June 21, 2019

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Attention: Ann E. Misback, Secretary
Docket No. R-1658; RIN 7100-AF45; and
Docket No. R-1628; RIN 7100-AF21

Office of the Comptroller of the Currency
400 7th Street, SW, Suite 3E-218
Washington, DC 20219
Attention: Legislative and Regulatory Activities Division
Docket ID OCC-2018-0037; RIN 1557-AE56

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attention: Robert E. Feldman, Executive Secretary
RIN 3064-AE96

Re: SIFMA Comment on Proposals Revising Applicability of Enhanced Prudential Standards for Foreign Banking Organizations

Dear Sirs and Madams:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on the following proposals by the federal banking agencies (the "Agencies") to revise the enhanced prudential standards that apply to foreign banking organizations ("FBOs"):

- the proposed rule of the Board of Governors of the Federal Reserve System (the "Board") to revise Regulation YY (the "Board Proposal");[2] and
- the Agencies' proposed rule to revise interagency liquidity and capital requirements (the "Interagency Proposal," and together with the Board Proposal, the "Proposals").[3]

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[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate on legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

[2] 84 Fed. Reg. 21,988 (May 15, 2019).

[3] 84 Fed. Reg. 24,296 (May 24, 2019).

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SIFMA has separately submitted comments to the Agencies related to certain potential changes in liquidity standards for large banking organizations. The purpose of this comment letter is to address the Proposals' changes to the enhanced prudential standards that apply to FBOs.

FBOs are important participants in the U.S. capital markets and engines of U.S. economic growth. Yet, enhanced prudential standards have limited the extent to which FBOs are willing or able to serve these important functions in our capital markets and economy. When Congress enacted the Economic Growth, Regulatory Relief, and Consumer Protection Act ("EGRRCPA"), it intended for the Agencies to address this problem by providing regulatory relief from enhanced prudential standards based on size and other appropriate risk-related factors.

SIFMA acknowledges and appreciates that the Proposals would tailor existing enhanced prudential standards in certain limited respects.[4] The Proposals would also, however, ***increase*** the stringency of liquidity, capital, and other prudential requirements for many FBOs, thereby undermining the regulatory relief the Agencies have sought to achieve. This broadening of enhanced prudential standards is due to fundamental flaws in the way the Agencies have structured the Proposals.

First, the Proposals would apply enhanced prudential standards to FBOs using risk-based indicators that disproportionately capture the capital markets activities on which FBOs focus in the United States. Notably, the use of "nonbank assets" as a risk-based indicator – with "nonbank assets" circularly defined as assets held by any subsidiary that is not a bank, disregarding the risk characteristics of the assets – would necessarily have a greater impact on FBOs than on comparably sized domestic bank holding companies ("BHCs") that focus on traditional banking businesses, because FBOs' assets in U.S. subsidiaries are largely traded assets held by broker-dealers. Provisions of the Proposals said to be comparable or equivalent to those proposed to apply to domestic BHCs would therefore be neither comparable nor equivalent in effect. The Proposals would put FBOs squarely at a competitive disadvantage, contrary to the Dodd-Frank Act's requirement that due regard be given to national treatment and equality of competitive opportunity.

Second, the Proposals would apply certain enhanced prudential standards to an FBO's U.S. intermediate holding company ("IHC") based on the footprint of the FBO's entire combined U.S. operations ("CUSO"). In this way, the Proposals would impose more stringent enhanced prudential standards on IHCs than on comparably-sized domestic BHCs.

As a result of these flaws, the Proposals would provide significant incentives for FBOs to continue shrinking their U.S. capital markets businesses, thereby amplifying, rather than easing, the disincentives for FBOs to invest in the United States. The Proposals would thus operate to the detriment of the U.S. capital markets and the U.S. economy more broadly. Additionally, the Proposals' broadening of prudential standards for FBOs would effectively ring fence liquidity and capital in the United States, risking fragmentation, retaliatory protectionism by home country regulators, and increased systemic risk.

[4] For instance, SIFMA appreciates that the Proposals would result in fewer enhanced prudential standards applying to an IHC that is not a Category II, III, or IV IHC – a so-called "entry-level" IHC.

The Agencies have not identified or explained these results, or presented reasons or evidence that would justify the disproportionately negative consequences the Proposals would impose on FBOs. For these reasons, the Proposals are inconsistent with the letter and the objectives of the EGRRCPA and the Dodd-Frank Act.

This letter discusses these issues in greater detail. Part I describes why FBOs' presence in the U.S. capital markets is critical to the U.S. economy, and how the Proposals' heightened liquidity requirements, expanded capital requirements, and other compliance obligations would incentivize FBOs to continue to decrease their participation in those markets. Part II explains how the Proposals' risk-based indicators would needlessly target capital markets businesses and other FBO activities and thereby put FBOs at a competitive disadvantage in the United States. Part III explains why the Proposals' heightened liquidity and expanded capital requirements could lead to global regulatory fragmentation and thus increase systemic risk. Part IV discusses the support that FBOs have provided their U.S. operations in times of stress, and structural enhancements FBOs have made to solidify that support in the future.

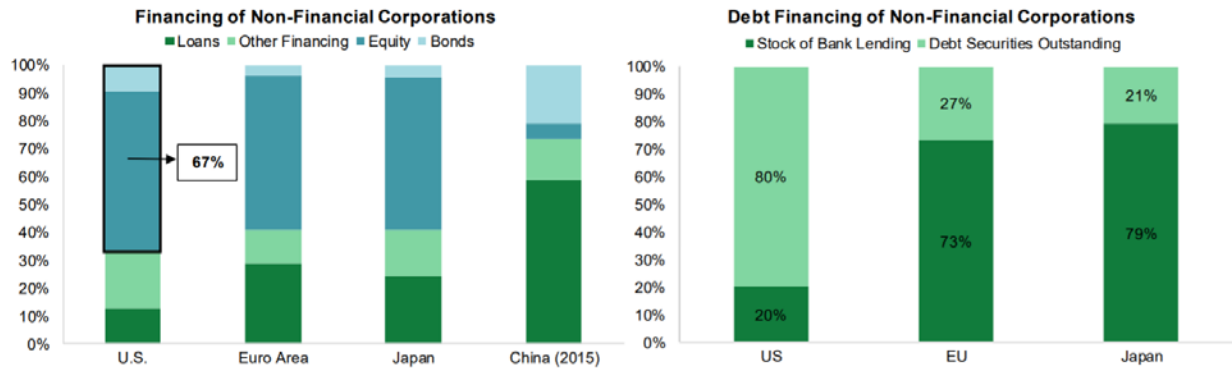
Finally, part V sets forth SIFMA's specific recommendations for how to revise the Proposals to alleviate the problem of FBOs decreasing their investment in the United States and exiting capital markets businesses here. Our recommendations center around four goals:

1. revising the risk-based indicators and their operation to avoid targeting capital markets and other common FBO activities and to better align the indicators with actual risk, such as by excluding interaffiliate transactions from each of the risk-based indicators;
2. preventing global fragmentation by revising the proposed application of heightened liquidity and expanded capital requirements to IHCs, and not advancing a proposal to subject U.S. branch and agency networks to standardized liquidity requirements;
3. applying enhanced prudential standards to an IHC based on its own footprint rather than the CUSO footprint; and
4. reducing compliance obligations that do not serve specific purposes under the Proposals' categorization framework and providing other transitional relief.

I. The Proposals Would Undercut the Competitiveness of the U.S. Capital Markets to the Detriment of the U.S. Economy

Capital markets fuel the U.S. economy, providing 67 percent of funding for economic activity and facilitating the transfer of funds from those who seek a return on their assets to those who need capital and credit to grow. Capital markets enable debt issuance, which is a more efficient and stable form of borrowing for corporations than bank loans. As depicted in Figure 1, below, the use of debt capital markets is more prevalent than bank lending in the United States, with around 80 percent of corporate funding coming through the debt capital markets versus 20 percent through bank lending. These proportions are reversed in other major developed economies and emerging markets.

Figure 1 – Sources of Financing in the U.S. and Elsewhere



Source: As of 2017, China 2015. (left) OECD, ECB, Bank of Japan, National Bureau of Statistics of China; (right) Bank of Japan, ECB, Federal Reserve
Note: (left) Euro Area = 19 members using the Euro; equity = listed, no listed and other; other financing = insurance reserves, trade credits & advances. (right) EU = 28 member states, with the UK

FBOs play an important role in the U.S. capital markets. As depicted in Figure 2, below, there are 12 global investment banks that facilitate the vast majority of trading activities, in both Fixed Income, Currencies and Commodities ("FICC") and equities, and execute a high proportion of issuance transactions (debt and equity) and M&A deals. In the Americas region, half of these firms are FBOs.

