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By Electronic Mail

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Federal Deposit Insurance Corporation
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Office of the Comptroller of the Currency
250 E Street, SW
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Re: Notice of Proposed Rulemaking, Prudential Standards for Large Foreign Banking Organizations; Revisions to Proposed Prudential Standards for Large Domestic Bank Holding Companies and Savings and Loan Holding Companies, Federal Reserve Docket No. R-1658 and RIN 7100-AF45; Joint Notice of Proposed Rulemaking, Changes to Applicability Thresholds for Regulatory Capital Requirements for Certain U.S. Subsidiaries of Foreign Banking Organizations and Application of Liquidity Requirements to Foreign Banking Organizations, Certain U.S. Depository Institution Holding Companies, and Certain Depository Institution Subsidiaries, Federal Reserve Docket No. R-1628B and RIN 7100-AF21, OCC Docket ID OCC-2019-0009 and RIN 1557-AE63, FDIC RIN 3064-AE96

The Institute of International Bankers ("IIB") appreciates the opportunity to comment on (i) the notice of proposed rulemaking issued by the Board of Governors of the Federal Reserve System (the "Federal Reserve") regarding proposed changes to the enhanced prudential standards ("EPS") for international banks and (ii) the notice of proposed rulemaking issued by the Agencies regarding proposed changes to the applicability thresholds for certain regulatory capital and liquidity requirements.[1]

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[1] "Prudential Standards for Large Foreign Banking Organizations; Revisions to Proposed Prudential Standards for Large Domestic Bank Holding Companies and Savings and Loan Holding Companies," 84 Fed. Reg. 21988 (May 15, 2019) (the "EPS Proposal"); "Changes to Applicability Thresholds for Regulatory Capital Requirements for Certain U.S. Subsidiaries of Foreign Banking Organizations and Application of Liquidity Requirements to Foreign Banking Organizations, Certain U.S. Depository Institution Holding Companies, and Certain Depository Institution Subsidiaries," 84 Fed. Reg. 24296 (May 24, 2019) (the "Capital/Liquidity Proposal"). In this letter, we refer to the Federal Reserve, the

This letter comments on both the EPS Proposal and the Capital/Liquidity Proposal. The IIB is submitting separate letters (i) responding to the Agencies' questions regarding whether to apply liquidity requirements to the U.S. branches/agencies of international banks and (ii) commenting on the Federal Reserve and FDIC's companion proposal to tailor resolution planning requirements. We are also submitting Appendices to this letter with recommended changes to the underlying EPS and capital and liquidity requirements.

The IIB represents internationally headquartered financial institutions from over 35 countries around the world doing business in the United States. The IIB's members consist principally of international banks that operate branches, agencies, bank subsidiaries and broker-dealer subsidiaries in the United States ("international banks").

Summary of Key Recommendations

- **General Framework**. The Proposal should be revised to conform to statutory mandates and internationally agreed principles of national treatment and equality of competitive opportunity, and to take into account comparable home-country regulation and the unique position of an international bank's U.S. operations as part of the larger organization. (Page 9)
    - In addition, the Proposal should take greater account of recent regulatory and structural changes meant to address risks of U.S. operations and how they mitigate any perceived need for increased stringency of EPS requirements. (Page 11)
        - IHCs have increased capital and liquidity resources substantially in recent years. In particular, many IHCs are (uniquely) subject to iTLAC requirements, which provide a large, additional layer of financial protection to address any U.S. concerns.
    - The final framework should be based on the following principles:
        - CUSO size and risk-based indicators should not be used to determine the applicability of more stringent requirements to (i) an IHC or (ii) a U.S. branch/agency network. (Page 13)
            - Utilizing CUSO attributes not only increases the requirements on an IHC based on attributes outside its own activities and risk profile but also results in inefficient and ineffective allocation of liquidity to the IHC, forcing the IHC to hold liquidity to address risks outside the IHC that it, in fact, cannot address directly.
        - Recognizing the differences of international bank U.S. operations in comparison to U.S. BHCs requires that (i) EPS applicable to IHCs be further modified to lessen their stringency and (ii) EPS applicable to a U.S. branch/agency network consist

Office of Comptroller of the Currency ("OCC") and the Federal Deposit Insurance Corporation ("FDIC") collectively as the "Agencies," and to the preamble and text of the EPS Proposal and the Capital/Liquidity Proposal collectively as the "Proposal," unless otherwise noted.

largely of confirmation of applicability of home-country requirements consistent with internationally agreed standards. (Page 15)

- **Risk-based Indicators**. The Agencies should adopt the risk-based indicator approach consistent with the domestic proposal, but important revisions to the approach are necessary to more appropriately measure the relative risk profile of international banks' U.S. operations. As noted below, the proposed risk-based indicators tend to capture a disproportionate number of international banks whose U.S. operations are smaller, less risky and better capitalized than U.S. peers in the same categories. Further, the risk-based indicator approach should fulfill the objectives of effectiveness, transparency, and risk sensitivity, and not just simplicity. (Page 18)

    - The Agencies should exclude transactions with affiliate counterparties, including with branches, agencies and an international bank's parent, from each risk-based indicator calculation. (Page 21)

    - **CJA**. The Agencies should:

        - Treat CJA consistently with the other risk-based indicators and not have it determine Category II status; (Page 25)

        - Clarify the change to the calculation of securities financing transaction exposure to an "ultimate-risk basis;" (Page 26)

        - Clarify that liabilities and claims between a U.S. entity, including an IHC, and any U.S. branches/agencies of any international bank would not be treated as CJA; (Page 27)

        - Exclude liabilities to and claims against a home-country sovereign (including a political subdivision thereof), as well as supranational, international and regional organizations; (Page 27)

        - Permit the use of settlement date accounting rather than trade date accounting, or limit trade date accounting exposure to the difference between the market value of the assets or cash expected to be received and the market value of the assets or cash expected to be delivered; (Page 28) and

        - Permit the netting of claims and liabilities with a counterparty. (Page 28)

    - **wSTWF**. The Agencies should:

        - Differentiate between more stable short-term funding (such as brokered deposit sweeps from affiliates) and other types of short-term funding; (Page 29) and

        - Consider the assets or transactions being funded by wSTWF liabilities, as potential mitigants to the Agencies' concerns. (Page 30)

            - The wSTWF risk-based indicator should take into account low/no risk collateral being funded, as well as financing situations that would not be subject to a "fire sale" of the funded asset. (Page 30)

        - The Agencies should provide a credit against wSTWF for Level 1 HQLA held by the U.S. operations of an international bank. (Page 31)

  - **NBA**.

    - The Agencies should remove NBA as a risk-based indicator because it is overly simplistic, relying on the location of assets as opposed to effective indicia of risk. (Page 32)

    - If the Agencies retain NBA as a risk-based indicator, the Agencies should:

      - Eliminate from the calculation of NBA several specific assets that are not indicative of risk, including (i) goodwill, deferred tax assets, defined benefit pension fund assets and other intangibles that are deducted from regulatory capital under the Federal Reserve's Regulation Q; (ii) cash and Level 1 & 2A HQLA (or securities financing transactions on such HQLA); and (iii) zero-percent RWA; (Page 33) and

      - Risk weight NBA to more accurately reflect the actual risk of such assets. (Page 34)

  - **OBE**. The Agencies should:

    - Apply a risk weight to exposures similar to the combination of credit conversion factors and risk weights applied under the capital rules to loan commitments, letters of credit and guarantees; (Page 34)

    - Allow Level 1 HQLA collateral received by the banking organization to be offset against, or otherwise reduce, the OBE; (Page 34)

    - Treat any OBE that cannot be drawn unless collateralized as collateralized for risk weight purposes; (Page 34) and

    - Offset the amount of any committed line of credit or other legally enforceable support from an affiliate that could be drawn, if needed, against third-party OBE. (Page 34)

- **Liquidity**. The application of standardized liquidity regulations to IHCs should be tailored more closely to IHC attributes and any standardized liquidity requirements should be imposed solely on the basis of the size and risk-based indicators of the IHC. (Page 36)

  - The Agencies should not change the application of the LCR to IHCs so as to penalize internal inflows by not permitting netting against external outflows. In addition, the Agencies should permit netting of internal inflows against external outflows for the Regulation YY liquidity buffer calculation requirements. (Page 36)

  - The Agencies should modify the reduced LCR to more closely resemble the current "modified" LCR by (i) setting the reduced LCR coefficient at the lower bound of the proposed 70-85% range, (ii) removing the maturity mismatch add-on, (iii) not applying the reduced LCR and NSFR to subsidiary depository institutions and (iv) permitting IHCs to include eligible HQLA held at subsidiaries up to the full amount of the net cash outflows of a subsidiary plus amounts that may be transferred without restriction to an IHC. (Page 37)

  - The Agencies should permit IHCs to manage their own HQLA rather than requiring management by the parent international bank. (Page 39)

  - To categorize international banks for the purpose of the NSFR is premature. NSFR should not apply at the IHC or CUSO level, as the objective of reducing funding risk over a longer time horizon is best achieved through centralized compliance at the level of the parent international bank. (Page 39)

  - The Federal Reserve should confirm that HQLA meets the test for highly-liquid assets. (Page 40)

- **Single Counterparty Credit Limits**.

  - The Federal Reserve should, as proposed, exempt the IHCs of all Category IV international banks with under $250 billion in global assets and allow certification of home-country standards for larger Category IV international banks that must comply with the SCCL at the CUSO level. (Page 40)

  - SCCL should not be part of the Proposal's categorization framework. The Federal Reserve should apply SCCL requirements for IHCs on the basis of IHC assets only and apply a $250 asset threshold to both IHCs and U.S. BHCs. (Page 41)

  - The Federal Reserve should not adopt the proposed modifications for Category II and Category III IHCs with respect to (i) using tier 1 capital (rather than capital stock and surplus) as a base and (ii) application of the more complex and burdensome economic interdependence and control tests and the special purpose vehicle look-through requirements. (Page 41)

  - The Federal Reserve should provide transitional relief for international banks with home-country supervisors that are still in the process of adopting an SCCL. (Page 42)

- **Capital and Stress Testing**.

  - The Agencies should finalize as proposed the availability of the AOCI filter for Category III and IV IHCs and should make this available for Category II IHCs. (Page 42)

  - The Agencies should finalize capital and stress-testing exemptions for IHCs with less than $100 billion in assets, while ensuring that liquidity and SCCL requirements would not merely apply to such an IHC due to CUSO risk-based indicator scores. (Page 20)

  - The Agencies should eliminate the CCyB and the SLR for Category II and III IHCs. (Page 42)

  - The Federal Reserve should immediately extend the due date of the 2019 mid-cycle company-run stress test until late 2019, as the Proposal would eliminate the mid-cycle company-run stress test for all IHCs. (Page 43)

- The Federal Reserve should eliminate the CCAR qualitative assessment for IHCs now, as they have done for U.S. BHCs in identical categories. (Page 44)

- Category III IHCs should be subject to a biennial stress-testing cycle. (Page 44)

- iTLAC and LTD requirements should be revisited and revised in conjunction with the tailoring exercise. (Page 45)

- **Risk Management**. Category IV international banks (and international banks with less than $100 billion in CUSO assets) that do not have IHCs should be permitted to rely to a larger degree on the international bank's consolidated risk management structure. (Page 46)

- **Regulatory Reporting**.

    - Dual reporting of IHC-level and CUSO-level metrics imposes burdens on international banks that are not applicable to U.S. BHCs and that are not necessary in relation to an appropriately tailored EPS framework. Our proposed framework would obviate the need for collecting data at the CUSO level. (Page 46)

        - If the CUSO-level data collection were retained, then several modifications to the reporting requirements are necessary to collect only the information needed and to tailor the reporting to the U.S. structure of international banks. (Page 47)

    - Daily FR 2052a reporting would be a significant, unwarranted and new burden for several international banks, and should be reserved for only the most systemically important institutions. The Agencies should revise the Proposal so that Category II and III international banks would be required to report monthly and Category IV international banks would be required to report quarterly. (Page 49)

- **Transition Periods**.

    - Transition periods are necessary for data collection, indicator calculation, categorization and ultimate compliance. We propose both an initial and an ongoing transition period framework. (Page 50)

    - The Agencies should permit international banks to shift between categories, in either direction, on the basis of a trailing four-quarter average. (Page 52)

- **Other Issues**.

    - The Agencies should index any thresholds to account for nominal economic growth. (Page 52)

    - The Federal Reserve should only include Category I institutions, i.e., U.S. GSIBs, in the LISCC portfolio. (Page 52)

    - We also recommend further tailoring of the underlying EPS and capital and liquidity requirements, as further described in the Appendices to this letter.

I. Introduction

The IIB supports the general goal of tailoring EPS for international banks based on the size and risk of their U.S. footprints and the specific goal of making the regulatory framework for international banks more efficient, transparent and simple. However, we believe that significant revisions to the Proposal are needed to calibrate EPS requirements appropriately to preserve economic vitality, to implement the Federal Reserve's principles of efficiency, transparency and simplicity,[2] to better align the EPS framework with U.S. statutory mandates and to remain consistent with internationally agreed principles respecting the roles of home- and host-country supervisors of international banks.

Our members' U.S. operations perform a vital role in providing credit to U.S. businesses, enhancing liquidity to U.S. financial markets and contributing to the employment of hundreds of thousands of people in the United States in the financial sector and through related services. For example:

- 71% of all infrastructure loan volume in the United States over a five-year period was provided by international banks (2012-2016);
- 15 of the 24 primary dealers registered by the Federal Reserve are foreign-owned;
- U.S. operations of international banks fund approximately 25% of all commercial and industrial loans made in the United States;
- International banks own 1/3 of all large syndicated loan commitments (in the Shared National Credit portfolio);
- Three of the top 10 U.S. agricultural lenders are owned by international banks;
- Two of the top 10 Small Business Administration lenders are owned by international banks;
- U.S. broker-dealer subsidiaries of international banks underwrite approximately 25% of all U.S.-dollar-denominated securities;
- 44 of the 105 registered swap dealers are affiliated with international banks and 50 are foreign owned;
- U.S. operations of international banks hold over $5 trillion in U.S. banking and non-banking assets; and
- International banks employ over 200,000 full time employees in the United States.

Federal Reserve Chairman Powell and Vice Chairman Quarles have noted the contributions of international banks to U.S. lending and capital markets and the resulting economic gains in the United States, and we were encouraged by Vice Chairman Quarles' recent statement that facilitating international banks' participation in the U.S. economy remains "very much in [the Federal

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[2] Federal Reserve, Supervision and Regulation Report (May 2019) 1–2 ("Supervision and Regulation Report"); see also Randal K. Quarles, Vice Chairman for Supervision, Federal Reserve, Early Observations on Improving the Effectiveness of Post-Crisis Regulation (Jan. 19, 2018) ("Quarles Early Observations").

Reserve's] interest."[3] **Miscalibrating the tailoring framework would threaten this important interest and has the potential to impede growth in the domestic economy** by creating disincentives for international banks to provide credit and other financial services in the United States. Experience with Regulation YY to date has demonstrated that the Agencies' regulatory architecture, particularly as applied to international banks, can significantly affect incentives to invest in the United States and participate in lending and capital markets. The current EPS framework has encouraged many international banks to shrink their U.S. operations, constrain their growth in the United States or exit entirely.[4] As one example, since 2011, international banks in the aggregate have significantly reduced the size of their combined U.S. operations ("CUSO") balance sheets, primarily through a substantial reduction in broker-dealer assets that has not been offset by a modest increase in branch/agency assets during this timeframe.[5] These reductions have occurred against a backdrop of rapid growth at broker-dealers overall in the United

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3 Semi-Annual Testimony on the Federal Reserve's Supervision and Regulation of the Financial System, Hearing Before the H. Comm. on Fin. Services, 115th Cong. (2018) (testimony of Randal K. Quarles, Vice Chairman for Supervision, Federal Reserve) ("Quarles 2018 Semi-Annual House Testimony"); see Jerome H. Powell, Chairman, Federal Reserve, Opening Statements on Proposals to Modify Enhanced Prudential Standards for Foreign Banks and to Modify Resolution Plan Requirements for Domestic and Foreign Banks (Apr. 8, 2019) ("Foreign banks play an important role in our economy. They facilitate commerce, and provide credit and needed investment."); Randal K. Quarles, Vice Chairman for Supervision, Federal Reserve, Opening Statements on Proposals to Modify Enhanced Prudential Standards for Foreign Banks and to Modify Resolution Plan Requirements for Domestic and Foreign Banks (Apr. 8, 2019) ("Quarles Opening Statement") ("The contributions of foreign banks domestically, to both lending markets as well as capital markets, are significant to the U.S. economy and should continue.").

4 See generally SIFMA, Insights: The Importance of FBOs to US Capital Markets (Apr. 2019), https://www.sifma.org/wp-content/uploads/2019/04/SIFMA-Insights-The-Importance-of-FBOs-to-US-Capital-Markets.pdf.

5 Federal Reserve statistics indicate that, from 2011 to 2018, the aggregate branch/agency assets of international banks with IHCs increased by 12% (from $763 billion to $855 billion), whereas aggregate broker-dealer assets of this same set of institutions decreased by 51% overall (from $1.48 trillion to $720 billion) and by 68% at the four LISCC international banks (from $1.15 trillion to $367 billion). See Federal Reserve, Structure and Share Data for U.S. Banking Offices of Foreign Entities, https://www.federalreserve.gov/releases/iba/ (follow "March 2011" and "December 2018" hyperlinks) (branch data); Securities and Exchange Commission, Company Filings, https://www.sec.gov/edgar/searchedgar/companysearch.html (broker-dealer; data in "X-17A-5" hyperlinks).

Over this same 2011-2018 period, U.S. real gross domestic product (in chained 2012 dollars) grew 19.17%, from $15.75 trillion to $18.77 trillion, exceeding the growth in assets at international bank branches. See Federal Reserve Bank of St. Louis, Real Gross Domestic Product, https://fred.stlouisfed.org/series/GDPC1/. Furthermore, total assets of all commercial banks operating in the United States increased over this same 2011-2018 period by 44.87%, from $11.79 trillion to $17.08 trillion in seasonally adjusted U.S. dollars, also far surpassing the aggregate growth at U.S. branches/agencies. See Federal Reserve Bank of St. Louis, Total Assets, All Commercial Banks, https://fred.stlouisfed.org/series/TLAACBW027SBOG. These statistics indicate that international banks actually constrained branch growth in comparison to the overall economy growth trend. Furthermore, if international banks contemplated moving assets or activities to their U.S. branches, significant issues regarding Sections 23A/23B, capital, liquidity, tax, permissibility/powers, accounting, etc. would have to have been considered, thereby increasing the complexity of any such move and reducing further any correlation between CUSO aggregate reduction and branch asset size increases.

