Institute of International Bankers

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January 16, 2024

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue N.W.
Washington, D.C. 20551

Attn: Ann Misback, Secretary
regs.comments@federalreserve.gov

Re: Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies, Systemic Risk Report (FR Y–15); Regulation Q; Docket No. R–1814; RIN 7100–AG65

The Institute of International Bankers (the "**IIB**") and the Bank Policy Institute ("**BPI**") appreciate the opportunity to comment on the notice of proposed rulemaking issued by the Board of Governors of the Federal Reserve System (the "**Federal Reserve**") regarding *Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Systemic Risk Report (FR Y–15)*.[1]

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**").

BPI is a nonpartisan public policy, research and advocacy group, representing the nation's leading banks and their customers. BPI's members include universal banks, regional banks and major foreign banks doing business in the United States. Collectively, they employ almost two million Americans, make nearly half of the nation's small business loans, and are an engine for financial innovation and economic growth.

The GSIB Surcharge Proposal includes certain serious flaws that should be rectified. In particular, the Preamble to the GSIB Surcharge Proposal suggests that changes to the Cross-Jurisdictional Activity ("**CJA**") risk-based indicator would have material adverse effects on the categorization of foreign banks, and no such effect on any U.S. banks. The Federal Reserve projects (with neither support nor data) that, based on changes proposed:

- The combined United States operations ("**CUSO**") of seven international banks would be re-tiered to Category II, from current Categories III or IV,

[1] 88 Fed. Reg. 60385 (Sept. 1, 2023) (the "**GSIB Surcharge Proposal**" or "**Proposal**").

- The intermediate holding companies ("**IHCs**") of two international banks would be re-tiered to Category II from Category III, and

- There would be no impact on the tiering categorization of any domestic firm.

If this re-tiering of international banks is the Federal Reserve's intended result, then this outcome signals a severe miscalibration of the GSIB Surcharge Proposal and the CJA risk-based indicator, and a specific targeting of international banks for more stringent regulation without any policy rationale. If this result were intended, then the cause of the re-tiering would need to be reproposed, as the Federal Reserve would need to substantiate this result with much more than it has provided in the Proposal.

IIB, BPI and our members believe, however, that there is one significant error in the Proposal and in the related Form FR Y-15 revisions that is likely the cause of this projected change in tiering of international banks. We discuss how this error might be corrected in Section I below.

Based on calculations by our members and outside consultants, assuming correction of this error, the projected re-tiering of international banks would not occur. Nevertheless, such a significant projected change should have been cause for alarm and re-examination of the causes. Yet, the Federal Reserve appeared unfazed by these results in its discussion of the projected re-tiering, going so far as to imply that it must have made the correct decision in adding derivatives to the CJA sub-components so as to capture the significant latent risks of international banks. In doing so, the Proposal did not provide any rationale for or any analysis of either the re-tiering of several international banks or the ultimate resulting categorization of international banks in comparison to domestic firms. All of this represents serious flaws in the process of the Proposal as well as in the supporting evidence required by the Administrative Procedure Act (the "**APA**") for such a significant change in the framework applicable to international banks.

Below, we provide our views on correcting the error in the proposed revisions to the Form FR Y-15, as well as our comments on including derivatives as a component of CJA.[2]

I. Errors in the proposed revisions to the Form FR Y-15 should be corrected.

The Federal Reserve released both the proposed revisions to the Form FR Y-15[3] and the proposed revisions to the Instructions for the Preparation of Form FR Y-15[4] in August 2023, but the two documents paint a very different picture as to the intended scope of changes to the CJA indicator.

The Proposed FR Y-15 Instructions properly carry over, into the derivative calculations and into the combined U.S./foreign bank form changes, the current treatment afforded to international banks with regard to cross-jurisdictional claims and cross-jurisdictional liabilities with affiliated entities outside the

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2 In the IIB's separately filed comment on the Basel III Endgame capital proposal (Federal Reserve, Office of the Comptroller of the Currency ("**OCC**") and Federal Deposit Insurance Corporation ("**FDIC**"), *Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity*, 88 Fed. Reg. 64028 (proposed Sept. 18, 2023) (the "**Capital Proposal**")), the IIB has provided comments on certain thematic elements such as the lack of appropriate differentiation based on risk attributes across the tiered categories and certain disparate effects on international banks. We incorporate those comments into this letter by reference.

3 *See* https://www.federalreserve.gov/reportforms/formsreview/20230727%20FR%20Y-15%20form%20NL.pdf (the "**Proposed FR Y-15 Form**").

4 *See* https://www.federalreserve.gov/reportforms/formsreview/20230727%20FR%20Y-15%20instructions%20NL.pdf (the "**Proposed FR Y-15 Instructions**").