Figure 2 – Major Investment Banks in the Americas

Rankings in the Americas – 6 FBOs, or 50%

	J.P. Morgan	Bank of America	Goldman Sachs	Morgan Stanley	Citigroup	Barclays	Credit Suisse	Deutsche Bank	Wells Fargo	RBC	UBS	BNP Paribas
Total Investment Bank	#1-3	#1-3	#1-3	#4-6	#4-6	#4-6	#7-9	#7-9	#7-9	#10-12	#10-12	#10-12
FICC	#1-3	#1-3	#4-6	#4-6	#1-3	#7-9	#7-9	#4-6	#7-9	#10-12	#10-12	#10-12
Equities	#1-3	#4-6	#1-3	#1-3	#4-6	#4-6	#7-9	#7-9	#10-12	#10-12	#7-9	#10-12
IBD	#1-3	#1-3	#1-3	#4-6	#4-6	#4-6	#4-6	#10-12	#7-9	#7-9	#10-12	#10-12

#1-3 #4-6 #7-9 #10-12

Source: CRISIL Coalition Proprietary Competitor Analytics, SIFMA estimates (as of 1H18)
Note: Based on revenues from the top 12 global investment banks. FICC = fixed income, currencies & commodities; IBD = investment banking division.

On a global basis, we estimate the largest foreign firms represent over one-third of global trading in both FICC and equities and 27 percent in investment banking.[5] Additionally, foreign firms represent 62.5 percent of primary dealers[6] and 48.6 percent of registered swap dealers,[7] both of which are crucial to running U.S. monetary policy and helping corporations manage risk.

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[5] *See* SIFMA Insights: The Importance of FBOs to the U.S. Capital Markets, at p. 4 (Apr. 2019), *available at* https://www.sifma.org/wp-content/uploads/2019/04/SIFMA-Insights-The-Importance-of-FBOs-to-US-Capital-Markets.pdf (hereinafter, "SIFMA Capital Markets Report").

[6] *See* Federal Reserve Bank of New York, List of Primary Dealers (last accessed May 11, 2019), *available at* https://www.newyorkfed.org/markets/primarydealers#primary-dealers.

[7] *See* U.S. Commodity Futures Trading Commission, Provisionally Registered Swap Dealers (Apr. 11, 2019), *available at* https://www.cftc.gov/LawRegulation/DoddFrankAct/registerswapdealer.html.

FBOs serve important markets in the United States that are underserved by domestic financial institutions. Financing markets where FBOs have an outsized presence in the U.S. include agriculture (46.4 percent), utility & energy (37 percent), and aerospace (20.8 percent), as well as the securitization of those loans.[8] Through these and other capital markets activities, FBOs make substantial contributions to market liquidity, job and economic growth, and financial stability.

Despite the importance of FBOs to the U.S. capital markets and the U.S. economy more generally, the implementation of enhanced prudential standards has incentivized FBOs to dramatically decrease their investment in the United States by shutting down or scaling back U.S. businesses.[9] Since 2014 – the year the Board finalized its enhanced prudential standards in Regulation YY and the Agencies finalized the liquidity coverage ratio ("LCR") – FBOs' market share has declined across all product types. From 2014 to 2018, FBO market share decreased 8.2 percent in equities, 3 percent in FICC, and 5 percent in investment banking.[10]

FR Y-9C data for the Large Institution Supervision Coordinating Committee ("LISCC") firms from 2016 to 2018 – the full time series available for FBOs – shows that foreign LISCC firms' total U.S. assets decreased 26.8 percent, while domestic LISCC firms' total assets increased by 5 percent.[11] Over that same period, foreign LISCC firms' U.S. trading assets declined 30 percent, while domestic LISCC firms' trading assets increased by 8.6 percent.[12] From 2008 to 2018, the FBO LISCC firms have decreased assets at the CUSO level by $668 billion, or 42 percent.[13]

Even more stark is the decrease in FBOs' investment in U.S. entities since 2010, the year the Dodd-Frank Act became law. Looking at the top 25 broker-dealers by assets that are owned by domestic BHCs or FBOs, FBO broker-dealer assets declined 52 percent in the aggregate from 2010 to 2018, as depicted in Figure 3, below. Domestic BHCs in this population have grown their broker-dealer assets modestly over the same period. Cumulatively, these changes may have dampened a core source of funding in the United States, as it appears that domestic BHCs are not picking up the business that FBOs have ceded.

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[8] SIFMA Capital Markets Report at p. 30.

[9] *See, e.g.*, n. 15 below.

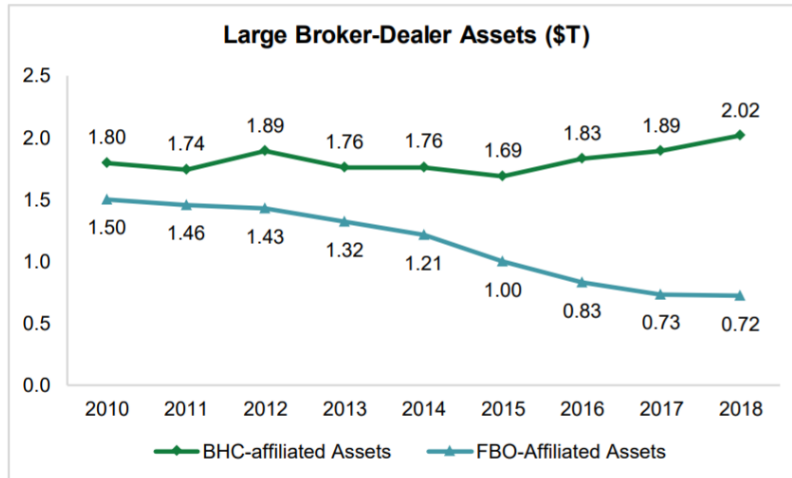
[10] SIFMA Capital Markets Report at p. 8.

[11] *Id.* at p. 13.

[12] *Id.* at p. 14.

[13] *Id.* at p. 15.

Figure 3 – Asset Size of Top 25 Broker-Dealers by Assets



Source: FINRA
Note: Data covers BHC and FBO affiliated broker-dealers that are among the 25 largest by assets

Over the same period, FBOs' market share in investment banking activities decreased by nearly almost one-third, from 34 to 24 percent of top 10 fee revenues generated from underwriting and advisory work.[14] From any perspective, then, participation in the U.S. capital markets by FBOs' U.S. operations has declined considerably in recent years.

The Proposals would amplify these negative effects in several ways:

- The Proposals would impose new standardized liquidity requirements on many FBOs. Currently, the LCR only applies to IHCs that independently qualify as BHCs, which means that most IHCs are subject to the modified LCR. Under the Proposals, the IHCs of Category II, Category III, and certain Category IV FBOs would be required to comply with more stringent versions of the LCR, as well as the net stable funding ratio ("NSFR").

- The Proposals could increase capital requirements for some FBOs by expanding the coverage of the supplementary leverage ratio ("SLR") and countercyclical capital buffer ("CCyB") to a broader range of IHCs. Currently, those requirements apply to advanced approaches institutions, which are those with $250 billion or more in assets or $10 billion or more in on-balance sheet foreign exposure. Under the Proposals, the SLR and CCyB would apply to Category II and III IHCs, which would be those with $250 billion or more in assets, or with $100 billion or more in assets and $75 billion or more in total nonbank assets, weighted short-term wholesale funding ("wSTWF"), cross-jurisdictional activity, or off-balance sheet exposure. The risk-based indicators would expand the class of FBOs subject to these capital requirements.

- The Proposals would increase the severity of single counterparty credit limits ("SCCL") for IHCs by basing the applicability of these limits on CUSO activity rather than IHC activity. For some

[14] *Id.* at pp. 4-5.

IHCs, this would mean that the SCCL's denominator would be Tier 1 capital rather than total capital as in the current rules, and other burdensome aspects of the SCCL would apply for the first time.

- The Proposals would impose substantial compliance burdens. FBOs subject to new or enhanced prudential standards will need to build out systems to comply with those standards. The Proposals' new detailed and frequent reporting requirements will also require new processes at multiple levels of an FBO's U.S. operations.

These changes would incentivize FBOs to further shed U.S. assets and exit U.S. businesses in at least two respects. First, heightened liquidity and capital requirements and higher compliance costs make it less economical to conduct activity in the United States, and incentivize FBOs to deploy their balance sheet resources elsewhere – specifically, to jurisdictions where risk-adjusted returns are more attractive due to the absence of localized and overlapping prudential standards. This dynamic is especially pronounced in the case of securities and derivatives activities, which standardized liquidity and capital requirements in the United States generally treat punitively.

Second, FBOs could very well decrease their U.S. activity in order to move to a lower risk category. This is no mere theoretical concern. In response to Regulation YY's IHC requirement, several FBOs took steps such as shrinking their U.S. footprints to avoid the need to form an IHC, or shedding assets to minimize the activity conducted out of their IHCs.[15] Likewise, several years of experience with the G-SIB surcharge has shown that institutions respond to regulatory categorization frameworks by carefully managing their balance sheets to fall safely below the next most stringent category.[16]

In sum, the evidence clearly shows FBOs making a conscious effort to decrease their U.S. capital markets activities and exit businesses as the Agencies have imposed increasingly stringent prudential standards on those activities and businesses. The Proposals are highly likely to exacerbate this problem. The resulting reduction in foreign investment would dampen U.S. economic growth and job creation, and decrease financial stability.

