Timothy D. Adams
President and CEO

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: Proposals Revising the Applicability of Enhanced Prudential Standards for the US Operations of Foreign Banking Organizations

Dear Sirs and Madams:

The Institute of International Finance (IIF) welcomes the opportunity to comment on the current 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 (the "Fed") to revise Regulation YY (the "Fed Proposal"); and

- the Agencies' proposed rule to revise liquidity and capital requirements (the "Interagency Proposal," and together with the Fed Proposal, the "Proposals").

As you are aware, a key element of the mandate of the IIF is to advocate efficient and consistent global regulation on behalf of members, which consist of internationally active financial institutions from the US and 70 countries. In this regard, the IIF considers it crucial to elaborate upon industry's concerns over the Proposals and also, more broadly, over a disconcerting regulatory trend in the imposition of disproportionate requirements for FBOs in different regions. This trend has negative implications for the internationally agreed bank resolution framework as well as for the provision of competitive financial services in funding global and regional economies.

This letter highlights our main views regarding the Proposals, through the lens of the international regulatory framework, with the following key messages:

- FBOs play a significant and crucial role in financing US economic activity, bringing diversity, competition and unique capabilities to the US financial system;
- However, since the enhanced prudential requirements were proposed in 2012, the activities of FBOs have been constrained and, in some sectors, they have declined precipitously. The Proposals could exacerbate this negative trend;
- The Proposals are disproportionate relative to their risk-reduction objectives. In particular, the use of the combined US operations (CUSO) measure to calibrate requirements for the IHCs of FBOs is a significant flaw in the Proposals;
- The risk-based indicators (RBIs) proposed to categorize FBOs lack robust risk-sensitivity, and they also appear to unfairly penalize the particular structure and operations of FBOs;
- The Proposals do not adequately account for the changed risk profiles of FBOs over recent years. The Agencies also do not give adequate recognition to the agreed global regulatory framework for systemic risk management or the home/host regulatory approach. The nature of the changes in the Proposals could lead to further fragmentation of the internationally agreed regulatory framework;
- In particular, the preplacement of significant dedicated internal and external TLAC at US intermediate holding companies (IHCs) is a powerful feature that should be used to offset fragmentation. Internal TLAC pre-funds parental support and TLAC enhances US financial stability interests in a way that is not replicated by standalone firms in the same tailoring categories. However, the existence of internal and external TLAC is not recognized in the Proposals; and
- The Proposals also look to consider imposing direct liquidity requirements on the branches of FBOs. Such a proposal is not consistent with the long-respected legal concept of a branch as an integral part of the same legal entity and it is one which could have very negative implications for home/host regulatory cooperation and efficient recovery and resolution arrangements.

The IIF recommends that the Agencies, as part of your efforts to enhance stability and to improve conditions for finance and investment in the US, reconsider certain elements of the current Proposals to better meet your stated objectives. We elaborate upon these key messages below. Later in this letter the IIF offers recommendations for amending the Proposals to ensure that they are more proportionate and to mitigate the negative effects that could result from the implementation of the Proposals as currently drafted.

FBOs are important, and often unique, participants in the US financial system

FBOs play a significant and important role in financing the US economy. The total assets of FBOs (including branches and affiliates) represent some 20% of US banking system assets, they provide more than 25% of commercial and industrial loans in the US[1] and they represent more than half of the primary dealers of the Federal Reserve Bank of New York.[2] The participation of FBOs in the US markets provides diversity of funding

[1] Federal Reserve Board, Share Data for the U.S. Offices of Foreign Banking Organizations (data as at end-2018), available at: https://www.federalreserve.gov/releases/iba/fboshr.htm. The Federal Reserve asset figures do not include certain non-bank affiliates and credit unions.
[2] US Department of the Treasury, June 2017. “A Financial System That Creates Economic Opportunities: Banks and Credit Unions” (page 5). Refers to data from Federal Reserve Bank of New York, Primary Dealers, available at: https://www.newyorkfed.org/markets/primarydealers.

sources, which is important for financial stability and enhanced competition. This benefit should not be underestimated, and it was recognized by the US Treasury in their 2017 report: *"Treasury considers foreign investment in the US banking system to be an aid to diversifying the risk of the financial system and propelling economic growth."*[3]

The FBOs operating in the US provide funding and financial services which directly benefit the US economy. For example, FBOs have extensive relationships with large corporations who are based in their home countries but operate significant businesses in the US. The FBOs provide funding and financial services to these clients for their US investments and businesses. One example is in Ohio, where Japanese banks provide funding and financial services for Japanese companies which operate in that state and these companies provide approximately 30% of the manufacturing jobs in Ohio.

Further, FBOs operating in the US also have particular specializations and capacities which can be very beneficial to the US economy. By way of example, many FBOs are experienced in the provision of long-term bank financing of infrastructure. Increasing investment in infrastructure is widely recognized to be necessary, would advance the Fed's mandated goals and is currently a particular focus area for agencies responsible for US development and growth. Any appropriate revisions to the regulatory and prudential requirements for FBOs should consider how to facilitate more efficient and cost-effective participation in the US by FBOs to increase the capacity of these groups to contribute to financing the desired growth in infrastructure investment and development.

The IIF also welcomed the recognition of the contribution of FBOs by the Vice Chair for Supervision, Randal Quarles in a speech last year:

"Non-US firms serve as an important source of credit to US households and businesses and contribute materially to the strength and liquidity of US financial markets, so it is critical--not just as a matter of fairness but as a matter of our domestic interest--that we as regulators ensure that they operate in a fair and open financial services sector."[4]

However, the activities and growth of FBOs have been constrained by US regulatory measures over recent years, restricting the benefits which FBOs can provide to US financial stability and the economy.