United States and with U.S. branches of affiliated non-U.S. banks.[5] The Proposed FR Y-15 Instructions set forth the calculation for cross-jurisdictional liabilities in a revised Schedule E: "Line Item 7 Total cross-jurisdictional liabilities. For domestic firms, the sum of items 5 and 6. For FBOs, the sum of items 5(a) and 6(a)."[6] Also, for items 5(a) and 6(a), as per the 2019 Final Tiering Rule, the Proposed FR Y-15 Instructions state: "For this item, do not include liabilities to offices of the FBO outside the reporting group."[7]

However, in contrast to the Instructions, the Proposed FR Y-15 Form indicates in the individual line item revisions for what will become line item 7 of Schedule E, "Total Cross-Jurisdictional Activities", that the total is the "sum of items 5 and 6".[8] These changes omit language stating "sum of items 5.a and 6.a for FBOs", as indicated in the Proposed FR Y-15 Instructions.

We believe that the Proposed FR Y-15 *Instructions* provide the proper, and intended, outcome. Therefore, the Proposed FR Y-15 *Form* is incorrect and should be corrected before finalizing.

There was no indication whatsoever in the Proposal that the Federal Reserve intended to overturn the regulatory treatment of liabilities to non-U.S. affiliated entities that was already well-considered when finalizing the 2019 Final Tiering Rule. Indeed, the 2019 Final Tiering Rule was specifically designed to take into account the materially different structural considerations related to U.S. operations of international banks. In 2019, the Federal Reserve noted that adjustments to the measurement of CJA were necessary to "reflect the structural differences between foreign banking organizations' operations in the United States and domestic holding companies."[9] Furthermore, "intercompany liabilities generally represent funding from the foreign banking organization to its U.S. operations and, in the case of certain long-term debt instruments, may be required by regulation."[10] In addition to long-term debt, regulations require the maintenance of liquidity buffers, some of which is permitted to be maintained outside the United States at the parent level and/or is based on drawn long-term credit lines from affiliates.[11] The Federal Reserve went on to state that the "proposed exclusion recognizes the benefit of the foreign

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5 *See* Federal Reserve, *Prudential Standards for Large Bank Holding Companies, Savings and Loan Holding Companies, and Foreign Banking Organizations*, 84 Fed. Reg. 59032, 59039 (Nov. 1, 2019) (the "**2019 Final Tiering Rule**") ("In recognition of the structural differences between foreign and domestic banking organizations, [the Federal Reserve] adjusted the measurement of cross-jurisdictional activity for foreign banking organizations to exclude inter-affiliate liabilities and certain collateralized inter-affiliate claims. Specifically, claims on affiliates would be reduced by the value of any financial collateral.").

6 Proposed FR Y-15 Instructions at 60.

7 Proposed FR Y-15 Instructions at 58-59. The instructions for line item 5(a) are to include all non-derivative liabilities, adjusted to eliminate liabilities to affiliated entities; the instructions for line item 6(a) are to include the newly proposed derivative liabilities, also adjusted to eliminate derivative liabilities to affiliated entities.

8 Proposed FR Y-15 Form at 5. We note that the correct language appears in the Total Cross-Jurisdictional Claims item: What will become line item 3 of Schedule E states, "Total cross-jurisdictional claims (sum of items 1 and 2 for domestic firms; sum of items 1.a and 2.a for FBOs)."

9 Federal Reserve, *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, 21995 (May 15, 2019) (proposed rule) (the "**2019 Tiering Proposal**").

10 Id.

11 *See* 12 C.F.R. §§ 252.145, 252.156 and 252.157. In particular, *see* 12 C.F.R. § 252.157(c)(3) (permitting calculation of liquidity buffer for 14 days of the 30-day buffer period, and permitting additional liquidity to be provided by home office or overseas affiliates).

banking organization providing support to its U.S. operations."[12] We also note that inter-affiliate, cross-border claims and liabilities are eliminated in consolidation for domestic institutions, and the 2019 Final Tiering Rule acknowledgement of the need for a modification for international banks is consistent with providing equality of competitive opportunity. No combination of the GSIB Surcharge Proposal, the Proposed FR Y-15 Form or the Proposed FR Y-15 Instructions should remove or overturn those conclusions by the Federal Reserve.

Based on analyses by our members, in our view, this error is the likely cause of the Federal Reserve's projections that seven CUSO and two IHCs would be re-tiered into more stringent categories. Analyses by our members and by our consultants have not been able to recreate the elevation of CUSO and IHCs to higher tiers based on the proposed changes to the CJA indicator alone. Therefore, the error should be corrected so that such a drastic change does not happen. Nevertheless, we are concerned that, instead of investigating this error, the Federal Reserve appears to have justified it with the unsupported assumption that international banks' cross-border derivatives activity was significantly more risky than previously thought.[13] Indeed, the GSIB Surcharge Proposal, as published, suggests a possible outcome-based targeting of the U.S. operations of international banks, given the Federal Reserve's apparent lack of investigation into this issue prior to the Proposal's publication, the stark contrast between the Proposal's effect on international banks and the lack of effect on domestic institutions, and the Federal Reserve's lack of any supporting rationale for such a significant re-tiering of international banks. An outcome-based targeting is squarely at odds with the principles of national treatment and equality of competitive opportunity.

