June 4, 2020
Via electronic mail

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Executive Secretary, Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Re: Guidance for Resolution Plan Submissions of Certain Foreign-Based Covered Companies (FRB Docket No. OP-1699; FDIC RIN 3064-ZA15)

Ladies and Gentlemen,

The Securities Industry and Financial Markets Association (SIFMA)[1] appreciates the opportunity to respond to the request from the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation ("**the Agencies"**) for feedback on proposed guidance for the 2021 and subsequent resolution plan submissions by certain foreign banking organizations (**"Specified FBOs**").[2] We have joined with the Bank Policy Institute and the American Bankers Association in a more detailed comment letter, and we agree with all of the comments in that letter. In this letter, however, we want to underscore the likely negative impact of this proposal on the U.S. capital markets.

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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 for 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] Board of Governors of the Federal Reserve system and the Federal Deposit Insurance Corporation, "Guidance for Resolution Plan Submissions of Certain Foreign-Based Covered Companies," 85 Fed. Reg. 15449 (Mar 18, 2020) (the "**Proposed Guidance**"). The Specified FBOs are Barclays PLC, Credit Suisse Group AG and Deutsche Bank AG. Proposed Guidance at 15452 fn. 21.

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Recommendations:

We respectfully request that the Agencies not adopt the approach in the Proposed Guidance and instead change the scoping methodology, eliminate the extraterritorial expectations, and show heightened consideration for the fundamental differences that make resolving an intermediate holding company ("**IHC**") of an FBO with a broker dealer as its material legal entity in the U.S. ("**MLE**") less systemically risky than resolving a bank.

In the joint trade associations letter, we recommend several ways to accomplish these goals, namely: (a) conduct a holistic review of the prudential regulations applicable to the U.S. operations of the FBOs; (b) engage in bilateral discussions with the impacted FBOs to consider alternative approaches; and (c) give greater consideration to the substantial home country resolution planning requirements applicable to the impacted FBOs, including plans for the resolution of the firms' U.S. operations which are material to these firms, and therefore to the home country's resolution plans.

In this supplemental letter, we wish to highlight the following concerns and recommendations:

1. The Method 2 scoring framework is methodologically flawed and should not be used as a scoping mechanism.

2. The extraterritoriality and duplication of the derivatives information and payment, settlement and clearing ("**PCS**") regulations violates the terms of the Dodd-Frank Title I requirements under which this Proposed Guidance has been issued.

3. Fundamental differences between FBO IHCs with broker dealers as their MLE in the U.S. also supports the argument for not adopting this approach.

4. If any appropriately revised scoping methodology does still capture any FBOs, the guidance should be tailored to reflect the reduced risk FBOs present to the U.S. financial system.

Background on Importance of the FBOs to the U.S. Capital Markets and Reasons for and Extent of Their Retrenchment from these Markets:

In 2017 the Treasury Department in its report on reforming the banking system stated:

> *"The U.S. operations of foreign banking organizations have total assets that exceed $4.5 trillion, which includes the assets of commercial banks, branches, agencies, and non-bank affiliates, representing approximately 20% of our banking system. This segment plays a large role in providing business loans and infrastructure finance. They also provide significant capital markets services, comprising more than half of the 23 primary dealers of the Federal Reserve Bank of New York."*[3]

However, the scale of capital markets services provided by FBOs has plunged in recent years. In January of 2020 Federal Reserve Vice Chairman Quarles noted:

> *"Since 2010, [Barclays PLC, Credit Suisse Group AG, Deutsche Bank AG and UBS AG (the 'LISCC FBOs')] have significantly shrunk their U.S. footprint, and their U.S. operations are much less risky than they used to be. Since 2008, the size of the LISCC FBOs' combined U.S. assets has shrunk by about 50 percent, and they have reduced the assets at their broker-dealers from a peak of $1.9 trillion in 2008 to $340 billion today, a reduction of over 80%. In addition, the estimated systemic impact of the LISCC FBOs today is much smaller than the U.S. GSIBs. The average method 1 GSIB score of the combined U.S. operations of the LISCC FBOs is less than a quarter of the average GSIB score of the six non-processing U.S. GSIBs."*[4]

Broader measures of FBO capital markets activity also show a continued decline in FBO-affiliated participation in the U.S. Market. In just 10 years, the assets of foreign-owned firms have declined from nearly half of the U.S. market to less than a quarter of the overall balance sheet.