II. The Proposals Would Put FBOs at a Competitive Disadvantage by Targeting Capital Markets Activities

The Proposals would apply the same asset size thresholds and risk-based indicators to the U.S. operations of FBOs that the domestic tailoring proposals would apply to domestic BHCs, as though these institutions have comparable business models, structures, and opportunities. They do not. Many FBOs focus on capital markets businesses in the United States, whereas their domestic peers are more likely to

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15 *See* Lawrence L. Kreicher and Robert N. McCauley, The New US Intermediate Holding Companies: Reducing or Shifting Assets? BIS Quarterly Review (Mar. 2018), *available at* https://www.bis.org/publ/qtrpdf/r_qt1803u.htm.

16 *See* Basel Committee on Banking Supervision, An Examination of Initial Experience With the Global Systemically Important Bank Framework, *available at* https://www.bis.org/bcbs/publ/wp34.pdf.

focus on retail banking or engage in a broader range of financial activities. Indeed, Governor Quarles has "acknowledged the uniqueness of FBOs"[17] and said "they are different cats, so they aren't identical to domestic banks."[18] At the same time, FBOs on a consolidated, global basis are diversified as a whole.

Given their different business models, facially equal treatment of the U.S. operations of FBOs and domestic BHCs through the application of the Proposals' risk-based indicators would amount to inequitable treatment. The U.S. operations of an FBO are likely to have significantly more nonbank assets, short-term wholesale funding, cross-jurisdictional activity, and off-balance sheet exposure than a comparably-sized domestic BHC. As a result, under the Proposals, the U.S. operations of many FBOs would be subject to the same enhanced prudential standards as domestic BHCs that are many times their size, an outcome that is plainly at odds with the principle of equality of competitive opportunity.

A. The Proposals' Risk-Based Indicators Disparately Impact FBOs

The Proposals would put FBOs into the highest regulated categories at a much higher rate than domestic BHCs under the domestic tailoring proposals. Putting aside the special category of U.S. global systemically important banks ("G-SIBs"), nine FBOs would be Category II or Category III FBOs, while five domestic BHCs would be Category II or Category III BHCs.[19] There are just 12 FBOs, compared to 54 non-G-SIB domestic firms, that have U.S. depository institution holding companies with $25 billion or more in total assets as of December 31, 2018.[20] Thus, 75 percent of the FBOs in this population would be Category II or III FBOs, while 9.3 percent of the domestic firms in this population would be Category II or III BHCs.

This discrepancy in the rate of capture is striking given that depository institution holding companies in this population that are owned by FBOs are ***less*** risky than their domestic BHC counterparts. The average IHC of an FBO in Categories II or III has significantly fewer assets, less risky assets, and higher capital ratios than the average domestic BHC in Categories II or III, as shown in Figure 4, below.[21]

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[17] Randal K. Quarles, The Federal Reserve's Regulatory Agenda for Foreign Banking Organizations – What Lies Ahead for Enhanced Prudential Standards and the Volcker Rule (Mar. 5, 2018), *available at* https://www.bis.org/review/r180308b.htm.

[18] Randal K. Quarles, Semi-Annual Testimony on the Federal Reserve's Supervision and Regulation of the Financial System, Hearing Before the H. Comm. on Fin. Serv. (Nov. 14, 2018), available at https://fraser.stlouisfed.org/files/docs/historical/house/sr/CHRG-115hhrg32971.pdf.

[19] For this purpose, we have counted a Category III savings and loan holding company as a BHC.

[20] *See* National Information Center, Holding Companies with Assets Greater Than $10 Billion, *available at* https://www.ffiec.gov/nicpubweb/nicweb/HCSGreaterThan10B.aspx.

[21] For this purpose, we have counted a depository institution holding company owned by a Category II or III FBO that is not subject to Regulation YY's IHC requirement as an IHC.

Figure 4 – Comparison of Category II and Category III Institutions, By Ownership, as of December 31, 2018

	Average IHC of a Category II or II FBO	Average Category II or III BHC
Total Assets *(in thousands)*	$172,344,476	$330,188,151
Standardized Risk Weighted Assets to Total Assets Ratio	50.23%	70.29%
Tier 1 Risk-Based Capital Ratio	20.48%	13.78%
Tier 1 Leverage Ratio	9.43%	8.82%

Additionally, nearly all of the IHCs in this population are required to issue internal total loss-absorbing capacity debt ("TLAC") to a foreign parent entity, which provides these IHCs with a further layer of going-concern capital that domestic BHCs in this population do not have.

The Proposals' high rate of capture for FBOs is also notable given the substantial decline in FBOs' U.S. footprints in recent years, as discussed above in part I of this letter.

B. The Proposals' Risk-Based Indicators Target Capital Markets Activities and Other Common FBO Transactions

The Proposals' disparate treatment of FBOs arises in large part because the proposed risk-based indicators – perhaps most egregiously, the nonbank assets indicator – would target capital markets activities and other transactions that are inherent in FBOs' business models and structures.

1. The Nonbank Assets Indicator Disproportionately Captures Capital Markets and Other FBO Activities

The nonbank assets indicator would disproportionately and needlessly target FBOs' capital markets activities. The U.S. operations of FBOs operate through broker-dealers and other nonbank entities to a much greater degree than comparably-sized domestic BHCs.

The use of nonbank assets as a threshold for application of enhanced prudential standards is based on a seriously flawed premise – that nonbank assets are a proxy for risk, interconnectedness, or complexity. The Proposals provide no reasoned explanation or evidence to support the Agencies' view that nonbank assets, as defined, serve as a reasonable proxy for these factors.

The Proposals would base the primary definition of a nonbank asset on an entirely superficial characteristic: whether the asset is held in a nonbank subsidiary.[22] This definition would lead to absurd

[22] Total nonbank assets would be defined as "(i) The sum of the assets of the foreign banking organization's nonbank U.S. subsidiaries, including the total nonbank assets of any U.S. intermediate holding company; plus (ii) The

results. Under the proposed definition, an asset that is not a nonbank asset when held in a bank or a branch would become a nonbank asset when transferred to a nonbank subsidiary. But an asset does not become more risky because it is held by a broker-dealer rather than a bank or branch. To the contrary, some broker-dealers assets (*e.g.*, U.S. Treasury securities and U.S. agency securities) have significantly less credit and liquidity risk than some bank assets (*e.g.*, subprime credit card loans, subprime mortgages, and commercial real estate loans). Put differently, the nonbank assets test would capture all of the assets of a broker-dealer exclusively holding highly liquid, low-risk or risk-free securities but none of the assets of a bank engaged exclusively in leveraged commercial real estate lending. This example reveals the arbitrariness of the Proposals' definition of nonbank assets.

Not only do the Agencies offer no evidence for the proposition that nonbank assets are riskier, more complex, or create more interconnections than banking assets, in reality the opposite is true. FBOs' nonbank assets tend to be traded assets for which there is greater price discovery, price transparency, and marketability than banking assets. And as shown in Figure 4 above, the IHCs of Category II and III FBOs have, on average, a significantly lower ratio of standardized risk-weighted assets to total assets (50.23 percent) than Category II or III domestic BHCs (70.29 percent). This lower ratio reflects the fact that broker-dealer assets, which comprise a substantial portion of IHCs' assets, are generally less risky than banking assets.

Discriminatory treatment of nonbank assets cannot be justified by differences in the regulation of nonbank subsidiaries and banks. The preamble to the Board Proposal states that "Nonbank assets . . . reflect the degree to which a foreign banking organization and its U.S. operations may be engaged in activities through legal entities that are not subject to separate capital requirements or to the direct regulation and supervision applicable to a regulated banking entity." But when engaging in capital markets activities through U.S. nonbank subsidiaries, banking organizations are subject to significant regulation and oversight by the Board, the Securities Exchange Commission ("SEC"), the Financial Industry Regulatory Authority ("FINRA"), and the Commodity Futures Trading Commission ("CFTC"). Nonbank subsidiaries of FBOs are also subject to a critical overlay of consolidated home country supervision and regulation. A broker-dealer subsidiary of an FBO can be subject to ***three layers*** of capital requirements: (1) the SEC's net capital rule that applies directly to the broker-dealer; (2) the Board's capital requirements that apply to the IHC parent of the broker-dealer; and (3) the home country supervisor's capital requirements that apply to the parent FBO.

Indeed, as shown below in Figure 5, large U.S. broker-dealers that are subsidiaries of FBOs have average amounts of leverage (1:9.7, or a 10.3 percent leverage ratio) that are lower than broker-dealer subsidiaries of domestic BHCs (1:13, or a 7.7 percent leverage ratio), and in line with highly-capitalized banks.