States,[6] principally among U.S. bank holding companies ("BHCs") (led by the global systemically important banks ("GSIBs") that are not custody banks),[7] thereby increasing concentration and decreasing competition. And while international banks have been shrinking their U.S. footprints, the U.S. banking sector overall has expanded significantly commensurate with U.S. economic growth.[8]

The modest tailoring the Agencies have proposed would not reverse or even arrest this trend. In fact, many features of the Proposal increase the stringency of applicable standards and introduce new reporting burdens. In the face of international banks reducing their engagement in the U.S. economy, the Agencies have provided no specific evidence as to why current rules are not sufficient, why home-country consolidated standards have not been effective and why new and increased requirements are required at this time. Finalization of the Proposal is likely to increase the trend of international bank withdrawal. The Proposal may also constrain growth of international banks with smaller U.S. footprints that wish to avoid the "cliff effect" of crossing the intermediate holding company ("IHC") threshold and having a new IHC subject to significantly increased requirements based on the characteristics of their CUSOs.[9] A shrinking international bank presence is stark, concrete evidence of disparate and costly effects of inefficient regulation on international banks' U.S. operations and risks increasing concentration among the banking organizations remaining in the United States, which can itself be a source of systemic risk. Ultimately, this trend could reduce the resiliency of U.S. credit and other financial markets.

The Proposal also does not conform to the clear congressional mandates to respect **the principles of national treatment and equality of competitive opportunity and to take into account comparable home-country regulation** in applying EPS.[10] Although we appreciate Vice Chairman Quarles' expressions of a commitment to upholding these principles,[11] the Proposal falls short of this commitment and of the statutory mandates. National treatment and equality of competitive opportunity require treating international banks no less favorably than similarly situated U.S. banking organizations.[12]

6 Federal Reserve, Financial Stability Report 29 (May 2019), https://www.federalreserve.gov/publications/files/financial-stability-report-201905.pdf ("FRB Financial Stability Report"). U.S. BHCs have increased the size of broker-dealer subsidiaries by 12% over the last 10 years. See Securities and Exchange Commission, Company Filings, note 5.

7 See Financial Stability Oversight Council, 2018 Annual Report 73 (Dec. 18, 2018), https://home.treasury.gov/system/files/261/FSOC2018AnnualReport.pdf. According to SEC data, the U.S. GSIBs that are not custody banks have increased the aggregate size of their broker-dealers by 13% from 2011 to 2018 (from approximately \$1.8 trillion to \$2 trillion). See Securities and Exchange Commission, Company Filings, note 5.

8 See note 5 above.

9 See Section III.C below.

10 12 U.S.C. § 5365(b)(2)(A).

11 Letter from Randal K. Quarles, Vice Chairman for Supervision, Federal Reserve, to Hon. Andy Barr (Oct. 26, 2018) ("With respect to the [IHCs] of [international banks], the Board . . . remains committed to the principles of national treatment and equality of competitive opportunity between the U.S. operations of [international banks] and U.S. banking organizations.").

12 "Prudential Standards for Large Bank Holding Companies and Savings and Loan Holding Companies," 83 Fed. Reg. 61408, 61411 n.27 (Nov. 29, 2018) ("The Dodd-Frank Act requires the Board to give due regard to national treatment and equality of competitive opportunity, which generally means that [international banks] operating in the United States should be treated no less favorably than similarly situated U.S.

Put another way, the Proposal should ensure, particularly when changes to regulation are being made, that it "creat[es] a level playing field between foreign banks operating in the United States and domestic firms of similar size and business models."[13] In contrast, the Proposal would create an unlevel playing field by imposing more stringent, more complex and new prudential standards on the U.S. operations of international banks relative to similarly situated U.S. BHCs.

Vice Chairman Quarles also described an additional tenet of tailoring based on **the unique position of an international bank's U.S. operations as part of a larger organization**.[14] We understand this tenet to suggest that host country regulation should take into account the complementary framework already applied to a banking organization by home-country regulators on a consolidated basis. Failure to properly consider standards already in place at the consolidated organization upsets the balance of "flexibility for the parent bank and certainty for local stakeholders" that Vice Chairman Quarles has described as necessary when approaching the home-host relationship.[15] According to Vice Chairman Quarles, as a large home and host regulator, the Federal Reserve should "find a middle ground and fine tune" its approach, in particular related to the pre-positioning of capital and liquidity.[16]

Not striking the right balance between flexibility and certainty also risks setting a precedent for other regulators, thus harming the interests of internationally active U.S. institutions in normal periods, frustrating international coordination in stress periods and complicating a cross-border recovery and resolution in a future crisis.[17] U.S. rules are generally viewed by other jurisdictions either

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banking organizations and should generally be subject to the same restrictions and obligations in the United States as those that apply to the domestic operations of U.S. banking organizations.").

13 Quarles Opening Statement; see Oversight of Financial Regulators, Hearing Before the S. Comm. On Banking, 116th Cong. (2019) (testimony of Randal K. Quarles, Vice Chairman for Supervision, Federal Reserve) (noting that the Federal Reserve is obligated in the Proposal to "consider national treatment, giving [international banks] a level playing field" with U.S. BHCs) ("Quarles 2019 Semi-Annual Senate Testimony"); Quarles 2018 Semi-Annual House Testimony (noting that the Federal Reserve seeks to "ensure . . . a level playing field" for IHCs and U.S. BHCs while also "tak[ing] account of their differences."); Semi-Annual Testimony on the Federal Reserve's Supervision and Regulation of the Financial System, Hearing Before the S. Comm. on Banking, 115th Cong. (2018) (testimony of Randal K. Quarles, Vice Chairman for Supervision, Federal Reserve) ("We need to ensure that we have a level playing field, that firms that are alike are treated alike, that's very important."); Randal K. Quarles, Vice Chairman for Supervision, Federal Reserve, Trust Everyone—But Brand Your Cattle: Finding the Right Balance in Cross-Border Resolution (May 16, 2018) ("Brand Your Cattle Speech") ("From a competitive equality standpoint, we believe that U.S. subsidiaries of foreign banks should operate on a level playing field with their domestic counterparts.").

14 Quarles Opening Statement (noting as a "unique feature" the "membership" of international banks' U.S. operations in a larger organization).

15 See Brand Your Cattle Speech.

16 Brand Your Cattle Speech.

17 Striking a balance is likely to amplify benefits for financial stability in the United States and around the world because, as Vice Chairman Quarles has noted, "any requirements [the Board] impose[s] on foreign banks operating in the United States may well be imposed on U.S. firms operating abroad." Brand Your Cattle Speech. See also Randal K. Quarles, Vice Chairman for Supervision, Federal Reserve, America's Vital Interest in Global Efforts to Promote Financial Stability (June 27, 2018) (noting that limited international coordination in the run-up to the financial crisis exacerbated vulnerabilities and impeded the regulatory response in the United States and around the world).

formally or informally as a potential template for their own rules. For example, the U.S. requirement to establish an IHC has been mirrored by a proposed parallel requirement in the European Union for international banks to establish an intermediate parent undertaking.[18] If the United States adopts stricter, host-centric policies for international banks operating in the United States, that approach raises a risk of replication by other jurisdictions. This prospect is potentially magnified due to the leadership role that Federal Reserve officials play in setting international standards at the Financial Stability Board ("FSB"). If major financial centers around the globe were to adopt a similar standard, the impact on flexibility and increased fragmentation would be adverse for all banks, including banks headquartered in the United States. The issue of fragmentation of the global economic system is a major focus of the G20 under the new agenda of the Japanese presidency.[19] The FSB is supporting this agenda through evaluating the effects of post-crisis financial reforms on market fragmentation.[20]

This tenet also suggests that U.S. regulations should take into account the support of the broader organization and not merely treat the parent and affiliates as third-party sources of exogenous risk. The parents of IHCs have historically provided an additional source of strength to their U.S. subsidiaries. The resources of both the parent and the IHC have been strengthened further by post-crisis reforms—elements such as pre-positioned internal total loss-absorbing capacity ("iTLAC") make support even more reliable going forward. But while international banks must bear additional and expensive requirements, the current proposal gives no weight to this support, even when in the form of pre-positioned and pre-paid iTLAC. The principle of equality of competitive opportunity should require that EPS applicable to international banks be lessened or made more flexible where there are material additional safety features imposed elsewhere.

The Proposal does not take into account how the broader regulatory framework globally, and domestically for international banks' U.S. operations, has already **strengthened and reconfigured the structure and resiliency of international banks**. Significant requirements and restrictions have been imposed on international banks at multiple levels, all designed to strengthen the safety and soundness of banks as a going concern and to reduce the risks to stakeholders if banks should approach gone-concern status. However, to support the Proposal's new burdens and expanded requirements, the Agencies refer back to symptoms or conditions of prior crises—before the development of U.S., and comparable international, regulatory frameworks that have been applied over the last 10 years. For example, multiple restrictions have already been placed on BHC and IHC broker-dealer subsidiaries by

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18 Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures, Presidency Compromise, Article 21b (Feb. 14, 2019).

19 Prime Minister Taro Aso, G20 Finance Ministers and Central Bank Governors Meeting under the Japanese Presidency (Dec. 2, 2018).

20 Letter from Randal K. Quarles, Chairman, FSB, to G20 Finance Ministers and Central Bank Governors (Apr. 9, 2019); Financial Stability Board, Evaluation of too-big-to-fail reforms: Summary Terms of Reference (May 23, 2019), https://www.fsb.org/wp-content/uploads/P230519.pdf. OICU-IOSCO is also focused on the impact of market fragmentation. OICU-IOSCO, Market Fragmentation & Cross-Border Regulation (June 2019), https://www.iosco.org/library/pubdocs/pdf/IOSCOPD629.pdf ("Fragmentation in the provision of cross-border wholesale financial services and activities can occur for several reasons, including market-led practices, investor preferences or domestic legislation that is not related to financial services (e.g., taxation). It can also arise from financial regulation (i.e., regulatory fragmentation)." (emphasis added)).

the Agencies.[21] However, the Agencies continue to increase the stringency of EPS based on perceived (and, given the significant de-risking that has occurred in response to post-crisis regulation, inflated) risks of broker-dealer activities in manifold ways, such as incorporation into both the weighted short-term wholesale funding ("wSTWF") risk-based indicator and the non-bank assets ("NBA") risk-based indicator. Rather than provide targeted and tailored relief from EPS in recognition of the increased resiliency of international banks, the Proposal would impose additional requirements and increase the stringency of existing requirements for many of our members. While the Proposal provides a rationale for differentiating among banking organizations, after nearly 10 years of increased regulation nothing in the Proposal supports the increase in stringency and burden relative to current rules.

Overall, despite the discussion in the Proposal that the Agencies' approach is consistent with the Economic Growth, Regulatory Relief, and Consumer Protection Act (the "Regulatory Relief Act") and the domestic proposal's general goal of relieving unnecessary regulatory burdens,[22] the Proposal would, in fact, impose new and additional burdens on international banks. Revisions to the Proposal's framework would be needed to eliminate these additional unwarranted burdens, as well as specific modifications to both EPS and their implementation, all of which we discuss below. We urge the Agencies to revise the Proposal to allow international banks to benefit from the goal of burden reduction and from the same degree of tailoring as their domestic counterparts so that international banks can contribute to U.S. economic growth.

II. A Tailored Framework: Simplification of Approach Would Improve Consistency with Statutory Mandates and Internationally Agreed Principles

We welcome the Agencies' initiative to revisit the post-Dodd Frank rule set with an eye towards appropriately calibrating standalone U.S. requirements to reflect the size and risk profile of an international bank's U.S. footprint. But a more faithful adherence to statutory mandates and incorporation of home-country rules is required to calibrate EPS appropriately.

In this Section we describe a few simple changes that should be made to the Proposal's framework to conform to statutory mandates and improve the efficiency and simplicity of the Proposal. In short:

- EPS should be applicable to an IHC based solely on attributes of the IHC and not attributes of the branch/agency network or the CUSO; and
- EPS for the branch/agency network should consist largely of confirmation of applicability of home-country requirements consistent with internationally agreed standards and should not be based on attributes of the IHC or the CUSO.[23]

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[21] These include, among other things, increased capital requirements (not only based on enhanced Basel III risk-based and leverage capital enhancements, but also the effects of targeted measures, such as, among others, the global market shock incorporated into stress testing and the yet-to-be-implemented revised market risk capital rules). See Basel Committee on Banking Supervision, Minimum Capital Requirements for Market Risk (rev. Feb. 2019), https://www.bis.org/bcbs/publ/d457.pdf.

[22] See also Supervision and Regulation Report at 12 (describing the Regulatory Relief Act as "reducing regulatory burden").

[23] We recognize that the current Regulation YY framework applies U.S. liquidity and risk management requirements to branches/agencies that are in addition to home-country requirements.

These two structural principles would, in an efficient manner, address a majority of the issues we describe in this letter. In particular, these modifications would:

- Eliminate the negative effect of the CUSO-wide attributes on the stringency of IHC requirements;
- Eliminate the need for CUSO-wide additional reporting and consolidation;
- Reduce or eliminate the transition period needed to calculate an international bank's category and to come into compliance;
- Reflect the IHCs' and U.S. operations' true risk to the U.S. financial system and potentially provide some tailoring relief as the domestic institutions received; and
- Be more consistent with statutory mandates of national treatment, equality of competitive opportunity and observance of home-country comparable rules.

We discuss below how these modifications would enhance the overall Proposal. Other Sections of this letter and its Appendices provide more specific comments on the risk-based indicators, the categorization framework, EPS, reporting requirements and implementation/transition issues.

A. <u>CUSO size and risk-based indicators should not be used to determine the applicability of more stringent requirements to (i) an IHC or (ii) a U.S. branch/agency network</u>.

The Proposal's use of CUSO attributes to determine applicability of requirements to an IHC or a U.S. branch/agency network represents a dramatic shift from Regulation YY's focus on structural reforms, such as the IHC formation requirement, IHC capital planning and stress testing, IHC liquidity stress testing and buffers (which are already relatively greater than branch liquidity buffers), iTLAC, resolution planning and U.S. risk committee requirements, as the primary mechanisms to address vulnerabilities. These structural reforms were already designed to decrease the potential contagion of risk from the branch/agency network to the IHC and vice versa. Furthermore, they were designed so that risks in the IHC were clearly separated and addressed with sufficient pre-positioned resources and mitigants within the IHC. In addition, existing pre-crisis regulations already limit interaffiliate transactions[24] between the branches and certain IHC subsidiaries and restrict activities of U.S. branches of international banks for safety and soundness reasons. The Proposal does not mention any change in circumstances that would justify attributing and conflating risks across the CUSO, particularly in light of the structural design imposed not only by the already enhanced prudential standards, but also by previously existing prudential standards that are broadly applicable to banking organizations that operate in the United States.

Moreover, this approach fails to recognize the Agencies' existing authority to examine for compliance across an international bank's U.S. operations and an extensive supervisory toolkit to address any deficiencies at both the IHC and branch/agency levels. For example, most IHCs are subject to the liquidity coverage ratio ("LCR") framework, an international bank must already report liquidity positions across the CUSO and Regulation YY imposes liquidity stress testing and a liquidity buffer requirement at the IHC and the U.S. branches. In addition, branches/agencies are already subject to comprehensive regulation by their primary U.S. prudential regulator, either the OCC or the applicable state banking regulator. Introducing CUSO size and risk considerations in the categorization of IHCs and

[24] We note that these restrictions (Sections 23A and 23B of the Federal Reserve Act) were also, in fact, enhanced post-crisis under the Dodd-Frank Act. <u>See</u> Dodd-Frank Act § 608.

branches creates complexity and illogical results that would be inconsistent with the Federal Reserve's objective of improving the "efficiency, transparency, and simplicity" of its regulatory framework.[25]

1. *CUSO size and risk-based indicators should not be used to determine the applicability of more stringent requirements to an IHC.*

Achieving national treatment requires categorizing IHCs based solely on the attributes of the IHC. Under the Proposal, the applicable category of enhanced risk management, liquidity and SCCL standards for an IHC would be determined based on the size and risk profile of an international bank's CUSO. For an international bank with an IHC in a lower category than its CUSO, the IHC would be severely and negatively affected by assets and risk attributes outside the IHC in determining applicable EPS. This construct would result in miscalibration of liquidity and other standards.[26] The IHC would be forced to bear more regulation than its own attributes and resources would otherwise dictate, thus materially and significantly distorting incentives for international banks' U.S. operations. In addition, the Agencies provide no supporting evidence that using IHC resources to comply with enhanced regulation would be an effective means of addressing or allocating resources to any perceived vulnerabilities across the CUSO. Applying increased liquidity requirements to an IHC based on these perceived risks would result in liquidity allocated to the IHC where it cannot be used to address such risks directly. Conversely, the Agencies have not identified any reasons why current home-country or U.S. regulations applicable to the branch/agency network is not sufficient or requires elevated standards for the IHC.

Leaving the IHC formation threshold at $50 billion in non-branch assets while applying most EPS based on CUSO attributes also contributes to this miscalibration by threatening to immediately subject a newly formed IHC to elevated standards. This construct undermines the Agencies' own goal of reducing the stringency of rules for banking organizations that present less systemic risk, deters international banks from growing in the United States, and discourages formation of an IHC in the first instance. This construct also eliminates any benefits of the "Other" firms category for smaller IHCs—a potential national treatment violation because U.S. BHCs with similar size and risk profiles would not become subject to elevated EPS.

We were encouraged to hear Vice Chairman Quarles explain that the Federal Reserve plans to "carefully consider comments as to whether" it should look solely at an IHC's attributes to determine the categorization framework.[27] In our view, applying the size and risk-based indicators of the CUSO to increase the stringency of requirements on the IHC (without empirical data or qualitative observations to justify use of CUSO attributes) would violate the statutory requirements to adhere to national treatment, equality of competitive opportunity and deference to existing, comparable home-country regulation. In particular, this approach would be detrimental to IHCs relative to U.S. BHCs,

25 Quarles Early Observations; Supervision and Regulation Report at 9.

26 For example, of the five IHCs that the Federal Reserve indicates would be subject to Category II liquidity standards, four of them appear to be subject to those EPS on the basis of CUSO attributes and only one based solely on the characteristics of the IHC. Both of the Category IV IHCs that are estimated by the Federal Reserve to be elevated to Category III liquidity requirements would be elevated on the basis of CUSO attributes. See Bank Policy Institute, FBO Tailoring Proposal Tightens Liquidity Requirements for IHCs (June 20, 2019), https://bpi.com/fbo-tailoring-proposal-tightens-liquidity-requirements-for-ihcs/ ("[T]he use of CUSO characteristics to determine IHC liquidity requirements creates inappropriate outcomes because it is misaligned with the IHC's activities, organizational structure, business model and risk profile.") ("BPI Tailoring Analysis").