In December 2012 the Fed published the proposal: *Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations (the FBO Rule)*. In April, 2013 the IIF wrote to the Fed detailing the concerns of the industry over this proposal.[5] We highlighted that the FBO Rule would have negative implications for global regulatory consistency, international cooperation and financial efficiency, leading to reduced global liquidity, increased borrowing costs for end users and a more fragile financial system.

In pointing out the concerns for increased fragmentation in the future, should the FBO Rule be implemented, the IIF letter stated: "*In all likelihood, the proposed rule would, if finalized, open a window for change in the general tenor of policymaking at the national and international levels, with the focus of regulatory change shifting toward regulatory protectionism, ring-fencing and obligatory subsidiarization.*"[6]

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[3] US Department of the Treasury, June 2017. "A Financial System That Creates Economic Opportunities: Banks and Credit Unions" (page 17).

[4] Randal K. Quarles, March 5th, 2018. "The Federal Reserve's Regulatory Agenda for Foreign Banking Organizations: What Lies Ahead for Enhanced Prudential Standards and the Volcker Rule" – Remarks at Institute of International Bankers Annual Washington Conference (page 2).

[5] See letter from the IIF to US Federal Reserve, April 2013. "*Re: Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies".*

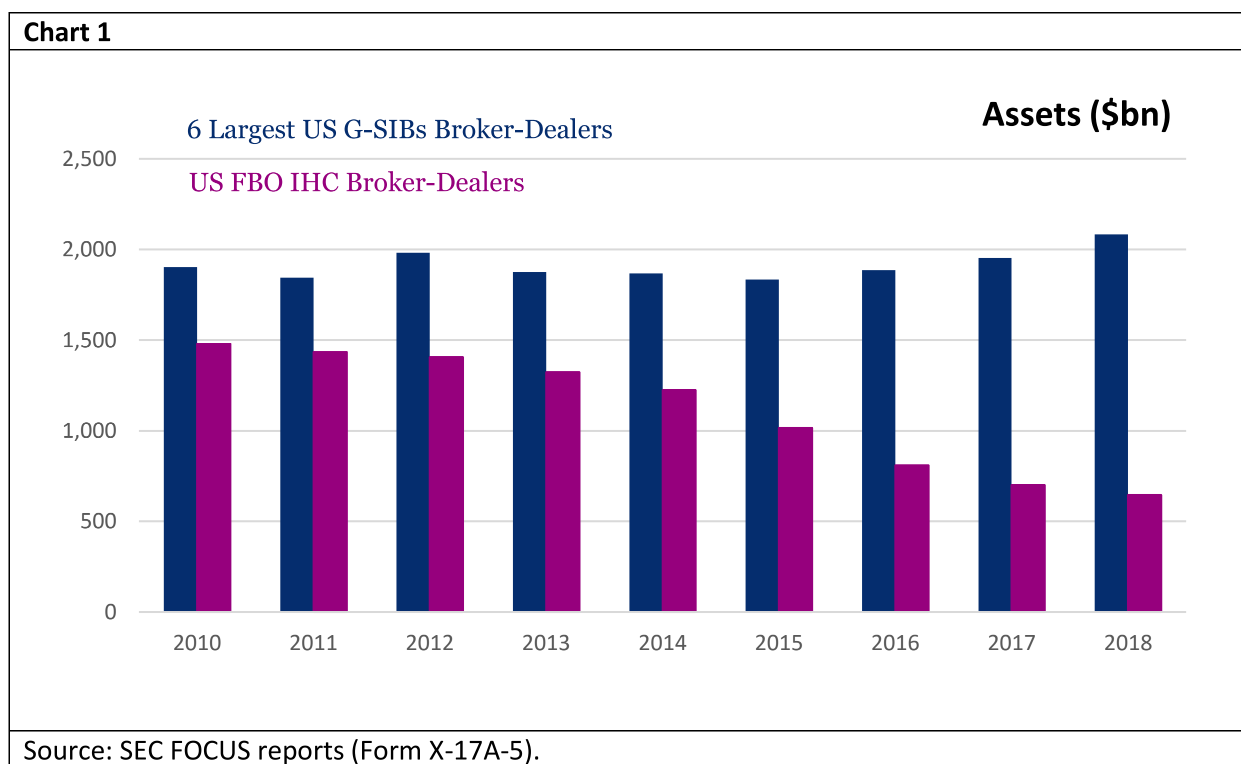
[6] Ibid (page 2).

As you are aware, in November, 2016 the European Commission published proposals for revisions to the EU prudential regulatory framework, as part of the CRD IV revision, including a proposal for certain non-EU financial institutions to establish an intermediate parent undertaking for their operations in the EU (the IPU Proposal). These rules have now been finalized and will impose more stringent requirements on third country banks operating in the EU, most notably on US banks which are the largest and most active foreign institutions in the region.

The IIF would reiterate these historic concerns: that the Proposals may encourage further retaliatory action in other jurisdictions with negative implications for international competition and global financial stability. This concern is most significantly seen in relation to the proposition for the imposition of direct liquidity requirements on FBO branches which is presented for comment in the Proposals. This is discussed in more detail later in this letter.

The FBO rule has already had a negative impact on the participation and investment by FBOs in the US. As demonstrated in Chart 1 below, since 2010 the assets of large broker-dealer operations of FBOs' IHCs have declined sharply, by some 56%, with most of that decline (54 percentage points, which equates to $761bn) occurring since the Fed's proposal of the FBO Rule at the end of 2012. The total assets of the major US broker-dealers have increased slightly over the same period, suggesting a differential impact from the FBO Rule. This result also means that overall credit provision has been negatively affected along with reduced liquidity in capital markets, resulting in a less competitive marketplace for financial services in the US.

