January 2, 2018

*By electronic submission to MRELfeedback@bankofengland.co.uk*

Resolution Directorate  
Bank of England  
Threadneedle Street  
London  
EC2R 8AH

Re: Bank of England’s Internal MREL Consultation Paper

Ladies and Gentlemen:

The Clearing House Association (“TCH”)1 and the Securities Industry and Financial Markets Association (“SIFMA”)2 welcome the opportunity to respond to the request of the Bank of England for comment on a proposed updated Statement of Policy (the “Internal MREL Proposal”) setting forth the Bank of England’s approach to setting a minimum requirement for own funds and eligible liabilities (“MREL”) within groups (“internal MREL”).3

The Internal MREL Proposal complements a policy statement issued by the Bank of England in November 2016 setting out its approach to external MREL (the “External MREL Proposal”).

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1 The Clearing House is a banking association and payments company that is owned by the largest commercial banks and dates back to 1853. The Clearing House Association L.L.C. is a nonpartisan organization that engages in research, analysis, advocacy and litigation focused on financial regulation that supports a safe, sound and competitive banking system. Its affiliate, The Clearing House Payments Company L.L.C., owns and operates core payments system infrastructure in the United States and is currently working to modernize that infrastructure by launching a new, ubiquitous, real-time payment system. The Payments Company is the only private-sector ACH and wire operator in the United States, clearing and settling nearly $2 trillion in U.S. dollar payments each day, representing half of all commercial ACH and wire volume.

2 SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the U.S., serving clients with over $18.5 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit [www.sifma.org](http://www.sifma.org).

Policy”). Together, the Bank of England’s external and internal MREL requirements implement the international total loss-absorbing capacity (“TLAC”) standard established by the Financial Stability Board (the “FSB”). The stated purpose of MREL is to “help ensure that when firms fail, the resolution authority can use a firm’s own financial resources to absorb losses and recapitalise the business so it can continue to provide critical functions without the need to rely upon public funds.” The Bank of England’s external and internal MREL requirements work in tandem to achieve this purpose, with external MREL serving to “provide assurance that there is sufficient loss-absorbing capacity . . . that can be exposed to losses or converted in a resolution,” and internal MREL enabling “the financial resources needed to absorb these losses [to be] appropriately distributed” within a banking group.

We support the key components of the Bank of England’s Internal MREL Proposal, which we believe makes a significant positive contribution to the efforts made in recent years by firms and regulators in many jurisdictions towards a durable end to the risk of “too big to fail” (“TBTF”). We believe that the Bank of England should consider those efforts, and particularly the progress made by the U.S. regulators and the U.S. global systemically important banking groups (“G-SIBs”), when adopting its final policy statement on internal MREL. As you know, the Board of Governors of the Federal Reserve System (“Federal Reserve”), the Federal Deposit Insurance Corporation (“FDIC”) and the U.S. G-SIBs have taken a variety of legal, regulatory and practical steps to make the single-point-of-entry (“SPOE”) resolution of the U.S. G-SIBs feasible. These actions include requiring the U.S. G-SIBs to comply with certain external TLAC and clean holding company requirements. These requirements are designed to ensure that the U.S. G-SIBs have sufficient contributable assets at the top of the groups to recapitalize all of their material subsidiaries, including any material U.K. subsidiaries, if the top-tier parent is put into a bankruptcy or special resolution proceeding.

In addition, each U.S. G-SIB has put in place or is in the process of putting in place a legally binding secured support agreement. Each of these agreements imposes secured obligations on the top-tier parent and all relevant intermediate companies and funding vehicles (the “Support Entities”) to use the group’s contributable assets to recapitalize its material subsidiaries, including its material U.K. subsidiaries, as part of the U.S. G-SIB’s SPOE resolution proceeding.


5 See Internal MREL Proposal at 9 (“The Bank is implementing the [FSB’s] total loss-absorbing capacity (TLAC) standard through setting external and internal MREL.”).