27 Quarles 2019 Semi-Annual Senate Testimony.

which would face no such external measures of riskiness under the domestic proposal, and thus would violate the principle of national treatment.

2. *CUSO size and risk-based indicators should not be used to determine the applicability of more stringent requirements to a branch/agency network.*

The Proposal's CUSO-wide approach would also be detrimental to non-IHC international banks relative to U.S. BHCs that are subject to the categorization framework. The Federal Reserve has already determined that the size and risk attributes of non-branch assets in non-IHC international banks do not rise to the level of requiring "enhanced" prudential standards. Therefore, such assets should not inform the level of requirements applicable to the branch/agency network. Requiring calculation across the CUSO of the risk-based indictors would impose a significant reporting burden on non-IHC firms, without any meaningful impact on the branch/agency network given the smaller size of the non-branch/agency U.S. subsidiaries. In addition, as discussed above, separation mechanisms between the branch/agency network and the U.S. subsidiaries, such as the restrictions on interaffiliate transactions and branch activity restrictions, should mitigate any concerns about these smaller non-branch assets impacting the riskiness of the branch/agency network.

Under our proposed simplifications, there should be no need to extend the requirement to collect Form FR Y-15 data to branches/agencies, or to collect and report risk-based indicators across the CUSO of international banks. Not applying the additional complexity of these reporting requirements would remove a key source of unsubstantiated and increased cost and burden to non-IHC international banks.

B. <u>Recognizing the differences of international bank U.S. operations in comparison to U.S. BHCs requires that (i) EPS applicable to IHCs be further modified to lessen their stringency and (ii) EPS applicable to a U.S. branch/agency network consist largely of confirmation of applicability of home-country requirements consistent with internationally agreed standards</u>.

In appropriate cases, taking into account the unique position of an international bank's U.S. operations as part of a larger organization should mean the application of less stringent requirements at the local operations than are applicable on a consolidated basis.[28] At the branch/agency level, certain elements of the current Regulation YY liquidity buffer regime (namely, the inability to offset internal inflows against external outflows) and the request for comment on additional liquidity regulation at the branch level run counter to these principles. At the IHC level, there is little or no tailoring in the Proposal reflective of these principles, notwithstanding consolidated application of home-country standards and significant existing capital and iTLAC (for most IHCs) pre-positioned by the parent. Therefore, each category of regulatory requirements should be reviewed to strike the appropriate balance between pre-positioning, which provides certainty to host jurisdictions, and centrally managing those risks with consolidated (and often regulatorily required) resources, which reduces misallocation and improves overall flexibility and resilience.

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[28] <u>See</u> Brand Your Cattle Speech.

1. *EPS applicable to IHCs should be less stringent than those applied to comparable BHCs due to home-country regulation applicable on a consolidated basis.*

The home-host balance described by Vice Chairman Quarles[29] suggests that the host country apply less stringent rules than those applicable to the consolidated firm where appropriate so as not to increase fragmentation of enterprise risk management, liquidity and capital pools. But the Proposal would, in contrast, apply more stringent rules in a number of respects. For example, the Proposal would ratchet up liquidity requirements for many international banks by applying the full LCR and net stable funding ratio ("NSFR") and daily FR 2052a reporting to IHCs that are in Category II (and many that are in Category III, depending on the amount of wSTWF in the CUSO) and would apply LCR and NSFR standards anew to IHCs that are not depository institution holding companies.[30] The Federal Reserve's own data show that setting liquidity EPS on the basis of CUSO attributes would result in a significant advantage for U.S. BHCs, which on aggregate would see their need to maintain high quality liquid assets ("HQLA") decrease, relative to IHCs, which would see their need to maintain HQLA increase.[31] Existing rules have effectively mitigated the Federal Reserve's concerns that the current funding profiles of both U.S. BHCs and IHCs present systemic risk[32] and, therefore, increasing HQLA requirements should not be necessary. The failure to provide an allowance in recognition that these IHCs are already subject to an LCR and NSFR on a consolidated basis is an example of tipping the balance too far in favor of host-country protectionism over international flexibility. In essence, the risk-based indicator structure in the Proposal requires that the IHC bear all of the risk of the international bank, but not be credited with any benefit from the support provided by being part of a larger organization. This is not consistent with a home-host balance and could weaken banks rather than strengthen them.

In addition, the Proposal does not recognize or credit the risk-reducing nature of iTLAC and long-term debt ("LTD"), which would result in different treatment of similarly situated international and domestic banks. These requirements are applicable to IHCs in any category that are subsidiaries of GSIBs, but are not applicable to U.S. BHCs in Categories II, III or IV. This approach departs from Vice Chairman Quarles' stated intention to ensure a level playing field while also taking into account the differences between IHCs and U.S. BHCs.[33] iTLAC in particular is a significant stability enhancing cushion at IHCs that can mitigate many of the concerns associated with the risk-based indicators that the Agencies have identified in the Proposal by, for example, being calibrated already to the size of non-bank and non-branch assets or by providing additional loss absorbency for off-balance sheet exposures. This additional layer of capital, which is pre-funded and pre-positioned in the United States, positively differentiates these IHCs from U.S. BHCs placed in the same category on a standalone basis, and yet no

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29 See Brand Your Cattle Speech.

30 See Quarles 2019 Semi-Annual Senate Testimony (acknowledging that certain international banks would see "significant increases" under the Proposal).

31 Compare Randal K. Quarles, Vice Chairman for Supervision, Federal Reserve, Opening Statements on Proposals to Modify Enhanced Prudential Standards for Large Banking Organizations (Oct. 31, 2018) ("The cumulative effect of the proposed changes, would be a reduction of between 2 to 2.5 percent of high quality liquid assets, depending on where the final rule lands in the proposed 70-85% range.") with Quarles 2019 Semi-Annual Senate Testimony ("The liquidity requirements on the U.S. operations of foreign banks as the result of our proposal are measurably higher, almost 4 percent higher, by our estimates.").

32 FRB Financial Stability Report at 5.

33 See note 13 above and accompanying text.

differentiation or tailoring results from this risk-reducing attribute. For example, according to IIB calculations, international banks that are projected to be in Category II or Category III have approximately 27% more TLAC than U.S. GSIBs in Category I and, a fortiori, much more TLAC than any of the Category II and III U.S. BHCs. The principle of national treatment requires that IHCs be treated no worse than U.S. BHCs that are similarly sized and exhibit similar risk attributes, as well as giving credit for regulations that are applied differently to IHCs such as iTLAC.[34]

Furthermore, the capacity for parent support in a stressed scenario has been strengthened by the introduction of consistent global capital and liquidity requirements, iTLAC and other resolution planning requirements that pre-position capital and liquidity in U.S. subsidiaries (or that require contractual means to ensure appropriate distribution of liquidity in stress), improved risk management requirements and other enhanced standards. This added layer of capital and liquid asset coverage at the parent level can protect subsidiaries in the event of failure and can be injected more quickly than a U.S.-headquartered BHC going to market. In addition, certain international banks have historically been a source of resilience for the U.S. financial system, including as sources of capital for U.S. GSIBs and as purchasers of failed or highly stressed U.S. banks and broker-dealers.[35] Moreover, according to Federal Reserve research, net funding inflows from international banks to their own U.S. bank subsidiaries

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34 See "Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements," 82 Fed. Reg. 8266, 8291–92 (Jan. 24, 2017) (invoking the home-host balance in calibrating lower TLAC and LTD requirements for non-resolution covered IHCs).

Furthermore, the iTLAC for IHCs is set much higher than that set by non-U.S. jurisdictions when they are host countries. We acknowledge that Vice Chairman Quarles has argued that it would be useful for the U.S. to shift to a lower range for iTLAC, to improve both flexibility and the balance of resources available at the parent. See Brand Your Cattle Speech.

35 See, e.g., Press Release, Sec. and Exch. Comm'n, Statement on Proposed Lehman Brothers, Inc. Acquisition by Barclays (Sept. 17, 2008), https://www.sec.gov/news/press/2008/2008-206.htm (noting that "this is welcome news for every one of Lehman's customers" because "[e]ven before the transaction is completed, they will benefit because the broker-dealer and 10,000 Lehman employees will be able to continue their work with . . . greater funding resources for the broker-dealer's operations."); Press Release, Banco Santander to acquire Sovereign Bancorp (Oct. 13, 2008), https://www.santander.com/csgs/Satellite/CFWCSancomQP01/en_GB/Santander/Press-Room/Press-Releases/Banco-Santander-to-acquire-Sovereign-Bancorp.html; Press Release, Fed. Deposit Ins. Corp., BBVA Compass Assumes Deposits of Guaranty Bank (Aug. 21, 2009), https://www.fdic.gov/news/news/press/2009/pr09150.html; Press Release, Fed. Deposit Ins. Corp., TD Bank, National Association Acquires All the Deposits of Three Florida Institutions (Apr. 16, 2010), https://www.fdic.gov/news/news/press/2010/pr10078.html; Press Release, Fed. Deposit Ins. Corp., [MUFG] Union Bank, National Association Assumes All Of The Deposits Of Tamalpais Bank (Apr. 16, 2010), https://www.fdic.gov/news/news/press/2010/pr10081.html; Press Release, Fed. Deposit Ins. Corp., [MUFG] Union Bank, National Association Assumes All Of The Deposits Of Frontier Bank (Apr. 30, 2010), https://www.fdic.gov/news/news/press/2010/pr10101.html; Mitsubishi UFJ Financial Group, Inc., Fed. Res. Bull. (2d Quarter 2011), https://www.federalreserve.gov/pubs/bulletin/2011/legal/q211/q211_all.htm ("[C]onsummation of the proposal would strengthen Morgan Stanley's capital position and allow Morgan Stanley to better serve its customers"); Press Release, U.S. Dep't of the Treasury, $1.7 Billion Additional TARP Funds Returned to Taxpayers, Positive Return on TARP Bank Programs Reaches $10 Billion (July 5, 2011), https://www.treasury.gov/press-center/press-releases/Pages/tg1232.aspx (BMO acquired Marshall and Ilsley Bank, returning $1.7 billion in TARP funds to the U.S. Treasury).

increased during the financial crisis.[36] The historical experience of parents acting as a consistent source of strength should be credited as a risk-reducing factor for international banks.

In many ways, therefore, the IHCs should be treated with greater flexibility and reduced burdens as compared to U.S. BHCs.

2. *EPS applicable to a U.S. branch/agency network should consist largely of confirmation of applicability of home-country requirements consistent with internationally agreed standards.*

Congress directed the Federal Reserve to take into account the degree to which an international bank is subject to home-country regulatory standards that are consistent with internationally agreed principles. This is especially true for branches as extensions of the foreign legal entity. While the Proposal often follows this guiding principle with respect to branches/agencies, certain aspects, particularly the request for comment on standardized liquidity requirements for U.S. branches/agencies, move too far in the direction of host certainty at the expense of flexibility. The IIB is submitting a separate letter responding to the Agencies' questions regarding whether to apply additional standardized liquidity requirements to the U.S. branches/agencies of international banks.

III. The Categorization Framework Should be Tailored More Appropriately to U.S. Operations of International Banks

A. The Agencies should adopt a general framework based on the risk-based indicator approach consistent with the domestic proposal, but important revisions to the framework are needed to more appropriately measure the risk profile of international banks' U.S. operations.

We generally support the use of risk-based indicators to tailor the application of prudential standards to international banks. In particular, we support the decision not to designate the U.S. operations of any international banks as Category I firms. We also appreciate that the Proposal adopts a framework based, for the most part, upon U.S. footprint rather than global consolidated assets and recognizes the steps that international banks have taken to structure their U.S. operations in accordance with IHC requirements. Furthermore, we welcome the proposed increase in threshold to $100 billion in assets before an IHC becomes subject to enhanced capital and stress testing requirements.[37]

We are in favor of a framework that goes beyond categorization based on asset size alone and incorporates some evaluation of risk of operations. While the risk-based indicators should be revised in several respects, the construct of the framework is an appreciated step. A consistent use of risk-based indicators for both U.S. BHCs and IHCs, with appropriate modifications, is an important transparency and simplification goal. Additionally, the increase in thresholds at which EPS apply to firms that do not have IHCs will better align the stringency of regulatory requirements with the relative risks posed by international banks' U.S. operations.

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36 William Goulding and Daniel E. Nolle, "Foreign Banks in the U.S.: A Primer," Federal Reserve International Finance Discussion Papers No. 1064, fig. 13b (Nov. 2012) (noting that inflows rose by 50% over pre-financial crisis levels).

37 See U.S. Department of the Treasury, A Financial System That Creates Economic Opportunities: Banks and Credit Unions 18 (June 2017) (the "Treasury Report").

Within this risk-based framework, however, application of the risk-based indicators to international banks exhibits certain biases that should be eliminated, and the Agencies should make targeted adjustments in recognition of the unique operations and structures of international banks. As discussed in more detail below, each risk-based indicator should be tailored further to (i) be more risk sensitive, (ii) take into account the nature of the U.S. operations as part of a broader, supportive organization and (iii) acknowledge that international banks are already subject to comprehensive home-country regulations applied on a consolidated basis.

B. The proposed categorization framework exhibits material biases that negatively affect international banks.

In view of the generally smaller asset size, smaller overall footprint, smaller corporate/investment banking activities and significantly lower GSIB composite scores of international banks' U.S. operations relative to U.S. BHCs, the risk-based indicators proposed by the Agencies would affect international banks disproportionately in comparison to U.S. BHCs. Although the indicators and the category thresholds may appear objective, and may be intended to be applied objectively, the results of the categorization indicate a bias toward more stringent requirements for international banks and an unlevel playing field when compared with similarly situated U.S. holding companies. A few examples illustrate this discriminatory effect:

- Of the 12 IHCs required to be formed under Regulation YY, eight are placed into Category II or III. By contrast, of the 24 non-GSIB U.S. holding companies with over $50 billion in assets, only five are placed into these two categories.

- The IHCs[38] in Categories II and III have an average of $188 billion in assets, whereas the five-firm average for the U.S. holding companies in those two categories is $330 billion. Average risk-weighted assets ("RWA") are $87 billion and $232 billion, respectively. Therefore, the average RWA density of these IHCs is slightly higher than 46%; average RWA density for the U.S. holding companies in those categories is slightly higher than 70%, indicating a significantly more risky asset mix on average.

- The average Tier 1 capital of the eight IHCs placed into Category II or III is 21.0%; that of the U.S. holding companies in those categories is 14.5%.[39] Moreover the TLAC resources of the Category II and III IHCs is even higher (at least 28.6%), providing nearly twice the overall loss absorbency of the domestic peer group in those categories.[40]

The risk-based indicators therefore appear to place international banks into Categories II and III, even though their IHC subsidiaries are smaller (based on total assets), less risky (based on RWA) and better capitalized (based on Tier 1 Capital and iTLAC) than U.S. holding companies placed in the same categories. We acknowledge the benefits of maintaining a framework that is similar to that employed for the U.S. BHCs. However, more attention should be paid to aligning the treatment of international banks with that of U.S. counterparts. Specifically, (i) elements significantly and negatively

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[38] This cohort includes the eight IHCs estimated by the Federal Reserve to fall into these two categories.

[39] As discussed in this letter, many of the IHCs comply with iTLAC requirements that are only applicable to Category I U.S. GSIBs (and have higher total TLAC than those U.S. GSIBs).

[40] Based on IIB estimates. The U.S. BHCs in those categories do not issue TLAC per se, so the relevant comparison was to total capital for this group, which averaged 15.5%.

affecting international banks, without effect at all on U.S. BHCs (e.g., the negative effect of CUSO attributes on the IHCs and the incorporation of significant interaffiliate exposures into the risk indicators, among others that we discuss in more detail in this letter), should be removed, (ii) more tailored modifications to the calculation methodology and the variables incorporated into each risk-based indicator should be made and (iii) more tailored application of EPS should be crafted.

C. The Agencies should not apply any EPS to IHCs with less than $100 billion in assets to avoid creating disincentives for smaller IHCs to grow.

By setting a $100 billion asset threshold for EPS imposed on the basis of IHC attributes, the categorization framework provides limited relief for smaller IHCs. Many of our members welcome the Agencies' proposal to raise the threshold for applying capital-related EPS, although further tailoring is necessary to remain consistent with policies supporting the current Regulation YY framework and the stated goals of the Proposal.

But by using CUSO attributes to determine the categorization of IHCs for many EPS, including LCR, NSFR, SCCL and liquidity reporting, the proposed categorization framework would create several "cliff effects" whereby a small IHC could become subject to the most stringent set of standards instantly upon crossing the formation threshold. The IHC threshold, maintained at $50 billion under the Proposal, would become an effective "ceiling" for the growth of non-branch assets for international banks wishing to avoid these effects, creating a disincentive for non-IHC international banks to grow, to extend credit and to contribute to the economy of the United States.[41]

These "cliff effects" would best be addressed by limiting EPS applicable to smaller IHCs between $50 billion and $100 billion in assets solely to risk management standards in Regulation YY.[42]

The intended progressive application of EPS to non-branch activities is undermined by the use of CUSO attributes to determine requirements applicable to an IHC. Under the Proposal, a new IHC with assets of $51 billion would be subject not only to EPS designed for IHCs under the current Regulation YY, but could, as a result of CUSO attributes (and notwithstanding its own size and risk attributes), be subject immediately to: (i) Category II EPS with respect to SCCL; (ii) the full, not modified, daily LCR and NSFR; (iii) daily FR 2052a reporting and (iv) more frequent liquidity stress tests. Almost all of these requirements are more onerous than those that a $51 billion IHC would experience under the current EPS framework in Regulation YY and would significantly exceed those that would apply to a U.S. BHC crossing the $50 billion asset size threshold. And yet this IHC would not

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41 See Treasury Report at 18.

42 The proposed revisions to Subpart N of Regulation YY focus on international banks with greater than $100 billion in total consolidated assets, but less than $100 billion in combined U.S. assets, and provide for fewer requirements for IHC subsidiaries of these international banks. However, (i) Subpart N still evidences the negative effect from branch/agency attributes, as an IHC of an international bank with less than $100 billion in combined U.S. assets is treated differently from an IHC of an international bank with $100 billion or more in combined U.S. assets (see Subpart O of Regulation YY), even if the IHC of each of these international banks is the same size and exhibits the same risk attributes, and (ii) Subpart N addresses only Regulation YY provisions and does not mitigate the broader negative ramifications in the Proposal from branch risk attributes that could impose on the IHC more stringent SCCL, LCR, NSFR and liquidity reporting requirements.