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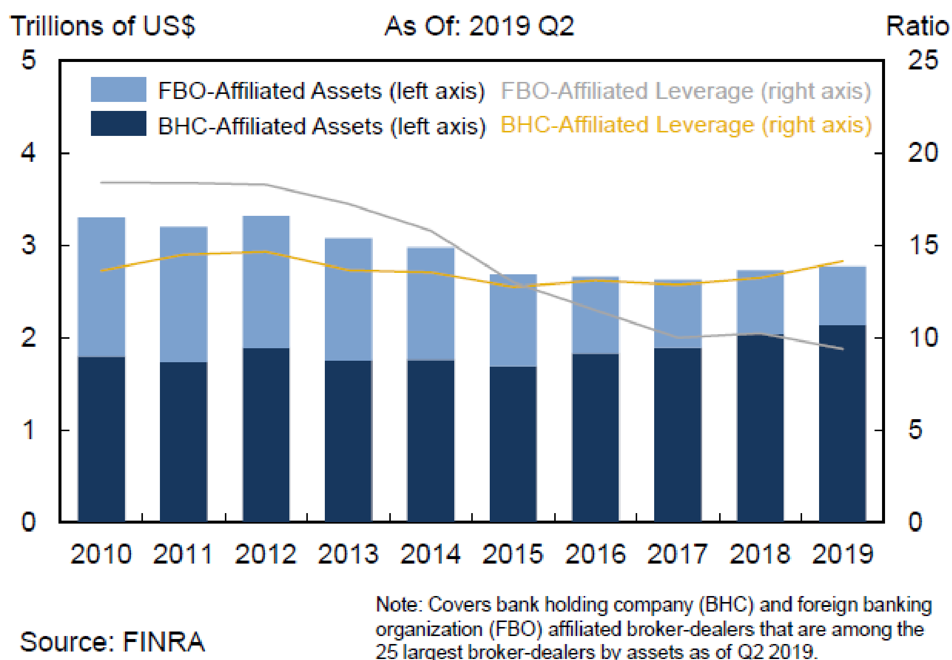
[3] Steven T. Mnuchin, Secretary of the Treasury, *A Financial System That Creates Economic Opportunities: Banks and Credit Unions* (June 2017) available at https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf

[4] Randal K. Quarles, Board Vice Chair for Supervision, *Spontaneity and Order: Transparency, Accountability, and Fairness in Bank Supervision* (Jan. 17, 2020), available at https://www.federalreserve.gov/newsevents/speech/quarles20200117a.htm.



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In 2019 SIFMA issued an Insights Report on "The Importance of FBOs to the U.S. Capital Markets" (the report is attached in the Appendix of this letter. We would note that the trends highlighted in this report have continued into 2020). In that report, which we shared with the Federal Reserve Board, SIFMA gave a detailed portrait of the importance of the FBOs in the U.S., especially in the U.S. capital markets. In the report we suggested the following key takeaways:

- FBOs are key participants in the U.S. capital markets across all asset classes and activities and are crucial to the U.S. markets' smooth and efficient operation. For example, FBOs comprise 65% primary dealers and 49% of swap dealers.
- However, FBO capital markets participation has dropped precipitously in recent years. This large and continuing reduction is deeply concerning and could have longer term impacts for the diversity and competitiveness of the U.S. marketplace.
- Between 2014 and 2018, FBO market share declined across all product types – Equities (-8.2% points), fixed income (- 3.0% points), investment banking (-5% points).
- The declines in asset size and market share coincided with the implementation of the Enhanced Prudential Standards (**"EPS"**), including the requirement to form an IHC (see Appendix A).

[5] Financial Stability Oversight Council, *2019 Annual Report*, available at https://home.treasury.gov/system/files/261/FSOC2019AnnualReport.pdf (see p84)

The new EPS rules subjected these businesses to numerous capital, stress testing and liquidity rules that were designed largely for bank holding companies with a broad number of legal entities and product mix rather than broker dealers. The consistency, extent and timing of the FBO broker dealer decline suggests that this major shift in U.S. regulation likely played an important role (alongside individual bank strategy choices) in the severe reduction in FBO activity in U.S. capital markets.