6 See id. at 8.

7 See id. at 5.


9 Contributable assets include any assets that could be contributed to material subsidiaries, including inter-company receivables and HQLA.
resolution in order to keep them out of their own insolvency or special resolution proceedings. They are also designed to keep the material subsidiaries in compliance with the regulatory capital requirements of the host jurisdiction. From the host perspective, a significant feature of these secured obligations is that the secured support agreements give each material subsidiary, including each material U.K. subsidiary, the secured right to be recapitalized as part of the U.S. G-SIB’s SPOE resolution with the necessary amount of contributable assets prior to the material subsidiary reaching its own point of non-viability ("PONV").\(^{10}\)

We hope that the Internal MREL Proposal will serve as an example to other host jurisdictions as they set internal MREL/TLAC requirements. Part I of this letter expresses support for specific components of the Internal MREL Proposal that we believe establish a promising foundation for international cooperation between home and host authorities. Part II of this letter describes the ways in which the Internal MREL Proposal can be improved, including through changes designed to recognize international progress on TBTF as well as changes to mitigate unintended tax consequences of internal MREL.

I. Support for Key Components of the Bank of England’s Internal MREL Proposal

A. TCH-SIFMA supports the calibration of internal MREL based on a starting point of 75% of external MREL.

TCH-SIFMA supports the Bank of England’s proposal to calibrate internal MREL based on a starting point of 75% of external MREL—i.e., at the low end of the FSB’s 75% to 90% range in the FSB’s TLAC Term Sheet.\(^{11}\) A starting point of 75% strikes an appropriate balance between the value of pre-positioning internal MREL and the value of maximizing the amount of surplus MREL/TLAC at the top of the group, which can be used to recapitalize material subsidiaries when, as and where needed.

As the Bank of England surely knows, any assets that are pre-positioned at material subsidiaries are likely to be trapped by host authorities and unable to be readily deployed to recapitalize other material subsidiaries during periods of material financial distress. As a result, excessive pre-positioning of assets is harmful in that it decreases the amount of surplus MREL/TLAC that can be relied upon to recapitalize any and all material subsidiaries, including material U.K. subsidiaries, when, as and where needed at the time of material financial distress. By calibrating internal MREL starting at 75%, the Bank of England will mitigate the risk of such excessive pre-positioning of assets and will permit G-SIBs to mitigate the risk that there will not be a sufficient amount of surplus MREL/TLAC in case the distribution of internal MREL does not match the distribution of losses in an actual financial distress scenario ("misallocation risk").


In addition to reducing misallocation risk, the Bank of England’s proposed 75% starting point mitigates another key risk of excessive pre-positioning—the risk that other host authorities will, as a result of a collective action problem, set internal MREL/TLAC requirements above the optimal level. If host authority A believes that other host authorities will require an excessive amount of internal MREL or TLAC, trapping any corresponding pre-positioned assets in those other host jurisdictions, host authority A will have a strong incentive to also impose internal TLAC requirements at excessive levels. If most, or all, host authorities were to act independently to require an excessive amount of internal MREL or TLAC for their jurisdictions, this would deplete the surplus MREL/TLAC and the corresponding assets held at the top of the group, which would otherwise be available to recapitalize material U.K. subsidiaries, thereby creating misallocation risk and expense.\(^{12}\)

By opting to calibrate internal MREL at 75% of external MREL absent certain aggravating circumstances, the Bank of England has sent a responsible signal to other host jurisdictions, reducing their incentive to set unnecessarily high internal MREL/TLAC requirements. In addition, by including the scaling of internal MREL/TLAC requirements by other host jurisdictions as a factor for consideration in its scaling of a material U.K. subsidiary’s internal MREL,\(^{13}\) the Bank of England has implicitly acknowledged this collective action problem and issued a positive call for international cooperation and coordination. We hope other host jurisdictions will do the same.

