

Timothy D. Adams  
President and CEO



April 18, 2017

The Honorable Steven T. Mnuchin  
Secretary of the Treasury  
U.S. Department of the Treasury  
1500 Pennsylvania Avenue, NW  
Washington, DC 20220

**RE: Presidential Executive Order 13772 on Core Principles for Regulating the United States Financial System**

Dear Secretary Mnuchin:

The Institute of International Finance (“IIF”)<sup>1</sup> welcomes the Trump Administration’s careful attention to issues concerning the appropriate regulation of financial services, as detailed in the February 3, 2017 *Executive Order on Core Principles for Regulating the United States Financial System* (the “Executive Order”).<sup>2</sup> We endorse the review process underway at Treasury and look forward to working with you to support policies which foster economic growth and vibrant financial markets while at the same time ensuring the safety and soundness of the global financial system.

The attached document outlines our members’ views with regard to several issues relevant to the review process. Specifically, we have focused on:

**1. The Importance of International Regulatory Consistency:**

The United States, in particular, benefits from consistent international standards. The US currently has a 70 Billion USD trade surplus with the rest of the world in financial services, which is a mix of profits earned by US banks overseas, income for US investors, fees for arranging bond issuances of foreign corporate entities and insurance services.<sup>3</sup> Consistent international standards benefit US consumers obtaining credit from US banks, advantage US investors who can assess investment opportunities abroad with a commonality of reporting frameworks and metrics, and support US companies looking to expand and sell their goods and services internationally. Consumers also gain from having a vibrant, consistently regulated insurance marketplace that benefits from a global distribution of risks.

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<sup>1</sup> The IIF is a global association of the financial services industry representing over five hundred commercial and investment banks, asset managers, insurance companies, sovereign wealth funds, hedge funds, central banks and development banks in 70 countries: [www.iif.com](http://www.iif.com)

<sup>2</sup> The White House: *Presidential Executive Order 13772 on Core Principles for Regulating the United States Financial System*, February 3, 2017.

<sup>3</sup> US Census Bureau, US Bureau of Economic Analysis, *US International Trade in Goods and Services December 2016*

## 2. Improving International Standard Setting Bodies:

While it is important that international standard-setters and processes continue to deliver the benefits described above, global regulatory bodies should adopt the same standards for transparency and accountability that are required of national authorities, and impact assessments that are detailed and published.

## 3. The Need to Address Certain Key Issues in Post-Crisis Regulatory Reforms:

While post-crisis financial reforms have been constructive in enabling a stronger, safer, and more resilient financial system, it is timely to take stock and assess whether the current regulatory climate is appropriately balancing safety and soundness with economic growth. Specific items include:

- Ensuring that final Basel III reforms don't significantly increase capital requirements and are subject to a final Quantitative Impact Survey
- Addressing implementation issues with (i) the Leverage Ratio; (ii) the Net Stable Funding Ratio; (iii) the Liquidity Coverage Ratio; and (iv) the Fundamental Review of the Trading Book
- Review negative downstream impacts from certain Foreign Banking Organization rules
- Review of the Dodd Frank Act's provisions, with preservation of Title II and the Orderly Liquidation Authority, and amendments to the Volcker Rule and the designation processes of the Financial Stability Oversight Council.

Ultimately, a properly calibrated, well-functioning global regulatory system that takes into account the same level of supervision for the same level of risk in a proportionate manner is good for domestic businesses and consumers.

Thank you for your close attention to these issues. We look forward to our continuing engagement as the Treasury completes its review in accordance with the Executive Order. Should you have any questions, please do not hesitate to contact me or Andrés Portilla, IIF's Managing Director of Regulatory Affairs (email: [aportilla@iif.com](mailto:aportilla@iif.com) / phone: 202-857-3645).

Sincerely,



Attachment

## IIF Comments – Executive Order 13772

### Background:

Section 1(c) of the Executive Order makes it clear that it is the policy of the US Administration to regulate the United States financial system in a manner consistent with fostering economic growth and vibrant financial markets through more rigorous regulatory impact analysis. This is an important step and an appropriate review of the post-crisis regulatory reform environment is a critical component in assessing its impact on economic development. We welcome this appraisal and note that the US is not in insolation on the world stage in terms of this type of review. The European Union (“EU”) in its 2015 “Call for Evidence”<sup>4</sup> through the European Commission asked for feedback on financial services rules which affect the ability of the economy to finance itself, place unnecessary regulatory burdens and give rise to unintended consequences. Currently, the Financial Stability Board (“FSB”) has also launched an exercise to analyze the effectiveness of the agreed international reforms and examine their potential negative unintended consequences.<sup>5</sup> This is an initiative that should be supported by the United States and, indeed, made more robust and ambitious in terms of its scope.