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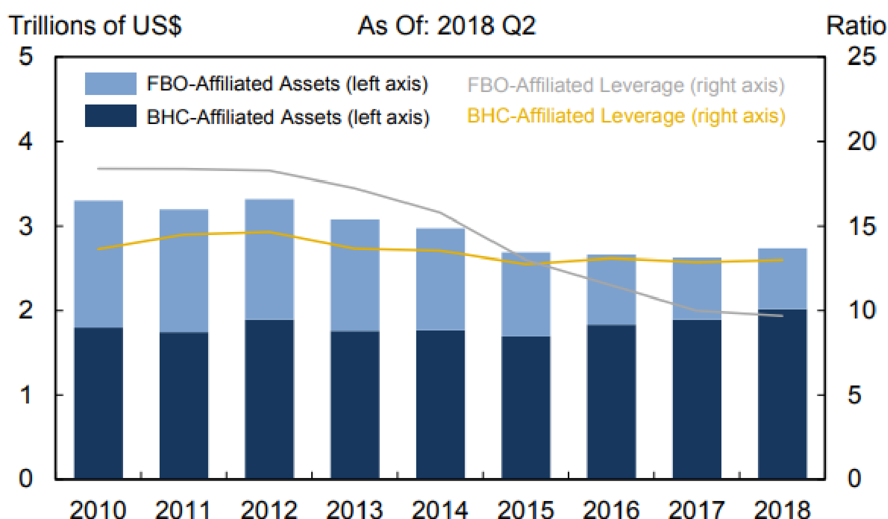
sum of the foreign banking organization's equity investments in unconsolidated U.S. subsidiaries, excluding equity investments in any section 2(h)(2) company."

Figure 5 – Large Broker-Dealer Assets and Leverage by Affiliation



This data is consistent with the capital levels of IHCs shown in Figure 4, above. Compared to Category II and III domestic BHCs, the IHCs of Category II and III FBOs have, on average, significantly higher Tier 1 risk-based capital ratios (20.48 percent for IHCs and 13.78 percent for domestic BHCs) and leverage ratios (9.43 percent for IHCs and 8.82 percent for domestic BHCs).

Additionally, the Volcker Rule, which applies to FBOs and their affiliates, including their U.S. bank and nonbank subsidiaries, limits the risk-taking of their nonbank subsidiaries in a manner that is similar to activity limits that apply to banks. The Proposals' use of nonbank assets as a differentiator ignores this critical bank regulatory constraint on the risk and complexity of FBOs' nonbank subsidiaries. Further, since the financial crisis, FBOs have vastly simplified the corporate structures, inter-affiliate transactions, and funding relationships associated with their U.S. nonbank operations as a result of resolution planning and the IHC formation requirement. As a consequence, for FBOs, nonbank assets do not reflect more complexity than banking assets.

The Proposals' other risk-based indicators would also target FBOs' capital markets businesses and other activities, despite the fact that such activities may not present meaningful risk to the U.S. financial system.

2. The Weighted Short-Term Wholesale Funding Indicator Disproportionately Captures Capital Markets and Other FBO Activities

The Proposals would measure wSTWF only by reference to an FBO's gross liabilities, without considering the asset side of the balance sheet, and thus would ignore a critical element of funding risk. While FBOs do access short-term wholesale funding to fund some of their capital markets activities, they can manage the liquidity risk associated with short-term wholesale funding by holding highly-liquid assets. Under the Proposal's definition of wSTWF, an FBO with matched-book funding in the United States would be

treated as presenting the same funding risk as an institution that holds long-term, illiquid assets against short-term wholesale borrowing, which is not the case. Additionally, the FR Y-15's measure of wSTWF is overly blunt, drawing little distinction among various types of wholesale funding sources, even though these sources can behave differently in a liquidity crunch. As defined, wSTWF is therefore not a reliable indicator of an FBO's risk, complexity, or interconnectedness. Moreover, U.S. branches and agencies can be important sources of funding for an FBO's global operations, and largely can only access wholesale funding. The use of wSTWF thus puts FBOs at a competitive disadvantage relative to their U.S. peers, which are able to access insured retail deposits.

The Proposals would also count FBOs' activities multiple times across different risk-based indicators. For example, it is common for FBOs' U.S. operations to access short-term wholesale funding and loan the proceeds to affiliates. The Proposals would double-count this activity. The funding would count as wSTWF, and the loan to the affiliate would count as a cross-jurisdictional claim. Domestic BHCs would not incur a comparable double penalty for their ordinary course funding activities under the domestic tailoring proposals.

3. The Cross-Jurisdictional Activity Indicator Disproportionately Captures Capital Markets and Other FBO Activities

The U.S. operations of FBOs tend to have substantial cross-border business that is related to home country business, as well as cross-jurisdictional claims on affiliates. For an FBO – unlike a domestic BHC – cross-jurisdictional activity is likely to be inherent to the way it does business and is structured. For example, many FBOs in the United States are primary dealers, and frequently engage in reverse repos whereby they make a short-term loan secured by U.S. Treasuries to a non-U.S. person or to a U.S. branch of another FBO. These capital markets transactions present very little risk to the lending FBO, but would count as cross-jurisdictional activity under the Proposals. Cross-jurisdictional activity, as defined, is therefore not a reliable indicator of an FBO's risk, complexity, or interconnectedness.

Further, by including transactions with U.S. branches and agencies as cross-jurisdictional claims and liabilities, the Proposals and domestic tailoring proposals would put FBOs at a direct competitive disadvantage in the United States. To minimize its cross-jurisdictional activity and stay below the $75 billion threshold, a domestic BHC or the U.S. operations of an FBO would be incentivized to transact with U.S. counterparties rather than the U.S. branches and agencies of other FBOs, because the latter type of counterparty would contribute to the first institution's cross-jurisdictional activity. This dynamic will make it harder for U.S. branches and agencies of FBOs to compete with domestic institutions in key markets involving bank-to-bank exposures, such as the repo and derivatives markets.

The problems with this indicator are particularly acute because cross-jurisdictional activity alone can sweep an FBO with $100 billion in combined U.S. assets into Category II – the highest category of regulation for an FBO, and the same category as a domestic BHC with $700 billion or more in assets. The cross-jurisdictional activity indicator's use in determining the applicability of Category II standards would create a substantial cliff effect that would further distort institutions' incentives.

4. The Off-Balance Sheet Exposure Indicator Disproportionately Captures Capital Markets and Other FBO Activities

Given their focus on capital markets activities, the U.S. operations of FBOs often engage in derivatives, repo, and securities lending activities. Many of these transactions present very little risk to the FBO, due to the liquid collateral available to the FBO, but can generate artificially high exposure values under the denominator of the SLR, which is a seriously flawed metric, intended to be used only as a backstop, that the Proposals would nevertheless use to measure off-balance sheet exposure.[23] Off-balance sheet exposure, as defined, is therefore not a reliable indicator of an FBO's risk, complexity, or interconnectedness.[24]

C. The Proposals' Targeting of Capital Markets Activities Would Violate the Congressional Mandate of Equality of Competitive Opportunity

In applying enhanced prudential standards to a foreign financial company, the Board is required under section 165 of the Dodd-Frank Act to (A) give due regard to the principle of national treatment and equality of competitive opportunity; and (B) take into account the extent to which the foreign financial company is subject on a consolidated basis to home country standards that are comparable to those applied to financial companies in the United States.[25]

The Proposals are inconsistent with this statutory requirement because their targeting of capital markets activities and other typical FBO activities would result in FBOs' U.S. operations being subject to more stringent enhanced prudential standards than equivalently-sized domestic BHCs. Additionally, the Proposals ignore the extent to which FBOs are subject on a consolidated basis to home country standards that are comparable to those applied to financial companies in the United States. Most FBOs are subject to versions of the LCR, NSFR, SLR, CCyB, and SCCL that are comparable to the relevant U.S. standard, but the U.S. operations of those FBOs could still be required to comply with the U.S. standards under the Proposals.

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[23] For example, the denominator of the SLR fails to recognize segregated initial margin available to an FBO acting as clearing member in a cleared derivatives transaction, despite the fact that this margin plainly reduces the FBO's off-balance sheet exposure. For additional commentary on why this treatment is unfounded, see SIFMA's Asset Management Group's March 18, 2019 comment letter on the Agencies' proposal to implement the Standardized Approach to Counterparty Credit Risk, available at https://www.sifma.org/resources/submissions/proposed-standardized-approach-for-calculating-the-exposure-amount-of-derivative-contracts/.

[24] The Board's concurrent proposal to simplify the control framework could exacerbate the issues associated with the risk-based indicators by increasing the amount of U.S. assets, nonbank assets, and other activity that would be attributed to FBOs under the Proposals. The control proposal would create a new presumption of control where a banking organization consolidates a company on its balance sheet. *See* 84 Fed. Reg. 21,634, 21,644 (May 14, 2019). In the course of routine capital markets activities, banking organizations sometimes consolidate conduit financing vehicles without "controlling" those vehicles under existing interpretations of the Bank Holding Company Act. In these circumstances, the new accounting consolidation presumption could increase the amount of activity counting toward banking organizations' risk-based indicators, making the Proposals more punitive.