While we support the Bank of England’s proposal to calibrate internal MREL based on a starting point of 75% of external MREL, we note that the internal MREL requirement in practice ultimately will depend on the external MREL requirement to which the 75% (or higher) scaling is applied. The Bank of England’s fully phased-in external MREL requirement for U.K.-headquartered resolution entities based on a risk-weighted assets (“RWA”) measure is 2x(Pillar 1 + Pillar 2A). Because Pillar 2A is firm-specific, the internal MREL requirement for each material U.K. subsidiary will vary based on its Pillar 2A requirement. Assuming, for instance, that Pillar 2A is set at 2.8%, the internal MREL requirement would be 75% of 2x(8% + 2.8%), which is 16.2% of RWAs. By contrast, the FSB-specified internal TLAC requirement would be markedly lower—equal to just 13.5% of RWAs—if calibrated at 75% of the FSB’s external TLAC requirement of 18% and would rise to 16.2% only if the calibration were set at 90% of the FSB’s external TLAC requirement. Please see Annex 1 for an illustration of the calibration of the Bank of England’s internal MREL requirements as compared to the FSB-specified internal TLAC requirements, which shows that although the Bank of England calibrated its internal MREL requirement at the low end of the 75% to 90% range when measured against the Bank of England’s external MREL requirement, the actual internal MREL requirement will for many

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\(^{13}\) Internal MREL Proposal at 15.
firms be at the FSB’s high-end or even higher when measured against the FSB’s calibration for external TLAC at 18% of RWAs.

In addition, as the Bank of England recognized in its consultation,\textsuperscript{14} the requirement for material U.K. subsidiaries to calculate their MREL requirements at the subsidiary level, which includes in RWA intragroup exposures that would net out at the group level, results in double counting of intragroup exposures among affiliates in RWA and therefore a higher internal MREL calibration across the firm than would be warranted by the group’s external TLAC requirement, which nets out those exposures. The inclusion of intragroup exposures in the RWA requirement that would be multiplied by 75% likewise, therefore, skews the internal MREL calibration.

As a result, although we support the Bank of England’s proposal to calibrate internal MREL at a starting point of 75% of external MREL, we recommend that the Bank of England apply it against the FSB’s external TLAC requirement of 18% instead of the Bank of England’s external MREL requirement of 2x(Pillar 1 + Pillar 2A).

\textbf{B. TCH-SIFMA supports the Bank of England’s decision not to impose a separate minimum internal debt requirement.}

TCH-SIFMA also supports the Bank of England’s decision not to impose a separate minimum internal debt requirement in addition to its proposed internal MREL requirement, but rather allow the entire internal MREL requirement to be satisfied with own funds.\textsuperscript{15} Consistent with its external MREL policy statement, the Bank of England does not propose to require firms to satisfy their internal MREL requirement using a particular combination of equity and debt instruments. Rather, it proposes to grant firms the flexibility to satisfy their internal MREL using any combination of own funds and eligible liabilities, subject to applicable regulatory capital requirements. Allowing firms to satisfy the internal MREL requirement through own funds or through a combination of own funds and eligible liabilities, without having to meet a separate minimum internal debt requirement, facilitates compliance in a cost-efficient manner tailored to firms’ business models.

\textsuperscript{14} See Internal MREL Proposal at 5 (“If internal MREL were set in exactly the same way as external MREL, the sum of the internal requirements could exceed the external requirement. This is because subsidiaries in a group often have exposures to each other which net out at the group level.”).

\textsuperscript{15} We believe this approach is preferable to that adopted by the Federal Reserve, which included separate long-term debt requirements for the U.S. intermediate holding companies of non-U.S. G-SIBs. See TLAC Rule at 8273–74. For our prior comments to the Federal Reserve on this requirement, please see Section II of our February 19, 2016 comment letter on the Federal Reserve’s proposed TLAC rule’s requirements for U.S. intermediate holding companies of foreign G-SIBs, available at https://www.theclearinghouse.org/-/media/action%20line/documents/volume%20vii/20160219%20TCH%20foreign%20g-sib%20tlac%20letter.pdf?la=en.
C. TCH-SIFMA supports the Bank of England’s proposal to not impose internal MREL requirements on U.K. branches of foreign banks.