Compare, e.g., Subpart O, proposed § 252.153(e)(5) (helpfully creating an IHC-specific threshold of $100 billion for application of stress-testing requirements).

even be required to calculate its standalone categorization because it has below $100 billion in assets. Therefore, this IHC would not need to apply the capital and stress-testing EPS, although standard U.S. capital rules would apply. Such an outcome for IHCs indicates that the Agencies have miscalibrated the categorization framework for international banks by creating significant potential for IHCs to be subject to liquidity requirements and SCCL that are materially and unnecessarily more stringent than otherwise should apply.

The calibration of the NBA risk-based indicator also demonstrates this "cliff effect" on new or small IHCs.[43] A new IHC without a bank subsidiary that grows to $75 billion would "leapfrog" over both Category IV and the "Other" firm category for many EPS. Under the Proposal, an IHC must determine its own categorization, which in turn determines its capital and stress-testing EPS, only if it has at least $100 billion in assets. An IHC without a U.S. bank subsidiary would thus experience a "cliff effect" well before it even reaches this threshold because it would, by definition, exceed the NBA risk-based indicator and be placed immediately in Category III at $75 billion of consolidated assets. This would mean jumping the Category IV exception for SCCL and immediately applying Category III standardized liquidity requirements (and possibly Category II liquidity requirements if negatively affected by CUSO attributes). In implementing the Regulation YY framework, the Federal Reserve sought to design the final rule to "reduce the potential that small changes in the characteristics of [an international bank] would result in sharp, discontinuous changes in the standards."[44] The same concern should motivate the Agencies to re-calibrate the thresholds applicable to international banks to address these "cliff effects" for smaller and newly formed IHCs.

D. The risk-based indicators should exclude interaffiliate activity.

Excluding transactions between an international bank's IHC and the international bank's affiliates would better ensure that the IHC is treated comparably to a similarly situated U.S. BHC for purposes of calculating risk-based indicators. Top-tier BHCs eliminate transactions between the BHC and its consolidated subsidiaries, as well as among consolidated subsidiaries (including subsidiary banks and broker-dealers), when reporting on the FR Y-15 and other relevant reporting forms. As a result, intercompany transactions within the consolidated U.S. BHC are not taken into account for purposes of calculating the thresholds in the reporting forms that inform the risk-based indicators.[45] IHCs, on the other hand, would not be permitted to eliminate transactions between the IHC and affiliates that are not consolidated subsidiaries of the IHC when reporting such figures. And, yet, these are the same types of transactions among affiliates for funding and risk management purposes, and are not "external" to the

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43 In Section III.G below, we recommend elimination of the NBA risk-based indicator for this and other reasons.

44 "Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking Organizations," 79 Fed. Reg. 17240, 17243 (Mar. 27, 2014).

45 Instructions for Preparation of Banking Organization Systemic Risk Report: Reporting Form FR Y-15 at GEN-1 (reissued Dec. 2016) ("As part of the consolidation process, the results of all transactions and all intercompany balances (e.g., outstanding asset/debt relationships) between offices, subsidiaries, and other entities included in the scope of the consolidated holding company are to be eliminated in the consolidation and must be excluded") ("FR Y-15 Instructions"); Instructions for Preparation of Consolidated Financial Statements for Holding Companies: Reporting Form FR Y-9C at GEN-4 (reissued Mar. 2013) (same).

organization. To treat IHCs consistently with similarly situated U.S. BHCs, the Proposal should be revised to exclude all interaffiliate activities from each of the risk-based indicator calculations.[46]

1. *Cross-jurisdictional activity ("CJA")*

Excluding all interaffiliate transactions from the calculation of CJA would be consistent with the principle of national treatment, ensuring that the CJA indicator does not discriminate against the U.S. operations of an international bank based on the fact that they are owned by a foreign entity and, therefore, inherently are likely to have a higher amount of CJA relatively and proportionately to a similarly situated U.S. BHC because of interaffiliate relationships.[47] Transactions with affiliates are often an integral part of an international bank's enterprise-wide risk management practices. For example, an international bank's U.S. operations often engage in transactions with affiliates to distribute risk to the geographic areas best suited to manage and hedge the risk. Similarly, an IHC or U.S. branch/agency network often provides access to U.S. markets for non-U.S. affiliates, especially access to high-quality U.S. collateral. These interaffiliate cross-jurisdictional activities do not implicate the considerations the Agencies seek to address through the use of an international activity indicator. On the contrary, many interaffiliate transactions are risk-reducing, intended to facilitate enterprise-wide risk management. The Agencies have reached this conclusion in the SCCL rule, which excludes affiliate exposures, and should take the same approach in the measurement of CJA in the Proposal.[48]

The current proposed approach of only excluding interaffiliate liabilities to the extent they are collateralized by financial collateral is not sufficient to ensure national treatment. In addition, requiring such collateralization, in addition to compliance with Section 23A, uncleared swap margin requirements and other EPS, further traps liquidity in the United States that could potentially be deployed more effectively elsewhere in the operations of an international bank. As the Agencies recognize in the Proposal, focusing "only on third-party assets and liabilities" would be a "less burdensome way to account for the structural differences between [international banks'] operations in the United States and large domestic holding companies."

If the Agencies do not exclude all transactions with non-U.S. affiliates from the calculation of CJA, the Agencies should, at a minimum, adopt the proposed modifications to the

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46 See BPI Tailoring Analysis ("While not fully representing equal treatment with respect to domestic BHCs, excluding all intercompany transactions would partially account for some of the structural differences between [international banks'] operations in the U.S. and domestic [BHCs].")

47 To be effective, the exclusion of affiliate claims and liabilities must also exclude such balances in relation to U.S.-located affiliates, because, for example, the CJA metric counts exposure to a U.S. branch of an international bank as cross-jurisdictional based on the instructions to the Form FFIEC 009. Therefore, for the IHC, transactions with the U.S. and foreign branch/agency network, home office and non-U.S. subsidiaries of the parent bank should be excluded. For the U.S. branches/agencies, to the extent CJA continues to apply as a metric for the CUSO, transactions with the entire branch network (including U.S. branches), as well as non-U.S. subsidiaries of the parent bank and of the IHC (if any) should be excluded. As discussed in this letter, due to/from positions of U.S. branches/agencies with other branches/agencies and home office should also be excluded.

48 See 12 C.F.R. § 252.171(f)(2).

definition of CJA that exclude liabilities to non-U.S. affiliates and claims on non-U.S. affiliates to the extent they are collateralized by financial collateral.[49]

2. *wSTWF*

Interaffiliate transactions do not implicate the considerations the Agencies are addressing through use of the wSTWF indicator. The Agencies have evidenced a concern that the use of wSTWF can be an indicator of vulnerability and interconnectedness among market participants, including other financial sector entities. However, exposures between different parts of the same organization do not suggest this same degree of interconnectedness. In addition, the Agencies state in the Proposal that the wSTWF risk-based indicator is an indication of whether operations are "vulnerable to large-scale funding runs."[50] Support from affiliates is much less likely to be curtailed than support from third parties that are engaged in constant credit and liquidity risk analysis of counterparties; indeed, support in the short-term from affiliates is more likely to replace support from third parties that may have been curtailed. Affiliates, and particularly parents, are also not likely to panic and withdraw funding given their close relationship, inside knowledge of the institution, and integrated enterprise-wide funding and risk management.

Furthermore, the wSTWF indicator is likely to capture interaffiliate transactions that are not the type of risky transactions reflective of dependence that the Agencies have in mind. International liquidity movements undertaken as part of enterprise-wide liquidity and foreign exchange management are likely to be undertaken across a range of maturities, many of which may, based on the timing of other transactions or obligations, fall within the one-year timeframe for "short-term." Indeed, long-term, external, centralized funding received at the top-tier parent is likely to be allocated short-term internally by the organization's treasury or financing division, so that it may serve its intended purpose and be re-deployed when and where needed. For example, an international bank may lend Euro temporarily to its U.S. operations to fund a draw on a multi-currency facility; the internal loan may be repaid shortly by the U.S. operations by leveraging collateral received after the draw is funded. There are countless similar examples, all designed to place funding, foreign exchange or liquidity from head office temporarily into the appropriate geographic location. These transactions, driven by prudent internal risk management and liquidity allocation, should not be penalized.

3. *NBA*

As the Agencies recognized in relation to the CJA indicator, the structural location of the U.S. operations of an international bank requires that interaffiliate transactions with non-U.S. entities occur in relation to centrally managed risk, capital and liquidity. Affiliate assets should be excluded from the NBA risk-based indicator since they do not reflect complexity of the organization, interconnectedness with third parties or systemic risk—the elements of risk that the Agencies suggest they are attempting to detect with the NBA indicator. Indeed, interaffiliate loans and positively marked derivatives often result from enterprise-wide risk management, including regulator-sanctioned liquidity and foreign exchange risk

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49 Furthermore, to the extent that the Federal Reserve declines to follow our recommendation that all affiliate transactions (including all claims, whether collateralized or not) should be excluded from the CJA measure, the proposed revisions to the Form FR Y-15 Instructions should be modified. Schedule L, Item 1(a) of the proposed revisions indicates that the collateral against claims should be taken into account by using the methodology for collateralized transactions in 12 C.F.R. § 217.37. The risk-weight substitution approach of the simple method described in 12 C.F.R. § 217.37(a)(1)(i) and (b) is not relevant, and only the collateral haircut method in 12 C.F.R. § 217.37(c) is relevant.

50 84 Fed. Reg. at 21998.

management. Including such interaffiliate NBA would also undermine the exception for certain interaffiliate activities in the CJA indicator by bringing back into the indicator framework transactions that have been deemed appropriately excluded.

4. *Off-balance sheet exposures ("OBE")*

Similar to the Agencies' acknowledgement of the structural placement of the U.S. operations within a larger organization in relation to the CJA indicator, OBE exposures between affiliates should be excluded from the calculation of the OBE risk-based indicator since they do not reflect activities with third parties that increase interconnectedness in the financial system or that would reasonably give rise to systemic risk.

An exclusion of affiliate-related OBE should cover, among other commitments, any guarantee issued by a U.S. bank subsidiary or U.S. branch of an affiliate's securities to enable a Securities Act Section 3(a)(2) exemption from registration for securities used to fund the international bank. In addition, an exclusion should address any guarantee implied by the function of a U.S. futures commission member or other clearing member subsidiary in facilitating the clearing of futures and swaps by any of its affiliates that are not clearing members. These clearing exposures are derived directly from mandatory clearing requirements that are intended to promote the safety and soundness of the U.S. markets. Penalizing clearing of affiliate transactions may also increase clearing through U.S. GSIB clearing members, because the swap clearing intermediary market is quite concentrated, with several institutions having dropped out of the market for other regulatory reasons. Moreover, an exclusion should address potential future exposures associated with derivatives cleared by an affiliate of an international bank, so long as the international bank affiliate complies with ongoing margin requirements. This adjustment promotes the central clearing objectives of the Dodd-Frank Act and the complementary derivatives reforms adopted by other host jurisdictions.[51] Without these clearing-related exclusions, financial activity could become further concentrated in U.S. GSIBs.

Including interaffiliate OBE would also undermine the exception for certain interaffiliate activities in the CJA indicator by penalizing OBE activity between the U.S. operations and non-U.S. affiliates that would otherwise be allowed under the CJA indicator. For example, if a loan from an IHC to an offshore affiliate were excluded from CJA exposure, then a guarantee by an IHC of that same affiliate should similarly be excluded.

5. *No risk-based indicator, if measured at the CUSO level, should include due-to or due-from positions between a U.S. branch and non-U.S. office of an international bank.*

To the extent necessary to measure risk-based indicators at the CUSO level, the Agencies should clarify that such risk-based indicator measurements do not include those of a U.S. branch to a foreign office of an international bank, including to non-U.S. branches and an international bank's head office. These transactions are within the same legal entity and are not indicative of complex or interconnected activity.

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51 E.g., 17 C.F.R. § 50.4 (U.S.); 2012 O.J. (L 201/1) 648 (EU); Respecting Mandatory Central Counterparty Clearing of Derivatives, N.I. 94-101 (Can.); cf. Press Release, Basel Comm. on Banking Supervision, Basel Committee Discusses Policy and Supervisory Initiatives and Approves Implementation Reports (June 20, 2019), https://www.bis.org/press/p190620.htm (allowing margin to offset potential future exposure amounts).

E. We support the proposed revisions to the CJA risk-based indicator to exclude certain interaffiliate cross-border activity, but the CJA risk-based indicator should be tailored further in the context of international banks.

1. *CJA should be treated the same as other risk-based indicators and should not determine an international bank's inclusion in Category II.*

The Proposal disproportionately weights CJA as a proxy for risk as compared to the other risk-based indicators, as CJA is the only risk-based indicator that could determine a firm's inclusion in the most stringent category applicable to international banks (Category II).[52] No one risk-based indicator in isolation should be sufficient to subject a firm to the most stringent category applicable to international banks. The general intention behind the Regulatory Relief Act was to calibrate regulation based on a comprehensive view of a firm, rather than any one indicator.[53] In addition, the Agencies do not provide adequate support in the Proposal for why the CJA risk-based indicator is any better or more sensitive a barometer of risk than other risk-based indicators.

This is particularly troublesome in the context of international banks. As the Proposal acknowledges, the CJA risk-based indicator is of limited utility in relation to international banks.[54] The underpinnings of the CJA indicator evolve from the "foreign exposure" measure originally designed to identify internationally active U.S. BHCs that should be subject to full Basel standards. In this respect, its value as an indicator of risk is minimal and its application to the U.S. operations of international banks is illogical. International banks are inherently internationally active by their nature, which evidences nothing about the risk of the organization. It is also not necessary to identify whether an IHC or the CUSO of an international bank is internationally active for scoping the IHC or CUSO into standards required by Basel accords, as these standards already apply on a consolidated basis under home-country implementation of the Basel accords (which the Dodd-Frank Act mandates the Agencies take into account).

Therefore, the Agencies should amend the categorization framework so that the CJA risk-based indicator only determines a firm's inclusion in Category III, consistent with the other risk-based indicators. If the Agencies do not treat CJA consistently with other risk-based indicators, it is especially vital that the CJA risk-based indicator be properly refined,[55] given both its relative importance in the

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52 We recognize that wSTWF may subject an international bank to Category II liquidity requirements, which is also inappropriate. No one risk-based indicator should subject an international bank to any Category II requirements, and we do not believe it would achieve the goal of tailoring if multiple (or different) risk-based indicators could subject an international bank to Category II standards.

53 Regulatory Relief Act § 401(a)(l)(B)(iii), Pub. L. No. 115-147 (2018) (adding a new subparagraph (C) to 12 U.S.C. § 5365(a)(2) requiring that if the Federal Reserve imposes EPS on firms with $100 billion or more of total consolidated assets, it must take into consideration such firm's "capital structure, riskiness, complexity, financial activities (including financial activities of subsidiaries), size, and any other risk-related factors that the [Federal Reserve] deems appropriate" (emphasis added)).

54 84 Fed. Reg. at 21995 (noting that the Proposal would make adjustments to the CJA indicator "in order to reflect the structural differences between [international banks'] operations in the United States and domestic [BHCs].").

55 Our proposed CJA calibration modifications set forth below are necessary whether or not CJA is a determinant of Category II.

Proposal and its limited utility in appropriately determining risk of an international bank's U.S. operations.

We are encouraged that the Agencies have proposed adjusting the measurement of CJA to reflect the fact that the U.S. operations of an international bank are part of a larger international entity by excluding interaffiliate liabilities and certain collateralized interaffiliate claims from the measurement of CJA.[56] As noted in prior IIB submissions, the foreign exposure measure, and now CJA, have become "penalty" measures used to increase the stringency of regulation of an international bank's U.S. operations. International banks and their U.S. operations should not be penalized for not being the top tier of an international entity and for having "external" transactions with affiliates. The reasoning behind the changes to the CJA measurement suggested in the Proposal should also be applied to make additional targeted modifications to address anomalies in the calculations underlying this and other risk-based indicators.

2. *The Agencies should clarify the change to the calculation of securities financing transaction exposure to an "ultimate-risk basis."*

We understand the Proposal to suggest changing the measurement of securities financing transaction exposure to an "ultimate-risk basis" for transactions with both affiliates and unaffiliated entities, which would permit the U.S. operations of international banks to treat U.S.-issued collateral in reverse repos and securities borrowing transactions as domestic activity.[57] We support adopting this approach in the calculation of CJA, although the implementation of this approach through the FR Y-15 should be clarified.[58] The IIB has long advocated for this change because of (i) the current FFIEC 009's

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56 84 Fed. Reg. at 21995 ("The proposed exclusion recognizes the benefit of the [international bank] providing support to its U.S. operations."; "[international bank]s' U.S. operations often intermediate transactions between U.S. clients and foreign markets, including by facilitating access for foreign clients to U.S. markets, and clearing and settling U.S. dollar-denominated transactions. In addition, they engage in transactions to manage enterprise-wide risk.").

57 See 84 Fed. Reg. at 21195 n. 44 ("The proposal would differ from the FFIEC 009 . . . Securities lending agreements and repurchase agreements . . . are allocated [under the FFIEC 009] based on the residence of the counterparty, without taking into consideration features of the collateral. The proposal would require allocation of exposures on an ultimate-risk basis (subject to the netting described above)."). See also 84 Fed. Reg. at 21996 (Questions 8–10).

58 The proposed revisions to the Form FR Y-15, Schedules E and L, pull a large portion of the claim and liability information from the FFIEC 009 and indicate that the Form should be populated with the "ultimate-risk basis" figures from Schedule C, Part II, Columns 1 through 10, of the FFIEC 009. However, because of the FFIEC 009 instruction not to shift counterparty exposure to the reversed/borrowed collateral, it is not clear whether Schedule C, Part II includes the correct information. It appears from the FFIEC 009 instructions that the Schedule C, Part II information is only counterparty data without the collateral taken into account. See Instructions for Preparation of Country Exposure Report: Reporting Form FFIEC 009 at C-3 (Mar. 2019) ("FFIEC 009 Instructions") (Columns 1 through 10 appear to include the counterparty exposure for securities borrowing and reverse repo transactions, because the collateral provided by those counterparties that does not result in a risk transfer is separately reported in Columns 13 through 16). See also FFIEC 009 Instructions at C-8, Section V.C., Example (18) (even though respondent received UK government securities from a Cayman hedge fund counterparty on a resale agreement, the only entries are the exposure to the Cayman fund). Therefore, the proposed revisions to the FR Y-15 Instructions should be modified as well to address incoming data from the FFIEC 009, to ensure that the collateral in a reverse repo or securities borrow transaction on U.S. securities is taken into account for the "ultimate-risk basis" of the calculation.

inconsistent approach among credit transactions (i.e., permitting exposures to be shifted to U.S. collateral in the context of loans or letters of credit, but not in the context of reverse repos or securities borrowing transactions)[59] and (ii) comparative treatment of securities financing transactions under the Agencies' capital rules (which calculate exposure by using the collateral haircut method, offsetting the collateral against the exposure to the counterparty), in contrast to the FFIEC 009's gross exposure calculation.

