposed rulemaking captioned above ("Proposal" or "Release"),[2] issued by the Board of Governors of the

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[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, one that protects and promotes Americans' jobs, savings, retirements, and more.

[2] 83 Fed. Reg. 66,023 (Dec. 21, 2018).

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Federal Reserve System ("Board"), the Office of the Comptroller of the Currency ("OCC"), and the Federal Deposit Insurance Corporation ("FDIC") (the Board, the OCC, and the FDIC collectively, the "Agencies"). The Proposal would require advanced approaches banking organizations ("AABOs") to deduct from their regulatory capital their investments in the unsecured debt of globally systemically important banking organizations ("GSIBs") where that debt satisfies the total loss absorbing and long-term debt rules of the Board ("TLAC Debt").

SUMMARY OF COMMENTS

Subject to the concerns discussed below, including in particular the regrettable decision not to simply require substantial additional capital, Better Markets generally supports the Proposal, which is intended to limit contagion during times of stress in the financial system. Specifically, because TLAC Debt is by definition loss absorbing, holders of that debt will be forced to take losses in the event of the failure and resolution of the issuing GSIB(s). If other banking organizations have invested directly or indirectly in the TLAC Debt of a GSIB in resolution, then the instability at the issuing GSIB could spread, through its TLAC Debt, to other banks, imperiling the stability of the financial system. The Proposal seeks to prevent this by making it more costly for AABOs, i.e. the largest and most complex banking organizations,[3] to invest, directly or indirectly, in the TLAC Debt of GSIBs, thereby discouraging such investments and reducing the risk of contagion.

However, the Proposal is a reminder of other significant deficiencies in the TLAC regime that the agencies must ultimately address. First, the TLAC framework is still capable of propagating systemic risk apart from interbank investments in TLAC. While AABOs, and other banking organizations holding the TLAC Debt of a failing GSIB are one channel through which the current TLAC regime could allow failure of a GSIB to spread through the financial system, it is not the only means. Even if nonbank holders of TLAC Debt are forced to take significant losses as a result of the failure of a GSIB, systemic risk could and likely would arise. In fact, a GSIB's failure, and the resulting losses imposed on all holders of its TLAC Debt—banks and nonbanks alike—is likely to undermine the capital and liquidity positions of other GSIBs. This concern is all the more important because, as the Agencies acknowledge, a GSIB failure is unlikely to occur in isolation, and multiple GSIBs would more plausibly be experiencing severe distress at the same time, further intensifying the destabilizing impact of cascading losses on any TLAC debt.

Second, even if imposing losses on TLAC Debt holders would not implicate systemic concerns, the holders of TLAC Debt are likely, directly or indirectly, to include a high proportion of individual retail investors through brokerage accounts, mutual funds, and pension funds. In the event of a GSIB's failure, there will likely be enormous political pressure not to impose losses on

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[3] Under a recent proposal by the Agencies, only GSIBs, or non-GSIBs with over $700 billion in assets or $75 billion in cross-jurisdictional activity, would be AABOs. Release at 13,818n.21.

those vulnerable investors. Both of the foregoing scenarios—the potential collapse of one or more GSIBs and the potential harm to retail investors—increase the likelihood that policymakers will experience irresistible pressure to resort to bailouts, thereby defeating the underlying purpose of the TLAC framework.

Thus, in addition to addressing the potential systemic issues involved with AABOs and other banking organizations holding TLAC Debt, the Agencies should also take steps to ensure that the TLAC regime more effectively and fairly reduces the likelihood of a taxpayer bailout. At a minimum, the Agencies must ensure that the cost of TLAC Debt appropriately reflects its heightened risk, which can be accomplished, in part, through a more robust disclosure regime. Such a reform will more accurately convey the risks associated with TLAC debt and ensure that the cost of TLAC Debt accurately reflects its risks. This transparency will also help ensure that investors knowingly undertake those risks. Even more importantly, the resulting cost increase will likely reduce reliance on the use of such debt to satisfy TLAC requirements, in favor of GSIBs' issuing equity instead, a much more desirable result.