Capital and liquidity rules across the financial sector needed reform after the 2008 crisis. However, the wholesale imposition of bank-oriented regulation on institutions with different business models (i.e. broker dealers) has produced severe and overbroad effects and warrants a more tailored approach. The new regulatory framework often seems to discriminate against trading-oriented firms, despite the greater transparency and liquidity of their positions. For example:

- CCAR rules often impose much more severe shocks to trading positions, in some cases applying shocks that are multiples of the charge for an identical position held in a banking book.
    - In our August 2019 CCAR study, SIFMA noted that several market risk parameters were calibrated to a 0.001% likelihood, whereas the banking book severity was "calibrated to the average level to which it has increased in the most recent three severe recessions."[6] The standard to which trading book positions are held appears to be far higher one than for banking-oriented activities. This is particularly noteworthy as trading book exposures are marked to market daily and have the ease of market sale in contrast to accrual book positions.
    - The loss rate for loans in the severely adverse scenario averaged 5.7% (Fig 2 FRB DFAST results, June 2019). In contrast, a loan position held in the trading book was subject to a shock of 15.2% for BBB loans and 34.7% for BB loans (CCAR severely adverse market shocks). We acknowledge this is not an apples to apples comparison however we believe that trading book shocks are more than 4x tougher on average.
    - More recently, we published a 2-part blog[7] comparing the recent extraordinary stress and volatility of the COVID shock to the CCAR framework. Many macro variables (e.g. unemployment) suffered extraordinary downdrafts, temporarily reaching or exceeding CCAR assumptions for severe recessions. We have yet to see how these

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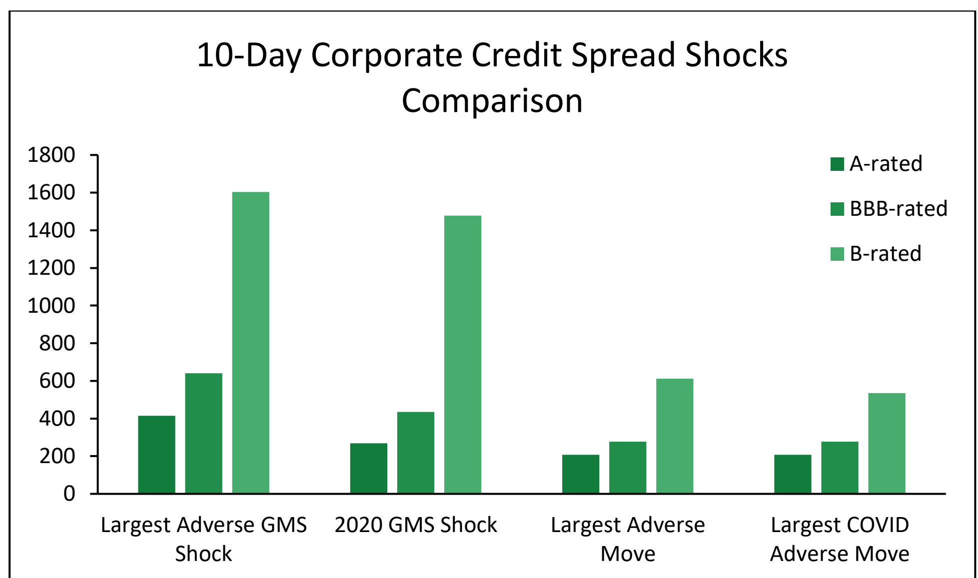
[6] See Appendix B

[7] Coryann Stefansson, *New SIFMA Analysis: The Fed & CCAR 2020 – Stay the course for the Sake of Economic Recovery*, available at https://www.sifma.org/resources/news/new-sifma-analysis-the-fed-ccar-2020-stay-the-course-for-the-sake-of-economic-recovery/ and *Revisiting the Fed's CCAR Scenario: A Case for Self-Fulfilling Prophecy*, available at https://www.sifma.org/resources/news/revisiting-the-feds-ccar-scenario-a-case-for-self-fulfilling-prophecy/

shocks transmit into banking book credit outcomes, but we can get an early read on market risk outcomes. Markets were turbulent, especially in the initial phase of shutdown, and some set a record for historical experience (like BBB credit spreads).[8] Nonetheless, these extraordinary COVID shocks remained far inside GMS assumptions, as can be seen in the graph below. Similar conclusions can be drawn from Treasury and Equity markets.