Under the Internal MREL Proposal, the Bank of England states that if a foreign legal entity has a U.K. branch that performs critical functions, the Bank of England will review the adequacy of the legal entity’s group resolution plan for the amount and distribution of the group’s loss-absorbing resources, the treatment of the branch in resolution and whether the legal entity of which the branch is a part is subject to MREL or equivalent requirements.\(^{16}\) Should the Bank of England have concerns, it will engage directly with the home authority.\(^{17}\) We support the Bank of England’s proposed approach, as it appropriately recognizes the responsibility of the home authority to oversee a bank chartered in its jurisdiction, including any U.K. branches of a bank. We request, however, that the Bank of England clarify in the final updated policy statement that discussions with a branch’s home authority will not result in the imposition of any internal MREL requirements on the branch, as such requirements would be very difficult to apply and are inconsistent with the FSB Term Sheet.\(^{18}\)

D. TCH-SIFMA supports the Bank of England’s decision to allow internal MREL instruments to be issued directly to the parent resolution entity or indirectly via other entities in the same resolution group.

Under the Internal MREL Proposal, the Bank of England recognizes that in order for the issuance of internal MREL to credibly support resolution and the passing of losses to the parent resolution entity, internal MREL instruments, including internal MREL debt, must be able to be issued either directly to the parent resolution entity or indirectly via other entities in the resolution group.\(^{19}\) We strongly support the Bank of England’s decision to provide firms the flexibility to issue internal MREL instruments directly or indirectly to the parent resolution entity, and in some cases outside of the chain of ownership, which will allow firms to structure their internal MREL in a manner that is consistent with their global resolution strategy and the efficient funding of their operations.

II. Recommended Improvements to the Bank of England’s Internal MREL Proposal

A. A qualified secured support agreement should be accepted as an alternative to the contractual write-down/conversion requirement.

Under the proposed updated policy statement, debt must “[a]s a general matter” include a contractual provision allowing the Bank of England to write it down or convert it to equity without placing the issuer in a resolution proceeding.\(^{20}\) The Bank of England states that the

\(^{16}\) Internal MREL Proposal at 13.

\(^{17}\) Id.

\(^{18}\) See FSB Term Sheet, at 18 (“Branches are not subject to internal TLAC requirements separate from any external or internal TLAC requirement applied to the legal entity of which they are a part.”).

\(^{19}\) Internal MREL Proposal at 18.

\(^{20}\) Id. at 19.
purpose of this provision is to ensure that losses can be passed from an operating subsidiary to its parent “without or ahead of any use of resolution powers in relation to the entity that issues [internal MREL].” We believe that qualified secured support agreements would accomplish the same goal. As a result, we urge the Bank of England to revise the proposed policy statement to permit debt to qualify as internal MREL if the issuer of the debt is the secured beneficiary of a qualified secured support agreement, even if the debt instrument itself does not contain a contractual write-down/conversion provision. Moreover, depending on the terms of the secured support agreement, such an arrangement might be less likely than a contractual write-down/conversion provision to cause recharacterization of the internal MREL debt as equity for U.S. federal income tax purposes.

A secured support agreement should constitute a qualified secured support agreement if it grants the material U.K. subsidiary a legally enforceable, secured right to require a Support Entity to contribute sufficient assets to (including in the form of the forgiveness, or a conversion to equity, of a sufficient portion of any debt issued by) the U.K. subsidiary. The Bank of England could rely on its supervisory powers to require the U.K. subsidiary to exercise that right when it was otherwise failing or likely to fail.

In its Internal MREL Proposal, the Bank of England indicated that it was open to working with individual G-SIBs to tailor their approach to internal MREL, proposing that “[t]he particular features of the contractual terms of an entity’s internal MREL may depend on the specific resolution strategy for a firm and may require discussion between the firm and the Bank.” Permitting a G-SIB to satisfy the contractual trigger requirement of internal MREL through the use of a qualified secured support agreement is consistent with the Bank of England’s proposed individualized and collaborative approach.

