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The Honorable David J. Kautter
Assistant Secretary for Tax Policy
U.S. Department of the Treasury
1500 Pennsylvania Ave. NW
Washington, DC 20220

Mr. William M. Paul
Acting Chief Counsel
Internal Revenue Service
1100 Constitution Ave. NW
Washington, DC 20224

Re: Regulations Proposed Under Section 59A As Applied to Foreign Banks Operating in the United States

Dear Messrs. Kautter and Paul,

The Institute of International Bankers ("IIB") appreciates this opportunity to provide comments on regulations proposed under section 59A, generally referred to as the "Base Erosion and Anti-Abuse Tax" or the "BEAT."[1]

The IIB represents internationally headquartered financial institutions from over 35 countries doing business in the United States. The IIB's members consist mostly of foreign banking organizations ("FBOs") that conduct banking operations in the United States through branches, agencies and bank subsidiaries, and nonbanking operations through subsidiaries such as commercial lending firms, broker-dealers, investment advisers and insurance companies. Our members' U.S. banking assets are over $3.7 trillion, and their U.S. operations fund 25 percent of all commercial and industrial bank loans made in the United States, contributing to the vitality of U.S. capital markets. Additionally, our members play a key role in the distribution and market making for U.S. government securities, as foreign-owned primary dealers constitute 15 out of the 23 primary dealers in U.S. Treasury securities. Our members also provide services that are critical to connecting foreign customers to the U.S. market, and vice versa.

The IIB wishes to express its appreciation for the strides made by the proposed regulations in fleshing out the novel statutory language of the BEAT into a coherent legal framework. We believe, in particular, that the proposed regulations' treatment of interest on

[1] Notice of Proposed Rulemaking, *Base Erosion and Anti-Abuse Tax* (REG-104259-18), 2019-02 I.R.B. 300. The BEAT was enacted as part of the legislation generally known as the Tax Cuts and Jobs Act ("TCJA") in December 2017.
All section references herein are to the Internal Revenue Code of 1986, as amended (the "Code") or Treasury regulations promulgated thereunder.

"internal TLAC" and their treatment of effectively connected income of U.S branches as amounts that are not base erosion payments properly balance the anti-base erosion objectives of the BEAT, with the recognition of the regulatory framework that governs FBOs, the other U.S. tax rules applicable to FBOs and the importance of FBOs to the U.S. economy and financial system.

The proposed regulations also raise new issues with respect to the application of the BEAT to FBOs, which may give rise to arbitrary differences between different FBOs and penalize FBOs and other financial institutions that carry out certain kinds of normal banking activities.

The most critical issues for a number of FBOs are (i) the branch interest expense provisions, (ii) the internal TLAC rules, (iii) the lack of similar rules for other regulatory debt issued by FBOs and their affiliates, (iv) the exclusion of foreign currency losses incurred on transactions with third parties from the denominator of the base erosion percentage, which severely and adversely affects banks that are dealers in foreign currency derivatives and foreign currency-denominated bonds, and (v) restrictions on the utilization of pre-enactment NOLs. Other important issues are (a) the treatment of repos and securities loans for purposes of the "qualified derivative payment" rules, (b) the interaction between the global dealing regulations and the proposed BEAT regulations, (c) the definition of "gross receipts" for BEAT purposes, and (d) whether section 15 should apply to fiscal year taxpayers.

I. SUMMARY OF RECOMMENDATIONS

Our recommendations are as follows:

Branch interest expense

- All FBOs should use either the "adjusted U.S. booked liabilities" ("AUSBL") method or an analogous surrogate AUSBL method to determine the amount of U.S. deductible interest expense that is treated as a base erosion payment.

- FBOs that have excess interest under the AUSBL or surrogate AUSBL method should be permitted to make simplifying elections in order to apply the worldwide liabilities fraction.

- Interest expense on foreign-to-foreign internal TLAC and other regulatory debt generally should not be treated as a base erosion payment and should be excluded from the numerator of the worldwide liabilities fraction.

Internal TLAC and other regulatory debt

- The proposed regulations' internal TLAC rule should be broadened to cover a maintenance buffer and transition periods, and to take into account possible future changes to the Federal Reserve Board's (the "Fed") internal TLAC regulations.

- Similar relief should apply to other categories of regulatory debt issued by U.S. subsidiaries and branches of FBOs.

- For purposes of the worldwide liabilities fraction, similar relief should apply to internal TLAC and other regulatory debt issued by foreign banks with U.S. branches.

Exclusion of foreign currency losses from denominator of base erosion percentage

- Foreign exchange losses should be excluded from the denominator only if they are excluded from the numerator of the base erosion percentage.

Restrictions on the utilization of pre-enactment NOLs

- Pre-enactment NOL carryforwards should not be prevented from giving rise to negative taxable income.

Other important issues

- Securities loans should not be subject to a general exclusion from the definition of a "derivative."

- Income sourced under the global dealing regulations should not be considered a payment with respect to the BEAT.

- Section 15 should not apply to fiscal year taxpayers for taxable years beginning in calendar year 2018.

Part II below (pages 3-14) addresses the branch interest expense issues. Part III below (pages 14-34) and Appendices I and II addresses internal TLAC and other regulatory debt issues. Parts IV-VI below (pages 34-40) address our other issues of concern.

II. INTERNAL FUNDING OF U.S. BRANCHES ("BRANCH INTEREST EXPENSE")

A. Summary of Concerns and Recommendations with Respect to U.S. Branch Interest Expense Deductions

As described in more detail below, U.S. domestic and treaty tax rules permit FBOs to elect one of several different alternative methods to determine the amount of interest expense deductible by a U.S. branch.[2] Each method allocates a portion of the FBO's global interest expense to the United States; while the details differ, the concept underlying each method is the same. Consequently, in our view, the BEAT should apply in a similar manner regardless of which interest expense calculation method is used.

However, the proposed regulations create enormous differences in how the BEAT applies to FBOs that have made different elections, ranging from potentially treating no interest expense of a U.S. branch as base erosion payments to treating 100 percent of a U.S. branch's interest expense deductions as base erosion payments. These differences do not serve any BEAT policy purpose, give rise to vast differences in how the BEAT applies to otherwise similarly situated FBOs, and effectively serve to prohibit taxpayers from making elections that the Internal Revenue Service (the "IRS") has expressly provided for or that the United States has agreed to with treaty partners. **We urge the IRS and Treasury to apply the BEAT in a neutral and consistent manner to determine which U.S. branch interest expense deductions of an FBO should be treated as base erosion payments.**

More specifically, our recommendations fall into three categories, each of which is discussed below.

- *Recommendation #1*: All FBOs should use either the "adjusted U.S. booked liabilities" ("AUSBL") method or a surrogate AUSBL method to determine the amount of U.S. deductible interest expense that is treated as a base erosion payment. Under the surrogate AUSBL method, analogous to the actual AUSBL method, for BEAT purposes branch interest expense would be treated as paid first on booked liabilities of the U.S. branch, and any excess interest expense would be treated as paid to related parties pro rata based on the worldwide liabilities fraction provided by the proposed regulations, subject to the two recommendations below.

- *Recommendation #2:* Taxpayers should be permitted to elect simplifying methods for the pro rata calculation. We propose four simplifying elections below, as well as a recommended change to the proposed regulations.

- *Recommendation #3:* For purposes of applying the worldwide liabilities fraction provided by the proposed regulations, the same principles should apply to TLAC and regulatory debt issued by an FBO outside the United States to related parties as would apply under the proposed regulations to internal TLAC issued by a U.S. intermediate holding company ("IHC"). That is, interest expense on such debt treated as paid by the U.S. branch should not be treated as a base erosion payment and that debt should be excluded from the numerator of the worldwide liabilities fraction.

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[2] The discussion in this comment letter assumes that section 163(j) does not apply, except where expressly stated otherwise.

B. Current Law Rules Governing U.S. Branch Interest Expense Deductions

1. *Overview*

For the reasons described in detail in our July 24, 2018 letter on section 59A as applied to foreign banks,[3] U.S. branches of FBOs fund their operations through a mixture of third party borrowings, such as wholesale deposits, and funding from their home office or non-U.S. branches. As a financial intermediary, a bank's borrowings from customers around the world are an integral part of the ordinary business operations of a U.S. branch. That is, those borrowings are the equivalent of the purchase of inventory or supplies for a retail or manufacturing business. Banks borrow in order to lend to customers, with the loans made being the equivalent of the sale of inventory. Most FBOs do not have a substantial U.S. retail customer base and generally have a larger and broader deposit-taking (borrowing) capability in their home country. Consequently, it borrows from customers outside the United States in order to raise money that it lends to customers inside the United States. To that end, the home office of a bank often will make substantial loans (as a legal matter) to its U.S. branches.

In order to prevent FBOs or other taxpayers with U.S. branches from stripping earnings out of the United States through excess leverage, there are long-standing regulations governing the amount of interest expense that a U.S. branch may deduct. As explained below, those regulations may either (i) preclude a U.S. branch from deducting all of the interest expense it pays on liabilities on the branch's books, or (ii) permit a U.S. branch to deduct a portion of the foreign bank's interest expense paid on liabilities that are not on the branch's books. These rules are unique to U.S. branches. Prior to the enactment of the TCJA, U.S. branches were the only U.S. taxpayers for whom the amount of their interest expense deductions were determined by reference to a formula imposed by law, in this case under Treasury regulation section 1.882-5.

Alternatively, a U.S. branch of a foreign bank that is resident in a country that has an income tax treaty with the United States may use a method permitted under the treaty (a "treaty method") to determine its interest expense.[4] Under some treaties, taxpayers may use the so-called "authorized OECD approach" ("AOA"), meaning a method approved in principle by the OECD's 2010 report on the attribution of profits to permanent establishments.[5] We understand that the principal AOA approach used by taxpayers is a "treasury dealings" or "internal dealings" approach that in effect recognizes funding arrangements between a U.S. branch and the home office or other branches, based on the assets used, risks assumed and functions performed by the U.S. branch.[6]

Each of these alternatives has the same purpose, which is to allocate a portion of a foreign bank's global interest expense to its U.S. operations in order to determine the amount of

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3 See https://cdn.ymaws.com/www.iib.org/resource/resmgr/tax/20180724IIBCommentLetterBEAT.pdf.

4 *National Westminster Bank, PLC v. United States*, 512 F.3d 1347 (Fed. Cir. 2008).

5 Organisation for Economic Co-operation and Development, 2010 REPORT ON THE ATTRIBUTION OF PROFITS TO PERMANENT ESTABLISHMENTS (22 July 2010).

6 The OECD report also contemplates a tracing approach or a fungibility approach.

the bank's net income that is subject to U.S. federal income taxation as "effectively connected income"("ECI"). Each of these alternatives is available on an elective basis to qualifying taxpayers.

2. *AUSBL and SCP methods (Treasury regulation section 1.882-5)*

Treasury regulation section 1.882-5 provides the domestic rules that govern the determination of the amount of U.S. deductible interest expense of an FBO. The regulation requires an FBO to (a) determine the value of its assets that give rise to ECI (such assets, "U.S. assets");[7] (b) determine the amount of debt that is deemed to fund those assets ("U.S.-connected liabilities"), by multiplying U.S. assets by a prescribed ratio,[8] and (c) determine the amount of interest expense on its U.S.-connected liabilities.

The amount of U.S.-connected liabilities may be more than, or less than, the amount of liabilities that are recorded on a U.S. branch's books or that are treated as liabilities of the branch for U.S. tax purposes ("booked liabilities"). If booked liabilities exceed U.S.-connected liabilities, the branch will not be able to deduct all of its interest expense. This rule, and the formulaic determination of U.S.-connected liabilities, ensure that FBOs cannot overleverage their U.S. branches, or more accurately that they will derive no U.S. tax benefit from doing so. Treasury regulation section 1.882-5 is thus inherently an anti-base erosion rule.

The third step in the three-step process described above may be carried out in either of two different ways. Under the AUSBL method, the amount of U.S. interest expense that the taxpayer may deduct is equal to the sum of (i) interest expense on its U.S. booked liabilities ("booked interest"), plus (ii) potentially, additional interest expense if U.S.-connected liabilities exceed U.S. booked liabilities. As described above, the amount of booked liabilities taken into account in the first leg of this formula cannot exceed the amount of U.S.-connected liabilities.[9] If U.S.-connected liabilities exceed booked liabilities, the excess U.S.-connected liabilities give rise to "excess interest," determined by multiplying the excess liabilities by a prescribed interest rate.

Taxpayers are permitted to make numerous elections in applying these rules, including electing under specified circumstances to use either basis or fair market value to determine the amount of their U.S. assets; using either a fixed ratio or the "actual ratio" to determine their U.S.-connected liabilities; and using either interest actually paid or a 30-day LIBOR rate to determine the interest rate on excess U.S.-connected liabilities.

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7 Treasury regulation section 1.882-5(b)(2).

8 Treasury regulation section 1.882-5(c).

9 By way of example, assume that a U.S. branch has $100 of booked liabilities. If its U.S.-connected liabilities are $90, it can deduct 90% of the interest on its booked liabilities. If its U.S.-connected liabilities are $120, it can deduct all of the interest expense on its booked liabilities and additional interest expense on the excess $20 of deemed liabilities.

Under the "separate currency pools" ("SCP") method, taxpayers carry out the same steps as under the AUSBL method, but (a) calculations are made on a currency-by-currency basis for U.S. assets denominated in different currencies, and therefore can give rise to U.S.-connected liabilities in different currencies, (b) interest is deductible on U.S.-connected liabilities without adjustment for U.S. booked liabilities, and (c) the interest rate on U.S.-connected liabilities is determined by reference to the bank's interest expense on worldwide liabilities in the relevant currency.[10]

C. The Proposed Regulations and Our Recommendations

1. *The proposed regulations*

The proposed regulations provide rules for determining the amount of branch interest expense to be treated as a base erosion payment that track the interest expense allocation rules described above.[11] That is:

- a taxpayer that uses the AUSBL method treats (a) interest expense on booked liabilities that is paid to a foreign related party as a base erosion payment, and (b) treats any excess interest as a base erosion payment in an amount equal to the excess interest multiplied by a fraction equal to (i) worldwide liabilities due to a foreign related party over (ii) worldwide liabilities.[12] (We refer to this fraction as the worldwide liabilities fraction.)