BACKGROUND AND SUMMARY OF PROPOSAL

Taxpayer Bailouts and the Dodd-Frank Act

As the 2007-2009 financial crisis unfolded, policymakers were repeatedly faced with the same unacceptable dilemma: either allow large, systemically important firms to fail, potentially imperiling the entire financial system, or bail those firms out, forcing taxpayers to foot the bill for the reckless risk-taking of these companies. With some exceptions, policymakers chose the bailout option, spending or pledging vast amounts in taxpayer funds (often with dubious legal authority) to save companies like AIG from failure. Ultimately, as much as $29 trillion was lent, spent, pledged, committed, loaned, guaranteed, and otherwise used or made available to bailout the financial system during the crisis.[4]

Preventing massive bailouts, which punish Main Street taxpayers for the sins of irresponsible Wall Street companies, was one of the primary objectives of the Dodd-Frank Wall Street Reform and Consumer Protection Act.[5] As explained in the Release, a core element of the

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[4] See, James Andrew Felkerson, A Detailed Look at the Fed's Crisis Response by Funding Facility and Recipient, Public Policy Brief No. 123, at 4, LEVY ECONOMICS INSTITUTE OF BARD COLLEGE (2012) ("Levy Report"), https://www.econstor.eu/ bitstream/10419/121982/1/689983247.pdf. See also, Better Markets, Wall Street's Six Biggest Bailed-Out Banks; Their Rap Sheets & Their Ongoing Crime Spree at 1 (Apr. 9, 2019), https://bettermarkets.com/sites/default/files/Better%20Markets%20-%20Wall%20Street%27s%20Six%20Biggest%20Bailed-Out%20Banks%20FINAL.pdf.

[5] Public Law No. 111-203, 124 Stat. 1376 (July 21, 2010) ("Dodd-Frank Act").

Dodd-Frank Act framework is the imposition of minimum capital requirements on banking organizations by the Agencies. Included in these measures are requirements that banking organizations deduct from their regulatory capital investments in the capital instruments of other financial institutions. The broad underlying purpose of these capital deduction provisions is "to reduce interconnectedness and contagion risk among banks by discouraging banking organizations from investing in the regulatory capital of another financial institution."[6]

The Board's 2015 Proposal and TLAC Final Rule

The Board has indicated a preference for using a single-point of entry ("SPOE") strategy to resolve failed GSIBs.[7] In an SPOE resolution, only the top-tier holding company is placed in a resolution proceeding; losses are passed up from subsidiaries, and operating subsidiaries continue to operate.[8] To enhance the resiliency and resolvability of GSIBs under an SPOE strategy, in 2015 the Board issued the 2015 TLAC Proposal, which included total loss absorbing capacity and long-term debt requirements for GSIBs.[9] In 2016, the Board issued its Final TLAC Rule. In the Final TLAC Rule, the Board asserted that TLAC Debt serves a different, albeit complementary, purpose from regulatory capital:

> The TLAC and LTD requirements in the final rule build on, and serve as a complement to, the regulatory capital requirements in Regulation Q. While regulatory capital requirements are intended to ensure that a banking organization has sufficient capital to remain a going concern, the objective of the TLAC and LTD requirements in the final rule is to reduce the financial stability impact of a failure by requiring companies to have sufficient loss absorbing capacity on both a going concern and a gone-concern basis. A company's gone-concern loss-absorbing capacity is different from the company's going-concern capacity in a few fundamental respects. Although regulatory capital theoretically can absorb losses after a firm has entered resolution, the firm's regulatory capital, and especially its equity capital, is likely to be significantly or completely depleted in the lead up to

6 Release at 13,816.

7 Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations; Regulatory Capital Deduction for Investments in Certain Unsecured Debt of Systemically Important U.S. Bank Holding Companies, 80 Fed. Reg. 74,926, 74,928 (Nov. 30, 2015) ("2015 TLAC Proposal"); Stephen J. Lubben & Arthur E. Wilmarth, Jr., Too Big and Unable to Fail, 69 FLA. L. REV. 1205, 1221 (2017).

8 2015 TLAC Proposal at 74,928; 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, 82 Fed. Reg. 8266, 8271n.29 (Jan. 24, 2017) ("Final TLAC Rule").

9 2015 TLAC Proposal.