The Treasury Department should take the opportunity to examine the US financial system in light of the Core Principles of the Executive Order (“Core Principles”) by also taking a wider view of the system’s role in the world, the contribution of that role to domestic and global economic growth, and how staying engaged globally and helping to ensure regulations are properly calibrated is a benefit to the United States overall. As such, our comments herein focus on how the review should take into account the benefits of international regulatory consistency, the role of international standard setting bodies and the need to address certain key issues in post-crisis regulatory reforms.

### 1. Support International Coordination and Avoid Regulatory Fragmentation:

The IIF strongly believes that properly calibrated international standards in financial regulation make positive and important contributions across all economies, from large developed markets like the United States to emerging market economies. International standards yield benefits by:

- supporting the global flow of capital to investment opportunities and facilitating international trade;
- promoting greater and more fair competition, and better pricing and services for borrowers and end-users;
- reducing compliance costs and increasing efficiencies; and
- supporting financial stability.<sup>6</sup>

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<sup>4</sup> European Commission, *Call for Evidence - EU regulatory framework for financial services*, 2015.

<sup>5</sup> Financial Stability Board, *Proposed Framework for Post-Implementation Evaluation of the Effects of the G20 Financial Regulatory Reforms*, April 2017.

<sup>6</sup> In February 2017, the IIF published a staff paper expanding upon these issues: *International Regulatory Standards: Vital for Economic Growth*: <https://www.iif.com/publication/regulatory-report/international-regulatory-standards-vital-economic-growth>

Elements of the Executive Order that are particularly relevant to an evaluation of international coordination and cooperation in financial services regulation by the Treasury include the following:

*(c) foster economic growth and vibrant financial markets through more rigorous regulatory impact analysis that addresses systemic risk and market failures, such as moral hazard and information asymmetry;*

*(d) enable American companies to be competitive with foreign firms in domestic and foreign markets;*

*(e) advance American interests in international financial regulatory negotiations and meetings; and*

*(f) make regulation efficient, effective, and appropriately tailored.*

a. Overview:

A common set of minimum standards for cross-border finance can contribute to efficiency in the system, removing barriers to entry and creating positive downstream incentives to finance the real economy. Financial firms do not function solely within national boundaries, and indeed some of the most important growth opportunities for US financial institutions rest in their ability to serve clients abroad as well as at home.

For capital markets to function internationally, it naturally follows that you need international banks to provide connectivity and facilitate inter-mediation across different pools of capital. Consistent rules and regulations across borders encourage banks to invest and operate wherever there are sound investment opportunities, increasing competition for borrowers and depositors. International standards also increase financial stability and help address new vulnerabilities in the system.

It is also significant that while the compliance costs for financial firms of all sizes have increased post-crisis, this effect is magnified when operating across multiple jurisdictions in cases where there are inconsistent standards and these costs often impact the users of financial products. In this context, international standards play a significant role in helping to provide greater clarity as to how regulations are to be interpreted and applied. This is critical for enabling and incentivizing US financial institutions and foreign firms alike to provide cross-border financial services, and to enable the benefits of competition to be realized for end-users and the economy.

While national specificities play an important role in the development of any regulatory framework, and the consideration of national priorities is vital, variable rules layered upon one another can lead to unintended differences and create potential conflicts. The requirements of individual jurisdictional mandates can trap resources and capital that could be more effectively deployed, a situation that is particularly acute for low-margin but growth-critical business lines, such as trade finance and SME financing. Ambiguity in the application of rules across countries can lead to a reevaluation of transactions and a potential withdrawal from certain sectors, with ultimately deleterious consequences for downstream lending to US businesses and consumers.

Currently, however, the international regulatory environment is displaying signs of a trend away from global, cooperative approaches, with increased pressure on international agreements and towards greater localization and even protectionism, whether intended as such or not. Such a trend is at odds with the cooperative foundations upon which the international financial regulatory framework has been built. Since the financial crisis, the G-20 has consistently supported developing stronger cooperation and coordination among its member states on financial oversight matters and has encouraged its member states to work jointly to develop consistent regulation and cross-border solutions. Any decision by a country not to engage in multilateral processes for defining common standards in international banking could impede that country's domestic market and negatively impact not just the banking sector but downstream consumers.