Chart 1



Source: SEC FOCUS reports (Form X-17A-5).

While it could be argued that the reduction in asset size and activity of FBOs may be due to a number of factors, and may in fact represent a broader trend in financial activity, the data suggests that FBOs operations have been particularly and specifically affected.

The FBO members of the IIF strongly believe that the FBO Rule has had a significant impact on the growth and activity of their business.

The restrictive nature of the original FBO Rule, particularly in light of significant enhancements in resilience and liquid capacity at FBOs since its introduction, was recognized by Treasury in their 2017 report: "…*the application of these requirements needs to be reevaluated so that FBOs are not unduly constrained*."[7]

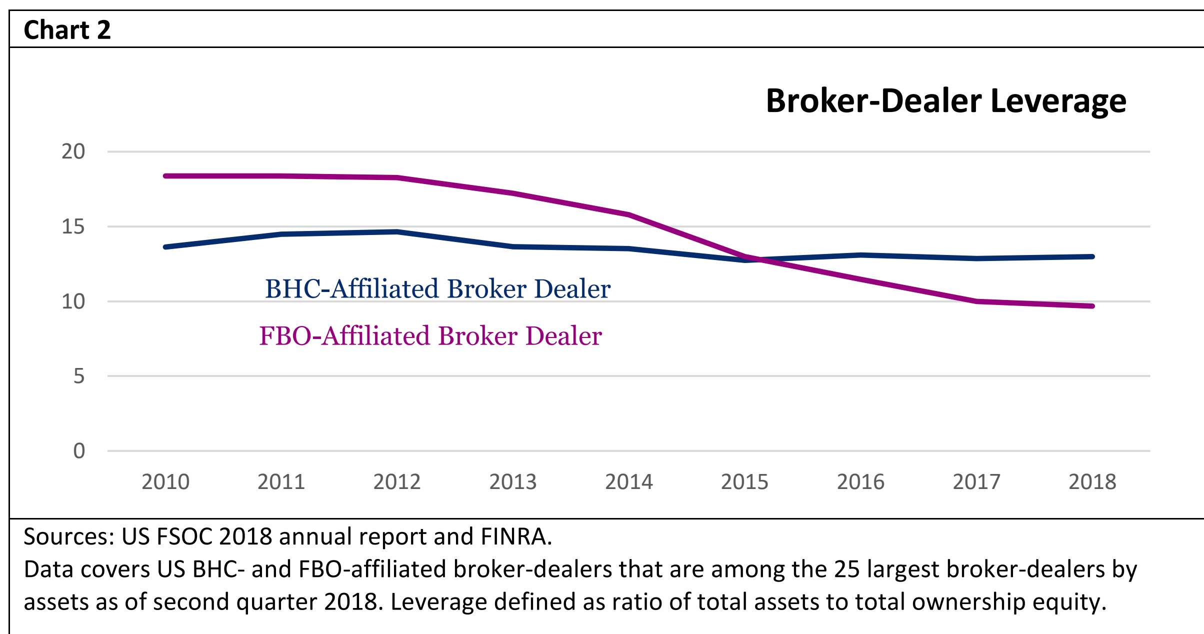
However, as currently designed, the Proposals are in many ways more restrictive, and would make the US market a less attractive business location for global banks, which would likely exacerbate this negative trend of investment by FBOs in the US.

The increased stringency of the Proposals would also appear to be inconsistent with the prior stated intention of the Fed to implement and maintain rules which are commensurate with the genuine risk profile of FBOs:

"We are committed to tailoring our regulatory and supervisory regimes to align with the risk posed by financial institutions to the US financial system. We are also continuing to evaluate whether our rules are sensitive to changes in the risk profile of banking organizations. We want our rules both to increase in stringency as firms' risks grow and, just as important, to decrease in stringency when firms have actively reduced their risk profiles."[8]

These Proposals come at a time when the riskiness of the FBOs operations has actually been significantly reduced. Chart 2 highlights a dramatic change in the degree of leverage of the broker-dealers of FBOs, which has declined by nearly half. The decline in leverage at FBO-owned entities has also been dramatic on a relative basis, when compared to the flat trend at the broker-dealers affiliated with US bank holding companies (BHCs).

Chart 2



Sources: US FSOC 2018 annual report and FINRA.
Data covers US BHC- and FBO-affiliated broker-dealers that are among the 25 largest broker-dealers by assets as of second quarter 2018. Leverage defined as ratio of total assets to total ownership equity.

[7] US Department of the Treasury, June 2017. "A Financial System That Creates Economic Opportunities: Banks and Credit Unions" (page 68).

[8] Randal K. Quarles, March 5th, 2018. "The Federal Reserve's Regulatory Agenda for Foreign Banking Organizations: What Lies Ahead for Enhanced Prudential Standards and the Volcker Rule" – Remarks at Institute of International Bankers Annual Washington Conference (page 7).

There has been some concern expressed that the reduction in FBO broker-dealer size and activity might have been purely due to the shifting of assets from subsidiaries to the FBOs' branches. The data suggest that some transfers have occurred but that the scale of branch increases is quite modest.[9] The dominant effect has been an outright reduction in activities.

As was demonstrated in Chart 1 (page 4), the broker-dealer assets of FBO's IHCs declined by approximately $761bn in the period from 2012 to 2018. Data published by the Fed shows that the branch/agency assets of FBO IHCs increased by approximately $118bn over the same period.

Therefore, while there has been some increase in the branch/agency assets of FBOs since 2012, the data demonstrates that the magnitude of that increase is overwhelmed by the decline in broker-dealer assets over the same period. Overall, there has been a very significant *net decline* in assets and activity at FBO groups since the FBO Rule was first proposed.