B. The Bank of England should allow MREL requirements above 75% to be satisfied by qualified secured support agreements.

If a material subsidiary would be subject to an internal MREL requirement higher than 75% of external MREL, we believe the final updated policy statement should allow the material subsidiary to satisfy any portion of the required internal MREL amount above 75% with a qualified secured support agreement. The Bank of England indicated that the internal MREL for a material subsidiary could be scaled above 75%, up to 90% of the external MREL requirement, based on certain factors, including (1) the resolution strategy applicable to the group and the credibility of the resolution plan for delivering it, (2) the availability of other uncommitted resources within the group that could be readily deployed to support the material subsidiary and (3) the scaling of internal loss-absorbing resources applied by overseas authorities to material subsidiaries located in their jurisdiction. If the Bank of England sets internal MREL for a material subsidiary above 75% of external MREL based on any of these factors, we believe that

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21 Id.
22 Id.
23 Id. at 15.
the Bank of England should allow the portion of the requirement above 75% to be satisfied by a qualified secured support agreement.

C. The Bank of England should clarify the scope of its contractual write-down/conversion requirement.

As discussed above, a qualified secured support agreement should be treated by the Bank of England as an alternative to a contractual write-down/conversion right. But to the extent the Bank of England requires a contractual write-down/conversion provision, the Bank of England should clarify that it would be consistent with that requirement for the Bank of England to be provided with the flexibility to write down or convert to equity only the portion of MREL debt instruments that is needed for the subsidiary to satisfy the Bank of England and the market that it has sufficient going concern capital to continue to be viable. For example, if a contractual conversion provision were triggered, the Bank of England should have the option to write-down/convert only the portion of internal MREL necessary to recapitalize the U.K. entity. For example, it should have the option to convert only 50% of the internal MREL if that is all the U.K. entity needs to be recapitalized. The Bank of England under such a contractual write-down/conversion provision would still have the authority to write down or convert all of the MREL debt instruments if it considered that action to be necessary at the time it exercised its contractual right.

D. The Bank of England should clarify the contractual trigger requirements.

The Internal MREL Proposal requires that a contractual provision include triggers that would provide the Bank of England with the right to write down or convert to equity an internal MREL debt instrument when certain conditions are met. The proposed triggers would allow the Bank of England to initiate a write-down or conversion if (i) the Bank of England determines that the material subsidiary is failing or likely to fail, and without the write down or conversion will continue to be so, and the home resolution authority either consents or does not object within 24 hours’ notice, or (ii) a direct or indirect parent of the subsidiary that is a resolution entity is subject to resolution proceedings. We request that the Bank of England clarify the two contractual trigger requirements as follows:

- The first contractual trigger requirement would be satisfied if the contractual write-down/conversion provisions in the internal MREL debt instrument provided that
  
  (i) the Bank of England’s contractual right to write down or convert to equity any internal MREL debt is conditioned on the Bank of England providing the issuer and holder of such internal MREL debt and each home resolution authority identified in the relevant internal MREL debt instrument (e.g., both the Federal Reserve and the FDIC in the case of a U.S. G-SIB) with written notice of the Bank of England’s intention to exercise such
contractual right and the amount of such internal MREL debt that it proposes to write down or convert to equity,

(ii) if within 24 hours of receiving such notice, the holder of such internal MREL debt contributes an amount of assets to the issuer of such internal MREL debt (including in the form of forgiving or converting to equity such internal MREL debt) equal to the amount of such internal MREL debt that the Bank of England had proposed to write down or convert to equity in its notice, then the Bank of England’s contractual rights would be automatically terminated with respect to such amount of internal MREL debt, and

(iii) if in the absence of such a contribution of assets any such home resolution authority objects within 24 hours of receiving such written notice, then one of the essential conditions for exercising the contractual right will not have been satisfied and therefore the Bank of England would be limited to using its statutory bail-in powers to write down or convert to equity such internal MREL debt after placing the issuer of such internal MREL debt in a statutory resolution proceeding.