Changing the calculation of securities financing transaction exposure to an ultimate-risk basis avoids the unintended consequence of generally reducing international bank repo activity as institutions (both U.S. BHCs and international banks) subject to the proposed categorization framework seek to stay under CJA and foreign exposure thresholds. Rather than reducing risk, decreased repo activity would have the opposite effect of potentially exacerbating financial stress by reducing market liquidity.

3. *The Agencies should clarify that no liabilities and claims between a U.S. entity, including an IHC, and U.S. branches/agencies of any international bank would be treated as CJA.*

The Agencies should clarify that cross-jurisdictional liabilities and claims do not include those between U.S. subsidiaries (including any IHC), on one hand, and any U.S. branches/agencies of any international bank (whether affiliated or not), on the other. These transactions should be treated as domestic activity. Exposures to U.S. branches/agencies are unfairly treated as foreign exposure based on a blunt rule in the FFIEC 009 that the exposure is assumed ultimately to be guaranteed by the parent bank. This discriminates against geographically domestic exposure simply because the counterparty is a branch of an international bank (affiliated or not) and, therefore, violates the principles of national treatment and equality of competitive opportunity. Any banking organization that is monitoring and managing its CJA exposure (after implementation of the Proposal and the domestic proposal, or merely in relation the GSIB indicators in Form FR Y-15) will be reluctant to transact with a U.S. branch of an international bank.

4. *The Agencies should exclude all liabilities to and claims against a home-country sovereign (including a political subdivision thereof), as well as supranational, international and regional organizations.*

The Agencies should exclude liabilities and claims between an international bank's U.S. operations and the home-country sovereign of the parent international bank, and any political subdivision of the home-country sovereign, because these exposures do not represent the type of operational complexity or international interconnectedness that the CJA indicator is intended to capture. These counterparties generally present limited credit risk, and international banks inherently have a substantial degree of overall exposure to their home countries, thus artificially inflating the CJA number with ordinary course exposure. Further, these types of exposures are often exempt from restrictions in other rules (such as the Volcker Rule[60]). Increased U.S. regulation based on this exposure is neither effective nor appropriate.

Similarly, exposures to supranational, international and regional organizations (e.g., the World Bank or the Asian Development Bank) should be excluded regardless of the organization's headquarters, because exposure to these institutions does not signify risk and typically carries zero risk

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59 FFIEC 009 Instructions at GEN-9–10.

60 See 12 C.F.R. § 248.6(b)(1).

weights.[61] Also, international banks may be required by their parent or home-country regulators to participate in credit or other exposures to these organizations and should not be penalized for meeting these home-country requirements, which would be inconsistent with equality of competitive opportunity.

5. *The Agencies should permit the use of settlement date accounting rather than trade date accounting, or should limit trade date accounting exposure to the difference between the market value of the assets or cash expected to be received and the market value of the assets or cash expected to be delivered*.

Use of trade date accounting creates full exposure on the trade date when there has not actually been a failed settlement by a counterparty, leading to volatility in the calculation that is not indicative of activity. If the purpose of measuring CJA is to capture the complexity arising from assets and liabilities in foreign jurisdictions, trade date accounting is not consistent with this purpose because it creates exposures prior to any real claim on an overseas counterparty or asset having arisen. Accounting in this manner inflates true exposure and risk, as the reporting entity has not transferred payment or assets yet. These issues would generally be resolved through the use of settlement date accounting, which would not only reflect the true exposure of a trade, but would also be consistent with (i) regulatory capital rules; (ii) the accounting convention for broker-dealers' repurchase and reverse repurchase transactions, securities lending and activities with clearing organizations and banks and (iii) the accounting convention for banks (unless inventory is material). If the Agencies do not use settlement date accounting, the Agencies should at least limit the trade date accounting exposure to the difference between the market value of the assets or cash expected to be received and the market value of the assets or cash expected to be delivered.[62]

6. *The Agencies should permit the netting of claims and liabilities with a counterparty when calculating CJA.*

The CJA calculation should permit netting of claims and liabilities with a counterparty, with only the net claim or liability counting toward CJA. The FFIEC 009 currently allows netting only in limited circumstances.[63] For purposes of the CJA risk-based indicator, the Agencies should focus on the net cross-border exposure as the true indicator of risk.

7. *As we have raised in previous advocacy in relation to the calculation of "foreign exposure," the Agencies should make other changes to the measurement of CJA*.

We provide additional information in relation to these requested changes in Appendix A to this letter.

F. The wSTWF risk-based indicator is overbroad.

We appreciate the flexibility shown by the Proposal in relation to the CJA metric, which, as proposed, takes into account the unique position of the U.S. operations within a broader organization by addressing certain affiliate liabilities and claims. That principle, as well as a willingness to modify the

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61 See 12 C.F.R. § 217.32(b).

62 See 12 C.F.R. § 217.38 (applying capital to the positive net current exposure of an unsettled transaction, but only after a delivery-versus-payment or payment-versus-payment transaction remains unsettled for five business days).

63 See FFIEC 009 Instructions at GEN-9.

risk-based indicators to correct shortcomings, should be applied to the other risk-based indicators, not only to address appropriately the U.S. operations' context within the international bank, but also to focus the calculations more on the Agencies' goals of identifying risks to financial stability.

The Federal Reserve has recently observed that "short-term wholesale funding continues to be low compared with other liabilities, and the ratio of [HQLA] to total assets remains high at large banks."[64] According to the same research, leverage at broker-dealers is "substantially below" pre-crisis levels in part due to regulatory reforms enacted after the financial crisis that contribute to the resiliency of financial institutions.[65] The fact that short-term wholesale funding "remains close to historical lows as a share of banks' total liabilities" suggests that the primacy of the wSTWF metric in driving the current estimated categorization of international banks, and its newly imposed and more stringent liquidity regulation, results in a miscalibration because it would impose regulatory requirements that are not correlated with the Federal Reserve's own recent assessment of sources of vulnerability in the financial system.[66] We urge the Federal Reserve to modify the wSTWF indicator to make it more risk sensitive.

1. *The wSTWF indicator overstates the risk associated with brokered retail deposits and sweeps.*

The wSTWF metric, as measured by the Form FR Y-15, is a blunt instrument for determining risk of funding runs and fire sales, as it does not differentiate between more stable short-term funding (such as brokered deposits, which are viewed as "stickier" than other forms of short-term funding, particularly when sourced by an affiliate of the bank) and funding that may be susceptible to runs. Therefore, wSTWF calculations, together with calculations of other risk-based indicators, should be assessed at a more granular level in order to appropriately act as a proxy for the risk of banking operations.

The Agencies should provide a lower weighting for brokered and sweep deposits from affiliates relative to such deposits from third parties. First, the LCR rules differentiate between deposits swept from affiliate brokers and those from third party brokers. Under the LCR rules, insured brokered sweep deposits arising out of brokerage arrangements with affiliates are assigned a 10% outflow rate.[67] In contrast, brokered sweep deposits arising out of brokerage arrangements with third parties are assigned a 25% outflow rate.[68] In the final rule implementing the LCR, the Agencies noted that affiliate-brokered sweep deposits should be assigned a lower outflow rate because deposits from affiliate brokers "generally exhibit a stability profile associated with retail customers." These relationships tend to be stable because they are established over time and arise from multiple touchpoints with the customer. According to the Agencies, the "the affiliated company would be incented to minimize harm to any depository institution." By contrast, unaffiliated brokered sweep deposits are sourced from third-party intermediaries, rather than

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64 FRB Financial Stability Report at 7.

65 Id.

66 Id. at 36.

67 12 C.F.R. § 249.32(g)(7).

68 12 C.F.R. § 249.32(g)(8).

from more stable retail customers. These relationships can add volatility and "fluctuate significantly" in a stressed scenario because the third party may "move entire balances away from the bank."[69]

However, the Form FR Y-15 would weight all short-term brokered sweep deposits at 25%,[70] thus not sufficiently tailoring the measurement to the risks that the Agencies have determined in related situations. Second, the FDIC has taken the position that a broker-dealer that sweeps customer cash into an account at an affiliated bank may meet an exception from the "deposit broker" definition,[71] and the FDIC reiterated this position earlier this year.[72] This approach favors deposits received from affiliate brokers by allowing banks to accept these deposits without the potential restrictions that accompany brokered deposits. Particularly, given that affiliate-brokered sweep deposits reached $724 billion in September 2018, and given the FDIC's oversight of these deposits, we understand that granting such an exception has been well-considered by the FDIC.[73]

Not only does the wSTWF indicator factor prominently in whether and how stringently the LCR and NSFR rules would apply (the very rules that make this more nuanced brokered deposit distinction), but this indicator can also cause an incremental category increase for other measures and, therefore, even more care and nuance in relation to the measurement of risk is required of the metric. The Agencies may accomplish this by aligning the treatment of affiliated-brokered deposits for purposes of the categorization framework with their treatment of such deposits in the interagency LCR.

2. *The wSTWF indicator inappropriately focuses only on gross liabilities. The wSTWF indicator should also look to the asset side of the financing and take into account low/no risk collateral, as well as financing situations that would not be subject to a "fire sale."*

The wSTWF indicator looks exclusively at the liability side of an institution and ignores the tenor and liquidity of assets that may be financed by its liabilities. For example:

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69 "Liquidity Coverage Ratio: Liquidity Risk Measurement Standards," 79 Fed. Reg. 61439, 61493 (Oct. 10, 2014).

70 See 0.25 coefficient applied to Form FR Y-15, Schedule G, Line Item 5, Column A figures, including those in Item 1(e) (encompassing all brokered sweep deposits). FR Y-15 Instructions at G-2. This coefficient would not appear to change in the proposed revisions to the Form FR Y-15 Instructions. See Proposed Form FR Y-15, Schedule N, Line Item 5, Columns A-C, https://www.federalreserve.gov/reportforms/formsreview/FR_Y-15%20Instruction%20Revisions%20(FBO%20Tailoring)%20Final.pdf.

We note that the 25% weight applies to values that have a remaining maturity of 30 days or less or that have no maturity date (Column A figures). This is consistent with the 30-day stress horizon under the LCR. In addition, this constitutes the significant majority of affiliate brokered sweep deposits. It is much less likely that brokered sweep deposits would be in the 10% or 0% weighting for Columns B-D that apply to term funding of greater than 30 days.

71 FDIC Advisory Opinion No. 05-02 (Feb. 3, 2005).

72 "Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions," 84 Fed. Reg. 2366, 2372–73 (Feb. 6, 2019).

73 See 84 Fed. Reg. at 2369.

- An institution may engage in fully matched book repo as a service to clients, rather than funding its own assets. The curtailment of the liability side of this equation is not necessarily detrimental to the institution, as it can similarly curtail the asset (lending) side of the matched book.

- An institution may be financing its own highly liquid short term assets, such as U.S. Treasuries or other Level 1 HQLA, through repo or securities lending.[74] The curtailment of funding for these assets is not likely to result in a "fire sale" of the underlying assets, or even if a quick sale is required, these assets are likely to hold their value and not be subject to the typical pricing pressures of a "fire sale."[75]

- As a matter of prudent asset-liability management, banking organizations will often match the tenor of their funding with their assets. In a short-term funding context, a significant portion will be to carry short-term assets. Therefore, similar to the examples above, curtailment of term funding generally would not occur (unless the counterparty broke the contract) until maturity or sale of the underlying asset. Funding of this nature does not raise the vulnerabilities or funding "gaps" identified by the Agencies.[76]

The primacy of this metric, without making adjustments to recognize that some short-term funding has significant risk mitigants associated with it, would result in inappropriate calibrations and inaccurate placement of international banks (and U.S. BHCs) in the Agencies' categorization framework. Vice Chairman Quarles has noted that risks to broader financial stability occur "when banks . . . fund long-term or illiquid assets with short-term deposits" and then find themselves in need of "rapidly

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74 As another example, cash from short-term funding may be placed on short-term deposit at a Federal Reserve Bank. This readily available deposit number could be deducted from the wholesale unsecured funding amount with a maturity of less than 30 days without implicating the safety and soundness concerns expressed in the Proposal. More generally, Level 1 HQLA held by the U.S. operations of an international bank should be credited against the wSTWF threshold, as Level 1 HQLA would be available to cover any liquidity needs associated with wSTWF.

75 The measurement criteria nevertheless embed a "fire sale" haircut, thus further overweighting the safest of securities financing transactions. Compare 12 C.F.R. § 249.32(j)(1)(i) (LCR outflow rate for funding secured by Level 1 HQLA is 0%) with FR Y-15, Schedule G, Line Item 5, Column A (25% coefficient for Line Item 1(e)/1(a) funding secured by Level 1 HQLA). See also 12 C.F.R. § 249.20(a) (hallmark of Level 1 HQLA are those instruments that are liquid, readily marketable and issued or guaranteed by an entity whose obligations have a proven record as a reliable source of liquidity in repurchase or sales markets during stress market conditions).

See also Federal Reserve Bank of New York Memorandum to Bill Dudley, President, Federal Reserve Bank of New York (Feb. 11, 2010), https://fcic-static.law.stanford.edu/cdn_media/fcic-docs/2010-02-11%20FRBNY%20Memo%20re%20Repo%20Haircuts.pdf (study of repo haircuts in triparty and dealer markets during 18-month period encompassing the financial crisis (July 2008 – January 2010) indicates that Treasury and Agency repo haircuts stayed relatively low and stable during that entire period).

76 Examples of this tenor matching include supply-chain financing and trade financing. A financing bank will own a buyer receivable that is expected to be settled, typically within 30-60 days as stated in a goods invoice. If the bank seeks funding for its purchase of the receivables (rather than using its own cash reserves), it typically matches the funding to the expected receivable settlement date. Therefore, such funding does not exhibit the same maturity mismatch that would be the case if the bank used short-term funding for long-term assets. This is designed to eliminate the need to roll the financing.

sell[ing] less-liquid assets to maintain their operations."[77] Yet, the wSTWF metric does not adhere to this more nuanced view. Rather than focusing on long-term assets or illiquid assets as being the type of assets that raise the concerns articulated by the Agencies, or focusing on a tenor mismatch between liabilities and assets, the wSTWF metric looks solely at the liabilities of an institution. The Agencies should tailor the calculation and application of this metric to better account for the true "gap" or "net" risk that Vice Chairman Quarles discussed, rather than as a gross liability measure.

Based on the analysis in this Section III.F, the Form FR Y-15, and in particular its Schedule G, should be modified significantly (and beyond those modifications already proposed in connection with the Proposal) to create a more risk-sensitive metric that addresses the issues we have described. These examples are indicative of a more general need to review the coefficients in the Form FR Y-15 against previously well-considered haircuts and funding outflow rates in rules such as the LCR.

G. The Agencies should remove NBA as a risk-based indicator because they are not relevant indicia of risk.

The NBA risk-based indicator is opaque and ineffective. As proposed, the NBA risk-based indicator appears to be a proxy for regulating risks the Agencies believe are presented by broker-dealer operations. There is still no substantiation by the Agencies as to why broker-dealer activity is automatically, and without nuance or differentiation, deemed complex or risky. Broker-dealer activity is penalized not only through the NBA indicator, but also because such activity is likely to be a component of wSTWF.

For broker-dealers that are not IHC subsidiaries, their size and risk has already been determined to be outside the scope of Regulation YY. For broker-dealers that are subsidiaries of an IHC, the IHC requirement and related EPS (capital, liquidity, SCCL, etc.) already apply and already have a significant impact on their activities. Therefore, the belt-and-suspenders manner in which a broker-dealer subsidiary may increase an international bank's category placement, through the risk-based indicators, is not necessary and would contravene the Federal Reserve's stated goals of more risk-sensitive calibration and transparency in its approach.

The Agencies already apply a host of prudential regulation and supervision to broker-dealers affiliated with banks, regardless of, and in addition to, the regulations applied by their primary regulators. Application of the capital and liquidity rules and the supervisory rating framework at the IHC level should be sufficient to control any broker-dealer risk and are already designed to increase based on the risk profile or liquidity of the activity. Additional capital enhancements, such as the Fundamental Review of the Trading Book, are likely to increase further the amount of capital held against broker-dealer activities. Broker-dealer activity is fully incorporated into capital planning, stress testing and CCAR. Indeed, broker-dealer activity is likely to trigger additional stress-based capital requirements under the global market shock component applicable to several IHCs. Broker-dealers are incorporated into the consolidated liquidity stress testing and analysis of an IHC and into resolution planning. Broker-dealers are subject to the Volcker Rule's constraints on proprietary trading, which more broadly require inventories and risk to be focused on customer-driven activity and which the Agencies have perceived as mitigating risk.

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77 Randal K. Quarles, Vice Chairman for Supervision, Federal Reserve, Getting It Right: Factors for Tailoring Supervision and Regulation of Large Financial Institutions (July 18, 2018) ("Quarles Tailoring Factors Speech").

The Agencies have not cited any empirical evidence to support that current broker-dealer activities, or non-bank activities generally, are categorically more complex, less regulated or more interconnected than banks. All of these judgments require that some conceptual soundness and supporting analysis that the activities, relative to other activities that could be conducted by a financial services company, exploit some gap that is not otherwise covered by all of the specialized and risk-mitigating regulations that already apply.

Moreover, the NBA metric is generally unsupported as an indicator of risk. The Federal Reserve deployed this indicator and the prescribed threshold for determining "complexity" for certain non-U.S. GSIBs over the objections of commenters that indicated then that the indicator did not, in fact, "indicate" risk.[78] Prior to the "complex" definition, the Federal Reserve had only used this indicator in relation to tailoring resolution plan rules, as the presence of NBA is directly relevant to the breadth and scope of a resolution plan. We also note that NBA are not included as a risk indicator on the Form FR Y-15 or in the FSB's GSIB scoring methodology; in fact, complexity is defined using different attributes.