In the insurance sector, for example, the International Association of Insurance Supervisors ("IAIS") is developing a global capital standard. Given different approaches to valuation and accounting rules around the world, developing a common valuation basis for insurance liabilities is critical but proving to be a challenge. It is therefore important that while the role of the IAIS be maintained, its work should be inclusive and representative of the different conditions and circumstances across jurisdictions

b. Recommendations:

The IIF believes that it is in the interests of the US and all nations to stay engaged at an international level to avoid negative consequences for the real economy. As such, the Treasury should take the importance of international coordination into account when engaging in its Executive Order review. Specifically, the IIF believes that the review will show that it is important for the United States to reaffirm its active engagement at the FSB, the Basel Committee on Banking Supervision ("BCBS"), the Financial Action Task Force ("FATF") the International Organization of Securities Commissions ("IOSCO") and the IAIS. The US has long been a leader at these organizations and should continue to play such a role and it should continue to work with its international partners to pursue policies that promote growth and market efficiency.

In the context of the specific provisions of the Executive Order, US interests can be actively advanced in international financial regulatory negotiations and meetings at these fora. Indeed, through sound discussions undertaken in the global context, the US has the opportunity to effectively advocate for rules which are efficient, effective, and appropriately tailored and which contribute to fostering economic growth and vibrant markets at home and abroad. We respectfully suggest that in a globally connected world, enabling American companies to be competitive with foreign firms in domestic and foreign markets is not mutually exclusive to multilateral engagement. As has been noted above, consistent cross-border standards can actively improve circumstances for the domestic consumer, if properly calibrated. At the same time, it is important for national gold-plating of standards to be carefully evaluated, as such activity can in some cases harm growth and impede effective cross-border coherence.

**2. Improve the Processes of International Standard Setting Bodies:**

While it is important that international standard-setters and processes continue to deliver the benefits described above, global regulatory bodies should nevertheless take the opportunity to proactively pursue reforms to improve their processes and accountabilities, and create greater

assurances of their legitimacy. Elements of the Executive Order that are particularly relevant to an evaluation of international standard setting bodies include:

*(c) foster economic growth and vibrant financial markets through more rigorous regulatory impact analysis that addresses systemic risk and market failures, such as moral hazard and information asymmetry;*

*(e) advance American interests in international financial regulatory negotiations and meetings;*

*(f) make regulation efficient, effective, and appropriately tailored; and*

*(g) restore public accountability within Federal financial regulatory agencies and rationalize the Federal financial regulatory framework.*

a. Overview:

Criticisms of international regulatory bodies refer to their opacity, their governance and accountability, and how the scope of international rules intersects with local circumstances. Some of these criticisms are valid, although it should be noted that decisions at these bodies are generally made by mutual consent, multilateral bodies have no authority other than moral suasion, and it remains the domain of national authorities to incorporate international standards into national laws and regulations under their own due processes.

In the United States, no domestic regulator is obligated to put these standards into effect. If the US does choose to adopt national rules that meet the global minimum, the resulting regulations are put through domestic processes of review before adoption. The United States also typically chooses to enforce global standards because they have been set in a way consistent with US interests. In this regard, the US often leads in advocating practices aimed at making the global financial system safer.

Nevertheless, President Trump's Executive Order and the subsequent review by the Treasury Department presents an important opportunity to discuss issues for global regulatory coordination. There should be a proactive review of processes, enhancements to transparency, and continuing efforts to rigorously test costs and benefits. Such steps can be effective in ensuring that the value of international standards are preserved, for the benefit of borrowers in the US and abroad.

b. Recommendations:

Further improvement in international coordination and the advancement of many of the Core Principles of the Executive Order can be realized by active work on the part of the US and its counterparty governments in reform of the international standard-setting bodies. Fostering economic growth, advancing domestic interests, making better regulation and rationalizing the domestic regulatory architecture can be progressed through coordinated discussion on governance and structure of these bodies and through some aspects of revision to the domestic approach to international rulemaking and its subsequent national interpretation.

*First*, transparency and accountability could be improved at the international level by adopting the same standards that are required of many national authorities. These include the publication of meeting agendas, schedules and records, transparency as to the identity of meeting participants, and the members of the various working groups and streams that operate under the auspices of the FSB, IAIS, IOSCO and BCBS. Recent published updates from the Bank for International Settlements (“BIS”) have started to include the dates of upcoming BCBS meetings and the IAIS is actively considering how to continue to improve transparency and stakeholder engagement. These are welcome developments, and more are to be encouraged.