> a bankruptcy or resolution. Thus, if the ultimate goal is to have a failed firm re-emerge from resolution with sufficient capital to successfully operate as a going concern, there will need to be a new source of capital for the firm. In this regard, debt instruments, which count in regulatory capital in limited amounts and are subject to restrictions on their terms, are capable of absorbing losses in resolution.[10]

The Board also reasoned that the TLAC regime would promote financial stability by imposing losses on the holders of TLAC Debt, which would be issued by the parent holding company, while protecting creditors of operating subsidiaries. In theory, at least, this approach would "reduce the incentive" of the latter "to run" since those creditors "would not bear losses incurred by the subsidiaries because those losses would instead be transferred to the [parent] holding company and therefore borne by the external TLAC holders."[11] Functionally, as a GSIB fails and enters resolution, TLAC Debt would be expected to be "bailed in" to absorb losses at the parent holding company level, allowing critical operating subsidiaries to continue operating.

Recognizing the risk inherent in bank debt that is intended to absorb losses in the event of failure of the issuing GSIB, and the need to reduce interconnectedness among financial institutions, the Board's 2015 TLAC Proposal included provisions similar to the current Proposal, i.e. it would have required certain banking organizations to take a capital deduction for investments in unsecured debt instruments issued by covered BHCs.[12] However, the "Board did not finalize these limitations when it issued the TLAC Rule because it needed additional time to work with the OCC and FDIC towards a proposed interagency approach regarding the regulatory capital treatment for investments in certain debt instruments issued by covered BHCs."[13]

Summary of the Proposal

The Proposal now seeks to finally address the issue first identified by the Board in the 2015 TLAC Proposal. To function as intended, TLAC Debt must pose risks to its holders, because they must take losses in the event of the failure of the issuing GSIB. If other banks invest, directly or indirectly, in the TLAC Debt of a GSIB, "[d]istress at a GSIB and the associated write-down or conversion into equity of its covered debt instruments could have a direct negative impact on the capital of investing banking organizations, potentially at a time when investing banking organizations are already experiencing financial stress."[14]

The Proposal seeks to mitigate that risk of contagion by requiring that AABOs with direct or indirect investments in the TLAC Debt of GSIBs take a deduction from regulatory capital

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10 TLAC Final Rule at 8267.
11 Id. at 8298.
12 2015 TLAC Proposal at 74,930.
13 Release at 13,817.
14 Release at 13,818.

reflecting this investment. Specifically, an AABO investment in the TLAC Debt of a GSIB would be treated as an investment in a Tier 2 capital instrument.[15] Accordingly, an AABO would need to take a deduction from its own Tier 2 capital based on its investment in the TLAC Debt of a GSIB.[16] As a result, an AABO that invests in the TLAC Debt of a GSIB would need to ensure that it holds sufficient capital to address the risk of loss represented by that TLAC debt. Ideally, AABOs will be disincentivized from holding the TLAC Debt of GSIBs at all.

COMMENTS

I. The Proposal Is a Positive Step Towards Addressing the Risks Posed by the Largest Banking Organizations Holding Risky TLAC Debt

Better Markets generally supports the Proposal. When banks hold the TLAC Debt of GSIBs, the potential for contagion that could threaten the stability of the financial system is obvious. When a GSIB fails and enters resolution, the bail-in features of TLAC Debt are triggered, which will necessarily force holders of the debt to accept losses. If TLAC Debt holders are banks, especially AABOs, trouble at a GSIB, likely to come in the midst of an already stressed financial environment, will necessarily be transferred through losses imposed on TLAC Debt holders, to those banks. This result is the exact opposite of the intent of the TLAC regime, which is designed to prevent failure at a GSIB from spreading to the wider financial system without requiring taxpayer bailouts.

Requiring that AABOs take a deduction from capital for investments in TLAC Debt helps to mitigate this potential systemic risk—either AABOs will be required to set aside a capital cushion to cover the risk of their investment in TLAC Debt, or, preferably, will simply not invest in TLAC Debt. Accordingly, the Agencies are to be commended for proposing a solution to an obvious potential problem.

Nevertheless, the Agencies should consider additional measures, including an outright prohibition on banks' investing in the TLAC of other banks, as Better Markets has previously advocated.[17] Doing so, directly and clearly, would be far more effective than implementing a mere disincentive system, as in the Proposal. At a minimum, as the Agencies have indicated they will, they should consider broadening the scope of the Proposal so that it includes more if not all banking

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15 Release at 13,819.

