Meeting between Federal Reserve Board Staff and Barclays
October 28, 2013

Participants: Anna Lee Hewko, Michael Hsu, Tom Boemio, Jordan Bleicher, and Elizabeth MacDonald (Federal Reserve Board)

Patrick Durkin, Bret Hester, Thomas McGuire, Jeffrey Samuel, and Merritt Thomas (Barclays)

Summary: Representatives of Barclays met with Federal Reserve Board staff to discuss the Board's proposal to implement the enhanced prudential standards and early remediation requirements established under sections 165 and 166 of the Dodd-Frank Wall Street Reform and Consumer Protection Act for foreign banking organizations and foreign nonbank financial companies (the "FBO proposal"). As described in the attached presentation, the Barclays representatives raised concerns that the FBO proposal's requirement that foreign banking organizations meet leverage ratio requirements at an intermediate holding company would disadvantage foreign banking organizations relative to U.S. bank holding companies.

Dodd-Frank Section 165

Geographic leverage ratios and related key considerations

Meeting with the Federal Reserve
October 2013

Executive Summary

The financial stability objectives expressed in the FBO Section 165 NPR broadly align with the enhanced prudential standards applied by the PRA, although NPR's uneven application of leverage standards counters principle of national treatment and competitive opportunity

Four key level playing field objectives regarding the U.S. proposal

1. Consistent capital and liquidity standards at the 1) consolidated, 2) home country solus and 3) host country solus levels
2. Consistent application of sub-consolidated capital and liquidity requirements (U.S. and non-U.S.)
3. As Dodd-Frank requires, gauge requirements to the robustness of consolidated supervision ("due regard") and adhere to the principles of national treatment and competitive opportunity
4. Devise the leverage ratio to operate as a back-stop to risk-based requirements not as a binding constraint

We support strong capital and liquidity requirements, but we also seek consistency and fairness in standards

- Unlike risk-based capital requirements, application of non risk-adjusted leverage ratios on a geographic basis runs counter to principle of national treatment and equality of competitive opportunity
  - The proposal applies US geographic capital and liquidity requirements to FBOs, but not to U.S. banks
- Applying the US Tier 1 Leverage Ratio to a geographic, rather than activity-based, ring-fenced entity challenges FBOs' US business models in a manner not applied to US peers
- Assessments of capital adequacy at the IHC level should be assessed using Federal Reserve risk-based standards and CCAR stress testing rather than leverage, which is distortive on a sub-consolidated basis

Applying a non-risk based capital measure on a sub-consolidated basis increases systemic risk by ring-fencing that capital which would otherwise be available to be flexibly deployed anywhere in a consolidated entity during a crisis

The U.S. Sec 165 proposal has material implications for worldwide monetary policy and economic recovery to the extent it will force non-U.S. banks to reduce their role in supporting U.S. Treasury, agency and other markets

Europe is poised to respond in kind to the U.S. proposal: July 15, EC Commissioner Barnier: *"Whatever they [the United States] decide here, we're going to decide the same thing on our side."*

Level Playing Field Considerations

Key Issue: Competitive implications of IHC leverage ratios

Unlike risk-based capital requirements, application of non risk-adjusted leverage ratios on a geographic basis runs counter to principle of national treatment and equality of competitive opportunity

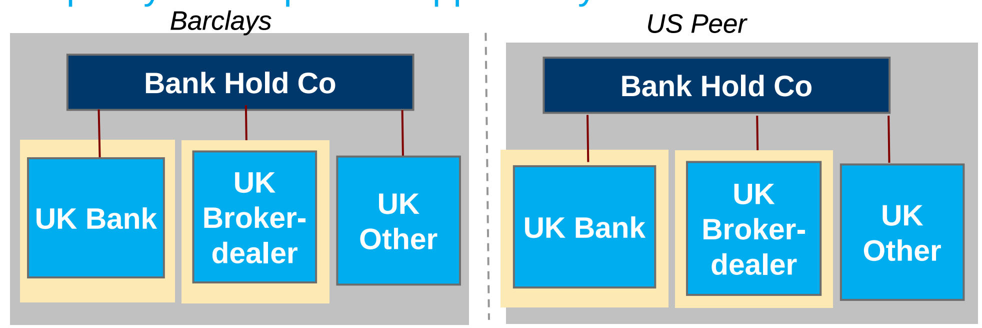
Key issues

1. NPR introduces additional, geography-specific leverage requirements not applicable to U.S. peers;
2. Requires IHCs with a primarily U.S. broker-dealer presence to reassess U.S. presence on a basis wholly unjustified by risk; and
3. Distorts assessments of IHC capital adequacy