If (i) the Federal Reserve had intended such a re-tiering result, or (ii) the Federal Reserve were to modify, in the finalized version, any of the elements of the Proposed FR Y-15 Form or the Proposed FR Y-15 Instructions that correctly provide for international-bank-specific adjustments,[14] or (iii) the Federal Reserve were to fail to correct the error regarding inter-affiliate liabilities in the Proposed FR Y-15 Form, then the Federal Reserve would need to re-propose the elements of the GSIB Surcharge Proposal related to international banks and explain why it desires such an outcome with regard to international banks. IIB, BPI and public commenters would provide a significantly more comprehensive set of comments related to

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12 2019 Tiering Proposal at 21995.

13 The Federal Reserve stated that (i) "some proposed changes, such as the amendments to the FR Y-15 reporting requirements, would affect all FR Y-15 filers, as well as, potentially, their categorizations and requirements under the regulatory tiering framework . . . Overall, the Board expects that the systemic stability and operational benefits of the proposed changes would outweigh their relatively small costs" (GSIB Surcharge Proposal at 60396), and (ii) the addition of derivatives to the CJA indicator would be a "notable benefit" and be "more consistent within the tiering framework through the enhanced measurement of the cross-jurisdictional activities of banking organizations" (GSIB Surcharge Proposal at 60398). Understating and, indeed, ignoring the large effect on international banks, the Federal Reserve also states, "The proposed amendments to FR Y-15 reporting requirements would further enhance the risk sensitivity of GSIB scores by improving the measurement of firms' systemic footprints. Most of the amendments would entail small refinements to the cross-jurisdictional activity, interconnectedness, and short-term wholesale funding systemic indicators." GSIB Surcharge Proposal at 60397.

14 Including the ability to (i) net derivative claims of the U.S. operations against an affiliated foreign office against financial collateral, also consistent with the treatment of claims in the 2019 Final Tiering Rule (Proposed FR Y-15 Instructions at 56), and (ii) net negative fair values from positions in derivative contracts against positive fair values if the transactions are executed with the same counterparty, including both affiliated and unaffiliated counterparties, under a legally enforceable netting agreement (Proposed FR Y-15 Instructions at 56, 59).

the recategorization and whatever rationale the Federal Reserve would provide in such re-proposal.[15] In addition, such a re-proposal would need to withstand scrutiny in relation to the requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**"), the Economic Growth, Regulatory Relief and Consumer Protection Act (the "**EGRRCPA**") and the APA; the current Proposal omits any evidence that the Federal Reserve considered these requirements with respect to the projected re-tiering result.

II. The final GSIB Surcharge rule should not include derivatives in the CJA indicator.

The GSIB Surcharge Proposal does not provide any reason why the derivative line item changes are being made now. The proposed addition of derivatives to the CJA calculations comes after only three years of the existing tiering framework being in place and four years after the 2019 Final Tiering Rule was promulgated. Consistent with our comments on the Capital Proposal, the Federal Reserve should provide more explanation and data regarding the inclusion of derivatives to allow appropriate comment and understanding by the public and affected entities. The Federal Reserve's 2019 Final Tiering Rule, and related modifications to the Form FR Y-15, were subject to a substantial notice and comment process, requiring an enormous amount of time, analysis and development of metrics from market participants and the Federal Reserve.

While the Federal Reserve left open the possibility of considering the inclusion of derivatives in the CJA line item elements following the 2019 Final Tiering Rule's release,[16] we would have expected that any such reconsideration would have led to the release, in the Proposal, of a significant amount of data about the analyses conducted over the time period since the 2019 Final Tiering Rule was released, any models of various outcomes and alternatives that were considered, metrics regarding the difference between international and domestic derivative books, and an understanding of why derivatives should be included now when they were not in 2019. Yet, nothing of the sort addressing any of these issues is included in the GSIB Surcharge Proposal. The Federal Reserve includes conclusory statements regarding risks of transmission through derivatives and the possibility of banks using derivatives to mask their true amount of risk if derivatives are not included in the CJA indicator.[17] None of these points is a new issue (and some are exaggerated).

Indeed, the use of derivatives has been made safer and more standardized since 2010,[18] and even since 2019.[19] When including derivatives as an intended enhancement of a risk-based indicator, the

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15 Among other potential comments, we note that re-tiered CUSO and IHCs would require significantly more time to undertake the incorporation of accumulated other comprehensive income and to address the increase in resolution planning burden and liquidity reporting required of Category II organizations. The GSIB Surcharge Proposal limits the phase-in of its changes to "two full quarters after the adoption of the final rule" (GSIB Surcharge Proposal at 60398), even though the Federal Reserve had projected a material re-tiering of several CUSO and IHCs.

16 *See* 2019 Final Tiering Rule at 59040 fn. 38 and 59041 (although the Federal Reserve couched the possibility at that time as merely "additional technical modifications and refinements").

17 *See* GSIB Surcharge Proposal at 60394.

18 The Commodity Futures and Trading Commission ("**CFTC**") and the Securities and Exchange Commission ("**SEC**") have spent more than a decade implementing Title VII of the Dodd-Frank Act. Their counterparts around the world have similarly put in place robust frameworks to implement international agreements on the enhancement of safety and soundness of the global derivatives markets. *See, e.g.*, "Comprehensive Regulation of Swap Dealers & Major Swap Participants" section of CFTC website, available at https://www.cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/index.htm; "Security-Based Swap Markets" section of SEC website, available at https://www.sec.gov/tm/security-based-swap-markets.