- a taxpayer that uses the SCP method treats interest expense in each currency pool as a base erosion payment in an amount equal to that interest expense multiplied by the worldwide liabilities fraction for each currency.[13]

- a taxpayer that uses the treaty "internal dealings" method treats all interest expense treated under that method as paid to its home office or a foreign branch as a base erosion payment.[14]

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[10] Treasury regulation section 1.882-5(e). If the taxpayer in note 9 elected to use the SCP method, it would determine the relevant currencies for its U.S. assets and its corresponding $90 of U.S.-connected liabilities and then multiply the relevant portion of the $90 by the worldwide interest rate for the relevant currency. If all of the branch's U.S. assets were U.S. dollar-denominated, the relevant interest rate would be the bank's funding cost in U.S. dollars.

[11] Proposed Treasury regulation section 1.59A-1(b)(4).

[12] Proposed Treasury regulation section 1.59A-1(b)(4)(i)(A). For the AUSBL method, the numerator and denominator of the worldwide liabilities fraction disregards booked liabilities, since they have already been taken into account.

[13] Proposed Treasury regulation section 1.59A-1(b)(4)(i)(B). Booked liabilities are not relevant for this purpose.

[14] Proposed Treasury regulation section 1.59A-1(b)(4)(v)(B). A taxpayer that uses a tracing or fungibility treaty method to determine the amount of its branch interest expense presumably would similarly follow those methods for BEAT purposes.

The result of this approach is that a U.S. branch may have dramatically different amounts of base erosion payments depending solely on which method it has chosen to determine the amount of its interest expense allocable to ECI.

By way of example, assume that a U.S. branch has $100 of U.S. booked liabilities, all of which are held by unrelated parties, and that the bank in question has worldwide liabilities of $1000, $300 of which are to foreign related parties. For the sake of illustration, assume also that the branch's U.S.-connected liabilities are $100.

- Under the AUSBL method, (a) none of the interest on the booked liabilities is a base erosion payment, and (b) the branch has no excess interest because booked liabilities equal U.S.-connected liabilities. As a result, none of the taxpayer's branch interest expense is treated as a base erosion payment.

- Under the SCP method, because 30 percent of the bank's worldwide liabilities are paid to foreign related parties, 30 percent of the branch's interest expense is treated as a base erosion payment.

- Under the treaty internal dealings method, assuming that the branch treats all of its funding as coming from the home office, all of the branch's interest expense is treated as a base erosion payment.

Neither the statutory language of the BEAT nor the policies underlying it compel or even suggest this result. All of the methods described above are methods for allocating an appropriate amount of interest expense against U.S. gross income. The fact that taxpayers can choose which method to use, and are permitted to make various elections in applying those methods, is expressly sanctioned by law and does not raise any base erosion concerns. The approach taken by the BEAT proposed regulations would effectively bar some taxpayers from using interest expense allocation methods that are otherwise permissible. We recommend that the regulations be revised to provide a single consistent method for determining the amount of branch interest expense that is treated as a base erosion payment (subject to our further recommendations for simplifying elections and other matters discussed below).

2. *Recommendation #1: Use of surrogate AUSBL method*

We recommend that taxpayers that use the AUSBL method for determining the amount of their U.S. branch interest expense use the approach provided by the proposed regulations and that other taxpayers be permitted to use a similar method for BEAT purposes. Under both the AUSBL and the surrogate AUSBL method:

- Step 1: Taxpayers would determine the amount of their U.S. branch interest expense under the method they have elected;

- Step 2: For BEAT purposes, that interest expense would be treated first as paid on U.S. booked liabilities, to the extent of such interest;

- Step 3: If there is more total U.S. branch interest expense than interest on U.S. booked liabilities, the excess would be subject to the worldwide liabilities fraction as it would apply to an AUSBL taxpayer. The application of the worldwide liabilities fraction would be subject to the simplifying elections listed below.

We believe that this approach properly addresses the BEAT's purpose of imposing additional tax on funding actually provided by a foreign related party. The fact that different taxpayers may use different methods to determine the amount of their U.S. branch interest expense does not change how much interest a branch actually pays to related parties. Moreover, taxpayers are familiar with a rule similar to Step 2, because the branch level interest rules of section 884 have a similar requirement.[15]

3. *Recommendation #2: Simplifying elections for Step 3*

In practice, the worldwide liabilities fraction will be difficult or impossible for many FBOs to apply as provided in the proposed regulations. That is true for both substantive and administrative reasons.

Substantive concerns include that U.S. tax law may treat some transactions as debt while non-U.S. tax law does not (for examples, repos and some instruments denominated as leases) and conversely, non-U.S. tax law may treat some transactions as debt while U.S. tax law does not (for example, perpetual "Additional Tier 1" instruments). Hedging costs that are integrated for U.S. tax purposes may not be treated in the same manner for non-U.S. purposes, or vice versa.

As an administrative matter, U.S. branches typically do not have full access to information about a bank's global operations, including its global funding arrangements. Moreover, information necessary to carry out the worldwide liabilities calculation may be embedded in other items in the bank's accounting records, because there has been no reason to break them out. By analogy, taxpayers that have used the "actual ratio" to determine the amount of their U.S.-connected liabilities by restating their global assets and liabilities under U.S. tax principles have experienced lengthy audits requiring the production of reams of information to IRS examiners. In a world with finite resources at both the taxpayer and IRS level, attempting to reconstruct a global bank's balance sheet and payments under U.S. tax principles should not be required.

Treasury regulation section 1.882-5 recognizes similar concerns with the use of the "actual ratio" to determine U.S.-connected liabilities, and permits taxpayers to use a fixed

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[15] Treasury regulation section 1.884-4(a)(2) ("excess interest" for section 884 purposes is defined as total branch interest expense determined under Treasury regulation section 1.882-5, minus "branch interest," which principally means interest on booked liabilities).

ratio instead.[16] In the same spirit, and recognizing that different taxpayers may have different constraints so that different elections may be more or less useful for different taxpayers, we make the following four recommendations. Since no one election will address the concerns of all FBOs, we urge the IRS and Treasury to consider all of our recommendations. We also make one recommendation for clarification of the proposed regulations.

Simplifying elections

Recommendation #2A: Book election. Taxpayers should be permitted to use their financial accounting books rather than U.S. tax principles to determine their worldwide liabilities. Under this election, the worldwide liabilities fraction would be determined by reference to worldwide book liabilities to foreign related parties over worldwide book liabilities.

In order to provide consistency across related calculations, we envision that (i) this election would not be available to taxpayers that use the actual ratio to determine the amount of branch interest expense, because they have already done the work to restate the foreign bank's assets and liabilities under U.S. tax principles; and (ii) if foreign-to-foreign internal TLAC and other regulatory debt are recorded as a liability on the foreign bank's books, the special rule for foreign-to-foreign regulatory debt described in Part II.C.4 below would not apply. That is, such debt would be treated as a liability for this purpose regardless of whether it constitutes debt under U.S. tax principles and regardless of any special rules that otherwise would apply to foreign-to-foreign regulatory debt.

Recommendation #2B: fixed ratio election. In order to avoid having to restate a foreign bank's global balance sheet or interest expense under U.S. tax principles, U.S. branches should be permitted to elect on an annual basis to treat a fixed proportion of their U.S. branch interest expense as paid to foreign related parties. Current law adopts a similar approach under both Treasury regulation section 1.882-5(c)(4) (fixed ratio election for determining U.S.-connected liabilities) and under the branch level interest tax rules of Treasury regulation section 1.884-4(a)(2)(iii). We recommend a rule based on the latter.

Treasury regulation section 1.884-4(a)(2) generally imposes domestic withholding tax on excess interest as if it were paid by a wholly-owned domestic subsidiary to the foreign bank. Under Treasury regulation section 1.884-4(a)(2)(iii), however, a bank's excess interest is treated as interest on deposits under a formula that treats a minimum of 85% of excess interest as such.[17] Since interest on deposits are not subject to U.S. withholding tax, this rule caps the amount of excess interest that is subject to withholding tax. This special interest-on-deposits rule

[16] Treasury regulation section 1.882-5(c)(1), (2) (taxpayer generally must determine the amount of U.S.-connected liabilities by multiplying U.S. assets by actual ratio of worldwide liabilities over worldwide assets, determined under U.S. tax principles); Treasury regulation section 1.882-5(c)(4) (taxpayer may elect to use fixed ratio rather than actual ratio).

[17] Treasury regulation section 1.884-4(a)(2) (excess interest is treated as interest on deposits in an amount equal to the product of (i) the excess interest and (ii) the greater of (A) the actual ratio of interest-bearing deposits to all interest-bearing liabilities, or (b) 85 percent.)

derives from a sentence in the Conference Report when section 884(f) was enacted stating that "the regulations may provide that where the indebtedness of the home office is attributed to the branch, the excess interest is to be treated as incurred on each type of *external borrowing* by the corporation (*e.g.*, a bank deposit)…"[18] That is, current law deems a minimum of 85% of a U.S. branch's interest expense to be paid to third parties on bank deposits.

We recommend that excess interest for BEAT purposes similarly be treated as paid to unrelated parties under a formula that treats a minimum of 85% of the excess interest as paid to unrelated parties. As under the existing section 884 regulations, banks should able to demonstrate that a higher proportion of their global funding is in fact from third parties.

Recommendation #2C: P&L method. Taxpayers should be permitted to elect to use a P&L method rather than a balance sheet method for worldwide liabilities fraction. The worldwide liabilities fraction in its current form compares liabilities. An alternate P&L approach would allow the taxpayer to compare interest expense, as determined for book purposes. That is, the fraction would be worldwide book interest expense paid to foreign related parties over worldwide book interest expense.

Similar consistency rules would apply as for the book balance sheet recommendation (recommendation #2A). Taxpayers that have used the actual ratio to determine their branch interest expense could apply the P&L method by reference to interest expense as determined for U.S. tax purposes on the liabilities taken into account for the actual ratio.

Recommendation #2D: Consistency method election. Many of the methods that taxpayers are permitted to use for purposes of determining their branch interest expense require the taxpayer to determine, for some or all of their global liabilities, how those liabilities are characterized for U.S. federal income tax purposes. The consistency method election would permit taxpayers who have used such a method to apply the worldwide liabilities fraction by reference to those same liabilities. This proposal is an expansion of the rules provided by the proposed regulations for SCP method taxpayers.

That is, under the election (i) taxpayers that use the actual ratio to determine their U.S.-connected liabilities (which we believe to be few in number) would apply the worldwide liabilities fraction by reference to their worldwide liabilities in all currencies, (ii) taxpayers that use the outside borrowing rate for U.S. dollar-denominated liabilities under Treasury regulation section 1.882-5(d)(5)(ii)(A) to determine their excess interest rate would take into account only those liabilities; (iii) as provided by the proposed regulations, SCP method taxpayers would take into account only liabilities in the relevant separate currencies; and (iv) taxpayers that use a

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18 H.R. Rep. No. 841, 99th Cong. 2d Sess. II-649, *Tax Reform Act of 1986, Conference Report to Accompany H.R. 3838* (Sept. 18, 1986) (emphasis added).

treaty method to determine the amount of their branch interest expense (i.e., a fungibility or direct tracing method) would take into account only the relevant class of liabilities.[19]

Allowing taxpayers to use the same set or subset of liabilities for purposes of both their branch interest expense calculations in Step 1 and their excess interest calculations in Step 3 would simplify audits for both taxpayers and the IRS, and allows for consistent use of U.S. tax principles to determine which liabilities are properly treated as such.

This rule would be subject to an anti-abuse rule to preclude FBOs from avoiding the application of the BEAT to related party debt by borrowing from related parties in other currencies and swapping the other currency into U.S. dollars. For example, if the top-tier entity in an FBO group borrowed in U.S. dollars, and then loaned an equivalent amount to the foreign bank in a different currency and directly or indirectly swapped that currency back into dollars with the bank, that borrowing by the foreign bank should be treated as a U.S. dollar liability for this purpose. [20] Similar principles would apply for other currencies if taken into account under the branch interest expense method used by the taxpayer, such as the SCP method.

We considered a broader rule that would treat as a U.S.-dollar liability any non-dollar liability hedged into U.S. dollars. We do not think that is appropriate, for two reasons. First, as a technical matter, such liabilities may not be taken into account in the computations listed above, thus undermining the consistency that the election is intended to provide. More substantively, many FBPs hedge their currency risk on a net global basis. That is, they net down offsetting currency positions, and hedge only the net remaining risk. In such a case, it is not possible to match a hedge to any particular asset or liability. Accordingly, the transaction-specific anti-abuse rule that we propose must be narrowly drawn in order to avoid creating exactly the kind of complexities and uncertainties that the consistency method is intended to eliminate. The proposed regulations' general anti-abuse rule would still apply in other circumstances.

Clarification

Modify effect of making 1.884-1(e)(3) election. Treasury regulation section 1.884-1(e)(3) permits a taxpayer to elect to reduce the amount of its U.S.-connected liabilities, for branch profits tax purposes. The reduction in liabilities effects a corresponding reduction in branch interest expense, for purposes of section 884, Treasury regulation section 1.882-5 and all

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[19] There are proposed regulations under Treasury regulation section 1.882-5 that address hedges. Those rules have never come into effect and we understand that different FBOs have adopted different approaches to them. FBOs that do take hedges into account for purposes of the actual ratio or other methods described in the text above should do it as well for purposes of this election.