The data above (Chart 2) also demonstrates the significant reduction in riskiness of the FBOs in the US. The industry is concerned that these more stringent Proposals are being made at a time when riskiness has been significantly reduced and could further exacerbate the decline in activity and investment by the FBOs when industry does not believe such measures are justified. The data would tend to support industry's position.

The Proposals appear to be inequitable and disproportionate

The scope of the Proposals is overly broad and goes beyond the IHC to incorporate the entire US footprint of an FBO. This would not adequately recognize or account for the regulatory requirements imposed by home regulators, and would result in disproportionate and inequitable outcomes, especially in relation to the requirements for a comparable US institution.

The Proposals calibrate requirements for an IHC based on both the size and profile of the IHC for some tests, and the size and RBIs of the FBO's CUSO for other tests. This two-tiered calibration framework is overly complex, and would result in requirements for the IHC which are disproportionate to the risk of the IHC.

The current Fed rules for FBOs (Reg W) restrict branches from dealing with IHCs, which also means that stress situations occurring at the branch shouldn't affect the IHC. The core Fed liquidity framework separates these entities structurally, but the Proposals would effectively integrate them. Also, traditionally the concept of regulation of IHCs is to treat the IHC as a standalone entity and ignore parent support. However, under the Proposals, the Agencies would be implementing an expansive standard that deviates from this philosophy – that is, to take into account the potential risk of the broader group, but to ignore any group support. This would, in our view, also appear to be inequitable and would merit further examination.

It is noted that in the calculation of the LCR the Fed permits the netting of internal cash inflows against external cash outflows (i.e. outside the group). The industry supports this approach and believes that it should be extended to the Fed's liquidity stress-testing requirements where, at present, internal cash inflows may only be used to offset internal cash outflows. This results in higher buffer requirements than would otherwise be the case. US BHCs, in contrast, do not have to manage this segregation of cash flows. In addition, FBOs should not be penalized for undertaking transactions which enhance the solvency of their

[9] We also note that any activities transferred to the branch are subject to supervisory review and branch eligibility tests. Such a move is possible only for activity that could have been conducted in the branch in the first place, that would have been done in close coordination with Federal Reserve supervision staff, and would have, in the case of primary dealer activity, required the designation as primary dealer by the Federal Reserve Bank of New York. Branch-eligible activity in turn is defined in largely the same manner for Federal and State chartered branches of FBOs as the OCC defines the activities that are permissible for National Banks. It is generally understood to be a restrictive list that would not allow for many of the activities conducted by broker-dealers.

operations in the US. Consequently, industry believes that liquidity stress-testing for CUSO/IHC/US branches should treat internal and external flows in the same manner, such that internal inflows can be used to offset external outflows.

Another area of apparent inequity is in the treatment of deposit holding subsidiaries. Under the Proposals, depository institutions that are consolidated under an IHC of an FBO may be subject to much more stringent requirements than similarly sized depository institution subsidiaries of US BHCs, not because of the specific risk carried by the depository institution, but only because of the CUSO activities that have little, if any, relationship with the depository institution activities.

The more stringent measures under the Proposals would also appear to lack sufficient prudential justification and could result in duplicative requirements. Liquidity rules and preparations have changed dramatically since the last crisis. FBO groups are subject to extensive liquidity regulation at the parent level, and the build-up of global HQLA has been significant. Moreover, local US branches are supervised by US authorities and subjected to regulation YY requirements. Lastly, the opportunity for FBOs to receive liquidity support from the Fed has been significantly reduced over recent years.[10]

While on the surface, using the same categorization metrics for FBOs that are to apply to domestic BHCs would appear to be equitable and consistent with the stated 'level playing field' objectives, the nature of these metrics would appear to unfairly penalize FBOs. The nature of the business models of FBOs means that they will almost always have significantly more cross-jurisdictional activity than comparable US domestic BHCs, and will often trigger one of the other RBIs because the business model of a subsidiary is likely to be more specialized than a consolidated group. Consequently, the categorization outcome for FBOs is inherently more strict for FBOs than for similar US banks.

This categorization bias can be seen clearly in the outcomes outlined in the Proposals: while FBO IHCs constitute only a modest proportion of all the non-G-SIB holding companies over $50bn in assets, they comprise 62% of all the firms placed into category 2 and 3. Of the 24 US holding companies over $50bn, 5 are placed into category 2 or 3, a capture rate of 21%. Of the 12 FBO IHCs over $50bn, 67% are placed into these buckets. Indeed, one FBO subsidiary that is even well below $50bn makes it into these more stringent buckets, in part because of the CUSO elements.

In addition to being inequitable, the RBIs lack risk-sensitivity. Consequently, the Proposals, if adopted as currently designed, will very likely result in a larger number of FBOs being categorized in higher risk categories than is currently the case or is justified by the actual risk they represent to the financial system of the US. The nature of these indicators would result in the perverse incentives of causing an FBO to increase the relative riskiness of their asset portfolios or to continue to shrink their US business altogether. Neither outcome would be desirable for stability or economic growth purposes.

In a later section of this letter we highlight specific concerns with the design of the RBIs and make recommendations for amending these categorization indicators to make them more appropriate and proportionate with respect to achieving the risk mitigation outcomes sought by the Agencies through the Proposals. We also seek to balance those recommendations with the streamlining goals of the Proposals. In

[10] Federal discount window access, in particular, is subject to collateral requirements and the Fed does not have the discretion that prevailed during the crisis to provide such support. See also, for example, comments by B. Bernanke, T. Geithner and H. Paulson at https://www.nytimes.com/2018/09/07/opinion/sunday/bernanke-lehman-anniversary-oped.html.

this vein, we also provide recommendations on how the reporting of RBIs could contain elective components, to account for the reporting burden newly created for FBOs.