Federal Reserve makes no mention of risk-mitigating factors. Derivatives have been the subject of a decade-long development of a robust international and risk-reducing framework, requiring clearing, collateralization and other mitigants to counterparty credit risk, whether those counterparties are cross-border or local. Nevertheless, the Federal Reserve cites a single pre-Dodd-Frank Act example from over 15 years ago (Lehman), referenced without recognition of the significant enhancements to regulation, supervision, risk-mitigation and safety of derivative businesses since that time, as support for making this change now after derivatives were consciously excluded four years ago.[20]

The Federal Reserve's addition of derivatives to the CJA indicator signals to the market and to the regulatory community that the Federal Reserve believes that somewhere in the last four years the derivatives portfolios of international banks' U.S. operations have become significantly riskier. However, this is not mentioned or discussed. To the contrary, the Federal Reserve and the FDIC recently stated that "most of the specified [international bank] firms have limited derivatives and trading operations compared to the U.S. GSIBs."[21]

In addition, to the extent that the Federal Reserve released the proposed change to the CJA indicator while it is still reviewing[22] the impact of the inclusion of derivatives, then such inclusion is currently inappropriate. The Federal Reserve should meet a higher standard if it proposes to significantly modify policies within such a short period of time, and a new determination made at this time requires more explanation than the determinations in the immediate wake of the EGRRCPA.[23] Therefore, more is needed for the public to understand and for the Federal Reserve to justify these changes.

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19 For example, security-based swap dealers were required to register with the SEC in 2021, and various temporary exemptions granted by the SEC ended at that time. *See, e.g.*, SEC, *List of Registered Security-Based Swap Dealers and Major Security-Based Swap Participants* (as of Sept. 28, 2023), available at https://www.sec.gov/tm/List-of-SBS-Dealers-and-Major-SBS-Participants; SEC, "U.S. Securities and Exchange Commission and the European Central Bank Sign Memorandum of Understanding Regarding Cooperation with Respect to Security-Based Swap Entities" (Aug. 16, 2021), available at https://www.sec.gov/news/press-release/2021-152.

20 *See* GSIB Surcharge Proposal at 60394.

21 Federal Reserve and FDIC, *Guidance for Resolution Plan Submissions of Foreign Triennial Full Filers*, 88 Fed. Reg. 64641, 64647 (Sept. 19, 2023).

22 See the IIB's separate comment letter on the Capital Proposal discussing the Agencies' ongoing collection and analysis of information. *See also* Federal Reserve, "Federal Reserve Board launches data collection to gather more information from the banks affected by the large bank capital proposal it announced earlier this year" (Oct. 20, 2023), available at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20231020b.htm.

23 *See, e.g., Watt v. Alaska*, 451 U.S. 259, 272-73 (1981) (finding that the Department of Interior's 1975 interpretation that 1964 statutory amendments required changes to a revenue distribution formula was not entitled to deference partly because, in 1964, the Department had determined the amendments did not require such a revision); *Udall v. Tallman*, 380 U.S. 1, 16 (1964) (noting that deference is particularly due "when the administrative practice at stake 'involves a contemporaneous construction of a statute by the men charged with the responsibility of setting its machinery in motion; of making the parts work efficiently and smoothly while they are yet untried and new"); *Gen. Elec. Co. v. Gilbert*, 429 U.S. 125, 141 (1976) (superseded on other grounds by statute) (finding that an EEOC guideline promulgated eight years after the passage of Title VII was not entitled to deference).

See also FCC v. Fox Television Stations, Inc., 556 U.S. 502 (2009) (when an agency is changing position, "the agency must show that there are good reasons for the new policy"; an agency must sometimes provide "a more detailed justification than what would suffice for a new policy created on a blank slate").

In sum, extra care is required when creating standards that may discourage the use of derivatives for risk management purposes. Derivatives, particularly those used by international banks' U.S. operations, facilitate enterprise-wide risk management on a cross-border basis, and discouraging derivatives activity would create impediments to efficient risk management. In general, supervision and regulation of enterprise-wide risk management tools should be the primary responsibility of home country regulators.

The Proposal does not contain a discussion of any of these effects or their implications for the U.S. economy or U.S. financial stability.

III. If the Federal Reserve were to adopt the addition of derivatives to the CJA indicator, material modifications are required.

CJA is already negatively biased against the U.S. operations of international banks,[24] which have a broader international connection with affiliates as well as with clientele of their international organizations. To remain consistent with statutory mandates of national treatment and equality of competitive opportunity, U.S. operations of international banks need to be "treated no less favorably than similarly situated U.S. banking organizations".[25] Therefore, we have the following recommendations:

A. <u>All interaffiliate derivatives should be excluded for IHCs and CUSO.</u>

Interaffiliate derivatives are integral to enterprise-wide risk management and should not be discouraged.[26] Interaffiliate derivatives, whether domestic or cross-border, are eliminated in consolidation for all U.S. domestic institutions.[27] International banks should be afforded the same treatment, in order to preserve consistency with U.S. banks, to encourage internal risk management and to prevent either the ratcheting down of competitive activity in derivatives or the isolation of the U.S. operations from being able to manage risk together with non-U.S. affiliates.[28]

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[24] A bias already acknowledged by the Federal Reserve. *See* 2019 Tiering Proposal at 21995 (international banks "engage in substantial and regular transactions with non-U.S. affiliates" and the Federal Reserve "recogni[zes] that the U.S. operations have increased cross-jurisdictional activity as a result of these activities").