[20] To the extent that a bank obtains funding in order to fund its U.S. branch, whose assets will be largely U.S.-dollar denominated, it will wish to do so actually or synthetically in U.S. dollars, to avoid the risk of currency fluctuations.

other Code sections for which the amount of interest expense determined thereunder is relevant.[21]

Proposed regulation section 1.59A-3(b)(4)(i)(D) provides that a foreign corporation that elects to reduce its liabilities under Treasury regulation section 1.884-1(e)(3) must reduce its liabilities on a pro rata basis. If that language is intended to mean that interest on both booked liabilities and excess interest must be reduced pro rata, we request that the rule be revised. Under the AUSBL method described above, interest is treated as paid first on booked liabilities and then as excess interest. Conversely, if the amount of branch interest expense is reduced, it would first reduce excess interest. We request that proposed regulation section 1.59A-3(b)(4)(i)(D) be revised to say that an election to reduce liabilities under Treasury regulation section 1.884-1(e)(3) is treated as first reducing excess interest, and then as reducing booked liabilities on a pro rata basis.

4. *Recommendation #3: Foreign-to-foreign regulatory debt*

For purposes of applying the worldwide liabilities fraction provided by the proposed regulations, the same principles should apply to TLAC and regulatory debt issued by an FBO outside the United States to related parties as would apply under the proposed regulations to internal TLAC issued by a U.S. IHC. Consequently, interest expense paid on foreign-to-foreign regulatory debt should not be treated as a base erosion payment and such debt should be excluded from the numerator of the worldwide liabilities fraction.

The worldwide liabilities method for characterizing excess interest gives rise to a need to determine how much of a foreign bank's interest expense is paid to foreign related parties. That is, an FBO will need to determine how much interest paid by the bank outside the United States, in transactions that have no direct connection to the United States, are paid to foreign related parties. In addition to the practical concerns addressed above, there are structural and regulatory reasons why this rule can give rise to arbitrary (from a BEAT perspective) results that have potentially severe impacts on some FBOs. We briefly describe those issues, and recommend further changes to the BEAT regulations to address them.

In the United States, virtually all large banks have a multiple-tier corporate structure. The top-tier company is a holding company that is not a bank. The legal entity that is the bank is a direct or indirect subsidiary of the holding company. This structure has a number of corporate and regulatory benefits. First, it allows a publicly traded banking organization to be organized at the top-tier (publicly traded) level as a Delaware or other state law corporation with an accepted and well understood body of corporate law. In general, the corporate laws of banks, even federally chartered national banks, are less well developed and less widely understood. Second, it provides regulatory flexibility for the parent company to engage in non-banking activities through non-bank affiliates. For most large banking organizations, the banking laws

[21] Treasury regulation section 1.884-1(e)(3)(iii).

permit a broader range of non-banking activities to be conducted through non-bank affiliates than would be permitted in (or under) an FDIC-insured bank.

Some other countries have similar rules. Other countries permit the bank to be the top-tier company. As a result of differences in rules, local market practice and history, bank corporate structures take various forms. For example, there may be a top-tier bank; or a bank holding company with one or more bank subsidiaries; or a top-tier bank with one or more lower-tier banks. There may also be other regulated entities carrying out non-banking activities (*e.g.*, insurance) or unregulated affiliates carrying out business activities not permitted to be carried out by a bank. These structures were not designed for U.S. tax purposes and, absent the BEAT, ordinarily would not be relevant for U.S. tax purposes. These corporate structures are, however, heavily influenced or dictated by the regulatory framework that the bank operates under, or in the case of a global bank, by the multiple regulatory frameworks that it must comply with.

One aspect of those regulatory rules has to do with intercompany funding. As explained in our comment letter of July 24, 2018 on section 59A as applied to foreign banks and below, the TLAC rules that have been adopted, and are coming into force, in many countries are based on international principles.[22] Those principles require that resolution entities – typically the top-tier company – borrow from the market and lend to subsidiaries.

The TLAC rules are only one of the myriad sets of bank regulations that govern intercompany funding, as discussed in more detail below. While the details differ, the same governing standards and principles apply across the globe. We request, therefore, that relief similar to what we describe in Part III below for U.S. subsidiaries and branches of FBOs also apply to intercompany funding between the foreign bank and its affiliates.

III. INTERNAL TLAC AND OTHER REGULATORY DEBT

The proposed regulations' exclusion of interest on internal TLAC from the definition of "base erosion payment," regardless of the IHC's resolution strategy, is very welcome. We understand that a premise behind the exclusion was that interest on regulatory debt that is required by law does not erode the U.S. tax base. We believe that that premise is correct, and more generally that it is appropriate for the BEAT to be interpreted, where permissible, in a way that ensures that U.S. tax rules do not conflict with compliance with regulatory rules.

We believe that similar relief should be provided more broadly. Our recommendations fall into three categories. First, we have some specific comments about the internal TLAC rule in the proposed regulations. Second, in light of (a) changes that the Fed may be considering to the internal TLAC rules, and (b) other regulatory rules that banks must comply with that give rise to identifiable amounts and types of related party funding, we recommend that the principles of the proposed regulations' internal TLAC rule be applied to other categories of

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[22] See note 3, *supra*.

regulatory debt issued by U.S. subsidiaries and branches of FBOs. Finally, we recommend that similar relief be provided for internal TLAC and other regulatory debt issued by foreign banks, for the reasons described in Part II.C.4, above.

A. Background Information on Bank Regulatory Rules Relevant to FBOs

Because our recommendations relate to complex bank regulatory rules, this section of our comment letter provides some background information on the rules mentioned above. We also refer you to our June 30, 2016 comment letter on the proposed section 385 regulations and our July 24, 2018 comment letter on the BEAT, which also describe these rules.[23] The purpose of this background information is to demonstrate that a portion, which may be substantial, of the intercompany debt issued by U.S. subsidiaries and branches of FBOs is necessary in order to comply with applicable regulatory law and practice. That portion of the intercompany debt ought to be treated in the same manner as the proposed regulations currently treat internal TLAC. Other intercompany debt would not be eligible for that relief.

1. *Total loss-absorbing capacity ("TLAC") rules*

(a) *Overview*

Under laws adopted around the world that are based on international principles and standards, globally systemically important banks ("GSIBs") are required to issue external securities with specified "loss-absorbing" terms ("external TLAC") in order to promote the orderly "resolution" of the bank if it ceases to be viable.[24] Material subgroups of a GSIB that are organized in a different country than that of the GSIB must maintain specific amounts of instruments with similar loss-absorbing terms ("internal TLAC"), which must be issued to affiliates.

Most FBOs that are GSIBs have "single point of entry" ("SPOE") resolution strategies at the global level. SPOE resolution involves putting the top-tier parent (the "single point") into resolution proceedings and using the parent's resources to recapitalize its operating subsidiaries. Losses at a subsidiary level would be "pushed up" to the parent and borne by shareholders and creditors of the parent. The intent is that the operating subsidiaries continue to operate without being put into resolution, bankruptcy or receivership proceedings. SPOE generally requires that third-party long-term debt be incurred at the top-tier parent level, and the proceeds loaned down to subsidiaries.

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[23] See note 3, *supra*, for our July 24 2018 comment letter. Our comment letter of June 30, 2016 on proposed regulations under section 385 addressed these issues in detail. The letter is *available at* https://c.ymcdn.com/sites/www.iib.org/resource/resmgr/Tax/20160630IIBSection385Letter_.pdf.

[24] "Resolution" is a term of art that means something like "bankruptcy," except that a bank or bank affiliate is taken over by a bank resolution authority rather than being subject to a judicial process and its "critical functions" continue in one form or another.

More specifically, the TLAC concept is that if losses arise at a bank or other regulated subsidiary, that entity would be recapitalized by writing off, or converting to equity, the internal TLAC that it has issued to a higher-tier affiliate. Similar internal write-offs or conversions on higher-tier internal TLAC ultimately bring the losses up to the top-tier resolution entity. The external TLAC issued by the top-tier entity then would also be written off or converted into equity, thus effectively transferring the losses that arose at the lower-tier bank to investors. The point of the entire regime is to save banks by imposing losses up the chain on investors ("bail in") instead of having public authorities use taxpayer money ("bail out").

In order for this scheme to work, there must be a chain of internal TLAC up from the regulated entity to the top-tier entity, coupled with external TLAC issued by the "resolution entity."[25] For the reasons described below, under internationally-agreed principles a substantial portion of the internal TLAC is likely to be in the form of long-term debt.

These rules apply to the eight U.S. banks that are GSIBs and to many large FBOs in their home jurisdictions, under home country law. FBOs with large U.S. operations are also subject to the U.S. version of internal TLAC rules, as described in more detail below. For banks with a SPOE resolution strategy, long-term debt must be issued by the top-tier entity and must have specified loss-absorbing terms in order to qualify as external TLAC.

Consequently, if a GSIB that has adopted a SPOE resolution strategy were to issue long-term debt to third parties at a subsidiary level, it would not count towards the GSIB's external TLAC requirement. Since the amount of long-term debt required to be issued by the top-tier entity would not be reduced by the debt issued by the subsidiary, the bank group as a whole would have to take on additional leverage, which regulatory rules discourage. Banks subject to these rules therefore cannot simply issue debt to third parties out of U.S. subsidiaries to reduce their BEAT exposure, unlike other taxpayers, or at least cannot do so in a manner that their regulators would consider prudent.

Consequently, as a matter of law and supervisory practice, most banks subject to TLAC rules must issue some portion of their internal TLAC in the form of debt. Thus, compliance with both U.S. law and non-U.S. law may lead an FBO to have internal TLAC in the form of long-term debt between U.S. and foreign affiliates, as well as between different foreign affiliates, for example between a foreign holding company and the foreign bank.

FBOs have developed detailed and extensive plans ("resolution and recovery plans") describing their internal legal structure, their operations, and the extent of intercompany transactions, which lay out how they would be resolved if a bank ceased to be viable. These plans have been mandated by international principle-setting bodies and through the laws and regulations of individual jurisdictions. Those laws and regulations require the resolution and recovery plans to be reviewed and approved by their regulators. The amount and terms of banks'

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[25] Similar rules apply to "multiple point of entry" banks, except that there may be multiple resolution entities rather than just the single top-tier resolution entity.

external and internal TLAC are also reviewed and approved by their regulators. As is the case for U.S. banks, ensuring compliance with these rules has been a long and detailed process for FBOs, subject to very close scrutiny by regulators. That is, any FBO that has intercompany debt between affiliates that qualifies as internal TLAC for purposes of their home country or U.S. bank regulatory rules has devoted months or years of work in order to satisfy their regulators that they are in compliance with applicable law or policy, and the internal TLAC is an essential component of that compliance.

(b) *International principles*

As a general rule, high-level principles and standards for bank regulation are promulgated by international bodies in which the United States plays a prominent role. In the case of internal TLAC, the relevant international body is the Financial Stability Board ("FSB").

The FSB promotes global financial stability by coordinating the development of regulatory, supervisory and other financial sector policies. Its particular focus is on systemic risk – that is, the risk that the failure of one financial institution or the collapse of one financial system could trigger a chain reaction throughout the broader global financial system. The FSB's recommendations do not have immediate effect, but are expected to be adopted into domestic law or regulation by its member states and others that look to it for guidance.

In 2015, the FSB issued its "Principles on Loss-absorbing and Recapitalisation Capacity of GSIBs in Resolution" (the "2015 Principles") which was supplemented in 2017 by additional principles relating to internal TLAC (the "2017 Principles").[26] The 2015 Principles lay out a framework for "resolution" planning. Some key FSB concepts include: (i) if a globally systemically important bank group is in financial trouble, the bank should be recapitalized and kept in operation, even if non-bank affiliates fail, (ii) banks should not be "bailed out" with taxpayer funds; rather, shareholders and creditors should be "bailed in," meaning that they should bear the losses of the bank; and (iii) in order to achieve that, loss-absorbing instruments – equity or long-term debt – should be issued to unrelated investors, who would bear the losses in question.

With this background, it is instructive to read the 2015 Principles. They state in part:

- There must be sufficient loss-absorbing and recapitalisation capacity available in resolution to implement an orderly resolution that minimises any impact on financial

[26] Financial Stability Board, *Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution: Total Loss-absorbing Capacity (TLAC) Term Sheet* (9 November 2015) (the "FSB TLAC Term Sheet"), *available at* http://www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf; Financial Stability Board, *Guiding Principles on the Internal Total Loss-absorbing Capacity of G-SIBs ('Internal TLAC')* (6 July 2017), *available at http://www.fsb.org/2017/07/guiding-principles-on-the-internal-total-loss-absorbing-capacity-of-g-sibs-internal-tlac-2/.*

stability, ensures the continuity of critical functions, and avoids exposing taxpayers (that is, public funds) to loss with a high degree of confidence. (main guiding principle)

- Each GSIB should be required to meet a firm-specific Minimum TLAC requirement that is at least equal to the common minimum agreed by the FSB. (principle (iii))
- Host authorities [for FBOs, the United States] must have confidence that there is sufficient loss-absorbing and recapitalisation capacity available to subsidiaries in their jurisdictions with legal certainty at the point of entry into resolution. (principle (vi))
- Instruments that are eligible to meet Minimum TLAC requirements should be stable, long-term claims that are not repayable on demand or at short notice. (principle (viii))

The 2015 Principles also attached a term sheet that set out terms for external TLAC and internal TLAC. The term sheet is supplemented by the 2017 Principles, which state in part:

- Host authorities should determine the composition of internal TLAC in consultation with the home authority. In particular, host authorities should consult with the home authority on the impact that the composition of internal TLAC relative to external TLAC could have on the credibility and sustainability of the resolution strategy and the ability of the material sub-group to effectively pass losses and recapitalisation needs to the resolution entity. (Guiding Principle 8)
- Host authorities in consultation with the home authority may consider the inclusion within the internal TLAC requirement of an expectation that internal TLAC consist of debt liabilities accounting for an amount equal to, or greater than, 33% of the material sub-group's internal TLAC requirement. (Guiding Principle 8)

(c) *U.S. rules*

Under U.S. law, if an FBO's total consolidated non-branch U.S. assets are at least $50 billion, the FBO is required to hold its U.S. subsidiaries through an IHC, which is subject to U.S. bank regulatory supervision on a consolidated basis. As the consolidated supervisor of IHCs, the Fed exercises oversight of all of an IHC's subsidiaries, and thus may, as part of the supervisory process, set capitalization and liquidity levels (or impose other requirements) on subsidiaries that are not otherwise subject to direct regulation by another regulator. As described above, because the IHC and its subsidiaries are ultimately owned by a foreign bank group parent, the IHC group is also subject to regulation by the FBO's home country regulator.