[25] 12 U.S.C. § 5365(b)(2).

III. The Proposals Create the Prospect of a Breakdown in International Cooperation, Increased Fragmentation, and Heightened Systemic Risk

The G20 Leaders acknowledged the risks of fragmentation, protectionism, and regulatory arbitrage at the 2009 Pittsburgh Summit, and committed to mitigate these risks through cross-jurisdictional regulatory cooperation.[26] Yet, if finalized, the heightened liquidity requirements that the Proposals would impose on IHCs and potentially U.S. branch and agency networks, as well as the Proposals' expanded capital requirements for certain IHCs, would likely to lead to global retaliation and fragmentation. Regulators around the globe could react to the Proposals by imposing their own localized liquidity and capital requirements on subsidiaries and branches operating within their jurisdictions, trapping liquidity and capital resources there. Other jurisdictions generally view U.S. regulations as a template for their own prudential rules, as Governor Quarles has recognized.[27] For example, the EU has responded to Regulation YY's IHC requirement by establishing a parallel requirement for non-EU banking organizations to establish an intermediate parent undertaking (IPU) in the EU. This trend of intensifying fragmentation runs counter to the G20 Leaders' commitments.

Regulatory ring fencing of liquidity and capital around the globe would increase systemic risk in the United States and globally. If liquidity and capital are trapped by regulation in local jurisdictions, banking organizations that operate globally – including U.S. G-SIBs – would lose their flexibility to deploy resources where they are most needed in times of stress, which is inconsistent with the single point of entry resolution strategy that many large banking organizations have adopted. For this reason, one commenter has compared national regulators' incentives to ring fence liquidity and capital to a prisoner's dilemma:

> At first, 'ring-fencing' seems to work, and improve the safety of the local subsidiary. There is a major advantage for a single 'ring-fencer' <u>if other jurisdictions do not match</u> that decision. The first 'ring-fencer' benefits from both a) local capital and b) the ability to tap a large central reserve . . . . However, trapping capital for one subsidiary cuts down the resources for others – and their risks begin to increase. If other jurisdictions adopt countervailing 'ring-fencing' policies to address this issue, then the benefit of a pooled 'central reserve' is lost. Eventually, <u>all jurisdictions become worse off</u> . . . .
>
> [I]f retaliation is pervasive – the outcome for a 'ring-fencing' host country will end up worse than when it started. Its local bank entities will become

[26] *See* G20 Leaders Statement: The Pittsburgh Summit (Sept. 24-25, 2009), *available at* http://www.g20.utoronto.ca/2009/2009communique0925.html.

[27] Randal K. Quarles, Trust Everyone – But Brand Your Cattle: Finding the Right Balance in Cross-Border Resolution (May 16, 2018), *available at* https://www.federalreserve.gov/newsevents/speech/quarles20180516a.htm ("We understand that any requirements we impose on foreign banks operating in the United States may well be imposed on U.S. firms operating abroad.").

> riskier, potentially dramatically so. This is analogous to a 'prisoner's dilemma', an economic paradox where each participant seeks to achieve a local benefit, but ends up worse off when others also pursue their own incentives.[28]

We respectfully submit that the imposition of heightened liquidity and capital standards on FBOs' U.S. operations would, in the long term, be at cross-purposes with the Agencies' goal of promoting the safety and soundness of domestic and foreign banking organizations.

We are especially concerned with the Agencies' suggestion that they are considering liquidity requirements that would "capture the risk of stressed cash outflows within the United States that could result from transactions, instruments and obligations booked at affiliated legal entities and offices outside of the foreign banking organization's U.S. operations."[29] In other words, the Agencies are considering imposing requirements on FBOs' U.S. operations to regulate risks ***anywhere in the world***. That the Agencies are even considering this approach suggests to us a fundamental lack of trust in other national regulators' ability to do their jobs, and calls into question the Agencies' support for the basic principle of international cooperation. Such an approach could lead to retaliatory measures from non-U.S. regulators that amount to regulation of U.S. banking organizations' domestic operations. The overlapping liquidity requirements that would result from this approach would lead to banking organizations maintaining excessive liquidity buffers well above internationally agreed standards – a result that regulators never contemplated when calibrating the LCR and other liquidity requirements. Additionally, the liquidity swaps that the Federal Reserve Bank of New York has entered into with foreign central banks mitigate the risk of an FBO's U.S. operations experiencing U.S. dollar outflows as a result of its foreign affiliates' U.S. dollar funding needs.

We urge the Agencies to de-escalate the trend of balkanization by withdrawing the Proposals' more stringent liquidity and capital requirements for IHCs and refraining from imposing new liquidity requirements on U.S. branch and agency networks.[30] At a minimum, the Agencies should reach agreement with their foreign counterparts at international standard-setting bodies such as the Financial Stability Board on how to approach the important issue of local liquidity and capital requirements before adopting a policy of ring fencing that could undermine global financial stability. Further, the prospect of international escalation of ring fencing underscores the need for the Agencies and national regulators in

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[28] Wilson Ervin, Understanding 'Ring-Fencing' and How it Could Make Banking Riskier, Brookings Center on Regulation and Markets (Feb. 7, 2018), *available at* https://www.brookings.edu/research/understanding-ring-fencing-and-how-it-could-make-banking-riskier/.

[29] 84 Fed. Reg. at 24,323.

[30] As discussed in part V.D.2, below, the Agencies should finalize capital *relief*, such as reduction in the frequency of CCAR and stress testing submissions, and expansion of the availability of the accumulated other comprehensive income filter, as soon as possible.

other jurisdictions to adopt a uniform set of principles on international supervisory cooperation, as GFMA has previously recommended.[31]

IV. The Proposals Ignore Parent Company Support and FBOs' Post-Crisis Structural Enhancements

FBOs are a significant source of strength for their U.S. operations. In this respect, the U.S. operations of an FBO are unlike a standalone top-tier domestic BHC, which has no further parent to serve as an additional source of strength during times of stress.

Not only do the Proposals fail to recognize this source of strength, they appear to be predicated on the view that foreign operations are a source of ***risk*** to the U.S. banking system.[32] Experience has shown the opposite to be true. We are not aware of any foreign-owned U.S. bank that failed during the financial crisis and in its aftermath. In fact, several FBOs were buyers of, or significant investors in, U.S. banks during this period. The Agencies have not provided evidence undermining this history, except to state that FBOs, like their domestic counterparts, used liquidity sources available to them during the crisis.[33]

Since the financial crisis, the strength of FBOs' support for their U.S. operations has only increased. In recent years, FBOs have implemented significant structural enhancements, including resolution strategies that allow for the continued operation of their U.S. operations, internal and external TLAC, and other prepositioning of capital and liquidity. Such enhancements facilitate the "bail-in" of an FBO's U.S. operations, allowing those U.S. operations to remain solvent and operating without engaging in fire sales in the event those U.S. operations or the FBO on a global basis experiences stress. For a single point of entry firm, these structural enhancements both require the FBO to support its U.S. operations in times of stress and ensure that it will be able to do so. In the case of a multiple point of entry firm, these structural enhancements allow the U.S. operations to be bailed in through internal and external TLAC. In contrast, large domestic BHCs that are not G-SIBs are not required to have ***any*** layer of TLAC, internal or external, to ensure their ability to recapitalize themselves in times of stress.

Additionally, the United States and FBOs' home country regulators have adopted a panoply of post-crisis regulations that have decreased the probability of the U.S. operations of an FBO experiencing stress in the first place, as well as mitigated the severity of such stress. The Agencies have achieved similar

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[31] *See* GFMA Principles for Achieving Consistent Regulatory Regimes and Supervisory Practices (Apr. 2018), *available at* http://www.gfma.org/correspondence/item.aspx?id=995.

[32] *See* n. 29, above.

[33] The preambles to the Proposals discuss the fact that FBOs borrowed from the discount window during the financial crisis. If the Agencies are proposing new liquidity requirements because FBOs, like domestic BHCs, borrowed from the discount window during the crisis, the Agencies should address their concerns through discount window rules and requirements. Moreover, the Agencies should recognize that post-crisis structural enhancements will make it less likely for FBOs to resort to discount window borrowing in the future. In any event, discount window loans must be fully secured, including after the application of collateral haircuts.

results through the supervision process, including by requiring large FBOs to manage liquidity risk at the U.S. branch and agency network level.

While the U.S. Department of the Treasury's June 2017 report on the banking system encourages the Agencies to consider a foreign parent's ability to provide capital and liquidity resources to its U.S. operations through TLAC,[34] the Proposals fail to consider these critical matters. Instead, the Proposals would require further prepositioning and create ring fencing by imposing stringent standardized liquidity requirements on IHCs and request comment on whether to impose standardized liquidity requirements on U.S. branch and agency networks. Such liquidity requirements for IHCs and U.S. branch and agency networks are simply unnecessary in light of the history of FBOs supporting their U.S. operations in stress and the structural enhancements that FBOs have made to solidify that support going forward.