- The second contractual trigger requirement would be satisfied if it provided that the Bank of England’s contractual right to write down or convert to equity such internal MREL debt upon a resolution entity that is a direct or indirect parent of the U.K. subsidiary becoming subject to a resolution proceeding is further conditioned on the Bank of England determining that the U.K. subsidiary would fail or be likely to fail without such write-down or conversion. Such an additional condition may be necessary to ensure that such internal MREL debt is treated as debt and not recharacterized as equity for tax purposes under home country tax laws and is consistent with the FSB’s guidelines on internal TLAC.25

E. The Bank of England should consider the U.K. tax consequences of the proposed contractual write-down/conversion provisions.

As discussed above, the Internal MREL Proposal proposes that internal MREL debt must contain contractual write-down/conversion provisions that would permit the Bank of England to write down or convert to equity such internal MREL debt upon the satisfaction of certain conditions. We are concerned that this feature could have significant adverse U.K. tax consequences (at least for internal MREL debt which does not qualify as AT1 or Tier 2 regulatory capital). Broadly, these tax consequences fall within the following four areas:

25 See FSB, Guiding Principles on the Internal Total Loss-Absorbing Capacity of G-SIBs (“Internal TLAC”) at 17 (July 6, 2017), available at: http://www.fsb.org/wp-content/uploads/P060717-1.pdf (“[I]nternal TLAC should only be triggered where the material sub-group reaches PONV . . . . [T]here should be no trigger clauses that allow internal TLAC to be triggered by host authorities automatically upon entry into resolution of the resolution entity or the write-down and/or conversion into equity of TLAC elsewhere in the group . . . .”) (footnote omitted).
• **Interest deductibility.** The write-down or conversion feature could result in the non-deductibility, for tax purposes, of interest payments on internal MREL debt. Potential difficulties arise under the “income distribution” and “loan relationships” tax legislation, and points of detail may need to be addressed under the “corporate income restriction” and “hybrid mismatch” rules.

• **Interaction with accounting treatment.** Further U.K. tax difficulties could potentially arise, depending on the accounting treatment of internal MREL debt instruments, for example, if relevant amounts are accounted for otherwise than through the issuer’s profit and loss account, or if the instrument is bifurcated for accounting purposes, or in connection with a write-down or conversion.

• **Withholding tax.** Eligibility for an exemption from U.K. withholding tax commonly used by banks may not be entirely straightforward.

• **Stamp duty and grouping.** The write-down or conversion feature could prevent internal MREL debt instruments from qualifying for an exemption from stamp duty, and could potentially impact on the application of U.K. tax grouping rules.

These issues are broadly the same as those which were identified in connection with debt instruments which qualify as AT1 or Tier 2 regulatory capital. In that context, the solution was to introduce tax regulations (the Taxation of Regulatory Capital Securities Regulations 2013), to provide certainty as to the tax treatment. H.M. Revenue and Customs (“HMRC”) has also issued guidance to provide comfort on the interaction of parts of the “income distribution” legislation with the U.K.’s statutory bail-in regime—although this guidance is not comprehensive, and its precise scope is not clear.

We request that the Bank of England work with HMRC to identify and resolve U.K. tax issues and, in particular, to ensure that the potential difficulties outlined above do not arise. It would be preferable for this to be achieved through legislation (for example, through an extension of the existing regulations applying to AT1 and Tier 2 regulatory capital), rather than through HMRC guidance, as this provides the maximum legal certainty. As a policy matter, it would seem logical and unobjectionable to ensure that the U.K. tax treatment of internal MREL debt is not less favorable than that of AT1 and Tier 2 debt instruments.