Under U.S. law, FBOs with at least $250 billion of global assets are required to submit resolution plans to the Fed that describe the group's strategy for rapid and orderly resolution of its U.S. operations under the U.S. bankruptcy code in the event of material financial distress or failure of the company. The FBO's resolution plans for their global operations are generally discussed in their U.S. resolution plans. In the United States, regulations adopted by the Fed require most U.S. IHCs of GSIBs ("Covered IHCs") to issue a minimum amount of TLAC in the form of long-term debt to foreign affiliates.

Other countries do not explicitly mandate a minimum amount of TLAC in the form of long-term debt as a matter of law. As noted above, however, the FSB's principles contemplate that at least one-third of total internal TLAC will be in the form of long-term debt and non-U.S. bank regulators in practice expect that a substantial portion of internal TLAC will be in the form of long-term debt. As described in more detail in Part III.B.4, below, it is possible that the U.S. rules will be revised in the future to be more similar to the international rules.

2. *Bank regulatory capital, liquidity and stress testing rules*

The TLAC rules described above apply to a subset of large FBOs. FBOs are also subject to an extensive array of other regulatory rules that affect the amount and nature of the equity and debt capital of an FBO and its regulated subsidiaries, as well as the composition of their assets. Among other matters, these rules require that regulated U.S. subsidiaries of FBOs, including U.S. banks, U.S. broker-dealers and U.S. IHCs, have minimum amounts of equity capital. Conversely, U.S. bank and U.S. IHC subsidiaries are subject to limits on how much leverage (*i.e.*, debt) they may have, under the "leverage ratio" rules described below. In the Fed's own words, "a leverage ratio puts a simple and transparent lower bound [that is, a cap] on banking organization leverage."[27]

As described in more detail below:

- U.S. bank regulators view the level of equity and leverage at regulated entities to be important in assessing their financial stability;
- U.S. bank regulations consequently mandate minimum amounts of equity that regulated entities must issue, and limit the amount of debt that may be issued by regulated entities;
- U.S. bank regulations impose many other requirements (including the maintenance of required amounts of liquidity on-hand) affecting the amount and type of debt issued by U.S. subsidiaries and branches of FBOs; and
- In order to determine compliance with these rules, FBOs must provide an extensive array of reporting to regulators and in some cases to the public.

Rules of this kind apply *only* to regulated entities and their affiliates.

As is the case with the "resolution" principles promulgated by the FSB, these rules are based on principles and standards set by an international body, which in this case is the Basel Committee on Banking Supervision. The Basel Committee's 2010 capital and liquidity

[27] 83 Fed. Reg. 17317, 17319 (Apr. 19, 2018).

framework is known as "Basel III" and has been implemented around the world through the adoption of national laws and regulations. FBOs are subject to the rules adopted by U.S. bank regulators with respect to their U.S. operations.

These regulatory rules have expanded significantly since the financial crisis of 2007 – 2009. They are designed to protect bank depositors as well as other customers and counterparties of the FBO by ensuring that the entity has adequate levels of capital to absorb losses, and that the nature of its assets and liabilities are such that it can withstand disruptions that can result in a liquidity squeeze. More specifically, these rules fall into three categories, some of which apply to all FBOs and some of which apply to some FBOs:

- *Regulatory capital*. Regulated entities such as banks, broker-dealers and IHCs are required to have a minimum level of capital in order to protect depositors, customers and other protected classes. For banks and IHCs, capital securities consist of common stock ("common equity Tier 1" instruments), Additional Tier 1 instruments such as perpetual non-cumulative preferred stock, and "Tier 2" instruments, which typically take the form of subordinated debt. U.S. regulatory rules establish minimum common equity Tier 1, minimum Tier 1 (that is, equity) and minimum total capital ratios, determined by reference to risk-weighted assets, and prescribe detailed rules for how these ratios are calculated. These ratios, among other things, prescribe a minimum level of common equity, as well as total equity.

  In addition to the regulatory capital requirements based on risk-weighted assets, a "leverage ratio" also applies. The principal objective of this measure is to place a constraint on the degree to which a banking organization can leverage its equity capital base.[28] The leverage ratio is expressed as the ratio of Tier 1 capital (that is, equity) to assets (determined on a non-risk-weighted basis). The higher this ratio is, the less leverage an institution has, because the ratio measures the percentage of capital against assets. The bank regulators typically mandate ratios in the 3 to 6 percent range. (Other types of leverage ratios may work inversely – *i.e.*, by indicating how many "times" the balance sheet is leveraged against existing capital. For example, 33-to-1 leverage would equate to a 3 percent leverage ratio; if the regulator mandated a 5 percent leverage ratio, then the balance sheet would only be 20-to-1 levered, and the higher capital requirement limits the amount of leverage or debt the bank may take on.) [29]

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[28] Federal Reserve's Bank Holding Company Supervision Manual, § 4060.4.1.1. The Manual is available at https://www.federalreserve.gov/publications/files/bhc.pdf.

[29] Institutions subject to the leverage ratio generally must have a minimum leverage ratio of 4%. For large banking organizations, an additional supplemental leverage ratio takes off-balance sheet exposures into account in the denominator, and mandated ratios are in the range of 3 to 6 percent.

For most banks, the risk-weighted asset-based rules and the CCAR rules described below drive the actual amount of their minimum equity capital, rather than the leverage ratio.

Noncompliance with minimum capital requirements will result in regulatory corrective actions including limits on growth and expansion, restrictions on existing activities, restrictions on dividends and leverage, and, ultimately, conservatorship or receivership. In practice, banks operate with a substantial buffer above the minimum, in light of the fact that "[t]he Federal Reserve has long held the view that bank holding companies (BHCs) generally should operate with capital positions well above the minimum regulatory capital ratios, with the amount of capital held being commensurate with the BHC's risk profile."[30]

- *Liquidity*. In response to the evident inadequacy of pre-financial crisis rules in this regard, U.S. bank regulators have adopted a number of measures intended to ensure that regulated entities have adequate liquidity. Under current law, the relevant requirements are liquidity buffers applicable to larger U.S. banks, U.S. bank holding companies, U.S. IHCs and U.S. branches of FBOs, and the liquidity coverage ratio requirements for some U.S. bank subsidiaries and for some U.S. IHCs.[31]

    - The "liquidity coverage ratio" ("LCR"), as applied to some IHCs in the U.S., requires FBOs subject to these rules to maintain a sufficient amount of high-quality liquid assets ("HQLA") to withstand a stress scenario lasting 30 days.
    - The "liquidity buffer" under U.S. law is a separate requirement for an FBO to maintain a buffer of highly-liquid assets for its IHC, across its U.S. branch network and across its "combined U.S. operations" against projected cash outflows based on internally modeled stress scenarios over prescribed time horizons. U.S. IHCs are subject to a 30-day liquidity buffer and U.S. branches of FBOs are subject to a 14-day liquidity buffer that must be maintained in the United States with an additional buffer permitted to be maintained outside the United States
    - In addition, a third requirement has been proposed but has not yet come into effect. The "net stable funding ratio" ("NSFR") would require an FBO to maintain a sufficiently stable amount of longer-term financing against its asset profile.

The LCR, and when it comes into effect, the NSFR also apply to FBOs in their home country through implementation of Basel III mandates, taking into account consolidated assets and liabilities of an FBO's entire group, including its U.S. assets and liabilities. They serve as binding liquidity constraints, often requiring an FBO to borrow term funding externally to maintain the necessary buffers.

While there is no explicit requirement to manage unsecured borrowings centrally at the top of the house, there are several reasons why the funding for local assets and

[30] Federal Reserve's Bank Holding Company Supervision Manual, § 4061.0.1.
[31] 12 C.F.R. Part 249, 12 C.F.R. § 252.157.

liabilities is often sourced globally and not locally. One of those is that the requirements at the group level may be more stringent than in host jurisdictions, requiring higher or longer-term borrowing that may not be required in the United States for the same asset. For example, the European Union is closer to NSFR implementation than is the United States. Another example is that the application of the LCR at the IHC level is modified compared to the full LCR on a global level. These examples are not exclusive. Finally, since an FBO in many cases must borrow from third parties under home country law in order to cover U.S. assets, it is only rational for the U.S. operations then to borrow these funds internally to avoid borrowing twice to cover the same asset.

Other regulatory rules similarly provide strong incentives for subsidiaries to borrow internally rather than from third parties. In the United States, for example, there are limits on the ability of a U.S. depository institution (that is, a bank) or a U.S. branch of an FBO to lend to non-bank affiliates.[32] In a liquidity crisis, these rules could prevent the bank from transferring liquidity to affiliates that need it most. The group has far more flexibility if it holds excess liquidity at a top tier bank holding company or holding company for an FBO, since it can transfer that liquidity wherever it is needed. Therefore, in order to manage liquidity requirements there are powerful reasons for bank groups to borrow from third parties primarily at the top-tier company and have that company lend money to its subsidiaries, due to restrictions on certain entities from lending to parent or "sister" companies.

- *Stress testing.* Under the Fed's Comprehensive Capital Analysis and Review ("CCAR") rules, IHCs must submit to the Fed for its review annual capital plans showing that they would maintain capital in excess of minimum requirements under a severely adverse stress scenario over a 9-quarter period. All dividends and other capital distributions must be approved by the Fed as part of the capital plan review. Approval of a capital plan depends on results of supervisory and company-run stress tests and the Fed's qualitative assessment of the company's capital planning processes.

  Failure to obtain approval of a capital plan, whether on qualitative or quantitative grounds, leads to restrictions on distributions and has immediate, adverse market implications because the result is publicly disclosed.

  Further, under the Fed's qualitative liquidity framework, large FBOs must also conduct internal liquidity stress tests, at least monthly but the Fed may require more frequent stress tests, to separately assess the potential impact of liquidity stress scenarios on the cash flows, liquidity position, profitability and solvency of its

[32] Sections 23A and 23B of the Federal Reserve Act, as implemented by Regulation W, impose quantitative and qualitative restrictions on transactions between the U.S. bank subsidiaries and branches of an FBO, on the one hand, and certain of its U.S. affiliates, on the other hand. While U.S. branches are subject to a modified form of these restrictions, any U.S. depository institution subsidiary of an FBO is subject to the full scope of these quantitative and qualitative restrictions on transactions with its affiliates.

combined U.S. operations, its U.S. branches and agencies on an aggregate basis and its IHC, if any.[33]

The planning horizons consist of overnight, 30-day, 90-day, 1-year and other horizons relevant to a liquidity risk profile. The liquidity requirement buffers discussed above are based upon the 30-day stress test results.

In practice, in order to "pass" the capital stress tests, IHCs generally must maintain capital levels well in excess of their minimum requirements. That is, the CCAR and internal liquidity stress tests are the real determinant of how much equity capital and available sources of cash inflow IHCs must have and how much debt they are permitted to have, as a regulatory matter.

Each of the rules described above implicates how an FBO funds its U.S. operations. The amount of Tier 2 debt issued by a regulated entity is taken into account in determining whether it has satisfied its total capital ratio requirement. Liquid assets must be obtained from somewhere, and regulators may (and do) expect that they will be provided by or supported by a foreign parent via an unsecured funding arrangement. CCAR stress testing requires FBOs to project sources and uses of capital over the next 9 quarters that may be indirectly affected by liquidity needs. As a result, while the rules on the books do not explicitly dictate whether funding is provided by related or unrelated parties, the choices that FBOs make are closely scrutinized by regulators and, as described in the next section, are often the result of guidance from regulators.

3. *Practical aspects of bank regulation*

Before turning to our recommendations, it may be useful to provide some additional context about the real-world constraints on and FBO's ability to manage its internal funding arrangements, as a result of the regulatory rules that govern them. Those constraints derive in the first instance from statutory law, implementing regulations and other formal regulatory guidance. As described above, in the case of a FBO's U.S. activities, there are four general types of U.S. regulatory rules that apply: (i) internal TLAC, in the case of U.S. IHCs, (ii) regulatory capital, for U.S. banks, broker-dealers, IHCs and other regulated entities, (iii) liquidity rules, and (iv) so-called "capital stress testing" rules, generally referred to as "CCAR." Similar home country bank regulatory rules may also apply to U.S. operations.

An additional, less visible, layer of restrictions derives from bank examiners and the bank supervisory process more generally. Bank regulators are charged with ensuring the safety and soundness of the banks they regulate, or similar concepts under non-U.S. law. As a result, they monitor and direct *how* banks comply with regulatory law. Banks do not have the flexibility that other taxpayers do to take advantage of the full range of options permitted by generally applicable (non-regulatory) law. Banks must satisfy their bank supervisors/examiners

[33] 12 C.F.R. Part 249, 12 C.F.R. § 252.157.

that the manner in which they operate pursuant to regulations is safe and sound. For example, a bank regulator may direct that capital or liquidity required in the United States under a particular bank regulation be provided in the form of debt rather than equity. A bank regulator may expect, or require, that debt undertaken in order to ensure compliance with a particular regulatory rule be provided by a foreign parent or foreign affiliate. These constraints are hard to see from the outside, but they are very real.