Furthermore, while the Agencies state that NBA "may involve a broader range of risks than those associated with banking activities," NBA are not differentiated based on risk, which makes this indicator inapposite and belies this categorical statement.[79] For example, U.S. treasury dealer positions at a broker-dealer would be treated the same as equity dealing positions at the broker-dealer; senior secured investment grade commercial lending at a finance company would be treated the same as high-LTV real estate lending. In addition, assets that are not NBA when held at a bank would become NBA if transferred to a non-bank subsidiary. Assets do not become more risky solely based on where they are booked.

For these reasons, we would urge the Agencies to eliminate the NBA risk-based indicator as a determinant of categorization in any final rule until a more transparent and meaningful indicator is developed.

If the Agencies do not eliminate the NBA risk-based indicator, then, similar to the Agencies' proposed modifications to the CJA indicator, the Agencies should have an interest in ensuring that the indicator, in fact, captures the complexity and risk that is intended to be captured. Several targeted revisions to the calculation, and related regulatory reporting, would make the NBA indicator more risk sensitive, and more likely to focus on those activities that evidence complexity and interconnectedness.

1. *The Agencies should eliminate from the calculation of NBA several specific assets to appropriately calibrate this indicator for risk.*

As proposed, the definition of NBA is opaque and not a suitable proxy for systemic risk or business and operational complexity. Accordingly, the Agencies should revise the measurement of NBA to exclude those assets that do not represent risk or complexity and include only assets and activities that demonstrate a firm's degree of systemic importance and its associated systemic risk. To align with the transparency and effectiveness objectives of re-calibration, the Agencies should eliminate the following assets from the calculation of NBA. Each of these asset classes is already subject to regulatory reporting and standardized definitions:

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78 See "Amendments to the Capital Plan and Stress Test Rules," 82 Fed. Reg. 9308 (Feb. 3, 2017).

79 84 Fed. Reg. at 24307.

- Goodwill, deferred tax assets, defined benefit pension fund assets and other intangibles that are deducted from regulatory capital under the Federal Reserve's Regulation Q. Such assets are not an appropriate measure of systemic risk since they are not exposures to counterparties that present default risk or that otherwise demonstrate interconnectedness or complexity. Through deduction, such assets do not contribute to the capital of an entity and cannot usually be leveraged to allow expansion of the assets of the entity. As a matter of simplicity, each of these elements can easily be cross-referenced to existing reports.

- Cash and Level 1 & 2A HQLA (and securities financing transactions on such HQLA).

    - Maintaining a minimum level of such HQLA is required to mitigate liquidity risk and thus serves to reduce systemic risk.[80] In addition, Level 1 and Level 2A HQLA are characterized by a low degree of credit risk and accordingly attract very low risk-based capital requirements, while cash is considered a riskless asset under the risk-based capital rules. These assets, even when held in a non-bank entity, do not gauge systemic risk—indeed, they mitigate it. Including such assets in the NBA risk-based indicator (because incremental units of the indicators are analogous to "penalties") would in fact have the perverse incentive of discouraging maintenance of cash or surplus Level 1 and Level 2A HQLA in non-banking subsidiaries (including at the IHC legal entity itself).

    - Level 1 & 2A HQLA should include debt instruments issued by an international bank's home country, which should also be excluded from the non-bank asset measure. To the extent that home-country bonds may not be included in such HQLA categories, they should still be excluded from the NBA metric.

- Zero-percent RWA. Assets weighted at 0% risk weight are by definition viewed to be safe, non-risky assets and should not be counted toward NBA as they do not implicate the concerns the Agencies have articulated with respect to NBA.

2. *The Agencies should utilize a risk-weighted NBA indicator to more accurately assess the riskiness of NBA.*

At the very least, the NBA risk-based indicator should be subject to weighting on the basis of risk to better reflect actual risks presented by such assets. The NBA calculation should use the weighting measure required under applicable capital rules to ensure that less-risky NBA are not unduly penalized solely by being conducted outside of the bank, as discussed above.

H. The OBE metric should be tailored to better represent the risks the Agencies are attempting to capture.

In the Proposal, the Federal Reserve states that OBE "can lead to significant future draws on liquidity, particularly in times of stress."[81] However, if the risk of those draws is low or otherwise mitigated, the commitment should not be counted toward OBE. Loan commitments, letters of credit and guarantees that are used for corporate financing matters, and therefore support the real economy, should not be penalized and should count in proportion with the risk weight they carry. Therefore, we

[80] 12 C.F.R. Part 249; 12 C.F.R. § 252.157.

[81] 84 Fed. Reg. at 21998.

recommend (i) applying a risk weight to exposures similar to the combination of credit conversion factors and risk weights applied under the capital rules to loan commitments, letters of credit and guarantees; (ii) allowing Level 1 HQLA collateral received by the banking organization to be offset against, or otherwise reduce, the OBE, and (iii) treating any OBE that cannot be drawn unless collateralized as collateralized for risk weight purposes.

The Agencies should also offset the amount of any committed line of credit or other legally enforceable support from an affiliate that could be drawn, if needed, against third-party OBE (i.e., "back-to-back" situations). Such committed affiliate support would mitigate the risks the regulators have pointed to in connection with OBE of unexpected and significant draws on liquidity, so long as the notice period for the draw from the affiliate does not exceed the OBE item's notice period.

IV. The Application of Standardized Liquidity Regulations to IHCs Should be Tailored More Closely to IHC Attributes[82]

The IIB agrees with the objective of the international LCR and NSFR to promote stable funding structures and resilience of the liquidity profile of banks. In particular, our members agree that banking organizations should have enough HQLA to survive a short-term liquidity stress scenario and should maintain a sustainable funding structure over the longer term. Indeed, Vice Chairman Quarles has recognized that the existing supervisory framework, in particular standardized liquidity requirements that have already decreased reliance on short-term wholesale funding, has "reduced funding risk among large banks and their affiliated broker-dealers."[83]

The Proposal, however, would generally result in more stringent standardized liquidity requirements by imposing them on an IHC based on risk attributes at the CUSO level. This increased stringency is not justified by any change in circumstances or by any evidence supplied by the Agencies in the Proposal indicating that the current framework is ineffective, and in our view it is not necessary to achieve the Agencies' regulatory aims. Indeed, the Proposal's increase in liquidity regulation is directly inconsistent with both the intention of the Proposal (to reduce and tailor regulatory burdens) and the priorities articulated by Vice Chairman Quarles.[84] In addition, the use of a CUSO test intrinsically initiates a discussion of branch liquidity policy. This "front runs" the broader consideration of how best to manage branch liquidity concerns, which the Agencies sensibly shifted to a longer timetable to allow for a carefully planned process of engagement with international regulators, as well as issuing a separate proposal for public comment.

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82 See also Section VIII.A.4 for a discussion of the increased burdens placed on some international banks based on the change in Form FR 2052a filing frequency and criteria.

83 Randal K. Quarles, Vice Chairman for Supervision, Federal Reserve, Frameworks for the Countercyclical Capital Buffer (Mar. 29, 2019) ("Quarles CCyB Speech").

84 See Quarles CCyB Speech ("In contrast to the pre-crisis framework, . . . liquidity requirements and regulatory incentives to limit reliance on short-term wholesale funding have reduced funding risk among large banks and their affiliated broker-dealers; and resolution planning requirements reduce the risks that the failure of a large firm would spill into the broader economy."); Quarles Tailoring Factors Speech ("Similarly, banks with more than $250 billion in assets that are not G-SIBs currently face largely the same liquidity regulation as G-SIBs. As I've said previously, I believe it would make sense to calibrate the liquidity requirements differently for these firms relative to their G-SIB counterparts.").

In addition to the recalibration of the tailoring framework discussed below, we propose additional changes to the underlying U.S. liquidity requirements in Appendix B.

A. Any standardized liquidity requirements applicable to an IHC should be imposed solely on the basis of size and risk-based indicators of the IHC.

The Proposal would determine the applicable category of liquidity standards for an IHC based on the size and risk profile of an international bank's CUSO. Based on the Federal Reserve's projections, several IHCs are expected to be negatively affected by assets and risk attributes outside the IHC in determining applicable standardized liquidity requirements. For IHCs in Category III that alone have less than $75 billion in wSTWF but together with their parent international bank's U.S. branches have above $75 billion in wSTWF, this means that the IHC would be required to meet the full daily LCR and NSFR and full daily FR 2052a reporting. For IHCs in Category IV that alone have less than $50 billion in wSTWF, but together with their parent international bank's U.S. branches have above $50 billion in wSTWF, this means that the IHC would move from having no LCR and NSFR requirement to being required to meet the reduced monthly LCR and NSFR. As discussed in Parts I and II above, this outcome violates the principle of national treatment because U.S. BHCs do not need to account for extraneous measures of risk in determining the applicable standardized liquidity requirements. Indeed, the elevation to higher categories of liquidity regulation projected by the Federal Reserve (either from Category III to II or Category IV to III) is, based on our estimates, for every IHC other than one (that is, 6 of the 7 IHCs estimated by the Federal Reserve to be elevated) caused not by the IHC's own attributes but by additional wSTWF at the branch level. Not only does a U.S. BHC not have to monitor attributes outside its own assets and liabilities, but in fact no U.S. BHC is elevated to a higher category of liquidity requirements based on wSTWF, including based on the newly created $50 billion threshold for elevation from Category IV to Category III liquidity standards.

Tailoring requires acknowledging the differences of international bank U.S. operations in comparison to U.S. BHCs, in particular the structural reforms that have been designed to decrease the potential attribution of risk from the branch/agency network to the IHC and vice versa. Moreover, the Agencies' concerns that funding vulnerabilities at an international bank's U.S. branch may present risks at its U.S. subsidiaries[85] should be mitigated by existing restrictions on interaffiliate transactions and activities restrictions for foreign branches that effectively prevent an international bank from using its branch as a funding source for its principal U.S. subsidiaries. Furthermore, any such concerns are mitigated by the existing Regulation YY liquidity framework, which already separates the liquidity analyses and requires separate liquidity buffers.

In the Proposal, the Agencies requested comment on whether standardized liquidity requirements should apply to branches/agencies of international banks. We are separately submitting a comment letter on that topic. The issue of branch liquidity should be considered and addressed separately, rather than penalizing an IHC and requiring commitment of additional resources at that level based on a perceived (but, in our view, nonexistent) incremental risk to the IHC from branch/agency attributes. Applying additional liquidity requirements on an IHC based on branch/agency attributes would only result in inefficient and ineffective allocation of liquidity to the IHC, forcing the IHC to hold liquidity to address risks outside the IHC that it, in fact, cannot address directly.

B. The Agencies should not change the application of the LCR to IHCs so as to penalize internal inflows by not permitting netting against external outflows. In addition, the

[85] See 84 Fed. Reg. at 21990.

Agencies should permit netting of internal inflows against external outflows for the Regulation YY liquidity buffer calculation requirements.

The Proposal would not import into the LCR the limitation from the Regulation YY liquidity buffer that prohibits the offset of inflow amounts from affiliates of the IHC against external outflows. The Agencies noted that not importing this limitation into the LCR would align with Basel III standards[86] and allow for more direct comparability between international banks' and U.S. BHCs' LCR calculations. We agree with this application of the LCR regulations. As discussed in Section III.D above, the U.S. operations of international banks are uniquely positioned to have internal inflows as part of larger organizations and, at the same time, U.S. BHCs are permitted to offset intragroup financings in consolidation. In addition, any concern about affiliate inflows should be mitigated by the adoption of liquidity risk management requirements consistent with LCR and NSFR at the consolidated level that would ensure sufficient liquidity exists in the consolidated group to perform on external outflows from the U.S. operations, regardless of where the liquidity comes from, and the Agencies can ensure such requirements in fact exist through their engagement with the Basel Committee and the home-country regulators of international banks.

The same principles suggest that netting internal inflows against external outflows in calculating the Regulation YY liquidity buffer also should not implicate the Agencies' supervisory concerns, and this netting should be permitted.

C. The Agencies should revise the reduced LCR to more closely resemble the current "modified" LCR.

The reduced LCR should remain consistent with several aspects of the current "modified" LCR, specifically by leaving the reduction factor at 70%, removing the maturity mismatch add-on, not applying the reduced LCR to subsidiary depository institutions and not curtailing the availability of HQLA held at subsidiaries. Similar to our points with respect to the SCCL in Section V below, in a purported tailoring proposal, no reasoning is provided as to why the already tailored and modified LCR has not been effective since its implementation and now warrants strengthening and the removal of its tailored aspects.

1. *The reduced LCR coefficient should be set at the lower bound of the proposed 70-85% range, consistent with the existing modified LCR and proposed modified NSFR.*

The Agencies should maintain the current 70% scaling factor from the modified LCR and proposed modified NSFR in calibrating the reduced LCR and NSFR. The Federal Reserve recently determined in finalizing the LCR that a coefficient at the lowest point of the range was appropriate. This approach would be consistent with both the aims of the Proposal to provide targeted relief (rather than an increase in standards) and the current modified approach that IHCs subject to the rule have already adopted. This form of continuity is important to meeting Vice Chairman Quarles' principles of efficiency and transparency in the Federal Reserve's regulatory approach because the Proposal does not contain any discussion of why certain organizations that do not rely as heavily on wSTWF should face more stringent standardized liquidity requirements than the status quo. Transition costs to meeting a higher coefficient are likely to continue to drive the trend toward shrinkage of international bank contributions to the U.S. economy identified in Sections I and II above and divert allocation of resources to more static and trapped

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86 Basel Committee on Banking Supervision, Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools (Jan. 2013), https://www.bis.org/publ/bcbs238.pdf.

pools of liquidity. A continuation of the current scaling factor would, moreover, be consistent with the Agencies' commitment that the modified LCR is appropriate for companies that are "less complex in structure, and less reliant on riskier forms of market funding" than firms subject to the full LCR because they "have simpler balance sheets" that can make intervention and remediation in a stressed scenario easier.[87] Further, setting LCR at a higher coefficient would tip the scale too far towards host certainty at the expense of global flexibility, potentially leading to other jurisdictions setting more stringent liquidity requirements and increasing market fragmentation.

2. *The Agencies should remove the maturity mismatch add-on from the reduced LCR.*

The Proposal would require U.S. BHCs and IHCs subject to the reduced LCR to follow the maturity mismatch add-on, even though the current modified LCR does not require such gold-plating. This requirement is a significant departure from Basel III standards and should not be imposed on any international bank, particularly those that may meet the "reduced" LCR. It is not clear why a reduced LCR international bank should incur significant inefficiency in applying a different standard in the U.S. than it does on a consolidated basis (and a different standard than currently, if it is a modified LCR institution). Reduced LCR institutions also generally present low liquidity risk as evidenced by their lower levels of wSTWF and lower risk-based indicators. This is particularly true where the activities of the IHC present even lower risk (and indicate a lower category in the Agencies' framework), but the funding profile of its affiliated branches triggers application of the reduced LCR. The Agencies should revise the reduced LCR to eliminate the potential for such a miscalibration.

3. *The Agencies should not apply the reduced LCR or NSFR to subsidiary depository institutions.*

The Proposal would require a depository institution that has assets of $10 billion or more and is a subsidiary of an IHC to meet the same standardized liquidity requirement as its parent. For the reasons discussed in Parts IV.C.1 and IV.C.2 above, this requirement is unnecessary for many of the Category III and Category IV depository institution subsidiaries of IHCs subject to the reduced LCR and NSFR, which have limited U.S. footprints, stable funding models, more simple structures, engage in noncomplex lines of business in the United States and would be or are subject to the existing modified LCR. The application of the LCR and NSFR to these subsidiaries of IHCs would result in "trapping" excess liquidity at bank subsidiaries, which would limit the flexibility of an IHC and its parent to respond effectively to a stressed scenario. The subsidiary structures of these IHCs are not so complex as to warrant trapping liquidity at one of the relatively few U.S. subsidiaries, when it could be more nimbly employed at the IHC or across its subsidiaries, and yet still benefit the bank subsidiary.

The potential for smaller depository institutions that are subsidiaries of IHCs with less than $100 billion in assets to become subject to the reduced LCR and NSFR solely due to attributes of an affiliated branch or agency illustrates the national treatment issues created by the proposed categorization framework. If the Agencies nonetheless choose to apply the LCR or NSFR to subsidiary depository institutions, then the Agencies should apply this requirement to a depository institution based on the categorization of its parent IHC, rather than based on the categorization of its CUSO.

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[87] 79 Fed. Reg. at 61520.

4. *IHCs should continue to be permitted to include eligible HQLA held at subsidiaries up to 100 percent of the net cash outflows of the subsidiary plus amounts that may be transferred without restriction to the IHC.*

The Agencies should not limit the amount of HQLA held at consolidated subsidiaries that may be included in an IHC's LCR on a consolidated basis to 70 to 85 percent simply because the IHC may be subject to a reduced LCR of 70 to 85 percent.[88] Allowing IHCs to count eligible HQLA up to 100 percent of the subsidiary's net cash outflows (plus any amount of assets that would be available for transfer to the IHC) is appropriate because eligible HQLA held by a consolidated subsidiary are available to satisfy the liquidity needs of that consolidated subsidiary, regardless of whether the "required" HQLA pool is modified by the lower scalar. Any reduction in this amount would exacerbate issues under the current LCR rules, including trapping liquidity, and forcing excess liquidity to remain, in the United States. Similar proposed limitations within the proposed NSFR rules also should not be implemented because the amount of stable funding held by a consolidated subsidiary would also be available to ensure a stable funding profile of that consolidated subsidiary, regardless of whether the required ratio is modified by the proposed "reduced" NSFR.[89]

D. <u>IHCs should be permitted to manage their own HQLA rather than requiring management by the parent international bank</u>.

The LCR rule requires that a banking organization demonstrate the operational capability to monetize HQLA and to implement policies that require the HQLA to be under control of the management function of the banking organization. The Proposal includes a new requirement that the management function of the international bank that is charged with managing liquidity risks, rather than the IHC itself, satisfy these requirements. This change seems to presuppose an LCR applicable to the CUSO or the branch/agency network in addition to the IHC, front running the broader consideration of how best to manage branch/agency liquidity concerns, which should be considered separately. In line with current practice, IHCs should be permitted to manage and control HQLA for purposes of LCR.

E. <u>To categorize international banks for the purpose of the NSFR is premature and it should not apply at the IHC or CUSO level, as the objective of reducing funding risk over a longer time horizon is best achieved through centralized compliance at the level of the parent international bank</u>.

A significant amount of time has elapsed since the NSFR was proposed in the United States. During that time, significant changes to the overall regulatory framework have been implemented, and additional research has questioned some of the underpinnings of the NSFR and its mechanics.[90]

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88 <u>See</u> 84 Fed. Reg. at 24318, 24349.

89 <u>See</u> 84 Fed. Reg. at 24318, 24320, 24349-50.