1. Introduction of additional leverage requirements not required of U.S. peers

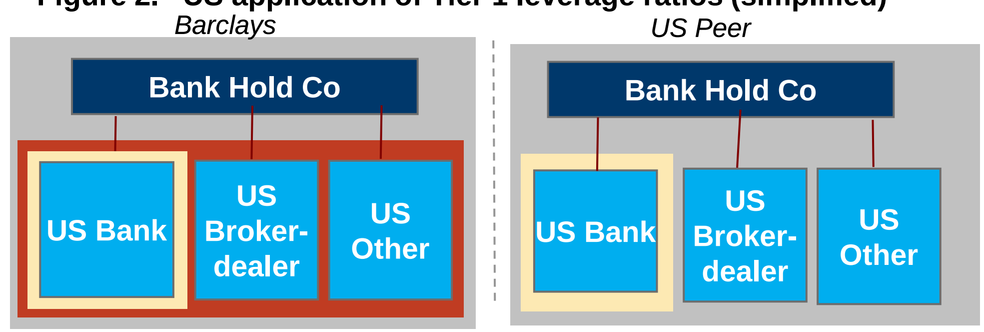
- Regulated UK subsidiaries of US banks are treated on par to UK subsidiaries of UK banks (see Figure 1)
- The preamble states that the intent in applying the leverage ratios to IHCs is to introduce ‘parity’ with U.S. bank holding companies (“BHC”)
- Applying leverage ratios to the IHC introduces an additional requirement not applicable to U.S. peers (see Figure 2)
- Thus, IHC leverage requirements and consolidated U.S. BHC requirements are not comparable.
  - U.S. BHCs may account for Tier 1 capital located globally, including in jurisdictions outside of the U.S.
  - A U.S. BHC may not meet the ratios if applied solely to U.S. capital and assets, particularly those operating a large U.S. broker-dealer subsidiary with a relatively smaller bank, which is what is being asked of the IHC (please see Table 1 on the following slide)

Figure 1. UK (EU) application of leverage ratios (simplified)



- Leverage ratio applicable at global, Group level for US and FBOs, respectively
- CRD IV leverage ratio applicable applicable to UK regulated subsidiaries

Figure 2. US application of Tier 1 leverage ratios (simplified)



- Leverage ratios applicable at global, Group level for US and FBOs, respectively
- The US Tier 1 Leverage ratios currently applicable applicable to all US bank subsidiaries of FBOs and US peers
- **In addition, NPR would require FBOs to meet the US Tier 1 leverage ratios over all US subsidiaries under the IHC, not just bank subsidiaries**

Key Issue: Competitive implications of IHC leverage ratios

Applying the US Tier 1 Leverage Ratio to a geographic, rather than activity-based, ring-fenced entity challenges FBOs' US business models in a manner not applied to US peers

2. Primary impact of leverage ratios is on those with U.S. broker-dealers

- Certain FBOs operate primarily U.S. broker-dealer activities, while others operate primarily through U.S. banking subsidiaries.
- The design of the leverage ratios would impact FBOs differently:
  - An FBO with a large U.S. bank subsidiary relative to its broker-dealer subsidiary will be minimally impacted
  - An FBO with a large U.S. broker-dealer and smaller U.S. bank subsidiary will be highly impacted: collateralized lending arrangements receive a low risk-weight, but this type of arrangement is treated exactly the same as highly risky lending as there is no adjustment for risk
- The likely outcome will be a substantial reduction in activity in broker-dealer operations such as activity in support of the US Treasury and agency markets, relative to banking activities
- Banking activities which draw higher RWA requirements given their illiquid and longer-term nature, are encouraged in order to meet leverage ratio and return requirements