A related point is that in the case of large multinational banks, bank examiners are resident on their premises. Unlike any other regulators that we are aware of, bank examiners can observe the day-to-day operations of the taxpayers that they regulate. They consequently have an intimate knowledge of the particular bank that they supervise. A bank examiner may observe that a particular risk – for example, the risk that the bank will not have enough capital or liquidity of a specified type – is quite volatile, and therefore expect that it will be managed primarily through funding that can be scaled up or down rapidly in response to that volatility. Conversely, the examiner may expect that the bank will use long-term funding for particular purposes, in order to provide stability but also allow for repayment under less onerous regulatory rules than apply when equity is repatriated. Under yet other circumstances, the bank examiner may consider that the risk is sufficiently systemic and long-term that it should be managed with equity capital.

A final point is that banks have large teams of people, and carry out extensive reporting, in order to ensure compliance with these bank regulatory rules and supervisory instructions, and to confirm to regulators and the investing public that they are doing so. In some cases, for example in the case of bank capital securities, banks must provide detailed reporting in their public securities law filings or on their websites as to the amounts of different types of capital securities and how those amounts compare to what is required by law.[34] In other cases, the reporting is confidential supervisory information provided only to the regulator. That reporting is provided on a regular basis and sometimes on a frequent basis. Many of these reports include information tracking how much intercompany debt of a particular kind the FBO has in place. The existence of this reporting demonstrates the deep interest that regulators and others have in the details of how banks comply with bank regulatory rules, often including monitoring either the required amount of, or the extent to which a bank, subsidiary or branch uses, intercompany debt.

Consequently, as a practical matter, although FBOs are not rigidly constrained to fund their U.S. operations in one and only one manner, they do not have the ability that other taxpayers do to structure their internal affairs in a manner that is most tax-efficient. Indeed, an FBO's tax department in the United States often hears about internal planning relating to funding late in the process, when key decisions have already been made, because the overriding

[34] For international disclosure standards, *see*, *e.g.*, Basel Committee, *Revised Pillar 3 Disclosure Requirements* (Jan. 2015), *Pillar 3 Disclosure Requirements—Consolidated and Enhanced Framework* (Mar. 2017), *Pillar 3 Disclosure Requirements—Updated Framework* (Dec. 2018). For corresponding U.S. disclosure requirements, see 12 C.F.R. § 217.61 - .63, § 217.171 - .173 (Federal Reserve), as well as the attached Appendix I.

imperative for an FBO is to comply with its regulatory obligations, and those decisions typically are made primarily by bank personnel in close touch with regulators inside and outside the United States.

We recognize that the goals of bank regulation and supervision are not the same as the tax policy goal of avoiding base erosion, and that the Treasury and IRS might be concerned that regulators require minimum amounts of specified types of debt, such as internal TLAC, but would have no objection to hypothetically infinite amounts of such debt. In fact, as explained above, this is very far from the case. Regulators are keenly aware of, and concerned about, how much debt a bank issues due to the potentially destabilizing consequences of issuing too much debt and over-leveraging the balance sheet. They also have preferences for whether debt is issued on an intercompany or third party basis.

In practice, regulatory debt also imposes significant economic costs on FBOs. For example, because of the bail-in features required by Fed rules as well the need to have arm's-length market terms for interaffiliate transactions, internal TLAC in the form of long-term debt has a coupon that is substantially higher than short-term senior intercompany debt. If an FBO were free to determine for itself how much internal TLAC in the form of long-term debt it needed as a prudent matter, in many cases the amount would be less than what is now required by law. Indeed, it is for that very reason, as well as an FBO's desire to tailor the amount and type of internal TLAC to what it believes best suits the institution, FBOs have attempted for years to persuade the Fed that there should be no specified minimum amount of internal TLAC in the form of long-term debt.

Other types of regulatory debt have similar characteristics – deeply subordinated, expensive debt – or impose other costs. In the case of the liquidity-related requirements described above, for example, an FBO is required to hold HQLA (high quality liquid assets) in specified amounts in order to ensure that it has adequate liquidity in times of stress.[35] If an FBO is required to fund HQLA through longer-term debt due to regulatory constraints or expectations, there is a significant negative spread (that is, interest expense costs exceed the return on the high quality assets) that the bank would not voluntarily incur except to the extent it believed that it was necessary in order to ensure adequate liquidity. Finally, we note that banks generally are organized in relatively high-tax jurisdictions. Stripping earnings out of the United States provides no global benefits to an FBO if it must pay tax at a similar or higher rate in the country where the earnings are received. Consequently, banks do not have the same opportunities that other taxpayers have to engage in earnings stripping.

[35] The relevant requirements are liquidity buffers applicable to U.S. branches, and the liquidity buffers and liquidity coverage ratio requirements for some U.S. bank subsidiaries and for U.S. IHCs. 12 C.F.R. Part 249, 12 C.F.R. § 252.157.

B. Recommendations with Respect to Internal TLAC

We have four specific recommendations with respect to the internal TLAC rule provided by the proposed regulations. Several of them are based on the assumption that the final regulations do not provide broader relief for regulatory debt (see Part III.C below). If such relief is provided, some of these specific recommendations could be unnecessary.

1. *Recommendation #1: Modify "specified minimum amount" limitation*

Under current Fed rules, the amount of internal TLAC that is required to be issued by a Covered IHC in the form of long-term debt ("eligible internal TLAC debt") is based on the greater of two independent variables: risk-weighted assets or total leverage exposure.[36] Risk-weighted assets is a reference to the consolidated assets of a Covered IHC, weighted to take into account how risky the asset is considered. The total leverage exposure is a non-risk-weighted measure of an IHC's outstanding leverage, the concept being that the more debt a Covered IHC has outstanding, the riskier its position may be.

The inputs into these variables change daily. Assets may go up or down. The amount of leverage may also change on a frequent basis. Thus, the amount of eligible internal TLAC debt that is needed may change on a daily basis. However, any increase in the amount of such debt may need to be approved by regulators, which is not a rapid process. Consequently, it would not be prudent for a Covered IHC to issue only the specified minimum amount as of any one measurement date, since it would risk falling below the minimum if assets or leverage increased. It would also not be prudent to reduce the amount of eligible internal TLAC debt in response to short-term dips in the amount required, since the FBO could not quickly issue additional eligible internal TLAC debt when the required amount rises in order to come back into compliance with the minimum requirement.

In practice, therefore, Covered IHCs effectively must issue more eligible internal TLAC debt than the minimum specified in the Fed's regulations. We understand that market practice is to operate with a buffer equal to 1 – 1.5 percent of risk-weighted assets, or in the case of the leverage ratio, with a buffer equal to 0.50 percent of total leverage exposure.[37]

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[36] 12 C.F.R. § 252.162(a). Large banking organizations must maintain Tier 1 capital equal to at least 3 percent of on-balance sheet assets plus certain off-balance sheet exposures (the "supplementary leverage ratio"). The "total leverage exposure" prong referred to in the text applies only if the IHC is required to maintain a minimum supplementary leverage ratio.

The minimum amount of eligible internal TLAC debt is based on the greater of (i) 6 percent of risk-weighted assets, (ii) if the IHC is required to maintain a minimum supplementary leverage ratio, 3.5 percent of total leverage exposure, and (iii) 3.5 percent of total consolidated assets. For some IHCs 3.5 percent of its total consolidated assets may exceed 6 percent of its risk-weighted assets.

[37] See Letter from the IIB to the Board of Governors of the Federal Reserve System, *Re: Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations; Regulatory Capital Deduction for Investments in Unsecured Debt of Systemically Important U.S.*

We request that the "specified minimum amount" of eligible internal TLAC debt that is eligible for relief from base erosion payment treatment be the greater of (i) the "specified minimum amount" plus a maintenance buffer of 1 percent of risk-weighted assets or 0.50 percent of total leverage exposure, as appropriate or the (ii) highest minimum amount required at any point during a taxable year or the prior year (the "high-water mark") (as revised, the "modified specified minimum amount"). This expanded definition of the "specified minimum amount" is appropriate because, as described above, Covered IHCs cannot readily scale up the amount of eligible internal TLAC debt and therefore cannot as a practical matter adjust the amount of eligible internal TLAC debt down unless they are confident that the reduction in the required amount will be sustained.

The modified specified minimum amount would replace the numerator in the scaling ratio in the proposed regulations.[38] As described in Recommendation 4 below, further modifications to the formula would be necessary in order to avoid the need to revisit the application of the scaling ratio in the event of changes to the Fed's rules.

2. *Recommendation #2: Include eligible internal TLAC debt issued in transition periods*

For Covered IHCs that were required to have eligible internal TLAC debt in place by January 1, 2019, the official transition period included the 2018 calendar year. For GSIBs that will in the future become subject to those rules, there is a three-year transition period.[39]

The amount of eligible internal TLAC debt that is required for a Covered IHC subject to those rules is in the billions of dollars for any particular Covered IHC. There is an extensive internal process for putting that eligible internal TLAC debt into place, taking into account the role that the eligible internal TLAC debt plays in the overall funding and resolution planning of the FBO on a group-wide basis – for example, the need to issue matching external TLAC from the top-tier company in the group – and the need to obtain approval from the Fed for the terms of the eligible internal TLAC debt. The transition period provided by the Fed is intended to permit an FBO to carry out this process in a deliberative and planned manner, and to allow the Covered IHC to issue the eligible internal TLAC debt and any related external TLAC over time. However, during the transition period, there is no minimum amount of eligible internal TLAC debt required.

Bank Holding Companies (February 19, 2016), *available at* https://c.ymcdn.com/sites/iib.site-ym.com/resource/resmgr/IIB_Comment_Letters/20160219IIB_TLACComments_fin.pdf. Page 31 contains a graph showing an assumed long-term debt maintenance buffer of 1% of risk-weighted assets.

38 See Appendix II for proposed regulatory language.

39 12 C.F.R. § 252.160. The "normal" transition period going-forward is three years. For IHCs subject to the January 1, 2019 implementation date, the effective transition period was shorter because while the Fed rules were effective in March 2017, the Fed did not approve the terms of Covered IHCs' eligible internal long-term debt until 2018. Consequently, FBOs did not put eligible internal long-term debt into place until 2018.

In their current form, the proposed regulations would grant no relief for interest on eligible internal TLAC debt paid in 2018, or for transition periods in the future. We request that the relief be extended (a) to 2018, and (b) to future transition periods, in a ratio equal to the number of transition years. That is, assuming a three-year transition period, relief should be granted for each phase-in year in an amount equal to 1/3 x the modified specified minimum amount, plus the amount for the prior year.

3. *Recommendation #3: Eligible internal TLAC debt held by ECI branch*

The proposed regulations provide a scaling ratio that limits the relief for eligible internal TLAC debt by reference to a fraction equal to the average TLAC minimum required amount over the average TLAC securities amount.[40] If the regulations are not revised to provide relief for the maintenance buffer, there is uncertainty about how the scaling ratio would apply if some eligible internal TLAC debt is held by an ECI branch and the rest is held by the home office or a non-ECI branch. Since eligible internal TLAC debt held by an ECI branch is treated as held by a U.S. person and therefore does not raise base erosion concerns, the specified minimum cap should apply only to eligible internal TLAC debt held by a person treated as a related foreign person.

> *Example*: Assume that the specified minimum amount of eligible internal TLAC debt for a Covered IHC is $900x. The Covered IHC has issued $1000x of eligible internal TLAC debt, of which $100x is the maintenance buffer. $150x of the eligible internal TLAC debt is held by a Cayman branch of the FBO, which is treated for U.S. federal income tax purposes as if it were a U.S. branch.[41] The remaining $850x eligible internal TLAC debt is held by the home office of the FBO.
>
> The scaling ratio in this case is $900x/$1000x, or 90 percent. Consequently, relief is provided only for 90 percent of the interest paid on the $850x of eligible internal TLAC debt held by the home office. If the Covered IHC had issued exactly $900x of eligible internal TLAC debt to the home office and Cayman branch, the relief would apply to all of the interest paid on the $850x eligible internal TLAC debt held by the home office. We do not believe that the fact that additional eligible internal TLAC debt was issued to a deemed U.S. person should reduce the relief available on the $850x eligible internal TLAC debt held by the home office.[42]

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40 Proposed Treasury regulation section 1.59A-3(b)(3)(v).

41 Cayman branches of FBOs are frequently treated as having effectively connected income, because they are managed by U.S.-based personnel.

42 We note in this regard that if the Covered IHC were permitted to and did issue $150x of eligible internal TLAC debt to an unrelated party, and the facts were otherwise the same, none of the interest on the $900x of eligible internal TLAC debt would be treated as a base erosion payment. That is, the scaling ratio would hypothetically be $1000x average TLAC long-term debt required amount/$900x average TLAC securities, but since the scaling ratio

We recommend that the regulations be revised to state that relief is provided for eligible internal TLAC debt held by a related foreign person up to the specified minimum amount.[43]

4. *Recommendation #4: Revise the scaling ratio to take potential changes to Fed rules for internal TLAC into account*

As described above, under the international standards adopted by the FSB, there are certain minimum requirements for external and internal TLAC. The rules adopted by the Fed go beyond those internationally agreed standards in a number of respects. The Fed may be considering changes to its rules that would bring them closer to the internationally agreed standards.

Under current Fed rules, there are several separate requirements that must be satisfied. First, Covered IHCs must issue a specified minimum amount of total TLAC. This first requirement takes into account aggregate TLAC in all forms, including common equity Tier 1 ("CET1"), additional Tier 1 capital (noncumulative perpetual preferred stock) and long-term debt instruments that satisfy the TLAC requirements. The minimum amount of aggregate internal TLAC is equal to 90 percent of the external TLAC that a U.S. bank holding company subject to TLAC rules is required to issue.[44] This is at the high end of the FSB recommendations for internal TLAC, which are 75-90 percent of external TLAC, and higher than the base rules of other countries like the United Kingdom.