[25] *See* Federal Reserve, *Prudential Standards for Large Bank Holding Companies and Savings and Loan Holding Companies*, 83 Fed. Reg. 61408, 61411 n. 27 (Nov. 29, 2018) (proposed rule).

[26] The 2019 Tiering Proposal agreed. *See* 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.").

[27] FFIEC, Instructions for the Preparation of Country Exposure Report, Reporting Form FFIEC 009 (eff. Dec. 2022) (the "**FFIEC 009 Instructions**") at Section II.E.1., p. GEN-7 ("Since the reports are on a fully consolidated bank (or bank holding company) basis, cross-border claims exclude any claims against those branches or subsidiaries that are part of the consolidated bank (or bank holding company). However, claims on unconsolidated subsidiaries or associated companies of the reporter should be reported. Thus, a banking subsidiary that submits an FFIEC 009 report should include claims on subsidiaries of the bank's parent holding company.").

[28] In addition to the recognition in the 2019 Tiering Proposal and the 2019 Final Tiering Rule (see footnotes 5 and 9-12, and their accompanying text above), the Federal Reserve has also acknowledged that affiliated entities of an international bank's U.S. operations should be removed from consideration to avoid unwarranted bias and skewing of results under several prudential frameworks. *See, e.g.,* Federal Reserve,

While we welcome the continuation of the specific international bank adjustments to cross-jurisdictional claims and liabilities included in the Proposed FR Y-15 Instructions in connection with the new incorporation of derivative claims and liabilities (see discussion in Section I above), in our view all interaffiliate derivatives should be removed from the derivatives line item in the CJA indicator (if derivatives more generally are not removed from the CJA calculation).

B. The exposure calculations for derivatives should take into account risk mitigation.

The GSIB Surcharge Proposal suggests that the derivative exposures added to the CJA indicator should be counted without taking into account collateral. The Proposed FR Y-15 Instructions indicate that both claims and liabilities are to be reported "gross of any collateral, including collateral in the form of cash."[29]

Finalizing the Proposal this way would ignore important mitigants of risk. The IIB has raised these considerations previously.[30] It remains unclear to us as to why volume and size of transactions has any relevance to a cross-border *risk-based* indicator; for the CJA measure, *risk mitigants*, such as high-quality collateral, should be taken into account. Other indicators already capture the size of derivative portfolios without collateral, such as Item 1 of Schedule A (Size indicator) and Items 1 and 2 of Schedule D (Complexity indicator) of the Form FR Y-15. Furthermore, the Federal Reserve and other agencies have acknowledged the risk-mitigating benefits of high-quality collateral, including in other Form FR Y-15 derivative indicators such as Schedule B (Interconnectedness indicator). In addition, the CJA indicator leverages "claims" and "liabilities" – when those claims and liabilities have been pre-paid through collateral (that is subject to the more robust collateral mechanisms put in place internationally after the 2007-09 crisis), the claim or liability should not factor into cross-border risk.

Indeed, in order to mitigate the risks of derivatives, the international regulatory community agreed on, and put in place over the last decade, robust frameworks for clearing and collateralization of derivatives, including cross-border derivatives. The GSIB Surcharge Proposal, however, implies instead that the Federal Reserve will ignore those efforts to cabin systemic risk and that derivatives are risky based on volume and size of portfolio alone.

We recommend that any final rule, and any final changes to the Proposed FR Y-15 Form and the Proposed FR Y-15 Instructions, should include the following:

- Derivative exposures (both claims and liabilities) should be included in the CJA indicator only net of cash collateral, as claims are currently collected in the memorandum items of the Form FR Y-15 CJA schedule and on the Form FFIEC 009.[31]

2023 Stress Test Scenarios (Feb. 2023) at 13, fn. 14 ("U.S. IHCs are not required to include any affiliate as a counterparty" in the counterparty default component of the stress test); 12 C.F.R. § 252.171(f)(2) (an affiliate, even if not consolidated, is not a "counterparty" for the single-counterparty credit limits portion of enhanced prudential standards).

29 Proposed FR Y-15 Instructions at 56 and 59.

30 *See* IIB letter re: the proposal for the 2019 Final Tiering Rule (submitted June 21, 2019), at Section E.

31 See Federal Reserve, Instructions for the Preparation of Systemic Risk Report, Reporting Form FR Y-15 (eff. Sept. 2021) at Schedule L, p. L-2 ("Report the positive fair value of all claims over all sectors from positions in derivative contracts that, on an ultimate-risk basis, are cross-border claims on non-local residents or foreign-office claims on local residents (see FFIEC 009, Schedule D, Columns 1 through 4, Total Foreign Countries). For this item, only include derivative positions with net positive fair values consistent with the instructions for preparation of the FFIEC 009. For definitions, also refer to the

- Derivative exposures (both claims and liabilities) should be included in the CJA indicator only net of <u>non-cash</u> collateral.[32]

- All derivatives that are settled to market should be eliminated from the metric, if not eliminated already under FFIEC 009 calculations.[33]

- All derivatives that are cleared, regardless of the location of the clearing house or central counterparty, should be eliminated from the metric. This exclusion would recognize the decade of work to mitigate the risk of international derivatives, through substantially enhanced clearing and collateralization requirements.