Table 1. Estimated leverage ratios of U.S. broker-dealer subsidiaries of the largest U.S. and foreign bank holding companies

	Top 6 U.S. Bank Holding Companies	Top 6 FBOs
Average U.S. Broker-Dealer Subsidiary Leverage Ratio (U.S. capital to U.S. Assets)	3.70%	4.03%

** Estimated based on 2012 FOCUS report filings. Estimated leverage ratios are estimates of the ratio of equity capital (adjusted as a proxy to Tier 1 capital) to on-balance sheet assets.*

- The comparison in Table 1 is used to compare broker-dealer subsidiaries of U.S. and FBO firms, since for several FBOs the leverage ratio would in effect apply to their U.S. broker-dealer.
- Were U.S. peers required to meet the same leverage requirements proposed in the NPR (i.e. U.S.-based capital to U.S.-based assets), a U.S. peer operating a U.S. broker-dealer subsidiary that is not otherwise subsidized by higher-RWA bank assets, would appear undercapitalized, even where the same peer might meet the ratios on a global, consolidated basis
- In effect, a U.S. geographic leverage ratio favors the growth of U.S. bank subsidiaries relative to U.S. broker-dealers, driven by the non-risk adjusted mechanics of the leverage ratio

Key Issue: Competitive implications of IHC leverage ratios

Assessments of capital adequacy at the IHC level should be assessed using Federal Reserve risk-based standards and CCAR stress testing rather than leverage, which is distortive on a sub-consolidated basis

3. Proposed leverage ratios would distort assessments of capital adequacy

- Table 2 illustrates the consequence of applying a leverage ratio on a geographic basis to an FBO's US subsidiaries using a generic example of two subsidiaries
- Comparing the adequacy of capital supporting the risk profile of the two entities, we note:
  - Both entities exceed Tier 1 risk-based capital minima, with comparable ratios at 10%
  - Both entities exceed Tier 1 risk-based capital minima on a *post-stress* basis
- The assessment of capital adequacy, however, is clearly distorted when framed according to the leverage ratio, which suggests a substantial capital deficit at the broker-dealer. This is primarily due to the fact that leverage ratios *do not adjust for risk*
- To align with regulatory objectives and avoid the distortions introduced by the geographic leverage ratio, we propose an assessment of capital adequacy as described in Table 3

Table 2. IHC Tier 1 leverage ratio impact (simplified)

Entity	Asset Profile	GAAP assets	RWA	Tier 1 capital	Tier 1 risk-based ratio	Post-CCAR Stress Tier 1 risk-based ratio	Tier 1 Leverage Ratio	Shortfall to post-stress risk-based ratios	Shortfall to Tier 1 leverage ratio
Large US bank subsidiary	Corporate and retail loans	$100bn	$100bn	$10bn	10%	7%	10%	$0	$0
Large US broker-dealer subsidiary	Highly-liquid cash trading and repo financing	$100bn	$30bn	$3bn	10%	8%	3%	$0	($7bn)