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cannot be greater than 1, it would be 1. Our recommendation with respect to eligible internal TLAC debt held by an ECI branch would treat FBOs in the same manner regardless of whether some portion of a Covered IHC's eligible internal TLAC debt was held by a U.S. branch or by a third party, which is appropriate since neither of those raise base erosion concerns.

[43] Another rule in the proposed regulations that involves coordination with another provision of the Code is proposed Treasury regulation section 1.59A-3(c)(4), relating to the application of section 163(j) to base erosion payments. That rule generally provides that business interest expense must be classified as "foreign related business interest expense," domestic related business interest expense and unrelated business interest expense, and provides ordering rules to determine how much of each is used in a particular year in which section 163(j) applies and how much is carried forward. The proposed regulations do not specifically address how the three subcategories of foreign related business interest expense should be treated for this purpose, meaning (i) interest expense that is not treated as a base erosion payment, in whole or part, because it is subject to withholding tax, (ii) interest expense that is not treated as a base erosion payment because it is paid on internal TLAC, and (iii) other interest expense. It would be consistent with the general approach of the regulations to treat foreign related business interest expense that is carried forward as comprising pro rata amounts of each relevant category, but the regulations leave open the possibility that some other allocation would be required. We request clarification on this point.

[44] 12 C.F.R. § 252.165(c). The minimum amount of aggregate TLAC is based on the greater of (i) 16 percent of risk-weighted assets, (ii) if the Covered IHC is required to maintain a minimum supplementary leverage ratio, 6.75 percent of total leverage exposure, and (iii) 9 percent of total consolidated assets. 12 C.F.R. § 252.165(a). There is also a required "covered IHC TLAC buffer," which must be common equity. 12 C.F.R. § 252.165(d). (This buffer is different from the buffers previously discussed). Since the Covered IHC TLAC buffer must always be equity, it should not be relevant for purposes of any scaling ratios. The discussion in this section describes the rules for "non-resolution" IHCs, which is most of the relevant IHCs. The rules for resolution IHCs are generally similar although the details differ.

In addition, the Fed rules have a second requirement that is not part of the internationally agreed standards. That is the requirement for a minimum amount of the aggregate internal TLAC to be in the form of long-term debt.[45] This is the rule cross-referenced in the proposed regulations' definition of "TLAC long-term debt required amount."[46]

The IIB and its members, and other trade associations, have long urged the Fed to bring these rules into closer harmony with the FSB rules, by eliminating the separate requirement for a minimum amount of long-term debt, reducing the aggregate TLAC minimum to 75 percent of external TLAC, and allowing all debt that qualifies as Tier 2 regulatory capital to be treated as TLAC.[47] The Fed has indicated it may be considering possible changes to its rules.[48] If the Fed determines to remove the minimum requirement for TLAC in the form of long-term debt, the relief currently provided by the proposed BEAT regulations will cease to exist.

However, Covered IHCs will still be required to have a minimum aggregate amount of internal TLAC, which may consist of equity, long-term debt and possibly debt that constitutes regulatory capital. Moreover, under the regulatory capital rules described in Part III.A.2 above (which take a Covered IHC's leverage – that is, debt – into account), a Covered IHC must have a minimum amount of equity. Further, as explained above CCAR imposes on FBOs capital requirements well above the regulatory minimum requirements, which is to say that the actual minimum equity required of a Covered IHC is well above the amount of equity nominally required by the regulatory capital rules.

If the Fed were to eliminate the minimum requirement for TLAC in the form of long-term debt, the regulatory capital rules will still apply. Unlike unregulated U.S. taxpayers, therefore, Covered IHCs will still be required to have substantial equity.

That equity will count towards the total TLAC requirement. The Fed is likely to expect that a significant portion of the remaining total TLAC that is required will be in the form of long-term debt, or possibly other debt (Tier 2 debt) that qualifies as regulatory capital. That is because TLAC in the form of long-term debt can be written off or converted into equity after the equity components of TLAC and other regulatory capital are wiped out – which as described in Part III.A.1 above is a critical component of global, and U.S., bank regulatory rules relating to

45 12 C.F.R. § 252.162(a).

46 Proposed Treasury regulation section 1.59A-1(b)(18).

47 See note 37, *supra*, for our February 2016 comment letter. Our comment letter of July 1, 2016 on *Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations; Regulatory Capital Deduction for Investments in Unsecured Debt of Systemically Important U.S. Bank Holding Companies available at https://www.sifma.org/wp-content/uploads/2017/05/sifma-and-other-associations-submitted-comments-to-the-federal-reserve-system-on-the-internal-tlac-proposal-for-ihcs.pdf.*

48 *See* Vice Chairman for Supervision Randal K. Quarles, *Trust Everyone--But Brand Your Cattle: Finding the Right Balance in Cross-Border Resolution* (May 16, 2018), *available at* https://www.federalreserve.gov/newsevents/speech/quarles20180516a.htm (stating that the Fed is considering whether to reduce the amount of required aggregate internal TLAC or to streamline the Fed's resolution loss-absorbing capacity regime).

the resolution of a failing bank.[49] Consequently, even if the Fed were to eliminate the minimum requirement for TLAC in the form of long-term debt, Covered IHCs would still be expected for regulatory purposes to issue a large amount of eligible internal TLAC debt.

If the proposed BEAT regulations are revised to adopt broader relief for regulatory debt of the kind set forth in Part III.C and Part III.D below, that relief should be sufficient to address this possibility. If final BEAT regulations do not include such broader relief, then we request that relief be provided by adjusting the scaling ratio so that it refers to the aggregate amount of TLAC required. The basic concept is that the scaling ratio would be determined by reference to the minimum amount of total TLAC required over the total TLAC issued.[50]

Under this approach, if a taxpayer issued more TLAC than the minimum required (as specially defined for this purpose), a pro rata portion of its total interest expense deductions on TLAC-qualifying debt would not be eligible for the special rule treating interest on TLAC-qualifying debt as a payment that is not a base erosion payment. That is, the "excess" TLAC would be treated as consisting of TLAC-qualifying debt and TLAC-qualifying equity in the same proportion that the taxpayer had issued such debt and equity.

By way of illustration, see the examples below. The examples assume that the aggregate TLAC required (including a maintenance buffer) is 1000; that the Covered IHC issues a total of 1200 TLAC with the equity/debt composition described below;[51] and that there is no longer any minimum amount of eligible internal TLAC debt required.

<table>
<tr><td></td><td>Example 1:
600 TLAC equity
600 TLAC debt</td><td>Example 2:
700 TLAC equity
500 TLAC debt</td><td>Example 3:
800 TLAC equity
400 TLAC debt</td></tr>
<tr><td>Total TLAC scaling ratio</td><td colspan="3">In each case, 1000/1200 of interest on the debt would be excluded from treatment as a base erosion payment</td></tr>
</table>

Finally, since it is not possible to know at this point what changes, if any, the Fed may make to its internal TLAC rules, we urge that the proposed regulations provide that the greater of the long-term debt scaling ratio described in Recommendation #1 or the total TLAC scaling ratio described above apply to determine how much interest on internal TLAC debt securities is excluded from treatment as a base erosion payment. This would "future proof" the

49 It is for that very reason that the FSB Principles recommend that at least one-third of total TLAC be in the form of long-term debt.

50 See Appendix II for proposed regulatory language.

51 The examples ignore the Covered IHC TLAC buffer required by 12 C.F.R. § 252.165(d). As described in note 44, *supra*, this is common equity required to be issued in addition to the normal TLAC requirement. Since the buffer must always consist of common equity, we have not included it in the formula.

proposed regulations to take into account various possibilities, including that the Fed would expand the types of debt that can qualify for internal TLAC; that it would reduce or eliminate the minimum requirement for eligible internal TLAC securities; or that it would adjust the total TLAC amount required.

C. Recommendations with Respect to Other Regulatory Debt of U.S. Subsidiaries and Branches of FBOs

As described above, FBOs are subject to an array of U.S. regulatory rules that drive the amount and terms of much of their intercompany funding. They are also subject to foreign regulatory rules with a similar effect.

We respectfully urge that final regulations provide relief for intercompany debt that is structured and issued in order to comply with regulatory requirements, on the ground that such debt should not be viewed as debt that erodes the U.S. tax base. We understand that Treasury and the IRS may be concerned that U.S. subsidiaries or branches of FBOs may voluntarily issue more related party debt than is necessary for regulatory purposes. We also understand that Treasury and the IRS may be concerned that relief for regulatory debt other than internal TLAC might be interpreted to apply to all intercompany debt of an FBO. While we believe that the regulatory rules described above impose sufficient limitations on the ability of an FBO and its subsidiaries (banks and IHCs) to issue debt, and provide sufficiently compelling non-tax reasons why debt incurred by U.S. subsidiaries and branches should be internal debt in many cases, our recommendation has been crafted in order to address those concerns.

We recommend that interest on related party debt incurred due to regulatory (including supervisory) requirements not be treated as a base erosion payment provided that:

(i) there are requirements or constraints imposed by regulators on the amount, maturity or other terms of intercompany debt,

(ii) the bank follows a defined internal process in order to comply with those requirements, and

(iii) the regulator monitors compliance and the bank regularly provides either public reporting or routine reporting or disclosure to the regulator demonstrating the amount of debt issued to the foreign affiliate that is allocated to satisfy the regulatory requirements, including the maintenance buffer in the case of internal TLAC.

Because many of these reports are confidential supervisory information, and regulatory reports in any event are not formulated with a view to tax compliance obligations, FBOs could be required to provide a statement attached to their return identifying the amount of such debt, and tying it to the relevant regulatory requirements.

We would be pleased to provide further information on the regulatory rules described above, if that would be helpful to you. We can also discuss further the reasons why we do not believe that providing relief for intercompany debt under the terms described above opens the door to unwarranted tax planning.

D. Recommendations Relating to Foreign-to-Foreign Regulatory Debt

The description of the regulatory debt obligations imposed on FBOs in Part III.A above makes clear, we hope, that FBOs are subject to overlapping obligations in their home and host countries; that although the laws imposing those obligations are based on the same international principles, they can be quite different in the details of how they are implemented, or the timing of implementation; and that foreign regulatory rules have a direct effect on how the U.S. operations of FBOs are funded.

This part of our comment letter addresses a different aspect of FBO funding. Because the proposed regulations' provisions relating to excess interest require that excess interest be treated as a base erosion payment by reference to the bank's worldwide liabilities, the application of the proposed regulations to an FBO's liabilities outside the United States will affect how much excess interest is treated as a base erosion payment.

We recommend that the same principles that apply to intercompany debt incurred by the U.S. operations of an FBO apply to intercompany debt incurred at the foreign bank level. That is, interest on foreign-to-foreign internal TLAC and other regulatory debt should not be treated as a base erosion payment to the same extent as would be the case if that debt were issued by a U.S. subsidiary or branch.

As an illustration of the commonality of interest between U.S. and non-U.S. regulators, one illuminating document may be a statement of policy issued last year by the Bank of England, relating to U.K. TLAC (referred to in the U.K. as "MREL") rules.[52] The Statement of Policy makes clear that the Bank of England will determine the amount of external and internal MREL that a U.K.-headquartered bank is required to have; that the Bank of England will take into account the need to ensure that an FBO has sufficient "eligible liabilities" (that is, debt instruments satisfying MREL requirements) to ensure that bailing in the FBO's MREL securities would result in the absorption of losses and the recapitalization of the bank; and more generally that the Bank of England will exercise its authority not merely in order to carry out applicable U.K. law but also to implement the policy that it believes appropriate. Thus, any bank subject to the U.K. MREL rules will be subject to close scrutiny by the Bank of England, including with respect to the amount of internal TLAC issued by its material subsidiaries.

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[52] The Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL), Statement of Policy (June 2018), *available at https://www.bankofengland.co.uk/-/media/boe/files/paper/2018/statement-of-policy-boes-approach-to-setting-mrel-2018.pdf?*

We note in this regard that home country regulators may impose internal TLAC requirements even in the absence of U.S. requirements. While the U.S. internal TLAC rules apply only to the IHCs of GSIBs, home country rules might apply to material foreign subsidiaries, as is the case for the approach taken by the Bank of England. Similarly, internal funding may be required in order to satisfy home country expectations about the ability of the FBO group to be resolved on a group-wide basis under a SPOE approach. This point is similar to the one made above with respect to the application of the LCR and NSFR at a group level, and the knock-on effects that home country rules have on how U.S. operations are funded. That is, the amount and terms of intercompany funding by U.S. subsidiaries and branches may be the result of foreign regulatory rules rather than, or in addition to, U.S. rules.

In light of the commonality of interests among U.S. and non-U.S. regulators, the similarity in the concepts underlying the applicable rules in each jurisdiction, the differences in the implementation of the applicable rules in each jurisdiction, and the evident lack of any intent to erode the U.S. tax base when a foreign bank borrows from a foreign affiliate in order to comply with a foreign regulatory obligation, we believe that our recommendation to give parity to U.S.-to-foreign regulatory debt and foreign-to-foreign regulatory debt is merited. We would be pleased to discuss these issues further with you if doing so would be helpful to you.

IV. FOREIGN EXCHANGE LOSSES

Another significant concern by FBOs about the proposed BEAT regulations are the proposed rules dealing with foreign currency losses, and in particular the exclusion of foreign exchange losses from transactions with third parties from the denominator of the base erosion percentage.