16 Id.

17 Better Markets, Comment Letter on Total Loss Absorbing Capacity Proposal (Feb. 19, 2●16), https://bettermarkets.com/sites/default/files/FRS%2●-%2●CL%2●-%2●Total%2●Loss-Absorbing%2●Capacity%2●-%2●Long%2●Term%2●Debt%2●and%2●Clean%2●Holding%2●Company%2●Re●uirements%2●2-19-2●16.pdf. This comment letter is incorporated by reference as if fully set forth herein.

organizations.[18] And the Agencies must resist calls by the industry to weaken the Proposal or abandon it.

II. The Agencies Should More Broadly Address Features in the TLAC Regime that Reduce Its Effectiveness in Preventing Taxpayer Bailouts.

The Proposal serves as an important reminder that there are still other significant weaknesses in the TLAC regime. As a threshold matter, Better Markets continues to believe that the TLAC regime represents the "second-best solution to the problem of ensuring that bank holding companies remain resilient and able to withstand losses similar to those they suffered in the financial crisis."[19] A more effective and simpler approach would be requiring banks to issue more equity.[20]

But focusing on the TLAC regime that is now in place, it is important to recognize and address its current limitations. The problem the Agencies make explicit in the Release is that if banks, especially large AABOs that hold TLAC Debt, the failure of one GSIB could rapidly spread through the financial system via those AABOs. However, under the current TLAC regime, AABO investment in TLAC Debt is not the only mechanism through which instability at a GSIB could spread through the financial system, nor is the potential for collapse of the financial system the only scenario that would result in extraordinary political pressure to bail out troubled GSIBs or holders of TLAC Debt. As explained below, at least one important way to help mitigate these concerns is to improve the transparency and pricing of TLAC Debt.

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18 Release at 13,818.

19 Better Markets, Comment Letter on Total Loss Absorbing Capacity Proposal (Feb. 19, 2016) https://bettermarkets.com/sites/default/files/FRS%20-%20CL%20-%20Total%20Loss-Absorbing%20Capacity%20-%20Long%20Term%20Debt%20and%20Clean%20Holding%20Company%20Requirements%202-19-2016.pdf.

20 Federal Reserve Bank of Minneapolis, The Minneapolis Plan to End Too Big to Fail at 79 (Dec. 2017) ("This approach [TLAC] is more complex relative to our preferred option of requiring covered banks to issue more equity. Equity holders have a long experience of suffering losses from bank failures in the United States. The government should just require banks to issue more equity if the government wants a straightforward way of imposing losses on the funders of banks.").

A. Even if the Proposal is finalized and broadened to include all banks, failure at a GSIB could still present systemic risk.

1. *Forcing the holders of a failing GSIB's debt to take losses will* likely result in heightened stress at other GSIBs.

The failure of a GSIB, and its entering resolution, is likely to both (1) occur in the midst of a period of financial stress and (2) severely exacerbate that financial stress. The failing GSIB will not be resolved in a vacuum, and resolving it successfully without requiring taxpayer bailout will not be a simple matter of the GSIB entering the resolution process, triggering the bail-in features of its TLAC Debt, and forcing TLAC Debt holders to accept the resulting losses.[21] Instead, "any decision by regulators to impose losses on bail-in debtholders of a failed SIFI…would likely trigger contagious spillover effects for other vulnerable SIFIs."[22] Put differently:

> [t]riggering the bail-in process is likely to generate a capital flight and a sharp rise in funding costs whenever the need for large-scale recapitalizations becomes apparent. Creditors who sense in advance the possibility of a bail-in, or creditors of institutions that are similar in terms of nationality or business models will have a strong incentive to withdraw deposits, sell debt, or hedge their positions through the short-selling of equity or the purchase of credit protection at an ever higher premium disrupting the relevant markets. Such actions could be damaging and disruptive, both to a single institution…and potentially to wider market confidence, a point that is also highlighted by proponents of the bail-in tool…[M]arket propensity to resort to herding at times of shock means that it is not realistic to believe that generalized adoption of bail-in mechanisms would not trigger contagious consequences that would have a destabilizing effect.[23]

Thus, while the Proposal addresses the risk that failure of a GSIB could pose to AABOs that hold its debt, it does not address the likelihood that forcing the TLAC Debt holders of that GSIB to take losses would have spillover effects at other GSIBs that are vulnerable (or perceived as vulnerable), which itself poses systemic risk.