The Proposals do not adequately recognize or account for the internationally agreed recovery and resolution framework

While not explicit in the Proposals, there appears to be an assumption that cross-border cooperation cannot be relied upon, in particular during a period of stress. In particular the Proposals do not appear to take into account the extensive enhancements to recovery and resolution frameworks which have been implemented in recent years, most notably the TLAC requirements.

The Proposals do not adequately acknowledge the comprehensive global resolution and recovery reforms of recent years: the development of credible resolution plans backed by significant amounts of "bail-inable" debt to support resolution. All FBO groups have increased their global capital and liquidity resources significantly in the post-crisis period, and most have also issued large amounts of external TLAC to ensure further resources in the event of resolution. Internal TLAC, and external TLAC issued by the IHCs of MPOE FBOs, (hereafter referred to collectively as 'dedicated TLAC') is a significant resource at many FBOs and provides an additional, locally pre-funded resource to support US financial stability. This additional resource means that FBOs are significantly safer than comparable domestic firms in the same categories, both because of the direct resourcing and also because it provides an incentive to ensure further parent support at times of stress.

The significance of dedicated TLAC should not be underestimated. Dedicated TLAC at the FBOs represents a substantial amount of prepositioned resilience that can be called upon when necessary, at the very time that the US financial system is likely to be most stressed. These Proposals are intended to support the stability of the US financial system in a balanced and tailored way, but there is no acknowledgement of this dedicated TLAC in the Proposals (or of the other risk-reduction measures that FBOs have undertaken). Such additional resourcing is expensive, and fair national treatment requires some consideration of the significant and differential reduction in systemic risk that is provided by these FBO resources.

The Proposals could more appropriately take into account the home/host cooperation agreements that have been developed over many years since the crisis. The importance of appropriate 'mutual recognition' was actually a cornerstone recommendation of the Treasury Report of 2017: "*Other IHC regulatory standards, such as resolution planning and liquidity, should also be recalibrated. In considering such a recalibration, greater emphasis should be given to the degree to which home country regulations are comparable to the regulations applied to similar US BHCs. Where regulations are sufficiently comparable, FBOs should be allowed to meet certain US requirements through compliance with home country regimes.*"[11]

The more stringent requirements under the Proposals could also have negative implications for the international regulatory landscape. Rules introduced by the US Agencies can often be viewed by other jurisdictions as a potential template for their own rules. The FBO Rule - which directly led to the EU's IPU Proposal - is one such example. If the US adopts stricter, host-centric policies for FBOs, it raises the risk of replication (or retaliation) by other jurisdictions. If all foreign countries were to adopt a similar standard, the impacts on flexibility would be adverse for all banks, including banks headquartered in the US. The proposal for a branch LCR regulation, in particular, is unprecedented in the international arena, and could well provoke similar proposals in response. This could exacerbate the problems of fragmentation at the international level, and result ultimately in a worse outcome for US, and indeed global, financial resilience

[11] US Department of the Treasury, June 2017. "A Financial System That Creates Economic Opportunities: Banks and Credit Unions" (page 18).

and stability. It is critical that this proposal is discussed carefully at the international level, and that any outcome be carefully evaluated to avoid the risk of a more fragmented end result.

The Proposals are fragmentary with negative implications for global system stability

In addition to the implications for the global regulatory agenda and financial stability, the IIF is concerned with the potential economic impact of any fragmenting regulatory trend. Addressing the increasing levels of fragmentation in financial markets has been a priority of the Financial Stability Board (FSB) under the Japanese Presidency of the G20. In a recent report on market fragmentation, the FSB identified jurisdictional ring-fencing of capital and funding resources as a potential source of fragmentation of bank capital and liquidity and specifically called for further analysis of the issue at the FSB level this year: "… *excessive siloing of capital and funding resources within national borders can be to the detriment of the overall resilience of financial institutions. For instance, such requirements that are not commensurate with the actual risk in those entities can constrain the degree to which financial institutions use capital and liquidity to meet shocks to their solvency and funding that occur across different jurisdictions."*[12]

The former Chairman of the FSB, Mark Carney, has spoken about the negative consequences of diminished trust and cooperation among regulatory authorities and increasing regulatory fragmentation, warning about the detrimental economic impacts of such a trend: "*If that happens, domestic authorities could impose local requirements on domestic entities of foreign firms. In a world where many banks and FMIs are highly interconnected that would generate significant inefficiencies, frustrating the benefits that flow from open trade and investment. Taking this low road would be sub-optimal for all, with fewer jobs, lower growth and higher domestic risks*."[13] And the current FSB Chairman, Randal Quarles, in his role as Vice Chair for Supervision, has also previously underscored the importance of "*determining the right balance of flexibility and certainty*" when addressing the issues of cross-border resolution and risks of fragmentation.[14]

The increased stringency and fragmentary implications of the Proposals would also appear to be inconsistent with the stated desires of the Fed to provide greater flexibility in the capacity of global institutions to deploy funds as and where required, particularly during times of financial stress:

"To enable cooperation and avoid a destabilizing seizure of assets by host regulators, I would submit that all jurisdictions must find a balance of flexibility for the parent bank and certainty for local stakeholders. Flexibility, or the ability to allocate capital and liquidity to different parts of the group on an as-needed basis, helps to meet unexpected demands on resources and reduces the risk of misallocation and inefficient use of resources. . . .