V. The Agencies Should Revise the Proposals to Better Tailor Enhanced Prudential Standards to the Risks that FBOs Actually Present to the U.S. Financial System

A. The Agencies Should Revise the Proposals' Categorization Framework

The Agencies have not provided any analysis or evidence to support the establishment of $75 billion thresholds for total nonbank assets, wSTWF, cross-jurisdictional activity, and off-balance sheet exposure. Instead, the Agencies appear to have set the thresholds to classify certain domestic BHCs into particular categories, and then applied the thresholds to FBOs afterwards. This is an arbitrary way to implement critically important regulatory policies.

If the Agencies finalize the $75 billion thresholds despite the absence of supporting analysis or evidence, we encourage the Agencies to revise the operation of those thresholds to better reflect the actual risk that FBOs and their capital markets activities present to the financial system. With the goal of improving risk sensitivity, our suggested revisions discussed below include the elimination of interaffiliate transactions from each risk-based indicator. By virtue of consolidation, domestic BHCs generally would not count interaffiliate transactions under the domestic tailoring proposals, and inclusion of these transactions for the U.S. operations of FBOs would needlessly penalize those operations for being extensions of a larger parent organization.

In making the following proposals to increase the risk sensitivity of the risk based indicators, we are cognizant of the Agencies' goal of simplifying the regulatory regime. Consistent with this goal, some of our proposed revisions include ways to make the risk-based indicators more granular at an FBO's option, which should be read in conjunction with our suggestions to make the reporting of those indicators under FR Y-15 modular. FBOs that are not at risk of exceeding a particular risk-based indicator threshold would not need to perform the more granular optional calculation or reporting.

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[34] *See* U.S. Department of the Treasury, A Financial System That Creates Economic Opportunities: Banks and Credit Unions, at p. 18 (June 12, 2017), *available at* https://www.treasury.gov/press-center/press-releases/documents/a%20financial%20system.pdf.

1. The Agencies Should Withdraw the Nonbank Assets Indicator or, at a Minimum, Make the Indicator More Risk Sensitive

For the reasons discussed above in part II.B of this letter, nonbank assets are not a reasonable proxy for risk, complexity, or interconnectedness, and instead serve to target the capital markets activities in which FBOs are, on average, more heavily concentrated in the United States than domestic BHCs. The Agencies should eliminate the nonbank assets indicator entirely from their final rules.

If, however, the final rules retain the nonbank assets indicator in some form, the indicator should be revised in the following ways:

- **Risk weight nonbank assets.** Without risk weighting, the nonbank asset indicator does not serve as a reasonable proxy for risk, as discussed above in part II.B of this letter. Risk weighting is a relatively simple and well-understood mechanism to differentiate assets by their levels of risk, and should be used in the context of the nonbank assets indicator.

- **Exclude HQLA.** As an alternative to risk weighting nonbank assets, the Agencies should exclude HQLA, as defined in the LCR, from total nonbank assets, including where the HQLA serves as collateral to an asset that would otherwise be a nonbank asset. As the Agencies have stated, HQLA have "high credit quality and favorable market liquidity characteristics, which reflect their ability to serve as reliable sources of liquidity."[35]

- **Exclude goodwill and deferred tax assets.** Goodwill and deferred tax assets are intangible assets that are purely artifacts of accounting and tax rules. They do not present any risk to the FBO or reflect any complexity.

- **Exclude assets in SEC-registered broker-dealers.** SEC-registered broker-dealers are subject to SEC and FINRA supervision and regulation, including the SEC's net capital rule, as well as supervision and regulation by the FBO parent's home country regulator and indirect regulation by the Board. Thus, these entities' risks are controlled in a manner that is not unlike prudential regulation of a bank or U.S. branch or agency.

- **Exclude interaffiliate transactions.** BHCs are able to exclude intercompany transactions by virtue of consolidation, and FBOs should be accorded the same treatment. FBOs should not be penalized for having affiliates outside the United States that are out of the scope of consolidation for the U.S. operations.

2. The Agencies Should Revise the Definition of Weighted Short-Term Wholesale Funding

The Agencies should revise the definition of wSTWF in the following ways to avoid targeting capital markets and other common FBO activities:

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[35] 81 Fed. Reg. 35,124, 35,142 (June 1, 2016).

- **Exclude liabilities to affiliates and other offices of the FBO.** Affiliates are much more likely than non-affiliates to roll over short-term funding with the U.S. operations of an FBO when those operations experience stress. An FBO that contributed to a liquidity crunch at its U.S. operations could lose access to dollar clearing, dollar-denominated funding, and other important benefits; default on its own obligations as a result of cross-default provisions; and suffer severe harm to its reputation with clients and with regulators. For an IHC that has issued internal TLAC, any failure to roll over short-term funding by its foreign affiliates could lead to the conversion of the internal TLAC into equity, which effectively eliminates any incentive of the FBO not to fund the IHC and mitigates the consequences of any failure by the FBO to fund the IHC. Additionally, intercompany short-term funding may be a result of enterprise risk management transactions that reduce, rather than increase, risk to the FBO. The Agencies should not discourage these transactions by including short-term wholesale funding sourced from affiliates in wSTWF.[36]

- **Provide FBOs the option to adjust wSTWF to reflect funding risk of their U.S. assets.** As discussed above in part II.B of this letter, wSTWF as defined in the Proposals only considers half of the equation of funding risk – *i.e.*, the liability side of the balance sheet. For an FBO that is at risk of crossing the $75 billion wSTWF threshold, the Agencies should provide a calculation methodology that permits reductions to wSTWF based on the liquidity of the FBO's assets in the United States. Specifically, an FBO should be permitted to deduct the value of the eligible HQLA owned by its CUSO or IHC, taking into account standardized haircuts, from the total wSTWF of the CUSO or IHC, as applicable. However, this methodology should remain optional so that FBOs are not required to develop new systems to calculate adjusted wSTWF unless doing so would provide a benefit.

- **Provide FBOs the option to use a more granular weighting of short-term wholesale funding that is aligned with the LCR.** Different types of uncollateralized short-term wholesale funding present different degrees of funding risk, but Schedule G to the FR Y-15 treats them as though they all present the same level of risk. For example, brokered deposits are more stable than other forms of wholesale funding, especially when swept by an affiliate to the U.S. operations of an FBO, but are not treated as such in Schedule G. In addition, Schedule G's weighting factors are inconsistent with other aspects of the regulatory framework. Schedule G weighs U.S. Treasury-backed repo funding at 25 percent, while the LCR assigns a 0 percent outflow rate to these transactions. The Agencies should develop a more granular methodology for weighing short-term wholesale funding that is aligned with the outflow rates assigned to

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[36] Failure to exclude intercompany short-term wholesale funding also could interfere with the Board's supervisory objective of encouraging FBOs to diversify their sources of dollar funding by obtaining dollar funding outside the United States. Some FBOs receive dollar-denominated deposits in non-U.S. branches and loan the proceeds to their U.S. operations in the form of short-term funding. Under the Proposal, this activity would toward the U.S. operations' wSTWF.

funding types under the LCR, and allow an FBO that is at risk of crossing the $75 billion threshold to use that more granular calculation.

3. The Agencies Should Revise the Definition of Cross-Jurisdictional Activity

The Agencies should revise the definition of cross-jurisdictional activity in the following ways to avoid targeting capital markets and other common FBO activities:

- **Exclude all interaffiliate transactions, whether secured or unsecured, from both cross-jurisdictional claims and cross-jurisdictional liabilities.** Interaffiliate transactions are inherent to the U.S. operations of FBOs, just as intercompany transactions – which are excluded from the scope of consolidation for BHCs – are common for domestic BHCs. Many interaffiliate transactions help the FBO manage currency and other risks on an enterprise-wide basis, and therefore decrease risk rather than create risk. Additionally, internal TLAC requirements have removed disincentives for FBOs' home country operations to pay on claims by their U.S. operations. In the event of stress of the U.S. operations that reduced the equity value of the IHC, the prospect of the IHC's internal TLAC debt converting into additional equity would provide the FBO parent with a continuing incentive to maximize the enterprise value of the IHC. Moreover, excluding all interaffiliate transactions would be simpler operationally than only excluding certain collateralized intercompany claims.

- **Calculate cross-jurisdictional activity on an "ultimate risk" basis.** When an FBO's cross-jurisdictional exposure is collateralized by a claim on a U.S. person, the FBO's ultimate exposure is to the U.S. person. For example, if a U.S. branch of an FBO engages in a reverse repo with a foreign counterparty that is secured by Treasuries, the FBO does not ultimately have foreign exposure. Thus, we support calculating cross-jurisdictional activity on an "ultimate risk" basis.