- While we understand the need for a conservative CCAR approach to designing a severely adverse scenario, these considerations all suggest that the current framework applies much tougher standards to trading positions than banking risks, and biases the regulatory capital regime against capital–markets oriented firms.



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- Similarly, harsh treatment of trading positions also occurs in some of the revised Basel standards for market risk, which has continually ratcheted up capital requirements without regard for cumulative effect. Some of our members report market risk charges that now exceed the market value of the underlying assets for a number of trading portfolios, especially as the additional volatility of COVID-19 stresses feeds into the rules. While we support a fair but conservative approach, it is difficult to lose more than 100% of a trading asset.[6]

- Further examples of disparate treatment arise in other areas, like liquidity rules.

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[8] We acknowledge and appreciate the extraordinary FRB interventions that helped to stabilize markets and kept these kinds of declines from continuing.

- For example, the short-term wholesale funding ("**STWF**") effectively penalize a balanced matching of assets and liabilities that would be natural and appropriate for a broker dealer business. This calculation ignores the asset side of the balance sheet. It takes no account of asset tenor or asset liquidity, ignoring the benefit of holding short term or high-quality liquidity assets ("**HQLA**") assets that are prevalent on broker dealer balance sheets.

While these issues affect both domestic- and foreign- affiliated firms, they often have a disproportionate effect on IHCs that focus on capital markets in their MLEs. Because these entities are more of a "pure play" in capital markets, the effect of bank-oriented regulation will be more disruptive and severe on these entities, consistent with the large declines in FBO footprint noted above. For example:

- The capital-markets FBO firms typically run far higher local capital ratios than standalone domestic banks, often driven implicitly by the severe trading-book shocks in the CCAR requirements. For example, the three Specified FBOs average a 22.7% common equity tier 1 ("**CET1**") ratio and an 11.1% Tier 1 leverage ratio, far above the average for large commercial banks.
- The Specified FBOs are also typically subject to substantial internal total loss absorbing capacity ("**TLAC**") requirements, where local institutions of a similar size do not have to carry this additional cost. No benefit is given for the likelihood of parent support, despite strong historical precedent and strong economic incentives.
- A parent bank-supported funding model is penalized despite bringing financial resources into the U.S. parent funding is treated as far riskier than retail deposits in the STWF calculation because it is categorized as a foreign financial investor, ignoring the strong history of parent support.
- Similarly, in this Proposed Guidance, the STWF metric in GSIB Method 2 was developed and calibrated subjectively with respect to large U.S. GSIBs and it has not been validated. This metric produces deeply misleading results when applied to a smaller capital markets oriented FBO subsidiary.

Given these numerous headwinds, there is no indication that the decline of FBO capital markets firms will abate. The capital and liquidity costs are considerable, costs which now must be supported by a smaller footprint.

Applying bank-oriented regulatory standards to capital-markets oriented subsidiaries has had a substantial and unfair impact. It has caused capital markets FBOs to exit businesses, which could have long-term adverse effects on markets and the economy. These effects could also lead to retaliatory actions in other countries, opening U.S. firms to quid-pro-quo regulations on their operations in foreign jurisdictions.

Clearly, the FBOs have substantially reduced their capital markets activities in the U.S. These changes appear to be at least partially correlated with the implementation of bank-oriented regulatory requirements and supervisory expectations. The Proposed