- As noted above, we appreciate that the Proposed FR Y-15 Instructions retain the concept of netting of in- and out-of-the-money (claims and liabilities) values with a counterparty, as permitted under a qualifying master netting agreement. We strongly agree that this should be preserved in the context of derivatives.[34]

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instructions for preparation of the FFIEC 009."); FFIEC 009 Instructions at Schedule D, p. D-1 ("All claims reported on Schedule D are to be reported on a guarantor basis (see Section II.C). Therefore, amounts that are guaranteed are reported in the sector and country of the guarantor. Similarly, if cash collateral is held, amounts that are collateralized are reported in the sector and country of the legal entity where the cash collateral is held; when securities are held as collateral, the exposure is reported in the sector and country of the issuer of the securities (see Section II.F).").

Indeed, modifying the Form FR Y-15 to require that institutions change the elements from the FFIEC 009 reporting prior to inclusion in the Form FR Y-15 is a significant and unwarranted burden itself.

32 This treatment would be consistent with another change in the GSIB Surcharge Proposal: Expanding collateral to allow the recognition of non-cash financial collateral to offset net fair value of derivatives for purposes of the FR Y-15 collection of intra-financial system assets and intra-financial system liabilities. See GSIB Surcharge Proposal at 60392.

At the very least, non-cash collateral should be recognized for both claims and liabilities as shifting to the issuer of the collateral, and thereby eliminating the derivatives' cross-jurisdictional nature when U.S. issued collateral (e.g., U.S. Treasuries) is posted. Under Basel Committee on Banking Supervision ("**BCBS**") instructions for CJA, securities collateral is deemed to "guarantee" the derivative exposure and exposure is shifted to the issuer of the collateral. *See* BCBS, *Instructions for the end-2022 G-SIB assessment exercise* (January 2023) (the "**BCBS Instructions**"), at ¶ 143 (for CJA purposes, reporting of derivative claims is on an "ultimate risk basis"), ¶ 142 n. 39 (definition of "ultimate risk basis") and ¶ 146 (for CJA purposes, "[w]hen the final risk lies with the guarantor, a derivative is considered foreign if the guarantor is not in the bank's home jurisdiction (eg *the collateral consists of government securities from other countries*)"; emphasis added). *See also* Bank for International Settlements ("**BIS**"), *Reporting guidelines for the BIS international banking statistics* (July 2019) (which is referred to in the BCBS Instructions, at ¶ 142, n. 38), at ¶ 4.39 ("Derivative assets should be reported against the guarantor.") and ¶ 4.34 and Table 4.6 (indicating that the guarantor for a derivative collateralized by securities is the issuer of the security). *See also* footnote 31 above regarding the FFIEC 009 Instructions.

33 See Federal Reserve, OCC and FDIC, Regulatory Capital Treatment of Certain Centrally-cleared Derivative Contracts Under Regulatory Capital Rules (Aug. 14, 2017) (discussing settled-to-market derivatives), available at https://www.fdic.gov/news/financial-institution-letters/2017/fil17033a.pdf.

34 See discussion of offsets in Items 2, 2(a), 5 and 5(a) in the Proposed FR Y-15 Instructions at 56 and 59.

This is also consistent with the BCBS Instructions at ¶ 141 ("The BIS Consolidated Banking Statistics (CBS) allow for certain netting arrangements to offset assets and liabilities against the same counterparty. A bank can apply these netting arrangements to cross-jurisdictional activity indicators (and related memorandum items presented in Section 21) which are based on the CBS provided that . . . they are limited

IV. The Federal Reserve should also make certain additional changes and clarifications to the Form FR Y-15.

A. <u>The use of SA-CCR in the Form FR Y-15 should be clarified for IHCs and CUSO.</u>

The Proposed FR Y-15 Instructions contain a number of references to calculating derivative exposures and potential future exposures ("**PFE**") under 12 C.F.R. § 217.34(a):

- Schedule A (Size), Line item 1(b) (PFE of derivatives) – "calculated in accordance with 12 CFR 217.34(a)"
- Schedule B (Interconnectedness), Line item 5(b) (Intra-Financial System Assets -- PFE) – "calculated in accordance with 12 CFR 217.34(a)"
- Schedule B (Interconnectedness), Line item 12(b) (Intra-Financial System Liabilities – PFE) – "calculated in accordance with 12 CFR 217.34(a)"

Under the Capital Proposal, subsection (a) of 12 C.F.R. § 217.34 would be modified to direct banking organizations (i) to use the current exposure methodology ("**CEM**") or to opt-in to the standardized approach to counterparty credit risk ("**SA-CCR**") if the banking organization is not subject to subpart E of part 217, or (ii) to use SA-CCR if the banking organization is subject to subpart E of part 217.