90 Bill Nelson & Francisco Coves, The Clearing House, The Net Stable Funding Ratio: Neither Necessary nor Harmless (July 2016); Bill Nelson & Francisco Covas, Bank Policy Institute, Foundational Basel Committee Study Estimates the Costs of NSFR Exceed its Benefits by Nearly $1 Trillion (Mar. 27, 2017); Gonzalo Gasos, European Banking Federation, NSFR bitter pill to swallow, needs recalibration (Sept. 19, 2017); Letter from Rob Nichols, President, American Bankers Association, to Randal K. Quarles, Vice Chairman for Supervision, Federal Reserve (Nov. 17, 2017); Joanna Wright, Basel Concession Strengthens US Opposition to NSFR, Risk.net (Nov. 27, 2017).

Moreover, the Agencies have not undertaken any impact analysis on either U.S. BHCs or how/whether the NSFR should apply to the U.S. operations of international banks. The proposed categorization framework would disregard the considerable risk-reducing changes in the regulatory landscape since the initial NSFR proposal. The Proposal also leaves unaddressed the underlying finalization of the NSFR rules, making it difficult to provide comments and contemplate implementation within the proposed framework.

The NSFR proposal's objectives of reducing the likelihood of disruptions to an institution's regular sources of funding and promoting improvements in the measurement and management of liquidity risk are meant to be achieved on a more centralized basis. While 30-day funding needs can be more "local" in nature, longer-term funding needs should be managed in a central treasury or financing function that can match enterprise-wide financing (such as through external corporate debt issuances backed by the consolidated group) and that can plan for uses of currencies and funding flows across the organization. The NSFR should not be applied to an IHC or the CUSO. IHC-level NSFR requirements would prevent the IHC from being able to use broader institutional financing (unless internal inflows from the parent were flexibly permitted to satisfy the requirements), and would inefficiently require various tenor- and currency-matching strategies at a sub-consolidated level of the organization. A separate NSFR requirement at the IHC level would create internal obstacles and limit operational flexibility, which could actually impede the ability of a bank to nimbly apply its financial resources in a crisis.

The longer-term funding needs for IHCs that would be imposed by the NSFR are likely to shrink the depth and breadth of U.S. capital markets with significant implications for customers in the real economy. For IHCs with significant broker-dealer operations that are projected to be in Categories II and III, it may become prohibitively expensive to continue engaging in key financing activities such as reverse repo and collateral sweeps for Treasuries and agency securities. These activities are low risk and low margin. But the proposed NSFR would nonetheless require an IHC to maintain a level of required stable funding for Treasuries and agency securities, which would reduce already low margins to the point where it may be uneconomical to continue to engage in these activities. This could reduce market capacity, increase bid-offer spreads and contribute to volatility and reduced liquidity, which would increase costs for end users. Given the low risk of these assets, subjecting these activities and assets to the NSFR would not accomplish any significant supervisory objective.

F. The Federal Reserve should confirm that HQLA meets the test for highly-liquid assets.

It would provide helpful clarity in the context of EPS for the Federal Reserve to confirm that assets that qualify as HQLA would also automatically qualify as highly liquid assets.

V. Single Counterparty Credit Limits

A. The Federal Reserve should, as proposed, exempt the IHCs of all Category IV international banks with under $250 billion in global assets and allow certification of home-country standards for larger Category IV international banks that must comply with the SCCL at the CUSO level.

Permitting Category IV international banks to certify compliance with home-country SCCL standards for their CUSO, and not imposing a standalone requirement for their IHCs, would meaningfully reduce compliance costs, consistent with the aims of the Proposal. We support these tailoring efforts and applaud the Federal Reserve for taking into account comparable home-country regulation in relation to the application of a rule to IHCs and not only application to branches/agencies.

B. The SCCL should not be part of the Proposal's categorization framework and should only be applied based on the size of IHC assets and not based on any risk-based indicator. The Federal Reserve should apply a $250 billion asset threshold to both IHCs and U.S. BHCs.

The SCCL, as originally finalized in 2018, was incorrectly applied to IHCs with $50-$250 billion of assets, given that no U.S. BHC under $250 billion was subjected to the SCCL. It was logically inconsistent to recognize home-country standards for applying SCCL to the CUSO, but then ignore home-country standards by applying the SCCL at a sub-consolidated level so much lower than any U.S. BHC subject to the SCCL.

However, the Proposal exacerbates this discriminatory effect. A Category IV IHC that is under $250 billion in total assets and exempt from the SCCL rules could be elevated to Category III or Category II, not only based on its own risk attributes, but based on the attributes of the international bank's CUSO. Many of the proposed risk-based indicators (CJA, wSTWF and NBA) do not correlate with increased risk of concentrated exposure. According to the Federal Reserve's projections, many of the IHCs in Category II or III land in those categories not because of the size of the IHC (most have under $250 billion of assets, unlike all U.S. BHCs (other than one) in those categories), but because of a risk-based indicator.

Therefore, the SCCL should apply only to an IHC or a U.S. BHC with at least $250 billion of assets in order to treat IHCs consistently with similarly situated U.S. BHCs and not base applicability of the SCCL on risk-based indicators unrelated to credit concentration risk.

C. The Federal Reserve should not adopt the proposed modifications for Category II and Category III IHCs with respect to (i) using tier 1 capital (rather than capital stock and surplus) as a base and (ii) application of the more complex and burdensome economic interdependence and control tests and the special purpose vehicle look-through requirements.

The Proposal provides insufficient justification for why Category II and Category III IHCs (most of which are under $250 billion in assets) should be subject to a more stringent SCCL requirement than would currently apply. While we disagree with the application of the SCCL to IHCs below $250 billion, the current rule is tailored already by offering flexibility to the $50-$250 billion IHCs. That flexibility and tailoring would be removed in the Proposal.[91] While it is true that Category IV international banks would not have to apply the SCCL at the IHC level, if they have an IHC, there were no reasons given as to why this may have been structured as a trade-off for increasing SCCL stringency for Category II and III IHCs. The SCCL rules were finalized only last year and have not yet come into effect. If interim developments have justified increased stringency of these requirements, those considerations are not discussed in the Proposal. The Federal Reserve should not finalize these changes until it has provided sufficient opportunity for operation under the SCCL and determined that, in fact, such changes are warranted.

The reinstatement of the economic interdependence and control tests and the special purpose vehicle look-through requirements would not only be an objective burden to smaller U.S. operations, but international banks have not had to plan for compliance with those provisions and the compliance dates in 2020 are fast approaching. Therefore, if the current SCCL's reduced requirements are not maintained, international banks newly subject to the Proposal's onerous requirements would need

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[91] See Section IV.C above where we note that the tailoring under the current modified LCR would also be removed without explanation.

sufficient transition periods to ensure compliance. An extended compliance period for the current rule—we suggest 18 months beyond the current compliance dates—is a reasonable recognition of the operational complexity of building the infrastructure required to monitor and limit exposures under the more complex provisions of the Proposal's SCCL.

D. The Federal Reserve should provide transitional relief for international banks with home-country supervisors that are still in the process of adopting an SCCL.

The current SCCL rule is due to be effective in January 2020, for U.S. and foreign GSIBs, or July 2020, for all other firms. The SCCL rule provides flexibility to the CUSO (rather than the IHC) of several international banks, by allowing for compliance through certification to the Federal Reserve that the international bank meets comparable home-country standards that apply on a consolidated basis. The Federal Reserve should provide transitional relief for international banks if adoption of home-country standards comparable to the Basel III large exposure framework is delayed beyond the U.S. SCCL effective dates.[92]

IIB has repeatedly requested consideration of this issue, because end-2018 was the cutoff for many of our members for systems and compliance projects that needed to occur in 2019. Therefore, several of our members have embarked on compliance projects anticipating that their home country might not have an effective rule by the date of U.S. SCCL compliance. If relief is forthcoming, we request it be released with urgency to avoid wasting additional time, money and related resources for a CUSO compliance project that will not be needed. Transition periods could be addressed in a final rule if that final rule is adopted in advance of January 1, 2020, but even then, some indication that the transition period will be extended for all international banks will be required much sooner.

VI. Capital and Stress Testing

A. The Agencies should finalize as proposed the availability of the accumulated other comprehensive income ("AOCI") filter for Category III and IV IHCs and should make this available for Category II IHCs. In addition, the Agencies should eliminate the countercyclical capital buffer ("CCyB") and the supplementary leverage ratio ("SLR") for Category II and III IHCs.

The Agencies should modify risk-based and leverage capital requirements for Category II and Category III IHCs. For the AOCI requirement, the Proposal would raise the triggers for including most elements of AOCI from $250 billion or more in assets to $700 billion or more and from $10 billion in foreign exposure to $75 billion in CJA. Because no IHC is close to the applicable size threshold, the effective trigger for applying the AOCI requirements would be $75 billion or more in CJA. The Proposal does not indicate why any perceived risks associated with cross-border interconnections by IHCs (i.e., CJA) can be addressed through counting most elements of AOCI in regulatory capital (which effectively increases regulatory capital requirements by forcing an institution to deal with portfolio volatility). These two concepts are not correlated and therefore AOCI changes should be filtered out for Category II IHCs.

With respect to the SLR and CCyB, these requirements are already applied on a consolidated basis under home-country rules. Consistent with the congressional mandate in the Dodd-Frank Act to take into account the application of home-country standards on a consolidated basis, the Agencies should revise the Proposal to permit meeting the SLR and CCyB on a consolidated basis rather

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[92] For example, the EU large exposure framework under the CRR II regulation will come into force on June 28, 2021.

than applying them on a standalone basis to IHCs. These two requirements call for added deference to home-country consolidated standards. The SLR is intended to be a backstop to risk-based capital requirements and not a binding constraint.[93] In addition, it is a newly applied leverage ratio by home-country regulators after Basel III and is given significant weight by international banks when looking at capital allocation to divisions, including the U.S. operations. And the CCyB is intended to build resilience only during times of increased vulnerabilities, which operates similarly to a backstop because the Federal Reserve has set high "through-the-cycle" capital requirements that would result in setting the CCyB at zero "most of the time."[94]

Applying duplicative backstops on a subconsolidated basis in the United States could lead other countries to follow the U.S. example, further fragmenting pools of capital and liquidity.

Modification of the capital rules applicable to Category II and III IHCs is important because of the additional risk vectors that could result in an IHC being subject to elements of capital and stress testing that were previously reserved for advanced approaches banks. In addition to size and foreign exposure (incorporated into CJA), an IHC may be subject to these elevated requirements based on other risk factors that do not, in our view, dictate additional capital requirements (as capital is already a dynamic EPS, requiring more if there is more risk). These modifications would also be consistent with national treatment because no IHCs cross the domestic proposal's $700 billion size threshold for application of the advanced approaches and neither the systemic risk impact on the U.S. financial system nor resolution concerns merit application of the SLR or CCyB or disallowing the opt-out of the AOCI filter.

B. <u>The Federal Reserve should immediately extend the due date for the 2019 mid-cycle company-run stress test until late 2019 and finalize the proposed removal of the mid-cycle company-run stress test for IHCs prior to such date</u>.

While we appreciate the relief provided to certain IHCs with respect to the mid-cycle company-run stress tests, other IHCs are still subject to the 2019 mid-cycle company-run stress test required by 12 CFR § 252.153(e)(5). The Proposal would remove the mid-cycle company-run stress test for all IHCs. The IIB supports the proposed removal of the mid-cycle stress test. Given its limited benefit, the IIB is requesting that the Federal Reserve provide immediate relief by extending the due date of the mid-cycle stress test until late 2019, as permitted by 12 CFR §§ 252.3(b) and 252.55(a). The Federal Reserve should then finalize the Proposal (at least as it relates to the mid-cycle stress test) prior to

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93 "Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for U.S. Global Systemically Important BHCs and Certain of Their Subsidiary Insured Depository Institutions," 83 Fed. Reg. 17317, 17319 (Apr. 19, 2018) ("Leverage capital requirements should generally act as a backstop to the risk-based requirements."); Randal K. Quarles, Vice Chairman for Supervision, Federal Reserve, Beginning Stress Testing's New Chapter (Nov. 16, 2018) ("As the Federal Reserve has long maintained, leverage requirements are intended to serve as a backstop to the risk-based capital requirements."); Basel Committee on Banking Supervision, Basel III Leverage Ratio Framework and Disclosure Requirements 1 (Jan. 2014), https://www.bis.org/publ/bcbs270.pdf ("The Basel III framework introduced a simple, transparent, non-risk based leverage ratio to act as a credible supplementary measure to the risk-based capital requirements. The leverage ratio is intended to . . . reinforce the risk-based requirements with a simple, non-risk based 'backstop' measure.").

94 Randal K. Quarles, Vice Chairman for Supervision, Federal Reserve, Frameworks for the Countercyclical Capital Buffer (Mar. 29, 2019) ("<u>Quarles CCyB Speech</u>").

the revised due date for the mid-cycle stress test. This approach would be consistent with the relief provided for company-run stress testing by the Federal Reserve, the FDIC and the OCC.[95]

C. The Federal Reserve should eliminate the CCAR qualitative assessment for IHCs now, as it has done for U.S. BHCs in identical categories.

The Federal Reserve recently eliminated the qualitative component of CCAR for any firm that has participated in CCAR for four consecutive years and did not receive an objection on qualitative grounds in the last year.[96] This effectively eliminates the qualitative objection for each U.S. BHC, but would continue to subject IHCs of international banks to the qualitative objection for at least another year. The additional years of experience with CCAR afforded to U.S. BHCs does not justify different treatment with respect to the qualitative assessment, particularly because the four-year time horizon that the Federal Reserve has chosen appears to be arbitrary. In addition, the Federal Reserve has already concluded that qualitative concerns arising from the largest and most complex firms operating in the United States (the U.S. GSIBs in Category I) may be addressed through the supervisory process. It would therefore be inconsistent with the core tenet of tailoring to continue to subject international banks in Categories II, III or IV to a public qualitative objection.

If the Federal Reserve has adequate supervisory experience to review and remediate a U.S. GSIB's capital planning process, then it is difficult to see how an additional year of a public objection is needed to address similar concerns that may arise from smaller and less risky IHCs. Moreover, each of the U.S. GSIBs has a widely dispersed group of public shareholders that have a significant interest in the transparency and outcome of the CCAR exercise as a determinant of their investment returns, making a public determination on their CCAR processes more important. By contrast, IHCs are wholly-owned by their parents, who already have access to the information that is provided by the existing public qualitative assessment. The Federal Reserve should clarify that the qualitative assessment for all institutions, whether foreign or domestic, should be undertaken solely as a matter of supervisory or examination review.[97]

D. Category III IHCs should be subject to a biennial stress-testing cycle.

We welcome the Proposal's reduction of the frequency of company-run stress tests for Category III IHCs from annual to biennial. Nevertheless, a Category III IHC would still be subject to annual CCAR and annual supervisory stress testing, as well as an annual capital plan submission. Our members expect that in practice, the extended cycle for company-run stress tests will therefore not deliver

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95 Federal Reserve, FDIC & OCC, Interagency statement regarding the impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act (July 6, 2018), https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180706a1.pdf.

96 "Amendments to the Capital Plan Rule," 84 Fed. Reg. 8953, 8953 (Mar. 13, 2019).

97 Prior indications from the Federal Reserve stated that removal of the qualitative assessment was currently a ripe issue, and did not make a distinction based on the foreign or domestic nature of the organization or based on the length of time the organization may have been subject to CCAR. See Randal K. Quarles, Vice Chairman for Supervision, Federal Reserve, A New Chapter in Stress Testing (Nov. 9, 2018) (". . . has the CCAR qualitative objection for the largest firms also run its course? In my view, the time has come to normalize the CCAR qualitative assessment by removing the public objection tool, and continuing to evaluate firms' stress testing practices through normal supervision.") (emphasis added); Randal K. Quarles, Vice Chairman for Supervision, Federal Reserve, Beginning Stress Testing's New Chapter (Nov. 16, 2018) (same).

meaningful relief because Category III IHCs would still be required to run their own stress test during the "off year" under the capital plan rule, and submit the Form FR Y-14A, including stressed information under the scenarios provided by the Federal Reserve to support annual CCAR and supervisory stress testing.[98]

To deliver more tailored relief to differentiate Category III IHCs relative to Category II IHCs, the Federal Reserve should revise the Proposal to adopt a two-year cycle for supervisory stress testing, CCAR and capital plan submissions. This modification would support the goals of tailoring by creating a more meaningful dichotomy under the categorization framework, bifurcating the categorization framework so that Category I and II banking organizations are on an annual cycle, whereas Category III and IV banking organizations are on a biennial cycle. Given the overlapping processes and operational complexity, aligning the supervisory and company-run stress test cycles would meaningfully reduce administrative burden for institutions that the Federal Reserve believes are less risky. Even in such a scenario, our members would expect that stress tests would "remain a core part of . . . supervision" consistent with the requirements of the capital plan rule to provide an annual capital plan, which should provide the Federal Reserve with an adequate lens into the safety and soundness of organizations subject to the categorization framework and a broad enough picture of common and systemic risks across the banking sector and financial system.[99] If the Agencies do not adopt a two-year cycle for capital plan submissions, then in years when Category III IHCs must conduct a stress test under the capital plan rule, but would not be subject to a company-run stress test, supervisory stress test or CCAR, Category III IHCs should be permitted to run such internal stress test based on a single stress scenario developed by the IHC rather than "under expected conditions and under a range of scenarios, including any scenarios provided by the Federal Reserve and at least one BHC stress scenario."[100] This approach would apply the capital plan rule annually, but with more flexibility such that IHCs would be able to relieve timing pressure on running models.

E. iTLAC and LTD requirements should be modified in conjunction with the tailoring exercise.

We provide additional information in relation to suggested iTLAC and LTD changes in Appendix D to this letter. We note that, if IHC capital requirements are not tailored more meaningfully than in the Proposal, and if IHC iTLAC and LTD requirements are not taken into account as a meaningful mitigant of the systemic risks presented by international banks, then it is even more important that these requirements be reduced and recalibrated for IHCs and international banks. In our view, even if all of the recalibrations described in Appendix D were made, the IHCs subject to these requirements would continue to apply a TLAC standard that would be above any requirement applicable to Category II, III or IV and "Other" firms under the U.S. BHC proposal.

F. Other recommendations and comments with regard to capital and stress testing.

We provide information on additional requested changes in Appendix C to this letter.

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98 See Instructions for the Capital Assessments and Stress Testing information collection (Reporting Form FR Y-14A) at 3 (Dec. 6, 2018), https://www.federalreserve.gov/reportforms/forms/FR_Y-14A20180331_i.pdf.