[a] host regulator should also recognize that it is ultimately in its interest for the SPOE resolution of the foreign bank to be successful and, given the uncertainty of the circumstances or location of losses that emerge in an actual stress, adequate flexibility for the parent to deploy resources where needed is likewise in the host regulator's interest".[15]

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[12] FSB, June 4th 2019. "FSB Report on Market Fragmentation" (page 9).
[13] Mark Carney, April 20th, 2017. "What a Difference a Decade Makes" - Remarks at the Institute of International Finance's Washington Policy Summit (page 8).
[14] US Federal Reserve 2018. "Trust Everyone--But Brand Your Cattle: Finding the Right Balance in Cross-Border Resolution." May 16, 2018 (page 4).

[15] Randal K. Quarles, May 16th, 2018. "Trust Everyone–But Brand Your Cattle: Finding the Right Balance in Cross-Border Resolution" (pages 2-3).

The IIF believes that it is crucial that the actions of regional authorities not undermine the efficacy and coherence of the internationally agreed cross-border resolution framework. Of equal concern is the potential economic impact of any fragmenting regulatory trend. The capacity to freely move funding across borders is valuable for economies and helps to better balance the needs of capital supply and demand. It is also a critical support for global stability.

The NSFR should not be imposed on the IHCs of FBOs

We have substantial concerns about the proposal to apply the Net Stable Funding Ratio (NSFR) at the IHC level. In particular, we note that the NSFR was not intended for a part of a larger consolidated organization and we also note that US BHCs are not subject to NSFR compliance at a subsidiary level. We therefore believe that FBOs should be allowed to adhere to the NSFR through substituted compliance at the consolidated level. The intent of the NSFR, to reduce funding risk over a longer time horizon, is achieved through compliance at the parent level. The funding risk at the IHC is appropriately managed through the current liquidity controls, Enhanced Prudential Standards and the Liquidity Coverage Ratio.

More broadly, any consideration of the NSFR needs to take account of the international regulatory developments in relation to this liquidity measure.

In addition, the Resolution Plans include Resolution Liquidity Execution Need (RLEN) and Resolution Liquidity Adequacy and Positioning (RLAP) which are calculated at individual material entity levels and should provide appropriate comfort for the Agencies to ensure that longer-term liquidity risk is properly addressed.

The proposition to impose standardized liquidity requirements on branches

Any proposal to include specific branch liquidity requirements within the rules would significantly increase international regulatory fragmentation, which would further hamper the ability of FBO groups to contribute to the US economy. The imposition of such requirements on branches would also be inconsistent with the legal concept of a branch as an integral part of the same legal entity and, among other things, would disrupt the leading role of the home regulator in regulating an entity including its branches. Furthermore, it could make resolution more difficult, by impeding the flow of resources within the group at a crucial time.

Industry also believes that this proposition lacks proportion and would be duplicative of similar requirements. Since the financial crisis, additional requirements have been imposed on FBO groups including on branch activity and the additional branch liquidity measures proposed do not take into account liquidity risk measures already in place at FBOs including branch restrictions and controls. Further, we believe that the Agencies should articulate the prudential justification for this proposition including any examples of branch induced liquidity problems that could underscore the necessity for such significant new measures.

In addition, we believe that it is important to consider how this proposition, should it be further advanced, could invoke damaging retaliatory responses. We note how, during the IPU Proposal discussions, the ECB had proposed imposing direct requirements on branches, but ultimately it was determined that such measures were neither prudent nor necessary. Promoting a direct branch requirement through these US proposals could reignite such measures in other jurisdictions. The US banks have by far the largest branches in these jurisdictions.

In his Opening Statement when tabling the Proposals, Vice Chair for Supervision Quarles stated that: *"…..I believe that we need robust public discourse – domestically and internationally – on its advantages and disadvantages*."[16] And in citing similar measures under consideration in other jurisdictions, went on to say:

[16] Randal K. Quarles, April 8th, 2019. "Opening Statement on Proposals to Modify Enhanced Prudential Standards for Foreign Banks and to Modify Resolution Plan Requirements for Domestic and Foreign Banks".

"…..*we should engage in much more dialogue on this subject.*"[17] Members of the IIF would certainly endorse the approach of international dialogue on these matters. The industry believes that any deliberations about concerns over branch liquidity, and potential measures to deal with such concerns, should not be introduced regionally, but should be discussed and evaluated through the FSB and the BCBS at the global level.

This is a delicate and important topic – it is essential that it be discussed in a cooperative and coordinated way among jurisdictions to ensure that any outcome is net positive to both the global resilience of banks and to local jurisdictions. We must avoid a 'tragedy of the commons' scenario where each jurisdiction, acting in its own apparent self-interest, results in everybody being worse off.[18]

Recommendations:

- The Agencies should recognize the framework of substituted compliance and defer to home country regulation in respect of the regulation and liquidity requirements of branches;
- The Agencies should recommend that the FSB and the BCBS undertake a review, and facilitate international regulatory dialogue, on the issue of branch regulation and branch liquidity; and
- This review could consider ways of providing to host regulators greater transparency and reporting of relevant home country LCR results (which would incorporate US branches/agencies). In addition, this reporting could reflect the quality of the assets held, as well as quality of underlying collateral in secured transactions.

The proposed categorization approach and the RBIs

The IIF believes that the FBO Rule can be tailored in a manner which ensures that it continues to meet the resolvability and financial stability objectives of the Agencies, but which is also more proportionate and appropriate in the international regulatory context. However, the RBIs and the proposed categorization methodology lack risk-sensitivity and misjudge the genuine risk-profile of the FBOs. The RBIs are also unfairly weighted towards the activities of FBOs. As stated previously, by the very nature of their structure and operations, FBOs will almost always have significantly more cross-jurisdictional activity, and will often trigger one of the other RBIs because subsidiaries are more specialized and heterogeneous by nature.