One of the core roles of FBOs is to provide the U.S. market with access to non-U.S. risks and opportunities. FBOs therefore are natural entities to act as dealers in foreign currency, foreign currency-denominated derivatives and foreign currency-denominated bonds for U.S. customers. For some FBOs this is a significant part of their U.S. business activities. The unexpected exclusion in the proposed regulations of all foreign exchange losses from the denominator of the base erosion percentage consequently has a significant effect on those FBOs.

The proposed rules also impose a significant administrative burden on FBOs acting as dealers in foreign currency-denominated bonds. Taxpayers subject to a mark-to-market method of accounting do not keep track of the foreign currency portion of the gain or loss on a particular foreign-currency denominated bond because all gain or loss is treated as ordinary. Because the proposed regulations exclude foreign exchange losses from the denominator of the base erosion percentage, taxpayers would be required to implement an entirely new method of tracking foreign currency losses.

We do not believe that any policy of the BEAT requires that foreign exchange losses be treated in this manner. On the contrary, at least with respect to foreign currency-denominated derivatives, Congress clearly (in our view) intended such instruments to be treated as "derivatives" and therefore to be subject to the rules relating to "qualified derivative payments."[53] More generally, losses incurred in transactions with third parties, such as sales of foreign currency or foreign currency-denominated bonds or payments on foreign currency derivatives, do not raise the base erosion concerns that the BEAT is intended to address.

We recommend that foreign exchange losses be excluded from the denominator only if they are excluded from the numerator of the base erosion percentage. That is, only foreign exchange losses arising from transactions with related foreign persons should be excluded from the denominator. This is consistent with how other exclusions from the numerator are treated.[54]

V. NET OPERATING LOSSES

The IIB appreciates the rules in the proposed BEAT regulations that use the "vintage" approach to determining the base erosion percentage of a net operating loss ("NOL") and treat pre-enactment NOLs as having a zero base erosion percentage.[55]

A number of IIB members have large pre-enactment NOLs as a result of losses incurred during the financial crisis. The rule of the proposed regulations that precludes NOL carryforwards from reducing a taxpayer's taxable income to less than zero gives rise to highly adverse consequences for those taxpayers.[56] The result is that pre-enactment NOLs have the perverse effect of increasing the amount of modified taxable income as regular taxable income approaches zero, thus making it more likely that BEAT tax will be paid regardless of whether the amount of the taxpayer's base erosion payments has changed. This would be true even if NOL

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[53] Section 59A(h)(4)(A) defines a "derivative" in part as any contract, including any option, forward contract, futures contract, short position, swap, or similar contract, the value of which, or any payment with respect to which is determined by reference to any currency.

[54] We would also support an alternative approach, under which dealers (as defined in section 475(c), but also including dealers in foreign currency) would not be subject to the requirement to exclude third party foreign exchanges losses from the denominator.

[55] The proposed regulations do not provide any detail on how the "vintage" approach to determining the base erosion percentage of an NOL carryforward is determined. We believe that further clarification is warranted. Assume, for example, that a taxpayer has $1000 of allowable deductions for Year 1, of which $250 are base erosion payments. If Year 1 gives rise to a $200 NOL, it is necessary to know both for Year 1 and for subsequent years how much of the $800 of deductions used in Year 1 constitute base erosion tax benefits. A logical approach would be to allocate those deductions pro rata between the $750 of non-base erosion payments and the $250 of base erosion payments. In that case, $600 of Year 1 deductions would not be base erosion payments and $200 would be base erosion payments and therefore base erosion tax benefits; the $200 NOL carryforward would have a base erosion percentage of 25 percent; and consequently when utilized, 25 percent of any portion of the NOL added back to modified taxable income in a future year would consist of base erosion payments.

However, other allocations are possible. If in Year 1 the $800 of allowed deductions were treated as first (or last) consisting of the base erosion payments, then the base erosion percentage of the NOL carryforward should not be 25 percent but instead should reflect the portion of the $250 of base erosion payments that has not yet been deducted. Even if a pro rata allocation is otherwise applicable, this issue will arise in respect of related party interest expense, since under section 59A(c)(3) interest paid to related parties is treated as deducted before interest paid to unrelated parties.

[56] Proposed Treasury regulation section 1.59A-4(b)(1).

carryforwards could give rise to negative taxable income for this purpose, but the effect would be mitigated by the fact that the starting point for determining modified taxable income would be negative if the NOL carryforward were large enough.

We believe that this result is contrary both to the statute and to BEAT policy:

- Section 59A(c)(1)(B) clearly provides that NOL carryforwards are taken into account in calculating modified taxable income. Limiting NOL carryforward utilization to the amount of regular taxable income imposes a cap on how much of the NOL is used to reduce modified taxable income that is not in the statute.

- When section 59A places a floor on the utilization of a beneficial tax item it does so expressly (*e.g.*, section 59A(b)(1)(B) regular tax liability is "reduced (but not below zero)" by credits.) There is no similar language with respect to NOLs.

- For pre-enactment NOLs, section 172(a) permits a deduction for the full amount of an NOL carryforward. The proposed regulations effectively reduce the extent to which an NOL carryforward can actually be used, because decreasing regular taxable income increases modified taxable income by the same amount. Nothing in section 59A suggests that taxpayers should be unable to use the NOL carryforwards granted by section 172.

- The proposed regulations permit current year losses to give rise to negative taxable income. As a matter of statutory interpretation, we do not understand how one class of losses can give rise to negative taxable income when another class of losses does not.

The IIB appreciates the administrability and authority issues expressed in the Preamble to the proposed regulations but urges Treasury to reconsider its approach. If Treasury is willing to do so, a subset of IIB members would welcome the opportunity to provide further thoughts on these issues in light of the disproportionate impact these rules have on certain taxpayers.

VI. OTHER ISSUES

A. Repos and Securities Loans

FBOs are active participants in the sale-repurchase and securities lending market. IIB shares the views expressed in the letter submitted by the Securities Industry and Financial Markets Association ("SIFMA") about the importance of that market to the U.S. financial system, and to financial institutions that borrow and lend securities in that market.

The IIB shares the views expressed by the comment letter submitted by SIFMA on the exclusion of securities loans from the definition of the term "derivative," and strongly urges that the recommendations in the SIFMA letter be adopted.

B. Global Dealing Allocations

Under section 59A, there is a stark difference in treatment between a "payment or accrual" to a foreign related person as compared to a transfer to a foreign related person of income belonging to that foreign related person. We recognize that the proposed regulations generally decline to address issues of common law.

In the case of global dealing, however, there are long-standing proposed regulations that taxpayers have long relied upon as a basis for determining not only the amount of income that related parties derive but also the source of that income.[57] The proposed sourcing rule provides that income that is allocated to, or away from, a U.S. participant in a global dealing operation is treated as, respectively, U.S. source income or non-U.S. source income.[58] The sourcing rule is of particular significance since income from derivatives is sourced to the residence of the recipient of the income, and the global dealing sourcing regulation follows that paradigm. As we read those regulations, therefore, they treat income allocated under a profit split methodology permitted by the global dealing regulations as owned by the participant to whom it is allocated, and not merely paid by the booking entity to that participant.

In light of the significance of this point, and the fact that the issue raised is the interaction between two sets of regulations – the global dealing regulations and the section 59A regulations – we request clarification that the global dealing regulations effect a determination of tax ownership of income, for income subject to the sourcing rule of the global dealing regulations, and as such are not payments with respect to the BEAT.

C. Gross Receipts Determination

Proposed regulation section 1.59A-1(b)(13) provides that the term "gross receipts" has the meaning provided in Temporary Treasury regulation section 1.448-1T(f)(2)(iv). That regulation provides that gross receipts are reduced by a taxpayer's basis in the case of sales of capital assets but not in the case of sales of inventory and property described in other subsections of section 1221 or for the cost of goods sold. It appears that the intent of the latter provision was to ensure that the definition of gross receipts did not override the method of accounting rules that normally apply to inventory.

This definition could give rise to unexpected results for BEAT purposes, and ones that we think would be contrary to the intent of Congress that section 59A apply only to taxpayers with substantial gross receipts. In the case of a bank that treats a loan that it originated

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57 See Proposed Treasury regulation section 1.482-8 (providing rules for the *allocation* of income earned in a global securities dealing operation); proposed Treasury regulation section 1.863-3(h).

58 *See* Proposed Treasury regulation section 1.863-3(h)(2), Proposed Treasury regulation section 1.863-3((h)(3)(v), Example (3)(v) ("Under § 1.863-3(h), the amounts allocated under the residual profit split is sourced according to the residence of each participant to which it is allocated"). This rule does not apply to income specifically sourced under sections 861, 862 or 865, or to substitute payments, but it applies to the profits from the global dealing operation, for example from derivatives transactions.

or acquired as property described in section 1221(a)(4),[59] the section 448 regulation would treat the gross amount received on sale (if any) as gross receipts. By contrast, the amount paid when a loan is repaid is not treated as gross receipts. That creates an artificial distinction between amounts received on repayment vs amounts received on sale of a loan for BEAT purposes. The use of the section 448 regulations' definition of gross receipts could substantially increase the number of banks that are potentially subject to the BEAT should they sell a loan rather than hold it to maturity.

A similar issue arises for stocks and bonds held in inventory by a bank or broker-dealer. Notwithstanding how inventory accounting may otherwise apply, we do not believe that Congress intended that the gross proceeds from the ordinary course sale of a stock or bond were intended to be treated as gross receipts for BEAT purposes.

By way of example, assume that an FBO holds two bonds in inventory. It sells bond A to a third party for $105, for a $5 gain, and bond B to another third party for $98, for a $2 loss. For BEAT purposes, gross receipts in that fact pattern should be $5, not $203. Similarly, the FBO should be entitled to treat the $2 loss as a deduction in the denominator of the base erosion percentage.

Section 59A does not require that the definition of gross receipts be derived from section 448. While Congress evidently considered the concepts expressed in section 448 to be relevant, in light of a number of cross-references to it in section 59A(e)(2), we believe that Treasury is authorized to, and should, provide a BEAT-appropriate definition of gross receipts and clarify how losses from sale of inventory and other listed section 1221(a) assets are treated by addressing the points raised above.

D. Section 15

We recommend that Treasury revise proposed regulation section 1.59A-5(c)(1)(ii) and (3) to provide that a fiscal year taxpayer is subject to a 5 percent tax rate under the BEAT for the entirety of its fiscal year beginning in calendar year 2018, consistent with the statute and its legislative history.

Section 15 provides a formula for calculating a rate of tax when a change in the tax rate occurs during the taxpayer's taxable year. In general, the rate is a weighted average rate based on the portions of the taxpayer's taxable year falling before and after the effective date of the change in rate. More technically, section 15 applies if any rate of tax changes, and the taxable year includes the "effective date of the change" (other than the first day of a taxable year). The term "effective date of the change" is defined in section 15(c) for rate changes in taxable years "beginning after," "ending after," or "beginning on or after" a specified date.

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[59] *Burbank Liquidating Corp.*, 39 T.C. 999 (1963).

Those phrases appear in quotes in section 15(c) and are typically used when a tax rate is changed. Section 59A itself uses one of those formulations for a change of tax rate in section 59A(b)(2): "In the case of any taxable year beginning after December 31, 2025 …."

Section 59A(b)(1)(A) uses a different formulation. It provides that the rate of tax under the BEAT is "10 percent (5 percent in the case of taxable years beginning in calendar year 2018)." Thus, section 59A(b)(1)(A) does not use the terminology that section 15 is designed to apply to.

A logical reading of the phrase "taxable years beginning in calendar year 2018" is that the 5 percent rate applies to the entirety of any taxable year beginning in 2018, regardless of the day on which that taxable year begins. This phrase necessarily contemplates taxable years that begin on days other than January 1, 2018 and treats them equally. Under this reading, a taxpayer with (say) a November 30 fiscal year would be subject to the 5 percent rate for its first taxable year to which the BEAT applies (December 1, 2018 – November 30, 2019) and then to the 10 percent rate. Like a calendar year taxpayer, therefore, the taxpayer would benefit from the 5 percent rate for one taxable year.

The proposed regulations take a different approach. Proposed regulation section 1.59A-5(c)(1) and (c)(3) provide that the applicable tax rate is 5 percent for taxable years beginning in calendar year 2018, but that section 15 applies to fiscal year taxpayers. That is, a fiscal year taxpayer is subject to the BEAT at a blended rate for its first taxable year beginning in 2018. This approach treats section 59A(b)(1)(A) as if it used the conventional language referred to in section 15(c). But it does not.

The unusual language in section 59A(b)(1)(A) is particularly notable with respect to the 10 percent rate. Nothing in section 59A(b)(1)(A) directly addresses the question of when the 10 percent rate kicks in. There is no stated "effective date of the change" for the 10 percent rate. Instead section 59A merely allows the 5 percent rate to lapse at the end of the taxpayer's taxable year beginning in 2018.

Thus, section 59A in one place uses conventional "effective date of the change" language and in other places, notably section 59A(b)(1)(A), uses non-standard language. The most logical interpretation of this difference is that Congress intended to treat the two circumstances differently. Had Congress intended to effect a change in rate under section 15, it logically would have used the language in proposed regulation section 1.59A-5(c)(1)(ii) but it did not.

If Treasury believes there is any ambiguity in the statute, we believe it is clarified by a sentence in the Conference Report: "[the] 5 percent rate applies *for one year* for base erosion payments paid or accrued in taxable years beginning after December 31, 2017."[60] The

[60] H.R. Conf. Rep. No. 466, 115th Cong. 1st Sess. 656 n.1547, *Tax Cuts and Jobs Act, Conference Report to Accompany H.R. 1* (Dec. 15, 2017) (emphasis added).

latter part of this sentence, starting with "base erosion payments," is simply a restatement of the effective date of section 59A.[61] Consequently, the significant part of the sentence in the Conference Report is the statement that the 5 percent rate applies for one year. That language simply cannot be reconciled with treating a fiscal year taxpayer as subject to a blended tax rate, as in that case the taxpayer benefits from the 5 percent rate for only part of a taxable year.