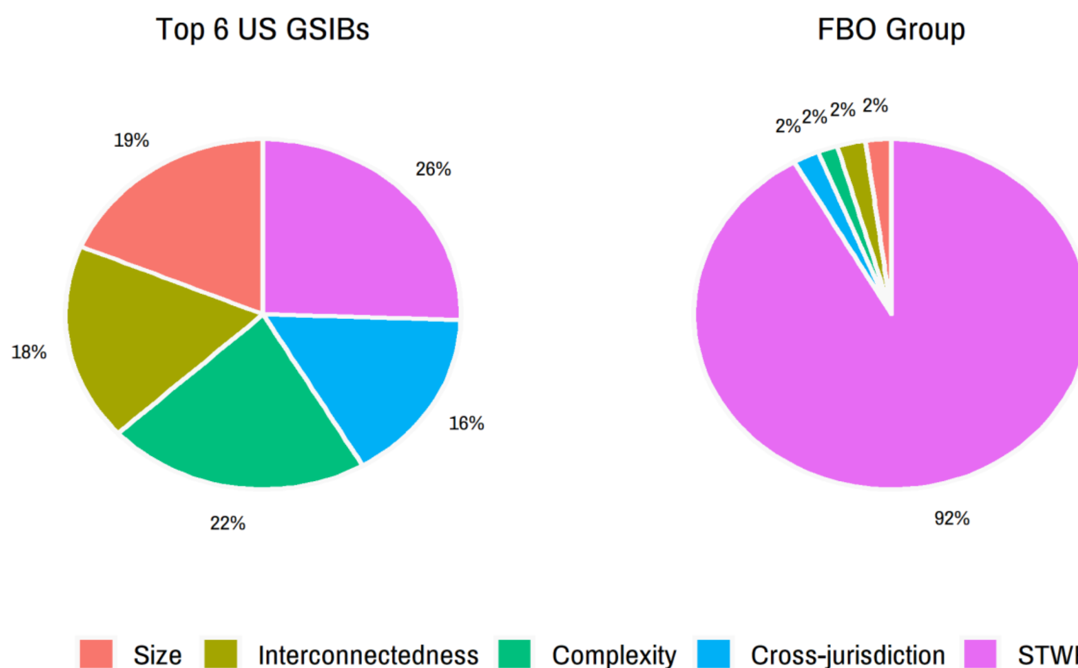
Guidance continues this trend by extending a framework that was developed to calculate the surcharge for the U.S. GSIBs, not as a scoping mechanism for the broader industry and certainly not for the Specified FBOs. Moreover, the Proposed Guidance increases the expectations on these firms rather than tailoring the burden they face, ignoring the fact that they have dramatically reduced their systemic footprint over the past ten years.

The remainder of this letter highlights several points which highlight how the Proposed Guidance is particularly harmful to the capital markets activities of the Specified FBOs, all of which operate significant broker dealers in the U.S. as part of their IHCs.

The Use of Method 2 Scoring as a Scoping Mechanism Distorts the Systemic Risk the Specified FBOs Pose: It Should be Replaced in the Final Guidance:

The GSIB Method 2 approach should not apply to the Specified FBOs, because it leads to distorted and incorrect results which we discuss extensively in the ABA/BPI/SIFMA letter. Several of these points bear repetition here.

First, when applied to the FBO IHCs, the Method 2 calculation overstates the systemic risk of these firms in a dramatic and disproportionate manner as compared to BHCs. For example, the STWF score makes up fully 92% of the total Method 2 score for the IHCs of the Specified FBOs. In contrast, it only makes up 26% of the total Method 2 score for the U.S. GSIBs, in part because it was calibrated specifically to produce a balanced result for those entities (i.e. originally to produce 20% of the total Method 2 score). The IHCs did not get the benefit of a similar calibration to ensure a balanced weighting.



The Agencies note that the "comparably high Method 2 scores of the Specified FBOs have largely been driven by reliance on short term wholesale funding."[9] This is true only as a technical matter within the Method 2 calculations, but is not true as a substantive one.

For the IHCs of the Specified FBOs, the other four Method 2 categories produce systemic risk scores that are far lower than the corresponding average for the U.S. benchmark group. The IHC score components range from 4.6% to 8.3% of the U.S. GSIB score (i.e., 92% to 95% lower risk), as seen in the figure above.

Second, the STWF score in the Method 2 results from an idiosyncratic ratio weighting system specifically designed for the purpose of estimating a surcharge for the U.S. GSIBs, not as a scoping tool for a broader group of firms, such as the Specified FBOs.

This balancing effort should apply to all firms, including the Specified FBOs, or the Method 2 scoring should not be used. While the Specified FBOs have dramatically cut their RWA, without the balancing given to the U.S. G-SIBs, the Method 2 scoring has the bizarre impact of increasing the weighting ratio applied to the STWF category of the

[9] Proposed Guidance at 15452.