99 Randal K. Quarles, Vice Chairman for Supervision, Federal Reserve, Inviting Participation: The Public's Role in Stress Testing's Next Chapter (Feb. 6, 2019).

100 12 C.F.R. § 225.8(e)(2)(i)(A).

VII. Risk Management

A. Category IV international banks (and international banks with less than $100 billion in CUSO assets) that do not have IHCs should be permitted to rely to a larger degree on the international bank's consolidated risk management structure.

Risk management requirements should provide for the flexibility to structure risk management compliance taking into account the status of the U.S. operations of international banks as part of a broader corporate group. Specifically, the U.S. chief risk officer requirement should be modified so that international banks in either of these categories may instead identify a senior officer who will serve as the point of contact responsible for all communications with the Federal Reserve. This construct would align non-IHC international banks' U.S. risk management structure with its U.S. risk committee structure by providing a similar degree of flexibility regarding reporting lines, governance and location of operation.

B. Other recommendations and comments with regard to risk management.

We provide information on additional requested changes in Appendix E to this letter.

VIII. Regulatory Reporting

The Proposal increases the reporting burdens for international banks with $100 billion or more in CUSO assets, relative both to current reporting requirements and to reporting requirements applicable to U.S. BHCs in the same category.

A. Dual reporting of IHC-level and CUSO-level metrics on the Form FR Y-15 imposes burdens on international banks that are not applicable to U.S. BHCs and that are not necessary in relation to an appropriately tailored EPS framework.

Only the 12 international banks that have IHCs are currently required to report data on the FR Y-15, and the report is in relation to solely the IHC. The Proposal, however, would dramatically increase the number of international banks that must report on this form by requiring any international bank with $100 billion or more in CUSO assets to complete the FR Y-15 regardless of whether it has an IHC. Those with IHCs must prepare significantly more information by reporting at the CUSO level and at the IHC level. Furthermore, the threshold for the reporting panel of the FR Y-15 exacerbates the disproportionately negative effects on IHCs that we have described in several different ways above—an IHC with $50-$100 billion of assets would have benefited from the Proposal's tailoring by not having to report on the FR Y-15 under the Proposal; however, if its parent's U.S. branches/agencies would cause the CUSO size to exceed $100 billion, then the IHC is required to separately report in the Form's IHC columns regardless of its size.[101]

Requiring international banks to report both IHC-level and CUSO-level metrics would result in significant modifications to their existing data reporting and information technology systems to produce the additional data at a substantial cost. Additionally, international banks may face data integrity and measurement issues, as the CUSO asset base is not typically subject to separate consolidation for financial reporting purposes. U.S. BHCs would not have this dual reporting structure or these accounting difficulties.

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[101] See also note 42 (on Subpart N) and accompanying text.

As we indicated in Section II above, our proposed framework would subject an international bank's branch/agency network, as part of a foreign legal entity, to no more than certification of compliance with comparable home-country regulations and elements of the current Regulation YY. Filing of FR Y-15 data by branches, agencies or CUSO would therefore be unnecessary. In addition, we have indicated throughout this letter the serious problems with IHCs being categorized based on CUSO data. The reporting panel for the current FR Y-15 would, under our proposed framework in Section II above, not be modified—it would continue to apply to the IHC (of $100 billion or more) in order to categorize the IHC based on IHC attributes and would not apply to branches, agencies or the CUSO at all.

We therefore urge the Agencies to adopt our proposed framework, remove the negative effect of CUSO attributes on IHCs and avoid the new and expanded FR Y-15 reporting requirements.

If the Agencies decline to adopt our proposed framework, then we urge the Federal Reserve to consider the modifications and clarifications that we describe below. (We note that several of the complexities for which clarification is needed evidence again that the much simpler approach of our proposed framework should be adopted.)

1. *International banks should be permitted to file a modified Form FR Y-15, with an option to prepare conservatively derived and unadjusted "top-line" line items of the FR Y-15 Schedules for those international banks that do not require the more nuanced risk-based indicator calculations with respect to a particular risk-based indicator.*

To balance the burden and risk sensitivity of its reporting requirements, the Federal Reserve should create a more tailored, short-form FR Y-15 that collects information related only to those items and schedules that form the basis for the risk-based indicators. If the risk-based indicators were to stay the same as proposed, then there would be no need to prepare or file Schedule B (Interconnectedness Indicators), Schedule C (Substitutability Indicators), Schedule D (Complexity Indicators) or Schedule F (Ancillary Indicators).[102]

Indeed, given the practical conclusion that no IHC is likely to become a U.S. GSIB on a standalone basis and that the Proposal's categorization framework would be the primary (if not sole) reason why an IHC would file the FR Y-15, even IHCs currently subject to an FR Y-15 reporting requirement should file a tailored, short-form FR Y-15.

We acknowledge that our comments regarding modifications to the risk-based indicators to make them more risk sensitive (see Section III above) would create additional granularity in the Form FR Y-15 fields. However, any attendant complexity could be alleviated by allowing an international bank to prepare certain conservatively derived and unadjusted "top-line" line items of the FR Y-15 Schedules, if the international bank knows that it is clearly under or clearly over a relevant risk-based indicator threshold. For example, if a risk-based indicator is below $75 billion, prior to the deductions or adjustments that the Agencies or we have proposed, then that international bank should not be required to report the granular data required to make such deductions or adjustments. Conversely, if an international bank's risk-based indicator is above $75 billion, and believes that any deductions or adjustments would not affect its categorization, then that international bank should be able to opt out of reporting each granular deduction or adjustment.

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[102] For simplicity, we identify the Schedules based on the current Form FR Y-15 rather than the multitude of schedules proposed in the revisions to the Form FR Y-15.

2. *The Agencies should clarify how international banks should report data for branches/ agencies on line items that reference forms required to be filed by holding companies only.*

The Proposal appears to retain the line item instructions for reporting the several risk-based indicators that cross-reference figures or fields in reporting forms that must be filed by IHCs, but not by branches/agencies.

For example, proposed Schedule L of the FR Y-15, on which international banks would report the CJA indicator, cross-references instructions to Form FFIEC 009 for several of the line items. This form is only required to be filed by IHCs. Branches/agencies, however, must report country exposures on Form FFIEC 019, which requires reporting only of exposures to the home country and the five countries to which foreign exposure is the largest. Therefore, reporting CJA on a CUSO basis would require, in effect, filling out the FFIEC 009 or its equivalent on a branch/agency level. As another example, proposed Schedule M requires reporting of values exactly as they are reported on Form FR Y-9C, which is only required to be filed by IHCs. Clarifications to these instructions, or revisions to the FR Y-15 or cross-referenced reporting forms, would be needed for branches and CUSO reporting.

This dilemma has potential to create data integrity and measurement issues that can distort the categorization framework and yield different outcomes for similarly situated banking organizations. Ultimately, these gaps in instructions illustrate the problematic nature of categorizing international banks on the basis of CUSO attributes. The existing reporting framework is designed for a holding company structure. Although we are mindful that the Agencies have apparently sought to minimize reporting burdens by retaining existing reporting forms, the instructions do require significant additional tailoring in order to be workable and effective.

3. *Similarly, the Agencies should clarify the methodology to be used or the sources of FR Y-15 information in the context of a branch, agency or the CUSO.*

The branches/agencies and CUSO do not aggregate to a balance sheet currently reported on any form to the Agencies. In addition, the branches/agencies and CUSO do not perform U.S. capital calculations. For these and other reasons, the FR Y-15 Schedules create significant ambiguities. Without standardization and guidance in this area, data integrity issues may result in miscalibrated regulatory requirements. For example:

- Several line items in proposed Schedule H (Size Indicator) reference the U.S. capital rules' credit conversion factors, which are not typically applied to branch/agency off-balance sheet exposures.

- Line item 7 in proposed Schedule N (Short-Term Wholesale Funding Indicator) requires "average risk-weighted assets" for branches/agencies and the CUSO. The branches, agencies and CUSO do not currently calculate U.S. RWA. In any event, CUSO RWA should not be required as it is not used for any of the risk-based indicators, even if it is used for the FR Y-15 composite score.

- Other items cross-reference a "balance sheet" for international banks, but neither the instructions nor the glossary to the Form FR Y-15 contain guidance regarding whether a specific reporting form (or aggregation of reporting forms) should be used (such as the Forms FFIEC 002 and FR Y-7Q).

- The Agencies should also provide guidance on (i) how any due-to or due-from amounts at branches or agencies should be incorporated into the metrics, if at all (we advocate above that they should not be) and (ii) elimination of certain items in consolidation (albeit an "unnatural" consolidation) across the CUSO.

4. *The Agencies should harmonize the reporting methodology for wSTWF on Form FR Y-15 for all international banks.*

The instructions to proposed Schedule N on Form FR Y-15 would retain the existing instructions requiring international banks that report the FR 2052a daily to report average wSTWF values using daily data, and all others to report average values using monthly data.[103] The Agencies should revise the instructions so that all international banks may report average values using monthly data, regardless of the frequency of FR 2052a reporting. An inconsistent methodology has potential to inappropriately tailor regulatory requirements even across similar institutions.

B. <u>Daily FR 2052a reporting would be a significant, unwarranted and new burden for several international banks</u>.

1. *No international bank should be subject to more frequent liquidity reporting as a result of the Proposal. Tailoring requires that Category II firms be differentiated from Category I in this respect.*

The Proposal would increase the frequency of FR 2052a liquidity reporting for several international banks. Daily FR 2052a reporting entails a significant technological and infrastructure build. Currently, only the four international banks that are identified as LISCC firms are subject to daily liquidity reporting on the FR 2052a, but based on Federal Reserve projections (i) one of these firms would become subject to monthly reporting as a Category III firm and (ii) three additional non-LISCC international banks (including one without an IHC) would become subject to daily liquidity reporting. In contrast, based on Federal Reserve projections only one additional U.S. BHC would become subject to daily reporting and eight of the nine U.S. daily reporters would be Category I GSIBs (compared to six international bank reporters, none of which is a Category I institution). This outcome is inconsistent with the principle of national treatment and with Vice Chairman Quarles' statements indicating that a goal of tailoring is to create a level playing field between U.S. BHCs and IHCs of similar size and risk profiles.

The Agencies should revise the Proposal so that Category II and III international banks would be required to report monthly, and Category IV international banks would be required to report quarterly. This reporting schedule would match the frequency of these firms' liquidity stress-testing requirements under Regulation YY. In addition, this schedule would be appropriately tailored for Category IV international banks which otherwise would be required to report granular liquidity-related information on a form that generally tracks a regulatory requirement (the LCR) to which they would not be subject.

Alternatively, daily reporting should not be required based merely on Category II or $75 billion of wSTWF. Potential options for tailoring this significant burden could include raising the threshold for daily reporting to $100-125 billion of wSTWF. The potential for a single risk-based indicator to result in daily liquidity reporting, combined with the extreme operational burden imposed by this requirement, makes calibrating the trigger for daily reporting particularly significant.

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[103] FR Y-15 Instructions at G-1.

2. *International banks that would not need to meet the full, daily LCR and NSFR should be permitted to file on a T+10 basis.*

The Proposal would require all FR 2052a filers, except Category IV international banks with less than $50 billion in wSTWF, to file on a T+2 basis. Formerly only CUSO or IHCs with greater than $250 billion in assets were required to report at this pace. Reporting data by day two, rather than by day ten, for international banks not previously subject to the requirement represents a significantly increased reporting burden, with an information technology build requirement roughly equivalent to that required for daily reporting. Also, according to Federal Reserve projections, five of the seven international banks in Category IV would be subject to reporting by day T+2, whereas no Category IV U.S. BHCs would be. The added burden on international banks relative to U.S. BHCs violates the principle of national treatment, particularly because this burden relates to reporting data to calculate a regulatory requirement that is applied in reduced form.

3. *The Agencies should clarify that international banks may use the FR 2052a to calculate both the LCR and NSFR.*

To the extent the Agencies apply the NSFR to international banks as proposed (see Section IV.C.3), the Agencies should clarify that the applicable ratios to calculate both the NSFR and LCR will be determined using data reported on Form FR 2052a. This clarification would avoid creating duplicative, or potentially divergent, reporting obligations.

IX. Transition Periods

A. Transition periods are necessary for data collection, indicator calculation, categorization and ultimate compliance.

Other than detail around the transition to LCR and NSFR compliance appearing in the Capital/Liquidity Proposal, there does not appear to be a transition period described in the Proposals.[104] While ostensibly a tailoring exercise that should have reduced burdens on international banks because of their smaller and less complicated U.S. operations, the Proposal in many instances would impose new or more stringent requirements on the U.S. operations of international banks. To the extent that the Agencies adopt any or all of these requirements as proposed (including basing categorization on CUSO-wide data), notwithstanding the reasons for elimination or modification offered in this letter, the Agencies should provide appropriate transition periods to implement the resulting requirements in an orderly and comprehensive manner. That such transition periods are necessary for systems builds and categorization determination in the context of new CUSO-level risk-based indicators is further evidence of the complexity, rather than streamlining, attendant to the Proposal, and is an additional rationale for determining IHC categorization by an IHC’s attributes as we recommend in Section II above.

[104] There is one ambiguous sentence in the Capital/Liquidity Proposal that is not clear as to whether it is referring only to capital and liquidity standards. See 84 Fed. Reg. at 24325 (“Following the date that is one year after adoption of a final rule (or, in the case of the proposed NSFR requirement, following the effective date of that requirement), a foreign banking organization would be required to comply with the requirements based on its applicable category of standards, according to the same timing as would apply to a U.S. banking organization under the domestic interagency proposal.”).

We propose the following with regard to categorization, transition and implementation:

- With regard to <u>initial</u> categorization:
  - Within six months following the finalization of the Proposal, all affected international banks would provide the Agencies with best available or estimated pro forma data regarding size and risk-based indicators for the most recent quarter-end.
  - At the time of submission of the data, each international bank would elect whether to (i) opt in to compliance immediately with some or all of the substantive requirements applicable to the category apparent from the data submitted, or (ii) delay compliance with some or all of the substantive requirements applicable to the category apparent from the data submitted.
  - If an international bank chooses to delay compliance with some or all of the substantive requirements, then an appropriate time period of between 1 and 2 years (or as otherwise agreed with the relevant Agency(ies)) would be provided in order to build appropriate data aggregation systems across the CUSO, determine the international bank's category based on four quarters of data[105] and come into compliance with the substantive requirements applicable to that category.
  - All international banks, whether they chose to comply or to delay, would work on new reporting requirements during the timeframe described in the previous bullet.
  - If an international bank chose to comply with the substantive requirements of its apparent initial categorization, and after build out of appropriate systems and data collection, it becomes evident that the international bank should be in a more stringent category for some or all substantive requirements (based on four full quarters of data), then the international bank would be provided 1 year from the date of such determination in order to come into compliance with the requirements of that new category.
- With regard to <u>future</u> categorization changes:
  - Compliance with a more stringent category of requirements warrants more than 1-2 quarters for coming into compliance.[106]
  - We suggest that a baseline of at least 1 year be provided, with Agency discretion to grant extensions.
- Other: Throughout this letter we have highlighted other transition issues, such as those related to SCCL and the Form FR 2052a.

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105 Basing categorization on one arbitrary or random quarter or, worse, one year-end, would not be appropriate, even if it may be expedient. Final categorization should be based on four full quarters of data.

106 The Agencies indicated that compliance would be required on the first day of the second quarter after the categorization threshold was tripped.

Finalization of the Proposal to provide clarity and certainty to both U.S. BHCs and international banks is also important. We urge careful consideration of the issues and challenges we have raised in this letter. We also believe that, in the context of provisions that provide relief to some of our members, the principles of equality of competitive opportunity and national treatment dictate that international banks be provided that relief at the same time as U.S. BHCs. Nevertheless, the transition mechanics described above should be incorporated into any final rule that is released in conjunction with the domestic final rule.

B. Shifts between categories, in either direction, should be on the basis of a trailing four quarter average.

Under the Proposal, an international bank would move up to a more stringent category if it meets one or more of the risk-based indicators averaged over the preceding four calendar quarters, but would move down to a less stringent category only if it no longer meets the risk-based indicators for its current category in each of the four most recent calendar quarters (i.e., without averaging). The Agencies should harmonize the transitions methodology so that international banks may also move down a category based on average data. Without this modification, an international bank's categorization may not be appropriately calibrated with its size and complexity.

X. Other Issues

A. The Agencies should index the thresholds to account for nominal economic growth.

International banks' asset size and risk-based indicators may increase naturally over time as their activities expand in response to growth in the banking sector and economy. Static risk categories become a ceiling, incentivizing international banks to artificially curtail their productivity in an effort to stay within their existing risk category and avoid being subjected to increased regulatory burden. Without a mechanism to automatically adjust the thresholds for the risk-based indicators and the asset size thresholds for the categorization framework, the Proposal risks becoming an artificial constraint on growth. Specifically, we believe the categorization framework should be indexed to the growth in domestic banking assets in the aggregate (of both U.S.-headquartered banking organizations and international banks) to reflect expansion of the banking sector and the economy. An international bank's risk profile within the banking system will remain stable if the value of its risk-based indicators rise proportionate to the size of the banking sector.

B. Only Category I institutions should be in the LISCC portfolio.

The Federal Reserve established the LISCC supervisory program to supervise the largest, most systemically important financial institutions in the United States. Since its creation, however, the criteria by which banks have been selected for inclusion in the LISCC portfolio has been undefined. According to the Federal Reserve, contributing factors include size, interconnectedness, lack of readily available substitutes, complexity and cross-jurisdictional activity, which mirror those that are reported on the Form FR Y-15.

No U.S. BHC proposed to be in Category II-IV would be in the LISCC portfolio. By contrast, the four international banks that are in the LISCC supervisory program would be spread across these risk categories and, in each case, would be in a lower risk category than any U.S. LISCC firm. This raises a number of national treatment and equality of competitive opportunity concerns.

No international bank proposed to be in Category II-IV should be in the LISCC portfolio. These banks should be evaluated and supervised based on comparison with their respective regulatory peer groups (i.e., categories), and not with U.S. GSIBs. As the Federal Reserve has now proposed a more considered and concrete categorization system for grouping domestic and international banks with their peers based on size and relative riskiness, this categorization system should govern for both regulation and supervision. Therefore, only Category I institutions, i.e., the U.S. GSIBs, should be subject to the LISCC supervisory program.

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We appreciate your consideration of our comments. Please contact me (646-213-1147, bpolichene@iib.org), or our General Counsel, Stephanie Webster (646-213-1149, swebster@iib.org), if we can provide any additional information.

Sincerely,

Briget Polichene
Chief Executive Officer