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[21] Stephen J. Lubben & Arthur E. Wilmarth, Jr., Too Big and Unable to Fail, 69 FLA. L. REV. 1205, 1235 (2017).

[22] Id.

[23] Charles Goodhart & Emilios Avgouleas, A Critical Evaluation of Bail-Ins as Bank Recapitalization Mechanisms 32 (Ctr. for Econ. Policy, Research Discussion Paper No. 10065, 2014), http://ssrn.com/abstract=2478647.

2. Non-bank holders of TLAC Debt can also propagate instability at a failing GSIB throughout the financial system.

Moreover, AABOs, or even banking organizations as a whole, are not the only potential TLAC Debt holders that could pose systemic risk in the midst of a crisis. One need look no further than the financial crisis, where non-bank financial companies played a significant role in triggering and spreading the crisis, including in unexpected and unpredictable ways. For example, in 2008, the Reserve Primary Fund ("Reserve Fund"), had significant exposure to Lehman Brothers.[24] As a result, the failure of Lehman Brothers triggered a run on the Reserve Fund, which eventually led it to "break the buck."[25] After the Reserve Fund broke the buck, other money market funds faced serious runs, **even funds that did not have direct exposure to Lehman**.[26] Because policymakers concluded that the panic in money markets was going to spread quickly and catastrophically,[27] policymakers guaranteed the entire $3.7 trillion money market fund industry.[28] This was a dramatic and unprecedented action. In fact, it was the first time in the history of the country that the full faith and credit of the U.S. was used to guarantee a single financial product.

The upshot is that, in the midst of a crisis, what entities will pose a threat to financial stability and where contagion transmission channels will appear are extremely difficult to predict. Thus, while the Board has stated in the Final TLAC Rule that "it is desirable that the [GSIB's TLAC] creditors be limited to those entities that can be exposed to losses without materially affecting financial stability,"[29] predicting which entities those will be is extraordinarily difficult. It is, however, fairly obvious that trouble at AABOs caused by significant investment in TLAC Debt would spread to the larger financial system – and so the Proposal is an appropriate way to reduce systemic risk. However, the Agencies should recognize that crises are unpredictable and entities that appear systemically insignificant now may not prove to be so in the storm of the next crisis.[30]

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24 Financial Crisis Inquiry Commission, The Financial Crisis Inquiry Report at 356 (2011), https://www.govinfo.gov/content/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf.

25 Id. at 357.

26 Id. at 357-58.

27 It is telling that the government acted before retail money market investors began to run. That is, a run by institutional investors, who are continuously monitoring the markets and are ready and able to act at the first sign of trouble, was sufficient for the government to act to both stop that run and forestall the inevitable retail run.

28 Financial Crisis Inquiry Commission, The Financial Crisis Inquiry Report, supra n. 24, at 359.

29 TLAC Final Rule at 8299.

30 This problem is made more acute by the actions of this administration's FSOC, whose membership includes each of the Agencies. As a practical matter, FSOC has functionally shut down, de-designating the three systemically significant non-banks previously designated and, even worse, issuing a recent proposal to subordinate its authority to designate non-bank financial entities as

B. Even if the systemic risk of TLAC Debt were somehow eliminated, there is likely to be significant political pressure not to impose large losses on those entities that ultimately hold TLAC Debt.

Moreover, it is not only the risk of financial instability that could lead to significant political pressure to bail out a troubled GSIB or its TLAC Debt holders. The most likely holders of TLAC Debt—the ones who in the Board's words "can be exposed to losses without materially affecting financial stability"[31]—are actually likely to be retail investors, directly or indirectly through their brokerage accounts, mutual funds, and pension funds.[32] In other words, if during a crisis policymakers indeed impose losses on TLAC Debt holders, they will be imposing losses on Main Street, except now in Main Street's capacity as investors and savers instead of as taxpayers.[33]

That is the bottom line policy choice the Agencies are making here. While that may make theoretical sense at this time of non-crisis when few are paying attention to, much less understanding, the implications of TLAC, it is almost certain to be viewed very differently in the midst of a crisis when Main Street is again going to pay the price to bail out Wall Street's too-big-to-fail financial conglomerates. Thus, this deliberate ex-ante loss-allocation policy choice by regulators to shift the costs of GSIB failure from GSIBs with adequate capital to retail holders of TLAC debt is likely to backfire, potentially spectacularly and at the worst possible time.[34]

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systemically significant to its hortatory authority to monitor and address risky activities. See Better Markets, Comment Letter on Proposed Interpretive Guidance on Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies (May 24, 2019), https://www.regulations.gov/document?D=FSOC-2019-0001-0030.