Table 3. Proposed capital adequacy assessment for the IHC

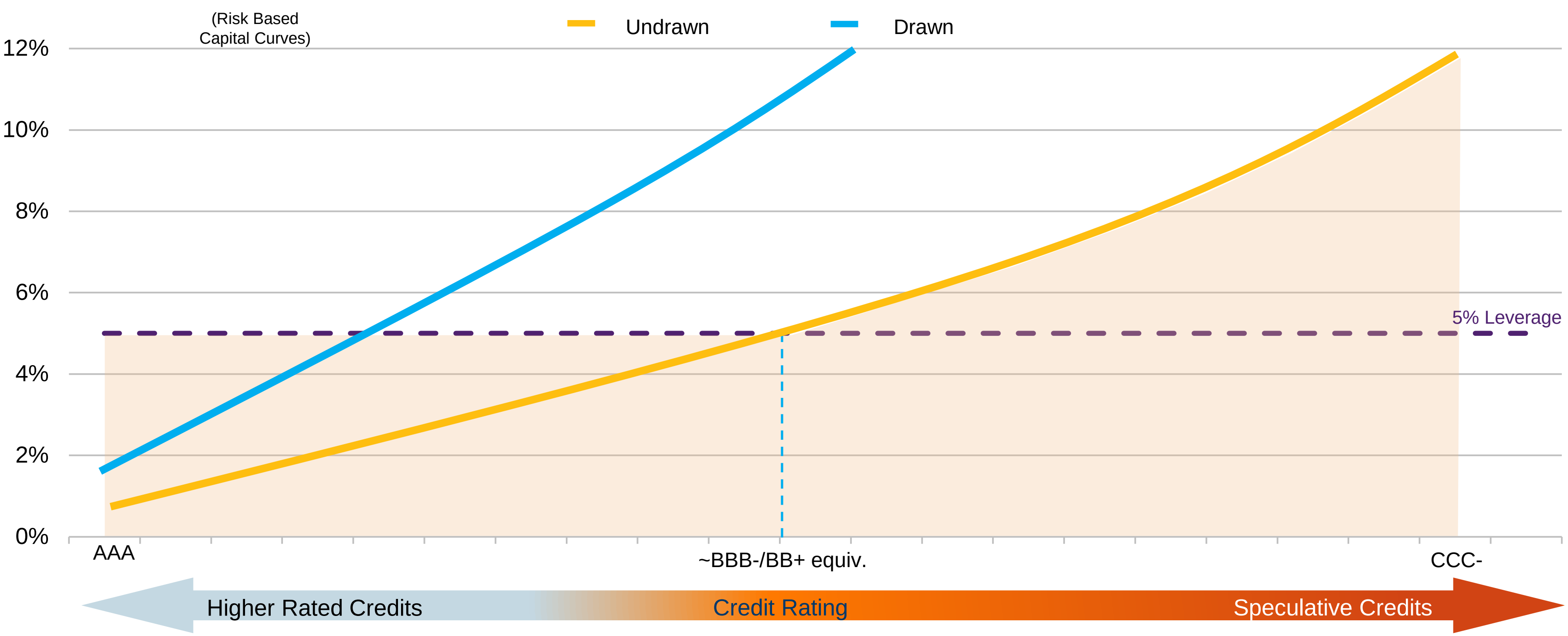
assessment category	Capital adequacy checklist	Assessment
1	Is consolidated FBO well-capitalized and subject to comparable home country supervision?	☑
2	Are U.S. consolidated subsidiaries well-capitalized on a risk-based basis?	☑
3	Are U.S. consolidated subsidiaries well-capitalized on a risk-based basis, *post-stress*?	☑
4	Do all U.S. subsidiaries meet capital requirements applied by primary regulators?	☑
	Does the FBO and U.S. subsidiaries meet a positive assessment in categories 1-4?	Yes

Distortions Introduced & Market Impact

Impact of Leverage vs. Risk-Based Capital

- In recent months banks have been focused on leveraged-based capital, in addition to risk-based capital
- Leverage-based capital requires banks to hold Tier 1 capital as a percentage of their assets
  - 3-4% for European banks and 5-6% for US banks
  - Simpler calculation, but does not take account of risk/quality of the assets
  - Captures both on balance sheet (i.e. loans) and off balance sheet (i.e. commitments)
- Leverage will be the dominant capital measure for highly rated credits, while risk-based will be dominant for lower rated
  - Further exacerbated for undrawn commitments

Tier 1 Capital Held for a 5-year Commitment



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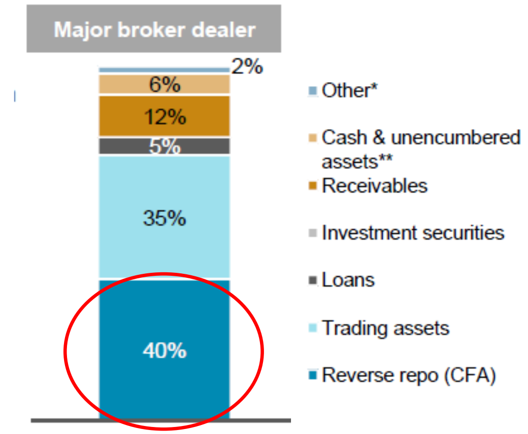
FBOs play a critical role in the US repo market, ensuring robust liquidity in US government and agency securities

