Statement on the Long-Term Debt and Total Loss-Absorbing Capacity Proposal by Governor Lael Brainard

If there is one simple lesson from the crisis, it is that no financial institution in America should be so big or complex that its failure would put the financial system at risk. Congress wrote that simple lesson into law in the Dodd-Frank Act. Today's rule puts in place the critical remaining plank to ensure that even the largest and most complex banking institutions in America can fail without posing unacceptable risks to financial stability, by requiring them to hold a cushion of long-term debt sufficient to fully recapitalize their important operating subsidiaries in the event of bankruptcy.

Today's rule complements previous rules, in which we significantly increased the amount of capital large banks must hold to greatly reduce the chance their distress spills over to the broader financial system, and to provide incentives to reduce the size and riskiness of their activities. The capital surcharge rule, which applies to global systemically important banks, or GSIBs, ties the amount of capital that the largest banking institutions must hold to their systemic footprint, inducing them to internalize the risks they pose to the financial system. The rule requiring rigorous stress testing tied to the capital planning process compels large banking institutions to maintain high quality common equity buffers capable of absorbing losses under severely stressed financial conditions, while still maintaining sufficient capital to continue providing credit. These greatly increased capital buffers reduce the probability that large banks might fail in response to a severe economic downturn or financial stress.

But it is not enough to reduce the risks of failure. It is also critical to ensure the largest banking institutions have credible plans and preparations to facilitate failure in an orderly manner. The rule we are proposing today facilitates orderly resolution by requiring large, complex banking institutions to hold a minimum amount of long-term debt calibrated to their systemic footprint. The required levels of long-term debt under today's rule are both achievable and calibrated to the specific riskiness and scale of their activities, taking into account the likely shrinkage of the operations of their subsidiaries in resolution.

This debt requirement is a necessary counterpart to the Dodd-Frank Act requirement that large banks have credible resolution plans laying out how the bank will be reorganized in bankruptcy without endangering financial stability and undertake preparations to make those plans operationally feasible. The long-term debt requirement is critical to ensuring the feasibility of the resolution plans by requiring a sufficiently large buffer of long-term debt that can be converted into equity and used to recapitalize important operating subsidiaries during bankruptcy. The availability of sufficient capacity at the parent to both absorb losses and recapitalize the critical operating subsidiaries is designed to mitigate contagion and fire sales by providing comfort to depositors, short-term debt holders, and counterparties of the firm and thereby forestall destructive runs, since the long-term unsecured debt issued by the parent holding company would be structurally subordinate to the claims on the operating subsidiaries. This ensures against a taxpayer bailout by requiring instead that the long-term debtholders of the large banking institution will be bailed in. The presence of long-term debt holders should also provide incentives to the managers of the largest banking institutions to preserve as much of the firm's value as possible as it approaches insolvency, thus aligning the firm's interests with the public's broader interest in financial stability.

As with the GSIB surcharge, the amount of long-term debt required will increase the greater the size and complexity of the banking institution's activities. More systemically important financial institutions will be required to hold more long-term debt, thus reinforcing incentives to reduce their systemic footprint.

Today's rule requires large banks to maintain both a minimum level of long-term debt and a minimum level of total loss-absorbent capital, or TLAC. Under our rules, because we are putting in place a very robust long-term debt requirement and already have rules requiring extensive capital buffers tied to the risks banks face and a rigorous stress testing framework, the TLAC requirement is not likely to be relevant for most of the large complex banking institutions under most circumstances. Those banking institutions satisfying the robust

common equity and long-term debt requirements should, in most circumstances, also satisfy the TLAC requirement. However, because the TLAC requirement is used internationally, its inclusion will help to ensure a level playing field across jurisdictions and a safe international banking environment.

Today's long-term debt requirement, together with rigorous resolution planning and preparedness, the GSIB surcharge, the capital stress tests, and the liquidity requirements will decrease substantially the risk that a large financial institution's distress could pose to the broader financial system and ensure that no banking institution is too large and too complex to fail. Today's rule moves us closer to our goal of a safer, more responsible, and more resilient financial system.

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