**F. The Bank of England should consider the U.S. tax consequences of the proposed contractual triggers.**

In addition to the potential U.K. tax consequences described above, the proposed contractual trigger provisions may cause internal MREL debt issued by a U.K. subsidiary to a U.S. bank holding company (or another U.S. entity in the resolution group) to be recharacterized as equity for U.S. federal income tax purposes, with potential adverse tax consequences to the U.S. group. The following consequences could result from such recharacterization:
• **Treatment as dividend.** Repayment of the recharacterized debt would generally be treated as a taxable dividend to the U.S. entity holding the internal MREL debt, rather than as a tax-free return of principal.

• **Tax credits.** Depending on the circumstances (including whether the U.S. entity holding the internal MREL is a direct parent of the U.K. subsidiary), recharacterization of the internal MREL debt as nonvoting equity could have an adverse effect on the U.S. group’s ability to claim U.S. tax credits for U.K. taxes that it otherwise would be entitled to take with respect to equity interests in the U.K. subsidiary. This could have the effect that economic income earned by the U.K. subsidiary is subject to tax by both the United Kingdom and the United States without offset.

U.S. tax reform recently enacted into law might in some situations mitigate the adverse consequences described above of recharacterizing internal MREL debt as equity. Nevertheless, we believe that concerns arising from the potential recharacterization of internal MREL debt as equity for U.S. federal income tax purposes should be considered by the Bank of England in formulating its requirements for internal MREL debt.

Notably, in the case of the Federal Reserve’s TLAC Rule, the Federal Reserve worked with the U.S. Treasury Department and the Internal Revenue Service (the “IRS”) to ensure that internal TLAC issued by a U.S. subsidiary of a non-U.S. banking group would be respected as debt, unless and until the internal TLAC was subject to conversion to equity by the Federal Reserve. The resulting IRS guidance express limits this treatment to instruments issued pursuant to the Federal Reserve’s regulations setting forth requirements for internal TLAC debt. In particular, while the IRS did not explain its reasoning, it appears to have taken comfort from the limited circumstances in which a conversion order could occur: a determination by the Federal Reserve that (i) the issuer is considered to be in default or in danger of default (pursuant to rules prescribed by the Federal Reserve) and (ii) one of three specified circumstances applies (such as the home country supervisor of the non-U.S. G-SIB consenting or not promptly objecting after notification of the conversion or exchange). Moreover, the IRS guidance appears to rely in part on the Federal Reserve’s acknowledgment that its regulations do not restrict an issuer’s ability to include certain traditional debt terms in internal TLAC debt, including (i) that, upon conversion to equity, existing equity would be transferred by the holder to the issuer and canceled upon transfer and (ii) debt covenants on the same terms permissible for covered bank holding companies, such as covenants providing for acceleration rights based upon the issuer’s insolvency or payment default.

The IRS guidance applies only to internal TLAC debt and would not be authority regarding the U.S. tax treatment of internal MREL debt instruments. As a result, tax advisers may have difficulty reaching affirmative conclusions that internal MREL debt instruments would be treated as debt for U.S. federal tax purposes in the absence of such authority. However, we believe that if the Bank of England were to permit internal MREL debt instruments to include

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27 Id. at 425-26.
similar provisions, it would be helpful to persuading the IRS to determine that internal MREL debt should be treated in the same manner as internal TLAC debt for U.S. federal tax purposes.

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We thank the Bank of England for its consideration of our comments. If you have any questions, please do not hesitate to contact John Court at +1-202-649-4628 and Carter McDowell at +1-202-962-7327.

Sincerely,

John Court
Managing Director and Deputy General Counsel
The Clearing House Association L.L.C.

Carter McDowell
Managing Director and Associate General Counsel
Securities Industry and Financial Markets Association
(1) The Bank of England’s proposal would require material U.K. subsidiaries to calculate their MREL requirements at the subsidiary level, which includes in RWA intragroup exposures that would net out at the group level. This may result in double counting of intragroup exposures among affiliates in RWA, as discussed in further detail in Section I.A of this letter.