FBO importance to US repo markets

- Repo & securities financing are the largest balance sheet consumers for broker-dealer oriented FBOs
- Importantly, they also provide critical functions to the market
  - Conduct important market making services, resulting in lower transaction and funding costs for participants
  - Facilitate deep liquidity in US government and agency securities through repo market facilitation and primary dealer operations, enabling the US government's execution of monetary policy
  - Bring countercyclical benefits to the US by distributing US capital and securities to a global network
  - Enable access to safe assets and provide liquidity for investors, i.e. money market funds

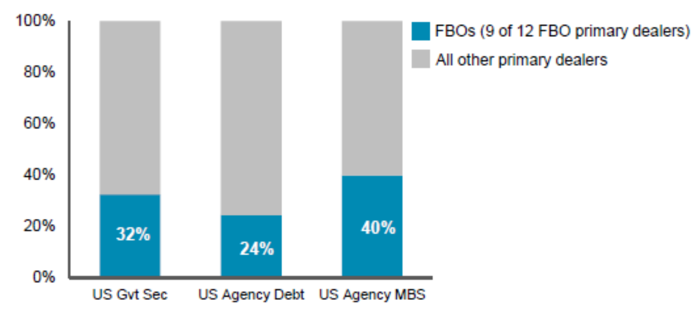
FBO broker-dealer asset composition

Pro forma consolidated view



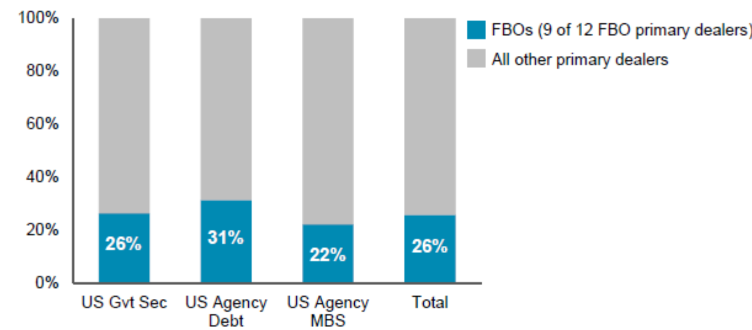
FBO proportion of US repo market

FBO share of trading activity of government and agency securities, % daily trading average 2012[1]



Total daily trading avg.	$521BN	$45BN	$339BN

FBO share of reverse repos and borrowed securities, average gross inventory 2012[1]



Securities In	$1.9TN	$0.2TN	$0.6TN	$2.7TN

1 Source: Oliver Wyman study, *Enhanced prudential standards for foreign banking organizations: An impact assessment,* April 30, 2013.

An Oliver Wyman study highlights that FBO reductions in US repo and securities financing activity may have material implications

Impact of FBO reduction in US repo activity

Reduced liquidity in US markets

- FBO reduction in US repo activity will result in a significant capacity withdrawal in the market, reducing liquidity in both repo and the underlying securities markets
  - Other institutions may fill some of the gap, but are unlikely to replace the full capacity; US money-center banks are well-funded with deposits
- Investor demand will reduce and cost of financing will increase, further reducing liquidity in the market
- Reduced capacity will severely impact many institutions' ability to manage their cash and resource needs - many firms depend on repo as a low risk investment to manage excess cash

Increased systemic risk

- FBO withdrawal from the US repo market will concentrate the market among domestic institutions
  - Could further concentrate market to domestic players
  - Unregulated shadow banking institutions may step in
- FBOs also provide important countercyclical and competitive benefits to the repo market that would be significantly reduced if capacity was withdrawn