*Second*, greater transparency should also extend to the consultation processes for proposed new standards. While the formal BCBS process invites industry and other interested parties to submit comments within a three-month window, it has appeared in the past on some topics that a *fait accompli* status had already been reached before officially launching the consultation.<sup>7</sup>

It also appears that in the early development stages of a proposed new standard at the global level, some national authorities will informally consult with their domestic stakeholders, but that practice has not been universal. This is an important activity for national authorities to undertake to ensure that they fully understand the potential ramifications that a change in international standards could have for the market conditions of their own country. Trust and support for the international process would be enhanced if all participating national authorities, including the United States, were to engage in local consultation during the early stages on a more consistent basis, giving a greater opportunity for local circumstances to be reflected.

That is not to say that national authorities should complete a binding process domestically before engaging with their international peers – to do so would clearly tie their negotiating hands and undermine international discussion and debate. But transparent engagement in the early stages would help to make the consultation process more meaningful and informed.

*Third*, there have also been occasions when global standard setters have issued a set of proposals for formal consultation, and then subsequently introduced new concepts during the course of their deliberations, that have been incorporated into the final standards.<sup>8</sup> Transparency would be enhanced if those new concepts were to be presented with an opportunity for comment in a second consultation. Rationale and explanations could also be provided for the decisions taken in final standards – something that several national authorities, including the US, already do.

*Fourth*, impact assessment and cost-benefit analysis for new regulatory proposals should be adopted as common practice, and the results of Quantitative Impact Study (“QIS”) activities should be published at a detailed level and conducted globally and nationally. When the IIF and the International Swaps and Derivatives Association (“ISDA”) prepared our own *Cumulative*

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<sup>7</sup> We note, for example, that the IAIS consultation process has improved, especially with respect to release of details regarding the assessment of insurers for designation as global systemically important insurers (“GSIs”); an improvement very much due to the efforts of the United States Federal Insurance Office. We encourage the Treasury to continue to support greater transparency and consistency in this and other processes.

<sup>8</sup> For example, under the Basel Net Stable Funding Ratio (“NSFR”), the concept of the 20% Required Stable Funding add-on that applies to gross derivatives liabilities before the netting of posted collateral or derivatives assets was not included in any BCBS NSFR consultative document prior to appearing in the final global standard. The industry did not have an opportunity to provide comment on this measure, which could have significant ramifications for banks’ business models. For further information, please see section 3 of this letter.

*Capital Impact Study* (an industry “shadow QIS”) on the BCBS proposals in 2016, several national regulators commented on the inherent shortcomings within the official Basel QIS process, and of substantial inconsistencies in the approaches taken by different national authorities in supplying and cleansing data submissions to the BCBS. Greater transparency, further engagement with contributing firms, adequate time for review during the consultation process, a greater focus on cost/benefit analysis and real economy impacts and the publication of results would help create a greater impetus to address this.

Impact assessments should also be undertaken periodically at a holistic level, examining the ways in which multiple sets of regulatory initiatives can sometimes compound or contradict others. This exercise through the Executive Order and work being done at the FSB can facilitate this. We also commend the intent of the BCBS in 2015 of mobilizing a dedicated Coherence and Calibration Task Force, and we hope this Task Force will address the issues that the IIF highlighted to it in June 2015,<sup>9</sup> and publish its research and deliberations.

### **3. Address Issues in Post-Crisis Regulatory Reforms:**

The financial and economic crisis of 2007-2011 revealed many shortcomings in financial regulation and supervision, as well as the governance and risk management standards of financial institutions. The global community has come a long way in building a stronger, safer, and more resilient international financial system. This is particularly true of the US system, however, a stocktaking of post-crisis regulatory reform, as well as a thoughtful pause on new regulations, is needed to assess whether the current regulatory climate is working appropriately to balance safety and soundness with economic growth. As such, the Core Principles of the Executive Order which are particularly relevant to an evaluation of the post-crisis regulatory reform agenda by the Treasury include the following:

*(a) empower Americans to make independent financial decisions and informed choices in the marketplace, save for retirement, and build individual wealth;*

*(b) prevent taxpayer-funded bailouts;*

*(c) foster economic growth and vibrant financial markets through more rigorous regulatory impact analysis that addresses systemic risk and market failures, such as moral hazard and information asymmetry;*

*(d) enable American companies to be competitive with foreign firms in domestic and foreign markets;*

*(e) advance American interests in international financial regulatory negotiations and meetings; and*