- **Allow FBOs to use settlement date accounting or modified trade date accounting to measure transactions with a delayed settlement date.** The Proposals request comment on whether transactions with a delayed settlement date should be calculated using settlement date or trade date accounting. Unmodified trade date accounting can produce an artificial "ballooning" of the balance sheet when a firm accounts for regular-way purchases and sales of securities that create cash payables and cash receivables, respectively. U.S. GAAP, which uses modified trade date accounting, allows a firm to offset cash payables against cash receivables to prevent this gross-up of exposure, resulting in a measure of exposure that is similar to settlement date accounting under IFRS.[37] The final rules should allow an FBO to use settlement date accounting if that is the FBO's operative accounting framework, or else allow the FBO to avail itself of the

[37] For a detailed discussion of why this ballooning of the balance sheet is inappropriate, see GFMA's July 2016 letter to the Basel Committee, available at http://www.gfma.org/initiatives/basel-iii/gfma,-iif,-isda,-jfmc-and-tch-respond-to-the-basel-consultation-on-leverage-ratio/.

offset available under U.S. GAAP, when calculating cross-jurisdictional activity or any other indicator.

- **Exclude claims on and liabilities to U.S. branches and agencies of other FBOs, including in the domestic tailoring proposal.** U.S. branches and agencies of FBOs are regulated by the Agencies as U.S. banking organizations, and should be treated as such for purposes of cross-jurisdictional activity. To do otherwise would incentivize domestic BHCs and FBOs' U.S. operations not to transact with the U.S. branches and agencies of other FBOs, creating a significant competitive imbalance between domestic firms and FBOs.

- **Exclude claims on and liabilities to home country sovereigns.** In the course of supporting home country operations, the U.S. operations of FBOs often transact with their home country sovereign, either directly, through sovereign guarantees, or the use of sovereign debt as collateral. A common example is a U.S. subsidiary of an FBO engaging in reverse repo with home country sovereign debt as collateral. These transactions do not reflect any added complexity, and FBOs' home country sovereigns generally have very low credit risk. The Agencies should not penalize this ordinary-course activity.

- **Exclude claims and liabilities secured by HQLA and highly liquid assets under Regulation YY.** Claims collateralized by HQLA and highly liquid assets under Regulation YY do not present the type of risk, complexity, or interconnectedness that the cross-jurisdictional activity indicator is intended to capture. By including such claims within the cross-jurisdictional activity indicator, the Proposal would disincentivize FBOs from entering into these transactions, which could lead FBOs not to diversify their liquidity buffers with collateral from a variety of jurisdictions.

4. The Agencies Should Revise the Definition of Off-Balance Sheet Exposure

The Agencies should revise the definition of off-balance sheet exposure in the following ways to avoid targeting capital markets and other common FBO activities:

- **Exclude interaffiliate transactions.** As with the other indicators, off-balance exposures can arise from common risk management transactions among affiliates. For example, pursuant to clearing mandates, the U.S. futures commission merchant ("FCM") subsidiaries of FBOs sometimes clear derivatives transactions for their non-U.S. affiliates to provide those affiliates with access to risk mitigation tools. The Agencies should not penalize FBOs for engaging in these affiliate transactions. These transactions are risk-reducing for the FBO, and create very little actual economic exposure for the U.S. FCM subsidiary, but would create significant off-balance sheet exposure under the Proposals. Counting such transactions toward off-balance sheet exposure could incentivize FBOs to clear their trades through an unaffiliated U.S. FCM, which may be owned by a U.S. G-SIB, instead of their own FCM subsidiaries.

- **Risk weight off-balance sheet exposures.** The Proposal provides no justification for calculating off-balance sheet exposures using the SLR methodology rather than risk-weighted

assets. The SLR methodology is, by design, not risk sensitive. Accordingly, it is inappropriate to use this methodology as a proxy for risk. The final rules should instead use risk weighting (including the application of credit conversion factors) to measure off-balance sheet exposures. In the context of risk weighting off-balance sheet exposures, a firm should be able to treat as collateralized any facility that must be collateralized to be drawn upon. An example is a Capped Contingency Liquidity Facility (CCLF) with a central counterparty ("CCPs"), which requires the CCP to post financial collateral when drawing upon the facility.

5. The Agencies Should Index the $75 Billion Thresholds for Inflation

Indexing the $75 billion thresholds for inflation would prevent the risk-based indicators from constraining banking organizations over time as the U.S. economy grows and prices increase. The Agencies have the discretion to index the thresholds for inflation because the thresholds are not set by statute.

B. The Agencies Should Revise the Proposals to Avoid Ring Fencing of Liquidity and Capital

For the reasons discussed above in part III of this letter, we urge the Agencies not to impose increasingly stringent liquidity and capital requirements on FBOs' U.S. operations in a manner that causes other national regulators to take retaliatory ring fencing measures that increase global fragmentation and undermine financial stability. The Agencies should come to agreement with their non-U.S. counterparts in international fora before addressing these issues domestically. If the Agencies nevertheless finalize the Proposals' changes to the liquidity and capital rules for the U.S. operations of FBOs before coming to an international consensus with their peers, the Agencies should make a number of changes to the Proposals to curtail the prospect of further ring fencing.

1. The Agencies Should Take Steps to Avoid Ring Fencing Liquidity

To avoid ring fencing liquidity, the Agencies should first make the following changes to the proposed LCR framework for IHCs:

- **Apply the LCR to an IHC on the basis of the IHC's own footprint rather than the CUSO's footprint.** We discuss this recommendation further in part V.C of this letter, below.

- **For all IHCs subject to the LCR, calibrate the LCR at 70 percent, require its calculation monthly, remove the maturity mismatch add-on, and do not require insured depository institution subsidiaries to comply independently.** For an IHC of an FBO subject to the LCR in its home country on a consolidated basis, the U.S. LCR should serve only as a backstop to the consolidated home country LCR. A backstop approach would recognize that IHCs have an additional liquidity source unavailable to domestic BHCs – their foreign parents. This approach would also avoid constraining the foreign parent's ability to deploy liquidity where it is needed most to alleviate stress. Consistent with the modified LCR that currently applies to most IHCs, the LCR should continue to be calibrated at 70 percent, and calculated on a monthly basis, for IHCs subject to it. The Agencies should not impose the maturity mismatch add-on, which is

overly complex and gold-plates the Basel LCR standard. The Agencies also should not expand the applicability of the LCR to FBOs' insured depository institution subsidiaries, given that these subsidiaries are often much smaller than depository institutions owned by comparably-sized domestic BHCs and therefore can be infused with liquidity by a parent entity more easily.

Second, the Agencies should not apply the NSFR to IHCs or their depository institution subsidiaries at this time. The purpose of the NSFR is to reduce funding risk over a longer time horizon, and an FBO can achieve this goal through compliance at the consolidated parent level. Other liquidity requirements that already apply to FBOs' U.S. operations render it unnecessary for the Agencies to apply the NSFR as well to IHCs. These requirements include Regulation YY's liquidity buffer, liquidity risk management, and liquidity stress testing requirements; the Resolution Liquidity Execution Need (RLEN) and Resolution Liquidity Adequacy and Positioning (RLAP) framework included in FBOs' U.S. resolution plans; the Comprehensive Liquidity Analysis and Review (CLAR) exercise in which LISCC firms must engage; and the LCR. We are also not aware of any supporting analysis that the Agencies conducted of whether and how to resolve the various issues inherent in applying the NSFR to an IHC of an FBO subject to home country liquidity requirements. The Agencies should thus allow for substituted compliance for FBOs that comply with the NSFR at the consolidated parent level.

More broadly, the Agencies proposed the NSFR over three years ago, and have yet to resolve the proposal's serious conceptual and design flaws, such as its arbitrary treatment of derivatives transactions and punitive treatment of securities financing transactions.[38] Without an indication in the Proposals of how the final NSFR might resolve these issues, it is difficult to comment meaningfully on how to calibrate the NSFR for IHCs, assuming the Agencies decide to apply the NSFR to IHCs notwithstanding the lack of analysis supporting such a step.

Third, the Board should not advance any proposal to apply standardized liquidity requirements to U.S. branch and agency networks, for the following reasons:

- Regulation YY already imposes branch and agency liquidity standards, including requiring U.S. branch and agency networks to maintain a buffer of unencumbered highly liquid assets that could be sold or pledged to withstand liquidity stress for a specified time horizon under adverse conditions. Under the Proposals, these standards would apply to the U.S. branch and agency networks of all Category II, III, and IV FBOs.
- U.S. branches and agencies already need to set aside a significant proportion of their assets in the form of asset pledges and capital equivalency deposits, as well as Regulation YY's liquidity buffer requirements. New requirements to set aside additional unencumbered liquid assets could significantly disincentivize FBOs from using branches and agencies as entryways into the U.S. banking system and financial markets, as they have historically done.

[38] For a detailed discussion of these conceptual and design flaws, see SIFMA's August 5, 2016 comment letter on the NSFR proposal, available at https://www.sifma.org/resources/submissions/sifma-and-other-associations-submit-comments-to-multiple-agencies-on-net-stable-funding-ratio/.