Effect on US capital markets

- A 25% reduction in US repo by 6 major FBOs would correspond to ~$350 BN of capacity reduction in the market (> 10% of the market)[1]
- Will have a significant impact on the effectiveness of US monetary policy
  - Repo facilitates Fed open market operations - almost 80% of the repo market represents government collateral and a reduction in repo capacity and liquidity will therefore impact Open Market Operation effectiveness
  - Shrinkage in repo will also boost US Treasury's borrowing costs and could impact asset prices
- Will increase overall risk in system and impact the flow of US capital to non-US institutions
  - 80% of repo done by primary dealers is with US MMF, of which a substantial portion is with non-US institutions
  - MMF have $2.5 trillion in assets, a third of which is invested in repo. Due to capacity reduction in the repo market, MMF may increase their unsecured bank exposure

Source: Oliver Wyman study, *Enhanced prudential standards for foreign banking organizations: An impact assessment,* April 30, 2013.

Industry Comments on Treasury and Agency Market Impact

Barclays

- "The activity most likely to be impacted by the leverage ratios is securities financing, particularly in the repo market, with knock-on impact to U.S. Treasury market liquidity and financing, and ultimately, monetary policy."
- "A reduction in repo market liquidity will increase costs and potentially reduce access to these instruments, which will substantially harm not only those firms that depend on the repo markets as a source of low-risk investment to manage excess cash liquidity, but critically, will also hinder the Federal Reserve in transmission of monetary policy and potentially impact the success of the current QE3 quantitative easing program. The Federal Reserve currently holds $3 trillion in Treasuries28 on its balance sheet, and is currently purchasing $85 billion of Treasuries and Agency Pass-Through Mortgages each month.29 Any material concurrent deleveraging of Federal Reserve and FBO balance sheets could have a substantial impact on asset prices."

Mizuho

- "…we believe the Board should exclude from the leverage ratio calculation U.S. Government Securities and claims secured by U.S. Government Securities, as well as other highly liquid and low risk assets (e.g., assets that would be eligible as highly liquid assets for purposes of the liquidity buffer calculation). The Board should also exclude repurchase and reverse repurchase transactions and securities lending and borrowing, which are inherently low risk activities due to their high level of collateralization and their protections from an automatic stay in bankruptcy."
- "We believe that the impact of the IHC structure, and its attendant capital and leverage requirements, on the markets for these low-risk assets could be considerable. The Japanese government, the Bank of Japan and Japanese financial institutions and corporations, in aggregate, are among the largest holders of U.S. Government Securities, and are all active in the repo market for such securities, with Japanese financial institutions and their US affiliates (including Mizuho) providing significant intermediary services for such market participants. Indeed, Japanese entities are the second largest foreign holders of U.S. Treasury securities as of February 2013. MSUSA is one of 21 primary dealers—the majority of which are subsidiaries of FBOs— and its participation in dealer activity for certain asset classes is substantial. Mizuho is therefore concerned about the potential impact on its business, and on these markets, of potentially being penalized for holdings of these safe assets."

UBS

- "Collectively, we believe these measures may reduce liquidity and increase market volatility for everything from government securities to equities and commodities."

IIB

- "We have especially serious concerns about the potential impact of the Proposal on U.S. Treasury repo markets, including potential adverse effects on the depth and liquidity of those markets and, ultimately, on the spreads on U.S. Treasury securities and borrowing costs for the U.S. government. FBO-owned primary dealers currently constitute a majority of the primary dealers. The proposal could have the unintended consequence of causing FBO-owned primary dealers to withdraw from the market or scale back their U.S. operations and thereby adversely affect pricing in the U.S. treasury securities repo markets. Indeed, Oliver Wyman has estimated that the proposed IHC requirement could result in a $330 billion reduction in capacity from the U.S . repo markets, representing over 10% of this market."