*(f) make regulation efficient, effective, and appropriately tailored.*

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<sup>9</sup> IIF, *Letter to BCBS Coherence & Calibration Task Force*, June 17, 2015, <https://www.iif.com/publication/regulatory-comment-letter/iif-letter-bcbs-taskforce-coherence-and-calibration>



a. Overview:

A number of weaknesses in the banking system were highlighted during the crisis, including too much leverage, excessive credit growth, a high degree of systemic risk, inadequate capital and liquidity buffers, and exposure to liquidity risk. Banks in turn have responded, making significant advancements in raising capital, strengthening recovery and resolution planning, enhancing internal and external reporting, and upgrading corporate governance and risk management standards in a comprehensive fashion. In doing so, banks have become more resilient and robust in terms of holding more and better quality capital, increasing liquidity buffers, reducing leverage and improving resolvability.

We believe the time has now come, however, for a careful review of the post-crisis regulatory reforms and the thrust of President Trump's Executive Order on Core Principles sets an important stage for that review to be undertaken in the domestic US context.<sup>10</sup> Throughout our comments and recommendations in this section of our submission, we encourage the Treasury to also take those issues which were agreed at a global level that require review back to the relevant international fora in order for maximum consistency to be achieved in amending certain rulemakings and preventing potential unintended consequences for cross-border finance.

b. Recommendations:

From the standpoint of issues to address in the context of the analysis of regulatory reform, we encourage the Treasury to take into account the following, non-exhaustive list<sup>11</sup> of issues for banks operating on a cross-border basis:

1. *Finalize outstanding Basel III reforms:* Basel III has been a noteworthy step in international regulatory cooperation. Adjustments to capital levels, the implementation of a global leverage ratio, and agreement on two liquidity metrics have all contributed in the aggregate to increased safety and soundness in the global financial system, as well as at national level (though important issues remain to be reevaluated, which we note further in this letter). In this vein, we understand and respect the goals of the Basel Committee's work to revise its current proposals to ensure an adequate role for internal models in the regulatory capital framework in a way that preserves risk sensitivity and establishes the right incentives within firms. We also welcome the Governors and Heads of Supervision ("GHOS") mandate of "no significant increase in overall capital" as a result of this exercise. The IIF has contributed much in terms of specific information and recommendations on the formulation of appropriate revisions to the Standardized Approach for Credit Risk, the Internal Ratings Based Approach ("IRB"), Operational Risk and Market Risk.<sup>12</sup> However, we believe it is essential that the completion of the Basel

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<sup>10</sup> As noted above, we also welcome the recent initiative of the FSB to examine the impacts of regulation in more detail at a global level and we encourage active US participation in that initiative. Invariably most reforms will have a cost and a benefit, and while ex-ante estimation of these is both necessary and difficult, this needs to be complemented with ex-post assessment on a periodic basis. The FSB's initiative may ultimately provide a template for ongoing periodic ex-post review.

<sup>11</sup> We note that regulations on derivatives (including the margin requirements and Swap Dealer regulations) and shadow banking also warrant careful review, particularly in terms of their impact on market liquidity, and we welcome further discussions with the Treasury on these areas as the Executive Order review progresses.

<sup>12</sup> For further information, the IIF submitted the following comment letters to the Basel Committee on the finalization of Basel III: IIF, *Comments on the second consultative document on revisions to the standardized approach for credit risk*, March 2016: <https://www.iif.com/publication/regulatory-comment-letter/response-bcbs-s-second-consultation-sa-credit-risk> ;

reforms be in line with a properly calibrated and sufficiently risk sensitive international standard that does not significantly raise capital. While the Basel Committee has made progress in this direction, it is essential that such goals be ensured as regulators (with the participation of the US authorities) make final decisions on the revised framework. We also encourage the completion of a QIS on the final reform package to gauge overall global impact before implementation.