31 TLAC Final Rule at 8299.

32 Stephen J. Lubben & Arthur E. Wilmarth, Jr., Too Big and Unable to Fail, 69 Fla. L. Rev. 1205, 1232 (2017) ("In contrast, regulators and executives of megabanks view mutual funds and pension funds as leading prospective targets for sales of bail-in debt. Government officials and G-SIB leaders evidently believe that, unlike Wall Street creditors, retail investors in mutual funds and pension funds can bear the costs of resolving failed megabanks without undermining financial stability.").

33 Id. at 1232-33.

34 Any thought that other investors like hedge funds will hold TLAC rather than retail and Main Street investors is unrealistic. As sophisticated investors who are continuously monitoring the markets and adjusting their holdings due to risk and perceived risks, they will be protecting themselves even if they hold TLAC prior to triggering events. The best example of this is Goldman Sachs' 2006-2007 big short where it neutralized its massive long subprime holdings exposure by buying CDS credit protection, thereby avoiding massive losses by shifting them to the then-unsuspecting sellers of credit protection. This is similar to the run on money market funds in the days after Lehman: institutional investors ran first and fast, before retail investors even knew their money was at risk. Another despicable example was described in John Authers' Financial Times' column entitled "In

To be sure, those Main Street investors who would face losses would have, directly or indirectly, voluntarily bought into the TLAC regime that could impose losses on them, as opposed to taxpayers who were involuntarily forced to save those financial firms during the crisis.[35] But, in the midst of a crisis, this is unlikely to make a difference—there will still be immense political pressure not to impose losses on Main Street retail investors and their pension funds.[36]

Indeed, this exact scenario has played out recently. As Professors Lubben and Wilmarth recount, when Italy rescued four banks and imposed significant losses on subordinated debtholders—many of them consumers—Italy's then-prime minister faced a severe political backlash.[37] Undoubtedly this was on the mind of Italian policymakers when, attempting to prevent the failure of Italy's third largest bank in December 2016, they "crafted its recapitalization plan to avoid imposing losses on some 40,000 retail investors who owned" the bank's subordinated debt.[38] There is simply no reason to believe that, in the midst of a financial crisis, policymakers and elected officials in the United States, almost certainly facing headlines accusing them of allowing pensions to be wiped out because of the actions of reckless bankers, will have the political will to impose those significant losses on retail investors.[39]

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a crisis, sometimes you don't tell the whole story," available at https://on.ft.com/2wUTIZ8. He confessed that, two days after Lehman collapsed, on September 17, 2008, he did not tell his readers that he and his fellow-in-the-know Wall Street comrades were lined up at their banks spreading out their riches in $100,000 amounts so that their money would be fully protected by deposit insurance when the banks failed. Thus, in addition to deliberately not telling his readers, i.e. the likely "retail" investor, he and the other Wall Street insiders were shifting their potential losses to the U.S. government and taxpayers, who could lose all amounts above the then-covered level of $100,000.

35 Although, as we note above, whether they did so knowing of the risks and were properly compensated for assuming them will remain an open question.

36 Lubben & Wilmarth, supra n. 32, at 1232.

37 Id. at 1235-36.

38 Id. at 1237; see also, Federal Reserve Bank of Minneapolis, The Minneapolis Plan to End Too Big to Fail at 79 (Dec. 2017) ("Unfortunately, these warnings [that debtholders will be forced to take losses] are not credible. This point was proved most recently when bank debt holders in Italy received protection despite holding debt designed to be 'bailed in.'"), https://www.minneapolisfed.org/~/media/files/publications/studies/endingtbtf/the-minneapolis-plan/the-minneapolis-plan-to-end-too-big-to-fail-final.pdf?la=en. The fact that there were serious allegations of "misselling" of that Italian bail-inable debt is not a material difference for two reasons. First, as noted above, those allegations are almost certain to be raised here when bail-in of TLAC Debt is triggered. Second, even if, as we suggest above, the risks of TLAC Debt are properly and fully disclosed and reflected in the pre-trigger compensation to those investors, it will still be Main Street investors suffering losses to bail out Wall Street megabanks. Enormous political pressure is inevitable.