CUSO Considerations. However, the U.S. capital rules do not apply to an international bank's CUSO, other than its IHC (if any). Therefore, an international bank's CUSO, which by the terms of the Proposed FR Y-15 Instructions would be required to calculate PFE "in accordance with 12 CFR 217.34(a)", has no way of knowing whether it is supposed to apply CEM or SA-CCR, or whether it has an option to choose.

The Federal Reserve should clarify that an international bank's CUSO, because it is not subject to subpart E of part 217, should apply paragraph (1) of § 217.34(a), and thereby should have a choice to apply CEM or to opt into SA-CCR for these calculations.

IHC Considerations. Under the Capital Proposal, Category III and IV IHCs would become newly subject to SA-CCR, through being subject to subpart E of part 217. The Federal Reserve (and other Agencies) should clarify that IHCs becoming newly subject to SA-CCR should have the full multi-year transition period under any finalized Capital Proposal to implement SA-CCR into the Form FR Y-15, and the first Form FR Y-15 that requires use of SA-CCR for elements of Schedules A and B should be the first Form FR Y-15 to be filed after the end of the full transition period. The Federal Reserve has previously acknowledged that SA-CCR requires a costly systems and operations build,[35] and more time

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to derivative contracts, repurchase agreements, and reverse repurchase agreements under legally enforceable master netting agreements with the same counterparty"). *See also* BCBS Instructions at ¶ 144 (derivative claims) and ¶ 149 (Item 14.b, derivative liabilities).

35 *See* Agencies, *Standardized Approach for Calculating the Exposure Amount of Derivative Contracts*, 83 Fed. Reg. 64660, 64662 (Dec. 17, 2018) (proposed rule) ("While the agencies recognize that implementation of SA–CCR offers several improvements to CEM, it also will require . . . internal systems enhancements and other operational modifications that could be costly and present additional burden").

would be needed than the transition timeframe set forth in the GSIB Surcharge Proposal ("two full quarters after the adoption of the final rule."[36]

International Bank Considerations. As the U.S. capital rules do not apply to an international bank's CUSO, the Federal Reserve should also allow both an international bank's IHC and CUSO to calculate the Form FR Y-15 required data using home country SA-CCR to the extent SA-CCR is applicable to it under its home country regulatory regime. This would acknowledge the global move toward SA-CCR by a significant majority of international banks' home countries, and would not impose a different potential calculation on the CUSO (or a difference between the CUSO and IHC calculation) merely for purposes of the Form FR Y-15.[37]

B. Collateral should be taken into account in Securities Financing Transactions.

In our view, the Proposed FR Y-15 Instructions do not correctly treat repurchase/reverse repurchase agreements and securities borrowing/lending agreements ("**Securities Financing Transactions**"). Notwithstanding the instructions for cross-jurisdictional claims to report "the adjusted value of all claims over all sectors that, *on a guarantor basis*, are cross-border claims or are the claims of a foreign office on residents of the country in which the office is located" (emphasis added), the Proposed FR Y-15 Instructions cross-reference "FFIEC 009, Schedule C, Part II, Columns 1 through 10, Total Foreign Countries." While those columns are also supposed to be on a guarantor basis, thereby taking into account the collateral issuer (the whole Schedule C, Part II is supposed to be on a "guarantor basis" in contrast to Part I which is on an "immediate counterparty basis"), these columns apparently continue to follow the lack of risk transfer for Securities Financing Transaction that is mandated in Section II.F of the FFIEC 009 Instructions. In particular, see Examples (14), (15) and (16) of the FFIEC 009, Schedule C, Part II instructions where no transfer of the risk to the issuer of the collateral in Securities Financing Transactions is contemplated, even under the "guarantor basis" section of the FFIEC 009. See also 2019 Final Tiering Rule at 59041.

This has been a long-standing concern for us, and the FFIEC 009 Instructions fail to provide a reason why Securities Financing Transactions should be treated differently from a secured loan under this Form. The calculations should permit the U.S. operations of international banks to treat Securities Financing Transactions under which the international bank receives U.S.-issued collateral (e.g., U.S. treasuries) as domestic activity. Making such a change would be consistent with (i) the use of FFIEC 009, Schedule C, Part II (which requires reporting on a "guarantor basis"), (ii) the comparative treatment of secured loans and letters of credit, and (iii) the 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). Changing the calculation of Securities Financing Transactions avoids the unintended consequence of generally reducing international Securities Financing Transaction activity as institutions (both U.S. and international banks) seek to manage CJA and foreign exposure thresholds. Rather than reducing risk, decreased Securities Financing Activity would have the opposite effect of potentially exacerbating financial stress by reducing market liquidity.

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[36] GSIB Surcharge Proposal at 60398.

[37] *See also* the IIB's separate comment letter on the Capital Proposal recommending Category III and IV IHCs be permitted to (1) opt in to using SA-CCR, with the default being CEM, and (2) if SA-CCR is chosen, use their home country's SA-CCR methodology instead.