2. *Address issues in implementation of agreed Basel standards:* While much has been accomplished through the Basel process on reforms to capital, liquidity and leverage standards, as noted above, outstanding issues do remain that would benefit from additional and careful review in the context of the Core Principles of the Executive Order, as well as further review at the Basel Committee level to ensure international consistency is maintained. For example, the agreed Basel reforms would benefit from review in several ways to make regulation at the domestic level more efficient, effective and appropriately tailored:

First, regarding the Leverage Ratio<sup>13</sup>, we encourage the US authorities and the Basel Committee to review the treatment of High Quality Liquid Assets (“HQLA”) in the denominator of that standard. Low risk assets, such as repos and US Treasuries, are used as collateral for central clearing and other financing transactions by most market participants and as liquidity reserves by small and large banks. As such, they play a critical role in the smooth functioning of financial markets. By excluding cash and cash-like equivalent assets (Level 1 HQLA) from the Exposure Measure of the Supplementary Leverage Ratio (“SLR”) and the enhanced SLR (“ESLR”) in the US, and more broadly from the global minimum leverage ratio set by the Basel Committee, regulators could alleviate the constraints on these important market activities, especially in distressed markets. This would improve market liquidity and, due to the fact that cash and Treasury holdings do not increase banks’ risk profiles (and because banks must comply with other liquidity requirements), it would also not adversely impact safety and soundness.<sup>14</sup>

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IIF, *Standardised Measurement Approach for operational risk – consultative document*, April 2016: <https://www.iif.com/publication/regulatory-comment-letter/iifgfma-response-bcbs-sma-operational-risk> ;

IIF, *Consultative Document, Reducing variation in credit risk-weighted assets – constraints on the use of internal model approaches*, June 2016: <https://www.iif.com/publication/regulatory-comment-letter/iif-response-basel-committee-proposal-internal-modeling-credit> ;

IIF, *Response to the BCBS Consultative Paper on the Outstanding Issues with regards to the Fundamental Review of the Trading Book (FRTB) capital standards*, February 2015: <https://www.iif.com/publication/regulatory-comment-letter/joint-associations-letters-fundamental-review-trading-book>

<sup>13</sup> Basel Committee on Banking Supervision, *Basel III leverage ratio framework and disclosure requirements*, January 2014 and Federal Reserve, FDIC, OCC: *US Supplementary Leverage Ratio and Enhanced Supplementary Leverage Ratio*, April and September 2014.

<sup>14</sup> For further information on recent discussions regarding the leverage ratio, please see the IIF response to the Basel Committee on finalizing the standard: IIF, *Comments in Response to the Consultative Document on the Revised Basel III Leverage Ratio Framework and Disclosure Requirements*, July 2016: <https://www.iif.com/news/regulatory-affairs/joint-trades-basel-supplemental-leverage-ratio-comment-letter>

Second, regarding the Net Stable Funding Ratio (“NSFR”)<sup>15</sup>, it is important that the NSFR – which is a new and untested regulatory standard – be carefully evaluated for its impact on activities and transactions where it would likely have excess effects or significant unintended consequences. In order to mitigate potential negative impacts on capital markets, the IIF believes the US should work at the Basel Committee to carefully review and rectify issues in the standard for, *inter alia*, derivatives funding, securities hedging, securities market making, the asymmetrical treatment of repo and reverse repo, client and firm short coverage, segregated client assets, and off-balance sheet collateral swaps. For example, the US should engage at Basel Committee level to reevaluate the 20% Required Stable Funding (“RSF”) add-on that applies to gross derivatives liabilities before the netting of posted collateral or derivatives assets. We believe this provision does not address some key elements of derivative pledge sensitivity and therefore cannot be practically translated into product pricing and trading actions. This will likely translate into an additional and sizeable funding burden that will ultimately impact end-users.<sup>16</sup>

Third, regarding the Liquidity Coverage Ratio (“LCR”)<sup>17</sup>, while global implementation is progressing, the LCR remains a standard that has never been tested in an economy with normal growth and interest rates and without large amounts of excess central bank supplied liquidity. We believe the LCR would benefit from a comprehensive review at the Basel Committee to assess its potential impact on bank lending.

Fourth, regarding the Fundamental Review of the Trading Book (“FRTB”)<sup>18</sup>, there is ongoing concern regarding the overall impact on capital from the finalized proposals. The US should encourage the BCBS to carefully review the standard for domestic and international impact through transposition and, in particular, address some outstanding issues. For example, uncertainty over the design and interpretation of the Profit and Loss Attribution Test (“P&L Attribution”) requirements will potentially have significant impacts on FRTB implementation and may make it difficult for banks to deliver the required infrastructure solutions, particularly within the proposed timetable. The industry is working on recommendations to Basel on the design and interpretation of the P&L Attribution eligibility test, with specific reference to the scope of Test input parameters, the Test design metric and the penalty function. The US should stay actively engaged at the Basel level on FRTB to ensure this and other areas do not result in a disproportionate capital impact which could potentially lead to banks withdrawing from products and markets.