- The imposition of liquidity requirements on U.S. branches and agencies would be likely to lead to retaliation by non-U.S. regulators, which would make U.S. banks less competitive when doing business abroad.

- U.S. branches and agencies are already subject to comprehensive supervision and significant regulation by federal or state licensing authorities, which includes examination of liquidity risk. Imposing prudential standards on U.S. branches and agencies would be an unwarranted intrusion on the prerogative of licensing authorities, akin to the Board imposing prudential standards on non-member banks. Moreover, such an intrusion would be inconsistent with the principle of national treatment.

- If the Board remains concerned about U.S. branch and agency liquidity, it could take an approach of substituted compliance, deferring to home country liquidity consolidated regulation as is done in the SCCL rule and relying on increased cooperation among regulators through the Financial Stability Board and other international fora. The Board could coordinate with its counterparts in other jurisdictions to obtain granular home country LCR reports from FBOs, which will incorporate the results of FBOs' U.S. branches and agencies.

Fourth, the Board should address the bifurcated treatment of internal and external cash flows under Regulation YY's internal liquidity stress test and liquidity buffer requirements. Under the Interagency Proposal, an IHC subject to the LCR would be allowed to net inflows from affiliates against outflows to third parties. In contrast, Regulation YY's liquidity standards that apply to the U.S. operations of FBOs only permit internal cash inflows to offset internal cash outflows, which can result in greater buffer requirements for FBOs than domestic BHCs. Regulation YY should treat an FBO's internal and external cash flows in the same manner as the LCR and the liquidity stress testing and buffer requirements that apply to domestic BHCs, such that internal inflows between the IHC and the FBO (including its U.S. branches and agencies) can offset external outflows.

2. The Agencies Should Take Steps to Avoid Ring Fencing Capital

To avoid ring fencing capital, the Board should not apply the SLR and CCyB to any IHC. FBOs are subject to comparable standards in their home countries on a consolidated basis. In addition, the SLR is intended to be a backstop measure rather than a binding capital constraint. Home country consolidated leverage ratios that apply to IHCs indirectly can effectively serve this function. And as discussed above, the SLR is particularly punitive to capital markets activities in which FBOs engage in the United States.[39]

Second, the Agencies should allow <u>all</u> IHCs to filter out accumulated other comprehensive income ("AOCI") so that unrealized gains and losses on available-for-sale ("AFS") securities do not create swings in IHCs' capital levels. Requiring AOCI to be included in regulatory capital is more punitive to IHCs than their domestic BHC counterparts because IHCs tend to have a greater proportion of AFS securities on their balance sheets in light of their focus on securities businesses. Additionally, there is no logical

[39] *See* n. 23 and accompanying text, above

reason why Category II IHCs should be the only IHCs that are not permitted to filter out AOCI. Since no IHC would be a Category II IHC by virtue of the $700 billion asset size threshold, the only difference between Category II and Category III IHCs under the Proposal would be the amount of cross-jurisdictional activity. There is no indication that the reasons the Agencies require the largest banking organizations to include AOCI in capital are related to any concern involving cross-jurisdictional activity.[40]

Third, consistent with the spirit of tailoring underlying the Proposals, the Board should conduct an impact analysis to inform the calibration of the stress capital buffer ("SCB") for IHCs and consider whether the global market shock ("GMS") and counterparty default scenario component need to apply to IHCs within the context of a notice-and-comment rulemaking process. As a threshold matter, the Board's proposal to adopt the SCB did not contain an impact analysis for IHCs, and the Board did not adhere to notice-and-comment procedures or provide any analysis in applying the GMS and counterparty default scenario to IHCs, notwithstanding the fact that the SCB, GMS, and counterparty default scenario all amount to significant new capital regulations for IHCs.[41] The SCB, which is generally expected to set a firm's binding capital constraint once implemented, can be volatile from year to year. Unlike domestic BHCs, which have been subject to stress testing for a decade, IHCs have limited historical experience to draw upon to predict and manage the inherent volatility of the SCB. The 2018 CCAR results provided IHCs with limited insights into buffer levels because they did not include the GMS or counterparty default scenario, both of which increase projected losses. Further, the SCB would deviate from international capital standards that home country regulators have applied to FBOs' consolidated operations, creating additional complexity and burdens for FBOs, which would be required to manage parallel but distinct systems, controls, models, and data in the United States and in their home countries. The Board should use a public rulemaking process to resolve these issues.

C. Enhanced Prudential Standards for IHCs Should Apply on the Basis of an IHC's Own Footprint, Not the CUSO's Footprint

If the Agencies decide to finalize new or more stringent liquidity requirements for IHCs, they should base the applicability of those requirements on an IHC's own assets and activities, not CUSO assets and activities. Similarly, the Board should base the applicability and stringency of the SCCL on an IHC's own assets and activity, not CUSO assets and activity.

The Agencies have not established that an IHC with $50 billion in assets would present comparable risk to an IHC with $250 billion in assets simply because their parent FBOs have a similar asset size footprint in the United States. The size of a FBO's branch and agency footprint does not necessarily have any bearing on the risk, complexity, or interconnectedness of its IHC.

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[40] 78 Fed. Reg. 62,017, 62,060 (Oct. 11, 2013) (Basel III final rule discussing the inclusion of AOCI in regulatory capital).

[41] *See* 83 Fed. Reg. 18,160, 18,167 n. 39 (Apr. 25, 2018) (SCB proposal stating that "[i]n connection with [its impact] analysis, the Board analyzed the stress test results in CCAR 2015 through 2017. U.S. IHC subsidiaries of foreign banking organizations were not subject to supervisory stress testing for this full period, and accordingly, were excluded from this quantitative analysis.").

D. The Agencies Should Make Other Changes to the Proposals to Ease the Compliance Burden on FBOs

1. The Board Should Streamline its Proposed Reporting Requirements

The Agencies should not impose any new reporting requirement that is highly burdensome and not necessary to the functioning of their enhanced prudential standards. This principle is not only good regulatory policy, it is a requirement of the Paperwork Reduction Act.[42] Thus, the Board should require FBOs' combined U.S. operations and IHCs to report only those items on the FR Y-15 that are needed to categorize FBOs and IHCs based on risk-based indicators. The remainder of the FR Y-15 items are designed to generate G-SIB surcharge scores – a consideration that has no relevance in the context of an FBO or IHC, which the U.S. capital rules do not require to calculate G-SIB surcharge scores. If the Agencies adopt our recommendations to provide FBOs the option to be categorized on more granular risk-based indicators, the Board could require any FBO taking advantage of such option to report the additional metrics that support its more granular categorization.

Further, we are not aware of any reason why FBOs' U.S. branch and agency networks should need to separately report on the FR Y-15 form to make the enhanced prudential standards function. Accordingly, the Board should not extend FR Y-15 reporting to U.S. branch and agency networks.

Similarly, the Board should not impose daily FR 2052a reporting on FBOs. Daily reporting would be highly burdensome and, under the LCR frequency we propose, out of alignment with the LCR. Similarly, FBOs that would not need to satisfy the full daily LCR should be permitted to file FR 2052a reports on a T+10 basis, as implementation of T+2 reporting would require potentially significant changes to management information systems.

Collectively, these recommended changes would balance the goal of minimizing regulatory burden with the need for reporting that supports the functioning of the enhanced prudential standards.

2. The Agencies Should Provide a Reasonable Transition Period for New or More Stringent Requirements

The Agencies should provide a reasonable transition period of between one and two years for any new or more stringent requirement that applies to an FBO's CUSO, IHC, and/or U.S. branch and agency network. As to reporting requirements, some of which we understand may need to be effective earlier in order to enable the categorization of FBOs and their IHCs, the Board should clarify that FBOs will not be subject to the same expectations regarding data quality in their first year reporting new items as firms that have already built systems to report those items. For instance, the Board could suspend the internal control requirements that ordinarily apply to FR Y-15 filings and allow FBOs to report data on a pro forma basis throughout the transition period.

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[42] *See* 44 U.S.C. § 3508 (requiring a collection of information to be "necessary for the proper performance of the functions of the agency" and to "have practical utility").

Any relief under the final rules, however, should be effective immediately, consistent with Congress's intent to provide regulatory relief from enhanced prudential standards by November 25, 2019, eighteen months following EGRRCPA's enactment. Relief that should be effective immediately following the release of the final rules includes the proposed reduction in the frequency of CCAR and stress testing submissions, and expansion of the availability of the AOCI filter. The Agencies could accomplish the goals of providing both a reasonable transition period for new requirements and immediate relief from existing requirements by setting a compliance date of between one and two years after the adoption of the final rules, but allowing FBOs to comply voluntarily with any subpart of the final rules before the compliance date.

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We appreciate the Agencies' consideration of our concerns. If you have any questions, please contact the undersigned at (202) 962-7327 or cmcdowell@sifma.org.

Respectfully submitted,

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