We believe that by virtue of the statutory language of the parenthetical in section 59A(b)(1)(A) referring to taxable years "beginning *in calendar year 2018*" Congress provided for the application of a 5 percent rate under BEAT for one year, regardless of the date on which a taxpayer's taxable year begins. We further believe that Congress intended this result by virtue of the cited language from the Conference Report and by the fact that Congress used a different formulation that clearly invoked section 15 with respect to the application of the 12.5 percent rate. For these reasons, we respectfully request that Treasury revise proposed section 1.59A-5(c)(1)(ii) to say simply "For taxable years beginning in calendar year 2019 through taxable years beginning before January 1, 2026, 10 percent."[62] Consistent with the foregoing, proposed regulation section 1.59A-5(c)(3) should also be revised to indicate that section 15 does not apply to taxable years *beginning in* calendar year 2018. The final sentence of that section could be deleted as it is unnecessary.

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We appreciate your consideration of our comments. Please contact me, if I can provide any additional information.

Sincerely,

Briget Polichene

Briget Polichene
Chief Executive Officer

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61 The effective date provision for section 59A reads as follows: "The amendments made by this section shall apply to base erosion payments … paid or accrued in taxable years beginning after December 31, 2017." Pub. L. No. 115-97, Section 14401(e).

62 We note in this regard that the initial references to calendar years in the form of headings in each of proposed Treasury regulation section 1.59A-5(c)(1)(i)-(iii) are also unnecessary and should be deleted.

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Appendix I
Summary of Reporting Requirements

U.S. INTERMEDIATE HOLDING COMPANIES ("IHCS"), BRANCHES AND BROKER-DEALER SUBSIDIARIES OF FOREIGN BANKS

FORM	AUTHORITY	TITLE	RELEVANT COVERED ENTITIES	RELEVANT REQUIREMENTS	PUBLIC AVAILABILITY
FR Y-7N/ FR Y-7NS	12 U.S.C. §§ 601-604(a), 611-631, 1844(c), 3106 and 3108; 12 C.F.R. § 225.5(b) (Regulation Y) .	Financial Statements of U.S. Nonbank Subsidiaries Held by Foreign Banking Organizations	Material U.S. non-bank subsidiaries, other than subsidiaries "functionally regulated" by the SEC, CFTC, etc.; filing at different frequencies/requirements depending upon size of U.S. subsidiary	• Report **interest expense pertaining to related organizations** (Schedule IS, item 2.b) • Report **non-interest expense pertaining to related organizations** (Schedule IS, item 7.b) • Balances **due to related institutions** (Schedule BS, item 16) • Report **balances due to related institutions** (both in and outside United States) (Schedule BS-M, item 7)	Publicly available
FR Y-9C	12 U.S.C. §§ 1467a(b), 1844(c), 1850a(c)(1) and 5365; 12 C.F.R. § 252.153(b)(2	Consolidated Financial Statements for Holding Companies	IHCs	• Report **liabilities**, including other borrowed money, subordinated notes and debentures (Schedule HC, items 16 and 19) • With regard to broker-dealers engaged in underwriting/dealing	Publicly available; aggregate data published

FORM	**AUTHORITY**	**TITLE**	**RELEVANT COVERED ENTITIES**	**RELEVANT REQUIREMENTS**	**PUBLIC AVAILABILITY**
	) (Regulation YY).			under Section 4(k)(4)(E) of the Bank Holding Company Act, report **balances due to related institutions** (intercompany liabilities, including amounts due to parent company) (Schedule HC-M, item 20(c)) • **Off-balance sheet liabilities** reported only with non-related institutions (see Schedule HC-L) • Report **regulatory capital ratios** (Schedule HC-R)	
FR Y-9LP	12 U.S.C. §§ 1467a(b), 1844(c), 1850a(c)(1) and 5365; 12 C.F.R. § 252.153(b)(2) (Regulation YY).	Parent Company Only Financial Statements for Large Holding Companies	IHCs	• Generally report information on balance sheet, and supporting schedules • Report **balances due to related institutions** (Schedule PC, item 18)	Publicly available
FR Y-11/FR Y-11S	12 U.S.C. §§ 1467a(b), 1844(c), 1850a(c)(1) and 5365; 12	Financial Statements of U.S. Nonbank Subsidiaries of	IHCs (for each of its nonbank subsidiaries subject to the reporting requirement, including any Section 4(k)(4)	• Report **all balances due to related institutions** (Schedule BS, item 16; Schedule BS-M, item 13) (see p. 5, 7)	Publicly available (with certain exceptions)

FORM	AUTHORITY	TITLE	RELEVANT COVERED ENTITIES	RELEVANT REQUIREMENTS	PUBLIC AVAILABILITY
	C.F.R. § 252.153(b)(2) (Regulation YY).	U.S. Holding Companies	subsidiaries, other than subsidiaries "functionally regulated" by the SEC, CFTC, etc.)		
FR Y-15	12 U.S.C. §§ 1467a, 1844, 3106 and 3108; 12 C.F.R. §§ 225.5(b) (Regulation Y), 238.4(b) (Regulation L L) and 252.153(b)(2) (Regulation YY).	Banking Organization Systemic Risk Report	IHCs	• Report any **foreign liabilities to related offices** (Schedule E)	Publicly available, except Schedule G, items 1-4 (Short-Term Wholesale Funding)
FFIEC 002	12 U.S.C. §§ 1817(a), 3102(b) and 3105(c)(2).	Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks	U.S. branches and agencies of foreign banks	• Report **net due to related depository institutions** (Schedule RAL, item 5; Schedule M (confidential))	Publicly available, except Schedule M (Due from/Due to Related Institutions in the U.S. and in Foreign Countries)
FFIEC 102	12 U.S.C. §§ 161, 324, 1464,	Market Risk Regulatory Report for	IHCs	• Report information related to calculation of regulatory capital	Publicly available

FORM	AUTHORITY	TITLE	RELEVANT COVERED ENTITIES	RELEVANT REQUIREMENTS	PUBLIC AVAILABILITY
	1467a(b), 1817, 1844(c) and 5365.	Institutions Subject to the Market Risk Capital Rule		requirements under Market Risk Capital Rule	
FFIEC 101	12 U.S.C. §§ 161, 324, 1817 and 1844(c).	Regulatory Capital Reporting for Institutions Subject to the Advanced Capital Adequacy Framework	IHCs that used advanced approaches risk-based capital calculations	• Report regulatory capital components	Schedule A is publicly available (regulatory capital information); Schedule B will generally be publicly available (risk-weighted assets information); other items are confidential
FR 2052a	12 C.F.R. Part 50 (OCC); 12 C.F.R. Part 249 (FRB); 12 C.F.R. Part 329 (FDIC) (Liquidity Coverage Ratio Rule).	Complex Institution Liquidity Monitoring Report	Foreign banking organizations with U.S. assets of $50 billion or more (separate reports required for each <u>material entity</u> of the FBO, including non-U.S. material entities managed from inside the United States; material entities include any entities subject to the Liquidity Coverage Ratio rule)	• Report **undrawn committed facilities** purchased (see p. 29 of the instructions) • Report **other cash inflows** (see p. 30 of the instructions)	Confidential

FORM	AUTHORITY	TITLE	RELEVANT COVERED ENTITIES	RELEVANT REQUIREMENTS	PUBLIC AVAILABILITY
FR 2644	12 U.S.C. §§ 225a and 248(a)(2).	Weekly Report of Selected Assets and Liabilities of Domestically Chartered Commercial Banks and U.S. Branches and Agencies of Foreign Banks	U.S. branches and agencies of foreign banks	• Report **net amount due to related foreign offices** (item 9.a)	Confidential; aggregate data published
FR 2900	12 U.S.C. §§ 248(a), 461, 603 and 615.	Report of Transaction Accounts, Other Deposits and Vault Cash (Branches and Agencies)	U.S. branches and agencies of foreign banks	• Respondents are instructed to "[e]liminate all interoffice transactions that reflect the existence of debtor-creditor relationships among the entities to be consolidated," except in the preparation of Schedule CC (Net Eurocurrency liabilities) (emphasis added) (see p. BA-3 of the instructions) • Worksheet for calculation of item CC.1 (Net Eurocurrency liabilities) includes **gross liabilities to non-U.S. parent bank** (see p. BA-37 of the instructions)	Confidential; aggregate data published

FORM	**AUTHORITY**	**TITLE**	**RELEVANT COVERED ENTITIES**	**RELEVANT REQUIREMENTS**	**PUBLIC AVAILABILITY**
				o Items that feed into this worksheet include **borrowings** by the respondent from the foreign parent bank, **repos/reverse repos** between the respondent and the foreign parent, **funds advanced** by the foreign parent bank to the respondent that are regarded as capital contributions o Specific liabilities to parent included in Schedule CC.1 are not broken out into line items on the actual reporting form (rather than the worksheet)	
FR Y-14Q	12 U.S.C. §§ 1844 and 5365.	Capital Assessments and Stress Testing (asset classes and capital components)	IHCs	• Report information on **regulatory capital instruments** as of quarter end (see FR Y-14Q Regulatory Capital Instruments Form) • Report **remittances of capital to IHC parent** even if not part of payment on/redemption or repurchase of a capital instrument (similarly, must report capital contributions made outside the	Confidential; aggregate data published

FORM	AUTHORITY	TITLE	RELEVANT COVERED ENTITIES	RELEVANT REQUIREMENTS	PUBLIC AVAILABILITY
				purchase of a capital instrument) (see p. 60, 62 in the instructions)	
FFIEC 009	12 U.S.C. §§ 161, 324, 1817 and 1844(c).	Country Exposure Report	IHCs meeting certain requirements	• Report **foreign office liabilities**, including **net due to or due from own related offices** in foreign countries (Schedule L)	Confidential; aggregate data published
Form X-17 A-5	15 U.S.C. §§ 78o, 78q and 78w; 17 C.F.R. §§ 240.17a-5, 240.17a-10, 240.17a-11 and 240.17a-12.	Financial and Operational Combined Uniform Single Report (FOCUS Report Part I)	Registered broker-dealers	• Report all **additions to capital** during the reporting period (item 7) • Report **aggregate indebtedness/debit items** (item 23)	Confidential; financial statements filed pursuant to Rule 17a-5(d) generally are public
Form X-17 A-5	15 U.S.C. §§ 78o, 78q and 78w; 17 C.F.R. §§ 240.17a-5, 240.17a-10, 240.17a-11 and 240.17a-12.	Financial and Operational Combined Uniform Single Report (FOCUS Report Part II)	Registered broker-dealers	• On statement of liabilities and equity ownership, report **liabilities subordinated to claims of general creditors** (with line items for equity subordination amounts vs. liabilities to outsiders) (item 25) • On statement of liabilities and equity ownership, report **accounts and other borrowings not qualified for net capital**	Confidential; financial statements filed pursuant to Rule 17a-5(d) generally are public

FORM	AUTHORITY	TITLE	RELEVANT COVERED ENTITIES	RELEVANT REQUIREMENTS	PUBLIC AVAILABILITY
				purposes (i.e., liabilities not covered by a satisfactory subordination agreement) (item 25) • On statement of income, report **interest expense**, including **interest on accounts subject to subordination agreements** (item 22)	

Appendix II
Proposed revised rules for internal TLAC

Scaling ratio (proposed regulation section 1.59A-3(b)(3)(v)(E))

The scaling ratio would equal the greater of the TLAC LTD scaling ratio and the total TLAC scaling ratio, except that the scaling ratio may in no event be greater than one.

TLAC LTD scaling ratio

$$\text{TLAC LTD scaling ratio} = \frac{\text{modified TLAC LTD required amount}}{\text{average TLAC LTD securities amount}}$$

"Maintenance buffer" means an amount equal to 1% x risk weighted assets, or 0.5% of total leverage exposure, as applicable

"Modified TLAC LTD requirement amount" means the greater of (average TLAC LTD required amount + maintenance buffer) or (highest TLAC LTD required amount for current and prior year)

"TLAC LTD required amount" means the specified minimum amount of debt that is required pursuant to 12 C.F.R. § 252.162(a)

"TLAC LTD securities amount" is the sum of the adjusted issue prices (as determined for purposes of §1.1275-1(b)) of all TLAC LTD securities issued and outstanding by the taxpayer

"TLAC LTD security" means an eligible internal debt security, as defined in 12 C.F.R. § 252.161

Total TLAC scaling ratio

$$\text{Total TLAC scaling ratio} = \frac{\text{modified total TLAC required amount}}{\text{average total TLAC securities amount}}$$

"Maintenance buffer" means an amount equal to 1% x risk weighted assets, or 0.5% of total leverage exposure, as applicable

"Modified total TLAC required amount" means the greater of (average total TLAC required amount + maintenance buffer) or (highest total TLAC required amount for current and prior year)

"TLAC debt securities" means TLAC LTD securities and any other debt issued by the taxpayer that satisfies the requirements of 12 C.F.R. § 252.165(c)

"TLAC equity securities" means any equity issued by the taxpayer that satisfies the requirements of 12 C.F.R. § 252.165(c) other than TLAC debt securities

"TLAC securities" means TLAC debt securities and TLAC equity securities

"Total TLAC required amount" means the specified minimum amount of TLAC securities that is required pursuant to 12 C.F.R. § 252.165(a) or (b)

"Total TLAC securities amount" is the sum of the adjusted issue prices (as determined for purposes of §1.1275-1(b)) of all TLAC debt securities issued and outstanding by the taxpayer and the amount of TLAC equity securities issued and outstanding by the taxpayer as determined for purposes of 12 C.F.R. § 252.165 (but not including common equity Tier 1 securities issued to satisfy 12 C.F.R. § 252.165(d))