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June 28, 2015

Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Re: Docket Number 1438 and RIN 7100-AD-86, Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies

Dear Mr. Frierson:

The Securities Industry and Financial Markets Association ("**SIFMA**") welcomes the opportunity to submit supplemental comments to the Board of Governors of the Federal Reserve System (the "**Board**") on its proposed rules to establish single-counterparty credit limits ("**SCCL**") for large bank holding companies and designated nonbank financial companies, as required by Section 165(e) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**").[1]

We continue to support the application of enhanced prudential standards, including a well-designed SCCL framework, to large bank holding companies and designated nonbank financial companies. We also support robust capital and liquidity standards for large bank holding companies, which complement enhanced prudential standards by reinforcing banking organizations' strength and resiliency. The Board has made impressive progress in reducing risks in the U.S. financial system in recent years by implementing most components of the enhanced prudential standards required by Dodd-Frank as well as by adopting entirely new capital and liquidity standards for large bank holding companies.

Our comments in this letter address the treatment of overnight non-term deposit relationships in the SCCL framework and the risk that an unnecessarily restrictive SCCL final rule might result in serious disruptions to the payment and settlement system in the United States. In particular, we recommend that the Board consider adopting a two-tier SCCL framework for exposures between the largest financial firms: (i) a credit exposure limit of 15% of regulatory capital[2] for covered exposures except overnight

[1] SIFMA previously submitted comments to the Board on various aspects of the SCCL proposed rulemaking. *See* comment letter from SIFMA and the Financial Services Roundtable, April 30, 2012, pp. 27-31; comment letter from SIFMA and other trade associations, April 27, 2012, Annex C. We continue to support the positions expressed in these comment letters with respect to the SCCL rulemaking.
[2] The Board's 2012 proposed rule (the "**Board Proposal**") would impose a 10% limit on credit exposures between the largest financial firms with total consolidated assets equal to or greater than $500 billion. 12 C.F.R. § 252.93(b)

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non-term deposits—including exposures arising from derivatives, securities financing transactions ("**SFTs**") and other types of exposure other than non-term deposits—and (ii) an aggregate 25% credit exposure limit that would apply to all covered exposures, including overnight non-term deposits.[3] Exempt exposures, such as intraday credit exposures, would continue to be exempt from both the 15% limit and the 25% limit.[4] A two-tier SCCL framework would establish robust, meaningful credit exposure limits while preserving the ability of banks to facilitate basic cash management transactions that support the broader economy.

1. Deposit relationships under SCCL

Deposit relationships between banking organizations support ordinary course payment and settlement activities, in particular where the banking organization uses a third-party bank to clear and settle its transactions. The use of third-party banks for clearing and settlement is common for banking organizations that do not self-clear at all or in certain jurisdictions, currencies or product areas. In such cases, the banking organization whose transactions are being settled at a third-party clearing bank will typically need to place funds on deposit with the clearing bank. Similarly, from the perspective of the clearing bank, receiving overnight deposits helps to manage credit risk and ensure payment and settlement system functionality. Depending on the volume of activity being cleared, the quantity of funds required to be placed on deposit can be large and may vary significantly on a day-to-day basis.

For example, a bank syndicate facilitating a client transaction will oftentimes route payment flows through a single bank account before proceeds are delivered to the client or other market participants, resulting in large overnight balances with a single depository institution. Likewise, firms with broker-dealer affiliates regularly deposit segregated client cash at other banks, with balances rising and falling on a daily basis in response to client activities. In other cases, banking organizations receive deposits from unaffiliated institutions to support coordinated market activities involving both firms. In these examples, as in numerous other cases, financial institutions place (or receive) non-term deposits with (or from) an unaffiliated bank to facilitate basic financial market activities vital to the economy.

(proposed). In 2014, the Basel Committee on Banking Supervision ("**BCBS**") published a large exposure framework that would impose a 15% limit on exposures between global systemically important banking organizations (GSIBs). BCBS, *Supervisory framework for measuring and controlling large exposures* (Apr. 2014) (the "**Basel Framework**"), ¶ 16.

[3] The Board Proposal and the BCBS Framework each apply more stringent credit limits to a banking organization's exposures to other major financial counterparties. 12 C.F.R. §§ 252.92(z), 252.93(b) (proposed) (the 10% credit limit would apply to exposures to major counterparties); Basel Framework ¶¶ 16, 90 (the 15% credit limit would apply to exposures to other GSIBs). We agree with the Board Proposal and the BCBS Framework that exposures to other counterparties should be subject to a general 25% credit limit, and the two-tier approach recommended in this letter would only be applicable to exposures subject to the more stringent limits.

[4] This letter solely addresses the treatment of overnight non-term deposit relationships. We do not address the issue of other types exposures that should be exempt from the credit exposure limits in this letter.

The SCCL correctly identifies overnight deposits placed with another bank as an exposure to that bank. If the deposit-taking bank fails instantaneously and unpredictably such that the deposit-placing firm is unable to reduce its deposit exposure, the deposit-placing firm is exposed to losses above the applicable deposit insurance limit. As such, we agree that overnight non-term deposit exposures should be subject to limits under the SCCL. However, these limits should be appropriately calibrated in light of the unique features of overnight non-term deposits and the need to avoid payment and settlement system disruptions, which might arise either from firms being unable to place deposits with unaffiliated banks or from banks being unable, as a practical matter, to receive such deposits.