IHC group because RWA applies only in the denominator of the STWF category. This makes the effective weight for STWF 16.7x larger for the Specified FBOs.

Third, the IHCs of the Specified FBOs manage liquidity conservatively, and their outright STWF is 84% smaller than the U.S. non-processing GSIBs. These FBOs also maintain significantly higher levels of HQLA than their U.S. counterparts; in fact, they hold 3x greater liquidity headroom (liquid assets over the 100% LCR standard). In short, their use of STWF to fund HQLA does not present the same level of systemic or liquidity risk as STWF used to fund riskier assets, since HQLA can be converted back into cash quicker than any other asset, by definition. This would be true for any firm using STWF to fund HQLA.

Fourth, vast differences exist between the U.S. operations of the Specified FBOs and the U.S. GSIBs. As noted in the quote from Vice Chair Quarles above, “The average method 1 GSIB score of the combined U.S. operations of the LISCC FBOs is less than a quarter of the average GSIB score of the six non-processing U.S. GSIBs.” Indeed, based on year-end data, the average method one score is only 14.6% of the non-processing U.S. GSIB average. It seems strange that a Method 2 calculation would be so out of sync with the method 1 calculation, as well as every other relevant measure of risk or scale. This is due largely to the unique ratio process of Method 2 and the lack of any calibration to achieve a balanced result. As the joint trades letter indicates, Method 2 produces spurious and misleading results when applied to FBOs.

Finally, we recommend that the Agencies revise the scoping methodology in order to achieve much more balanced results, and we suggest that any such methodology should use the recently developed tailoring categories to provide a more consistent and appropriate measurement of the risk profile of these firms. The scoping methodology should reflect those substantive factors, and not be used to create a new category of IHCs that are mistakenly viewed as comparable in terms of systemic risk to much larger U.S. GSIBs. No justification exists for imposing the full panoply of U.S. resolution requirements to institutions that are categorically smaller and less risky—particularly when those institutions are already subject to an equally robust global resolution planning requirement.

Extraterritoriality and Duplication of Derivatives Information and Payment, Settlement and Clearing Requirements Which Could Easily Be Obtained from Home Regulators:

The Proposed Guidance requires extensive information relating to the FBOs’ non-U.S. derivatives and trading activities. The proposal defines “U.S. derivative and trading activities” more broadly than and in contradiction of the Title I Rule under which the Proposed Guidance must operate. For resolution planning purposes, the focus should be on what is booked in the United States.

The Proposed Guidance also subjects the U.S. subsidiaries of the FBOs to PCS requirements that are essentially the same as, and in some ways more extensive than, the requirements applied to U.S. GSIBs.[10] The Proposed Guidance requires that the PCS framework address relationships that include "indirect relationships" with FMUs, including "a firm's . . . non-U.S. affiliate and branch provision of . . . key clients of the firm's U.S. operations with access to an FMU or agent bank."[11]

Likewise, the definitions of U.S. Prime Brokerage Accounts and Balances in the Proposed Guidance fails to conform to and goes beyond the scope of the 2019 Resolution Plan Rule. The FBO's home country supervisor provides regulatory supervision and oversight of activities booked outside of the U.S. entities (regardless of where the activities are originated), and consequently, the definitions should be removed from the Proposed Guidance.

The Agencies should not be able to impose by guidance something that exceeds the scope of the rule itself. U.S. regulators should also avoid creating issues of extraterritoriality and duplication of information, especially when they can request any necessary information from home country regulators under established procedures.

Fundamental Differences Between FBO IHCs with Broker Dealers as their MLE and Other Firms Without a Broker Dealer as the MLE:

The Specified FBOs conduct most of their U.S. activities in a U.S. regulated broker dealer which is their MLE in this country, and like all broker dealers, they operate in ways fundamentally different from traditional banks. First, their assets mark to market daily and trade in deep and liquid markets. Second, most trading occurs in secondary markets, and therefore, does not affect the primary credit supply. Third, the assets of these entities are typically more liquid and more transparent than those in other sectors of the financial industry. Together these features provide important benefits from a prudential perspective but are often ignored - or even penalized - under current regulations and supervisory expectations. These three reasons alone have major systemic benefits in the event of a resolution, but there are other reasons why these MLEs should not be subject to this guidance.