C. <u>In summary, additional clarity is needed in both the Form FR Y-15 and its Instructions.</u>

The two items described in Sections IV.A and IV.B. above are individual issues that highlight two broader weakness in the Form FR Y-15.

First, as these Forms, as well as the FFIEC 009 and other forms that are incorporated into the Form FR Y-15, continue to drive regulatory outcomes, rather than serve their original role of data collection, it is more critical that the Forms be clear and understandable on an integrated basis. For example, as noted above, there is a significant ambiguity in the use of "guarantor basis" when referring to collateralized Securities Financing Transactions. There is also a need to understand the translations between forms more clearly. As we highlighted, the transfer of derivative data from the FFIEC 009 into the CJA derivatives line items would seem to require additional manipulation of the data before it is entered into the Form FR Y-15 that is not fully or clearly explained.

Second, for international banks, the Form FR Y-15 applies also to data to be collected from international banks' CUSO. Yet the CUSO has unique challenges related to the aggregation between and among U.S. entities which are not addressed or explained appropriately. We recommend further explanation in the Form FR Y-15 with regard to unique reporting and data issues related to the CUSO.

We urge the Federal Reserve to more clearly explain the various interactions and integrations among Forms and their applicability, particularly in relation to the growing trend of reliance on these forms for regulatory requirements and classification.

V. If any of the modifications proposed in the GSIB Surcharge Proposal were to elevate a CUSO or IHC to a different category, compliance with that category's requirements should be provided additional and longer transition periods.

The transition period described in the GSIB Surcharge Proposal appears to be focused on changes to line item elements of the risk-based indicators. In particular, certain CJA derivatives information is largely already included in memorandum items in the Form FR Y-15. However, this focus on data collection misses the more significant implications of the GSIB Surcharge Proposal, namely the resulting changes in prudential requirements that could follow from a re-tiering of international banks' U.S. operations, should any of the modified risk-based indicators cause such a change.

As proposed, the transition period for the entire GSIB Surcharge Proposal is limited to "two full quarters after the adoption of the final rule."[38] This hidden and accelerated timing, which is radically different from the headline 1-year effective date and 3-year phase-in for the holistic capital review, is too short a transition period if the GSIB Surcharge Proposal results in elevated tiers for any institution. The proposed transition period of two quarters after release of a final rule appears to align with the current transition period provided under existing rules for when an institution crosses a tiering threshold. Under normal circumstances, an institution can expect, manage and prepare for such a significant change over a number of years, including potentially over periods where it projects and manages its size or volume of transactions to address a threshold. However, for such an unexpected change imposed by regulation a longer transition period is needed. It should not be expected that an institution would begin adjusting or building out its compliance policies based on a proposal alone; this would be a significant waste of resources that would undoubtedly be exacerbated by both the timing of any final rule and any changes to the final rule compared to the proposal.

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[38] GSIB Surcharge Proposal at 60398.

Furthermore, the transition period of two full quarters after adoption of the final rule is incompatible with proposed changes in the Capital Proposal and would create illogical and inconsistent outcomes.

First, should any IHC move into Category II, it would not be able to opt out of, and therefore would become subject to, the flow-through of accumulated other comprehensive income ("**AOCI**") to capital ratio denominator assets both (i) *in full* and (ii) *approximately 2.5 years earlier* than the phase-in planned under the Capital Proposal (depending upon relative effective dates).[39] We recommend that any re-tiered institution be able to rely fully on the timeline for the phase-in of AOCI allowed under the Capital Proposal, regardless of re-tiering.

Second, the Capital Proposal would eliminate the advanced approaches to credit risk. However, should any IHC move to Category II, it would technically be subject to implementation of advanced approaches for some period of time (depending upon the dates of release and of effectiveness of both the Capital Proposal and GSIB Surcharge Proposal). This is an illogical, and surely unintended, outcome that would result in an inefficient allocation of resources. Therefore, we recommend that any institution that is re-tiered to Category II not be subject to implementation of the advanced approaches at all, and should only be subject to the phase-in of the enhanced risk-based approach under the Capital Proposal.

More generally and in addition to these two specific anomalies, if any IHC is re-tiered, then (as these changes are part of the package constituting a holistic review of the capital adequacy and enhanced prudential standards) a transition period more consistent with the Capital Proposal would be more appropriate. We recommend that the changes to the Form FR Y-15 risk-based indicators for international banks (other than the changes to AOCI flow-through and advanced approaches applicability for which separate transition solutions are recommended above) should not be effective until two years after finalization of a rule based on the GSIB Surcharge Proposal. This would be similar to taking into account the effective date of the final rule based on the Capital Proposal (which is projected to be July 1, 2025, one year after finalization of the proposed rule, subject to potential modification in the final rule) plus one additional year.

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We appreciate the opportunity to comment on the GSIB Surcharge Proposal. We would also appreciate the opportunity to discuss any of our comments, or any other matters related to international banks, at your convenience.

Sincerely,

Stephanie Webster
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Institute of International Bankers

Brett Waxman
Senior Vice President and Senior Associate General Counsel
Bank Policy Institute

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39 While the requirement to include AOCI was noted by the Federal Reserve, the transition period in comparison to that under the Capital Proposal was not. See GSIB Surcharge Proposal at 60398.