We wish to highlight below the shortcomings of each of these indicators and we then propose constructive recommendations intended to make the RBIs and the categorization approach more appropriate, proportionate and effective in light of the Agencies' objectives.

Categorization Framework:

As a crucial overall recommendation, we would propose that the determination of enhanced prudential standards for IHCs should only be based on the IHC's own assets and operations and not determined on the basis of the CUSO. The size of an FBO's overall footprint (including branches and agencies) does not necessarily reflect the size, interconnectedness or complexity (and therefore riskiness) of the IHC and its business operations and, therefore, the enhanced prudential requirements for the IHC should not be categorized on that basis.

[17] Ibid.

[18] See, for example, Wilson Ervin (February 7th, 2018). *"Understanding 'Ring-Fencing' and how it could make banking riskier"* – Brookings Institution. https://www.brookings.edu/research/understanding-ring-fencing-and-how-it-could-make-banking-riskier/

Therefore, we recommend that IHC requirements (including liquidity requirements, reporting requirements, and single counterparty requirements) should be based strictly on IHC thresholds.

The nature of the indicators and the design of the categorization process are binary cut-offs, which could result in sudden changes in the categorization of an FBO. Such changes may be the result of a one-off transaction which may be relatively short-term. We would recommend that the Proposals incorporate a degree of flexibility that would allow for an FBO to engage with the relevant Agencies to seek an exemption for such transactions. Further, should the recategorization prove to be a durable situation, then we recommend an appropriate transition period for the FBO to adapt to such an outcome.

The design of the categorization process is such that there is the prospect of double counting activities and transactions of FBOs. For example, the short-term wholesale funding of an FBO would be captured and, if this funding is then lent to an affiliate, then this transaction would also be captured as a cross-jurisdictional activity.

RBIs – Issues, concerns and recommendations:

Cross-Jurisdictional Activity (CJA)

CJA is a natural situation for an FBO and is inherent to much of its business activities. Including this as a categorization metric would appear to unfairly penalize FBOs relative to US counterparts. FBOs undertake cross-border transactions, which are related to home country activities and relationships, on a far greater scale than a domestic BHC of similar size to the FBO.

However, the inherent assumption in this RBI, that a cross-border transaction is somehow riskier, is also flawed. Many FBOs are primary dealers and engage in transactions with other FBOs or other non-US persons. These transactions are often secured by government securities (and therefore represent extremely low risk activities) but the FBO would trigger the CJA categorization threshold by simply doing enough of these very low-risk transactions.

Recommendations

- The calibration of the CJA metric should allow for the particular nature and structure of FBOs and their business;

- The exemption from the CJA calculation should be expanded beyond intercompany liabilities and collateralized intercompany claims through exemption of all inter-affiliate claims from the CJA calculation;

- Additionally, trade date receivables on securities settlements that are treated as “secured” exposures should be excluded from the CJA computation, as they are comparable to other fully collateralized assets. Furthermore, such activities improve the distribution of treasuries in the global market and should be encouraged;

- FBOs should not be penalized for transactions and financial arrangements which enhance the solvency of the FBOs. Consequently, cross-jurisdictional transactions which are used to satisfy CUSO liquidity requirements should not count towards CUSO CJA. It is also important to note that foreign HQLA provides diversity of the FBOs’ (and therefore the US financial system’s) liquid resources and should not count towards CJA; and

- Secured transactions (such as US Treasury reverse repo) with a branch of a foreign bank should be considered US risk rather than CJA. Firms should be allowed to risk shift such transactions into a domestic category without prejudice. Such treatment will also be important for level playing field

issues; otherwise firms seeking to limit their CJA will eschew FBO transactions in favor of domestic counterparties.

Short-Term Wholesale Funding (STWF)

STWF is not a sound measure of the riskiness of an FBO. Liquidity risk is a net risk, that derives from a mismatch between assets and liabilities. However the STWF metric is designed as a liability view only, and ignores the asset side. For example, an FBO with a perfectly matched short term book with high quality assets (e.g. matched book repo positions) could result in a more stringent categorization of an FBO, despite the very low risk profile of that FBO's business.

This RBI does not appropriately account for the unique characteristic of the FBO business model (e.g. funding inter-affiliate transactions). Not all STWF is of the same character or results in the same outcomes during a period of stress. STWF provided by entities which are related to the FBO would be much more likely to be maintained during stress periods (compared to other funding sources) in order to ensure that the FBO could continue to meet its obligations and avoid default. Inter-affiliate funding should be encouraged.

Recommendations

- The calibration of the STWF metric should take into account the nature (and benefits) of inter-affiliate transactions and should be calibrated to be more risk-sensitive. In order to incorporate a better level of risk-sensitivity into the STWF RBI, we recommend adopting the weightings which are incorporated in the LCR standard, which are well understood and accepted. In particular, transactions secured by high quality collateral appear to be quite overweight in the STWF buckets;[19]

- The Agencies should exclude inter-affiliate/related party STWF from this metric; affiliate-based transactions are not subject to the panic or run-risk that is present in third party transactions, and that is set out as the rationale for this RBI in the preamble. If not excluded, such transactions should be allocated a much lower weighting, given their different profile; and

- The liquidity of assets should be incorporated into the test; in particular highly liquid assets (e.g. HQLA) should be treated as an offset to the liability side risk.

Non-Bank Assets

This RBI is a category that prioritizes form over substance. It appears to be based on the flawed premise that non-bank assets are inherently riskier than other assets. A stark example of the flawed nature of this presumption is that an FBO, whose broker-dealer only held a very large portfolio of US Government securities, would be categorized as a high-risk to the US financial system. The metric again would seem to more strictly penalize FBOs which deal more extensively in high-quality traded assets than comparable domestic peers. Also, when undertaking capital markets activities through their US non-bank subsidiaries, FBOs are subject to significant regulation and oversight by the Fed, the SEC, FINRA and the CFTC. It is very difficult to understand that the risk categorization of a financial institution's business can be determined by the domicile of these assets, rather than the true risk of these positions.