3. *Update rules for Foreign Banking Organization (“FBO”) Intermediate Holding Company (“IHC”) Requirements:* The issues of fragmentation in the global financial system are particularly acute when discussing how foreign banks are regulated in certain domestic markets. Recently, the European Union published proposals for revisions to the EU

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<sup>15</sup> Basel Committee on Banking Supervision, *Basel III: Net Stable Funding Ratio*, October 2014 and Federal Reserve, OCC, FDIC, Notice of Proposed Rulemaking, *Net Stable Funding Ratio: Liquidity Risk Measurement Standards and Disclosure Requirements*, May 2016.

<sup>16</sup> For further information, please see the IIF comment letter to the US Federal Banking Agencies on the Net Stable Funding Ratio Notice of Proposed Rulemaking: IIF, *Re: Notice of Proposed Rulemaking – Net Stable Funding Ratio: Liquidity Risk Measurement Standards and Disclosure Requirements*, August 2016: <https://www.iif.com/publication/regulatory-comment-letter/iif-response-us-notice-proposed-rulemaking-nsfr>

<sup>17</sup> Basel Committee on Banking Supervision, *Liquidity Coverage Ratio and liquidity risk monitoring tools*, January 2013.

<sup>18</sup> Basel Committee on Banking Supervision, *Minimum Capital Requirements for Market Risk*, January 2016.

prudential regulatory framework, as part of their Capital Requirements Directive V (“CRDV”) package, including a proposal for certain non-EU financial institutions to establish an intermediate parent undertaking in the EU.<sup>19</sup> As with the US Federal Reserve Enhanced Prudential Standards and Early Remediation Requirements for FBOs issued in 2014<sup>20</sup> (“US FBO IHC”), there is real potential for deleterious implications for international finance, domestic finance, financing of growth and cross-border cooperation when these types of proposals progress without careful review of certain implications.<sup>21</sup>

As such, we believe there needs to be an updated review of provisions within the US FBO IHC requirements to take into account the important role foreign banking organizations play in the US financial system. The US FBO IHC rule can arguably contribute to cuts in the size and operations of FBOs in the US. This decline can negatively impact credit provision in the economy and reduce the depth of liquidity provision in the capital markets. Excessive host-driven liquidity ring-fencing requirements, for example, can drive up the consolidated requirements for group liquidity far beyond the intent of the regulation and can impose costs that are detrimental to the supply of services via the banking industry and capital markets. Overall, this leads to a less competitive marketplace for financial services. By improving regulation around FBOs, American consumers will be more greatly empowered to make independent financial decisions and informed choices in the marketplace, save for retirement, and build individual wealth.

4. *Review or affirm certain Dodd-Frank processes and provisions:* As with our commentary on the Basel reform process, the Dodd-Frank Act (“DFA”) has contributed in many ways to increased systemic safety and soundness in the US and abroad. While certain aspects of the DFA and the Enhanced Prudential Standards (“EPS”) of the DFA are critical to a well-functioning, interconnected financial system, some others require further review in the context of the objectives of the Executive Order. We note that detailed comments on revisions to the DFA are being provided from the point of view of banking institutions and associations operating in the US as a host country and this letter will not attempt to address the many issues arising from that perspective. We instead emphasize certain thematic areas of general importance for further consideration by the Treasury.

Foremost in the DFA’s contribution to safety and soundness, Title II of Dodd-Frank concerning Orderly Liquidation Authority (“OLA”) is an essential component of the post-crisis regulatory regime. As noted recently by the National Bankruptcy Conference:

“Retaining a backstop regulator-supervised resolution regime with a source of temporary secured loans like OLA has a number of beneficial effects, even if the recapitalized SIFI cannot access the loans in its bankruptcy proceedings, and can only do so in a regulator-supervised process.....Whatever progress may be made in developing better strategies for resolving SIFIs under the Bankruptcy Code and

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<sup>19</sup> European Commission, *Directive of the European Parliament and the Council amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures*, November 2016.

<sup>20</sup> Federal Reserve, OCC, FDIC, *Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking Organizations*, February 2014.