Quantifying FBOs' USD Market Share

Foreign banking organizations' U.S. broker dealer subsidiaries account for a substantial share of the total USD securities' underwriting

Top 17 FBO Broker Dealers By Assets (≥ 10bn In Assets)

Bank of Montreal	ING Groep N.V.
Barclays Plc	Mitsubishi UFJ Financial Group, Inc.
BNP Paribas SA	Mizuho Financial Group, Inc.
Commerzbank AG	Royal Bank of Canada
Crédit Agricole Group	Royal Bank of Scotland Group Plc
Credit Suisse Group AG	Société Generale SA
Deutsche Bank AG	Toronto-Dominion Bank
Groupe BPCE	UBS AG
HSBC Holdings Plc	

Total Market Size By Asset Class

($bn)	2008	2009	2010	2011	2012	Average
Corporate Debt	935.3	1,300.1	1,186.3	1,195.8	1,537.7	1,231.0
Agency Debt	862.3	1,020.4	1,203.6	856.7	807.1	950.0
ABS	159.4	141.9	113.1	132.0	237.3	156.7
Equities	133.8	152.8	167.0	159.1	220.7	166.7
Equity Linked	41.3	30.8	35.3	24.2	21.8	30.7
Loans	661.7	475.1	1,007.0	1,772.0	1,511.8	1,085.5
Municipal Debt	449.9	474.6	498.6	355.5	439.5	443.6

Top 17 FBO Aggregate Market Share

	2008	2009	2010	2011	2012	Average
Corporate Debt	28.9%	31.8%	38.8%	38.0%	36.0%	34.7%
Agency Debt	45.1%	43.3%	48.7%	47.3%	45.7%	46.0%
ABS	33.1%	38.0%	35.0%	44.9%	42.9%	38.8%
Equities	28.7%	21.5%	28.1%	33.0%	33.8%	29.0%
Equity Linked	19.2%	22.2%	27.6%	18.0%	25.8%	22.6%
Loans	24.4%	25.3%	24.8%	25.0%	26.8%	25.2%
Municipal Debt	15.7%	12.5%	12.9%	11.7%	11.8%	12.9%

Barclays' Market Share

	2008	2009	2010	2011	2012	Average
Corporate Debt	8.3%	7.0%	7.6%	7.5%	6.8%	7.4%
Agency Debt	14.5%	14.5%	13.1%	10.9%	11.6%	12.9%
ABS	11.1%	12.2%	11.8%	10.5%	10.8%	11.3%
Equities	7.2%	5.3%	8.8%	9.7%	11.2%	8.4%
Equity Linked	6.1%	4.6%	5.6%	4.2%	6.2%	5.3%
Loans	3.3%	3.9%	4.0%	4.3%	5.6%	4.2%
Municipal Debt	6.3%	6.5%	4.0%	5.3%	4.7%	5.4%

Source: Bloomberg, Thomson Reuters.

Conclusions

Ensure a Level Playing Field and Mitigation of Systemic Risk

Global Supervisory Cooperation and Mutual Recognition

- As Dodd-Frank requires, gauge requirements to the robustness of consolidated supervision ("due regard") and adhere to the principles of national treatment and competitive opportunity
- Effective resolution mechanisms are key

Ensure Consistency

- Consistent capital and liquidity standards at the 1) consolidated, 2) home country solus and 3) host country solus levels
- Consistent application of sub-consolidated capital and liquidity requirements (U.S. and non-U.S.)

Devise the leverage ratio to operate as a back-stop to risk-based requirements not as a binding constraint

- Stress tests, as a supplement to risk-based capital ratios, offer a forward-looking assessment of capital adequacy and the range of stressed scenarios (baseline, adverse, and severely adverse) grant a more nuanced understanding of capital adequacy than can be achieved through the use of leverage ratios
- If regional sub-consolidated leverage ratios are used, they should be adjusted
  - At a minimum, the leverage ratio should be adjusted for assets that are collateralized by US Treasury, agency, or other highly liquid, high-quality instruments to avoid unnecessarily reducing the availability of financing and liquidity in the markets for such instruments and thereby increasing costs for the US government and other issuers of those instruments
  - This approach would also be consistent with the how leverage is measured at US broker-dealers by FINRA, which requires that US broker-dealers meet a leverage ratio adjusted for government collateral
- Should the Federal Reserve not choose to adjust for government collateral, the proposed framework in which both the U.S. Tier 1 leverage ratio and the Basel III leverage ratio apply is unnecessary
  - The Basel III leverage ratio is the most appropriate given the ratio is designed to more appropriately account for banks with larger broker-dealer activities which generally have larger concentrations of lower risk assets on their balance sheets than depository institutions