[19] For example, see a detailed memorandum to W. Dudley on Repo haircuts during the crisis era (dated February 11th, 2010), which was published by the Financial Crisis Inquiry Commission. Available at https://fcic-static.law.stanford.edu/cdn_media/fcic-docs/2010-02-11%20FRBNY%20Memo%20re%20Repo%20Haircuts.pdf.

Recommendations

- The Non-Bank Assets metric should be removed as an RBI in the categorization process;

- Should the Agencies determine that the Non-Bank Assets RBI should be retained in some form we recommend the following amendments to this metric:

  - Exclude HQLA. FBOs should not be penalized for owning assets which enhance the solvency and liquid resources of their operations. The Proposals suggests that the Non-Bank Asset category is designed to capture inherently riskier activities, but surely this would not apply to the accumulation of HQLA for additional balance sheet stability;

  - Exclude intangible assets which are deducted from regulatory capital. FBOs should not be penalized for having intangible assets (e.g. goodwill, deferred tax assets) which do not reflect risk and are in fact deducted from regulatory capital;

  - Risk weight the assets. This would at least provide a level of risk-sensitivity which is lacking in the RBI as currently proposed; and

  - Exclude inter-affiliate transactions. Such transactions are naturally eliminated in a consolidation and FBOs should not be penalized for holding affiliate assets.

<u>Off-Balance Sheet (OBS)</u>

Many financial transactions which would be captured under the OBS metric such as loan commitments, letters of credit and guarantees are used for corporate financing matters or risk mitigation arrangements. They therefore are important arrangements in supporting economic activity or reducing the riskiness of related transactions. Also, the metric as proposed does not take into account the security or asset which underpins the OBS transaction and therefore, like the other RBIs, is lacking in risk-sensitivity.

Also, OBS transactions with related parties and affiliates are usually undertaken for risk-mitigation purposes or for regulatory compliance. For example, potential future exposure (PFEs) associated with affiliate derivatives clearing – this is undertaken due to a regulatory requirement promoting safety and soundness of the US markets. Penalizing such exposures may force FBOs to shift from their own US Futures Commission Merchants (FCMs) to an unaffiliated FCM, likely owned by US GSIBs, because the currently designed OBS RBI would place the FBO at a competitive disadvantage through using an affiliate.

Recommendations

- Inter-affiliate transactions should be excluded from the OBS RBI;

- The OBS metric should be calibrated to make it risk sensitive including the following amendments:

  - Apply Risk Weight factors on top of the conversion factor to adjust PFE exposure;
  - Treat as collateralized any OBS that cannot be drawn unless it is collateralized;
  - Exclude all exposures to the extent of HQLA collateral, subject to the haircuts; and
  - Net the full OBS exposure for syndicated lending with any corresponding guarantees received from participating banks.

Counterparty limits and reporting – Recommendations:

- **Single Counterparty Credit Limits (SCCL)**

  - The application of SCCL should be determined only through the IHC categorization and based on IHC asset size to remain consistent with the SCCL final rule; and

  - The Proposals should incorporate transitional relief for those FBOs whose home country supervisors are still in the process of adopting a SCCL framework.

- **Reporting**

  - **FR Y-15 Reporting Burden and Phase-in**: The Proposals, and related reporting forms, would for the first time require reporting of FR Y-15 data for the CUSO, including for the CUSO of FBOs that are not required to operate an IHC but have at least $100bn in CUSO assets. In keeping with the Agencies' objectives of balancing simplicity and risk-sensitivity, we recommend that FR Y-15 reporting for the CUSO, if retained at all, should consist of basic reporting and elective components to evidence more risk sensitive data. Such data would only be required of FBOs who cannot evidence their risk category through basic reporting alone. Adding elective components will properly account for the reporting burden newly created for FBOs. We further recommend that the FR Y-15 reporting be phased-in by granting banks an appropriate period in which to evidence their category through pro forma data, until the new reporting infrastructure can be established;

  - **Liquidity reporting (2052a at T+2)**: T+2 liquidity reporting for 2052a currently only applies to firms complying with full LCR requirement. This consistency between full LCR and T+2 reporting should be maintained. Therefore, firms complying with reduced LCR should only have to report T+10 as is the case for the modified LCR;

  - **Capital reporting - IHC threshold reporting**: When FBOs fall into category III for CUSO, they are required to report IHC threshold on an average basis, instead of an end of quarter basis. All reporting requirements applying at the IHC level should be based solely on the IHC scope, especially on the capital side where all capital requirements apply to the IHC; and

  - **CUSO RWA computation**: CUSO RWA computation should not be required as it is not used for any of the RBIs. It is only used to calculate the G-SIB score under method 2, which is only an alternative method suggested by the Fed, and is not its preferred option as indicated in the NPR.

Conclusion

The IIF believes that the Enhanced Prudential Standards for the US Operations of FBOs can be tailored in a manner which ensures that they continue to meet the resolvability and financial stability objectives of the Agencies, but which are also more proportionate and appropriate in the international regulatory context. We respectfully put forward the constructive recommendations contained herein which we believe will make the Proposals more consistent with the global regulatory and resolution framework and would facilitate more efficient provision of financial services by FBOs for the benefit of the US economy.

We welcome your consideration of this matter and we remain at your disposal for further elaboration and discussion of the issues we have raised and the recommendations we have made.

Sincerely,