<sup>21</sup> Please see the 2013 IIF Comment Letter to the Federal Reserve on the FBO IHC Proposal: <https://www.iif.com/news/regulatory-affairs/iif-submission-fbo-comment-letter>

whatever amendments may be made to the Bankruptcy Code to facilitate execution of such strategies, it is impossible to anticipate all possible causes and consequences of a SIFI's failure. The possibility cannot be dismissed that there will be at least some cases where the additional tools available under a regulatory resolution regime like OLA.....will be needed to avert dire systemic consequences."<sup>22</sup>

Title II and OLA are important tools and are vital in a globally interconnected world. If Title II were to be repealed, the ability of foreign authorities to count on well-coordinated resolution planning with US authorities would be destroyed. As a result, US banks operating abroad are likely to face much more draconian ring-fencing and supervision requirements. Furthermore, while the Orderly Liquidation Fund ("OLF") could be rethought, some form of secured emergency liquidity assistance must be available as a standby in any major resolution. It is vital to make clear that such liquidity facilities are totally different from an equity bail-out by the government, but serve to protect the entire economy from momentary instability. The Treasury Department should consider the details of the Title II regime through its review, but the purposes of OLA (including OLF) should be reaffirmed as supporting the Core Principles, in particular to prevent taxpayer-funded bailouts.

Concurrently, certain DFA rulemakings warrant review in how they are impacting the wider market and economic growth. The Volcker Rule, for example<sup>23</sup> - which prohibits insured depository institutions or affiliates from engaging in proprietary trading - has been acknowledged as too complicated in the way it has been drafted and implemented and, as such, it may be having a deleterious effect on market making, particularly for some less liquid issues.<sup>24</sup> As such, the Rule would benefit from review regarding the definitions of covered funds as well as the extension of grandfathering provisions, the naming prohibition<sup>25</sup>, and proprietary trading provisions to ensure that they are accurately capturing private equity investments and true proprietary trading but not disallowing other fund investments, customer market making or liquidity risk management. In addition, there should only be a primary regulator to implement and enforce the Volcker Rule to avoid interpretative differences between agencies. Lastly, the Treasury should examine the extraterritorial application of the Rule relative to the objectives of the Executive Order.<sup>26</sup>

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<sup>22</sup> National Bankruptcy Conference, *Re: Resolution of Systemically Important Financial Institutions*, March 17, 2017: <http://nbconf.org/wp-content/uploads/2015/07/NBC-Letter-re-Resolution-of-Systemically-Important-Financial-Institutions-March-17-2017.pdf>

<sup>23</sup> CFTC: *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds*, January 2014.

<sup>24</sup> Recent acknowledgement of the need for revision to the Volcker Rule came from former Federal Reserve Governor Dan Tarullo in his speech "Departing Thoughts", April 4, 2017: <https://www.federalreserve.gov/newsevents/speech/files/tarullo20170404a.pdf>

<sup>25</sup> Regarding the naming prohibition, significant and unnecessary costs stand to be incurred by shareholders in hundreds of funds managed by investment advisers that do not share the name of a bank. A more permanent solution should be sought in this area.

<sup>26</sup> For example, it should be clarified that foreign banks may invest in foreign investment funds, and in derivatives linked to such funds, without the need to (i) rely on an exemption under the Rule and, as a result (ii) satisfy the related exemption conditions, so long as the bank itself does not market the fund to US investors. Similarly, the overly broad interpretation of what is considered to be an "affiliate" of a bank, and thereby treated as a "banking entity" subject to the Volcker Rule, has resulted in the trading and covered fund prohibitions being applied in a manner that interferes with and restricts a variety of bona fide asset management and other fund-related activities that are carried on outside the US. This outcome runs counter to the Core Principle of fostering economic growth and vibrant financial markets by unnecessarily limiting overall product availability and choice for consumers and restricting the ability of global banks to meet customer needs.

A second example relates to the treatment of non-banks. Title I of Dodd-Frank provides the Financial Stability Oversight Council ("FSOC") with the power to designate non-banks as systemically important financial institutions ("SIFIs"). The process established to determine which non-bank institutions should be designated SIFIs has been fraught with challenges and questions. At times, it has been unclear as to the connection between the FSOC's domestic process and considerations by international bodies, such as the FSB, IOSCO and the IAIS. To mitigate concerns regarding the nonbank SIFI designation process, FSOC should undertake a review of its nonbank SIFI designation process to increase transparency and the ability of companies and their primary regulators to engage throughout the designation process and establish a mechanism for greater consistency between the FSOC and parallel international processes with a focus on activities rather than entities.

In addition, in order to appropriately identify potential macro-prudential risks, FSOC should ensure that its focus emphasizes insurers' activities, as opposed to company-specific designations, while increasing its reliance on insurance expertise. FSOC's inconsistent exercise of its powers and failure to appropriately tailor EPS to the insurance business model has resulted in proposals and application of prudential standards that distort the insurance playing field and ultimately can be unworkable for the insurance sector.

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