These MLEs have higher effective capital requirements because CCAR shocks in stress testing discriminate against trading books as described in the SIFMA GMS and LCD Study (see Appendix B). These firms have higher local liquidity requirements versus domestic broker dealers because liquidity requirements must be funded in the U.S., not from the parent or outside the U.S. Finally, the TLAC and RRP requirements for these

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[10] For instance, the *Framework* subsection includes a requirement that the Specified FBOs "address the potential impact of any disruption to, curtailment of, or termination of . . . direct and indirection relationships on the firm's U.S. material entities, identified critical operations, and core business lines." *See* Proposed Guidance at 15463; Domestic Guidance at 1452. There is also a *Capabilities* subsection that does not appear in the Domestic Guidance. *See* Proposed Guidance at 15464–65; Domestic Guidance at 1453.
[11] Proposed Guidance at 15463.

MLEs exceed those applicable to similarly sized U.S. based peers. Together, these reasons add additional support to the arguments made above and in the joint trade letter.

The Proposed Guidance Must be Tailored

At a minimum, any institutions captured by a more appropriate scoping mechanism should only be subjected to guidance and expectations that are tailored to their reduced risk profile and not incremental to current regulatory rules, which should be the basis of constraining capital and liquidity requirements. In line with the principles of tailoring, the Agencies should tailor several expectations in the 2018 FBO Guidance, given the reduction in risk posed by the U.S. operations of the Covered FBOs and the enhanced capital and liquidity support now available. The Agencies should remove from the specifications resolution liquidity adequacy and positioning ("**RLAP**") and resolution capital adequacy and positioning ("**RCAP**") as they are redundant given other regulatory requirements (e.g., internal liquidity stress testing and TLAC, respectively). Standardized liquidity requirements set forth in rulemakings, and not RLAP, should set the binding constraint. Additionally, RCAP is duplicative to TLAC and should be removed because TLAC separately requires significant local bail-inable resources for the recapitalization of the Covered FBOs' U.S. operations. Clearly articulating unique constraints for these entities will enable a more efficient process in evaluating and managing their businesses.

Conclusion:

We see no logic in the approach set forth in the Proposed Guidance. The Proposed Guidance imposes requirements which exceed those applied to these FBOs in years past, despite the material reduction in their U.S. activities and the issuance of material total loss-absorbing capacity ("**TLAC**") to their parent organizations. This TLAC creates large new financial resources to support their local U.S. resolution plans, and further incentivizes parent support and cooperation with the U.S. agencies.

Likewise, the Proposed Guidance imposes requirements on the Specified FBOs that equal and, in some cases, exceed those applicable to the U.S. GSIBs, despite the fact that the U.S. operations of these FBOs are dramatically smaller and less complex than the U.S. GSIBs, and parent company backstops support their operations. At a minimum, any institutions subject to guidance should only be subject to expectations that are tailored and consistent with their reduced risk profiles, and not incremental to current [capital and liquidity] requirements established by rulemaking.

Finally, the Proposed Guidance does not appear to reflect any reliance by the Agencies on the supervisory colleges and crisis management groups in which they participate and which they continue to laud for their effectiveness. Nor does it reflect any reliance by the Agencies on the capital market and resolution rules and requirements of the SEC,

FINRA or the CFTC. For these reasons, we believe that the Agencies should not adopt the proposal and the U.S. resolution planning requirements for all FBOs, including the Specified FBOs, should be much more closely tailored to the risks that they pose.

Sincerely,

Kenneth E. Bentsen, Jr.
President & CEO
Securities Industry and Financial Markets Association

Appendix A

SIFMA Insights: The Importance of FBOs to the US Capital Markets
April 2019
https://www.sifma.org/wp-content/uploads/2019/04/SIFMA-Insights-The-Importance-of-FBOs-to-US-Capital-Markets.pdf

Appendix B

SIFMA Global Market Shock and Large Counterparty Default Study
September 2019
https://www.sifma.org/wp-content/uploads/2019/09/SIFMA-GMS-LCD-Study-FINAL.pdf