39 Martin Arnold, The Doubts That Linger Over Solution to *"Too Big to Fail,"* THE FINANCIAL TIMES (Dec. 8, 2014), http://www.ft.com/intl/cms/s/0/3f0d8832-7edf-11e4-b83e-00144feabdc0.html.

C. To reduce reliance on TLAC Debt and the likelihood of taxpayer bailouts, the Agencies should proactively require a more robust disclosure regime that will ensure that TLAC investors are knowingly incurring risk and appropriately compensated for assuming that risk.

While the existing TLAC regime may be an improvement and potentially an important step towards ending taxpayer bailouts, and while the Proposal would further improve the existing TLAC regime, as Better Markets has previously noted, it "is only the beginning."[40] To ensure that the TLAC regime functions as intended—ensuring the orderly liquidation of systemically significant banking organizations without taxpayer bailouts and without threatening financial stability—

> "regulators must closely scrutinize the trigger mechanisms, the pricing, the trading, and the composition of the purchasers and holders of the convertible debt to assess the likelihood that it will work as intended in an actual crisis."[41]

Scrutinizing the pricing of TLAC Debt is particularly important. Regulators must ensure that the price of TLAC Debt appropriately reflects its significant risk. In addition to monitoring the price of TLAC Debt, the Agencies can take proactive steps as part of this rulemaking to ensure that the price of TLAC Debt reflects its risk. In particular, the Agencies should enhance the disclosures associated with TLAC Debt. Currently, GSIBs are required to disclose "a description of the financial consequences to unsecured debtholders of the global systemically important BHC entering into a resolution proceeding in which the global systemically important BHC is the only entity that would be subject to the resolution proceeding."[42] This is a vague standard that could be misunderstood, misapplied, or gamed. At a minimum, it will almost certainly be inconsistently applied due to individual interpretation and application by GSIBs. It could also lead to insufficient disclosure of the actual risks, and accordingly, to TLAC Debt being mispriced and likely underpriced. The Agencies should adopt a disclosure regime that provides much more significant and detailed disclosure of the risks involved. Professors Lubben and Wilmarth have proposed a disclosure regime that includes the following elements:

- "Black box" warnings for individual investors purchasing TLAC debt through their online brokerage accounts, similar to that provided for purchases of high-yield debt, that make clear in plain language how extraordinarily risky the investment could be;

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40 Press Release, Better Markets, Applauding the Fed's Finalization of Key Financial Reform TLAC Rule (Dec. 15, 2016), https://bettermarkets.com/newsroom/applauding-feds-finalization-key-financial-reform-tlac-rule.

41 Id.

42 12 C.F.R. § 252.65.

- A requirement that pension funds or mutual funds that invest in TLAC debt disclose the bail-in risks and include a "black box" warning, similar to that proposed for individual investors, in their offering materials;

- A requirement that GSIBs issuing TLAC debt maintain a web page describing their resolution plans in detail.[43]

Such a disclosure regime, which requires that the risks of TLAC Debt be disclosed plainly and prominently would likely increase the cost of TLAC Debt, which will ensure that TLAC Debt holders are appropriately compensated for the enormous risk of investing in TLAC Debt. This will also likely result in GSIBs satisfying more of their capital requirements with non-TLAC debt, ideally through greater use of equity capital.[44]

CONCLUSION

The Proposal represents an appropriate measure that helps address an obvious weakness in the current TLAC regime—that the largest and most complex banking organizations could hold excessive investments in TLAC Debt, which could cause contagion in the event of the failure of a GSIB and increase the likelihood of a taxpayer bailout. However, the TLAC framework suffers from a number of other fundamental weaknesses, and the Agencies should take further steps to ensure that the TLAC regime more meaningfully reduces the risk of future bailouts. We hope you find these comments helpful.

Sincerely,

Dennis M. Kelleher
President & CEO

Stephen W. Hall
Legal Director & Securities Specialist

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43 Stephen J. Lubben & Arthur E. Wilmarth, Jr., Too Big and Unable to Fail, 69 FLA. L. REV. 1205, 1244-45 (2017).

44 Id. at 1246.

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