2. Authority to adopt a two-tier SCCL

a. U.S. law

Section 165(e) of Dodd-Frank provides the statutory authority for the SCCL rulemaking. Section 165(e) requires the Board to adopt regulations that prohibit a large bank holding company's credit exposures to any unaffiliated counterparty from exceeding 25% of the bank holding company's capital and surplus. In addition, the statute grants the Board discretion to impose a lower limit if "necessary to mitigate risks to the financial stability of the United States."[5] Finally, the statute also permits the Board to "exempt transactions, in whole or in part, from the definition of the term 'credit exposure'" if the Board "finds that the exemption is in the public interest and is consistent with the purpose" of SCCL.[6] We believe that the statute, which mandates only a 25% credit limit and gives the Board discretion to tailor SCCL appropriately, provides clear legal authority to adopt a two-tier SCCL framework.

b. Basel framework

We understand that the Basel Framework, published after the Board's proposed rule, may guide the Board's SCCL rulemaking. The Basel Framework requires banking organizations to use the accounting value of their exposures, which includes overnight non-term deposits placed at other banks.[7] BCBS notes, however, that the Basel Framework exempts intraday interbank exposures "to avoid disturbing the payment and settlement processes," and that BCBS is undertaking further observation to consider whether "a specific treatment for a limited range of [other] interbank exposures may be necessary."[8] Although this ongoing review is framed in the context of monetary policy, we note that BCBS has signaled its willingness to accommodate payment and settlement activities by exempting intraday interbank exposures, and we respectfully urge the Board to consider whether a limited

[5] Dodd-Frank § 165(e)(2).
[6] Dodd-Frank § 165(e)(6).
[7] Basel Framework ¶ 32.
[8] Basel Framework ¶¶ 65, 67.

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accommodation for overnight non-term deposits, which also support payment and settlement activities, would be consistent with BCBS' ongoing project to calibrate interbank exposure limits appropriately.[9]

3. Key considerations

Overnight non-term deposits have several unique characteristics that distinguish them from other exposure categories and support adoption of a two-tier SCCL framework.

a. Daily reevaluation of exposure

Other SCCL exposure categories—including exposures arising from derivatives, term SFTs, credit default swap risk-shifting and term deposits—generally involve longer-dated maturities than non-term deposits. Because they are longer-dated, in a crisis scenario, a firm may have little practical ability to reduce these exposures quickly to a failing bank, since new counterparties would have to be willing to accept an assignment of the failing bank's positions. A conservative SCCL for these exposures is a prudent approach to preventing the failure of one bank from having a "domino" effect on other institutions.

By contrast, non-term deposits are overnight placements of cash that support payment and settlement processes. Deposit levels can vary significantly on a day-to-day basis, sometimes by billions of dollars, in response to market activities and client needs, with firms placing (or receiving) deposits overnight that will be necessary to meet early morning obligations the following day to critical counterparties like clearing organizations. In a crisis, firms would avoid placing fresh deposits at a bank on the brink of failure, since overnight relationships provide firms with a daily opportunity to reevaluate their exposures.

b. Payment and settlement system functionality

Both the Board and BCBS have expressed concerns about the potentially disruptive effects of SCCL on payment and settlement system functionality. The Board's proposed rule included an intraday exception from compliance with SCCL to "help minimize the impact of the rule on the payment and settlement of financial transactions."[10] Similarly, as noted above, BCBS continues to focus on payment and settlement processes as it refines the Basel Framework.

The same policy concerns apply in the case of overnight non-term deposits. The intraday exception from SCCL is premised on recognition that banks often exchange large gross payments during

[9] We note that similar exemption for other intraday exposures is also necessary "to avoid disturbing the payment and settlement processes." We do not address that issue in this letter.
[10] 77 Fed. Reg. 594, 622 (Jan. 5, 2012).

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the course of a business day as part of normal course payment and settlement activities. Similarly, in advance of early morning obligations, firms may place large overnight deposits at banks or receive large deposits from other firms. In many cases it would not be practical to delay placement or receipt of deposits until the start of the following business day; in foreign exchange markets, for instance, firms are required to fund settlement of certain obligations before the business day begins in the United States.

Overnight non-term deposits support a wide range of transactions and client activities, and SCCL-related disruptions might have profound impacts on basic financial markets activities. Capital markets activities, including initial public offerings of equity securities, typically rely on overnight cash placement arrangements, as do client asset custody arrangements, clearing activities and foreign exchange settlement.

c. *Impact of capital and liquidity regulation*

Recently adopted capital and liquidity standards have two practical effects on inter-bank deposit exposures. First, the deposit-taking bank is effectively unable to rely on inter-bank deposits to fund income-generating assets, since the Liquidity Coverage Ratio requires the bank to assume 100% outflows for non-operational deposits placed by financial counterparties and excess operational deposits.[11] Second, the deposit-taking bank must pay a capital penalty for accepting deposits that it cannot utilize since the cash grosses up the bank's balance sheet for purposes of the leverage ratio and the Supplementary Leverage Ratio.[12] Third, the BCBS Net Stable Funding Ratio assigns 0% available stable funding recognition to these deposits.[13] The cumulative effect of all of these standards is that a bank has virtually no economic incentive to accept inter-bank deposits and, in fact, actually incurs a leverage capital penalty by accepting them.

Inter-bank GSIB deposit exposures will likely decline over time as banks adjust their deposit appetites in response to these new capital and liquidity standards. Indeed, with the advent of new capital and liquidity standards, in the past year some SIFMA member firms have already experienced a constrained ability to place inter-bank deposits, and many deposit-taking firms have been reevaluating whether to accept large dollar deposits from financial sector counterparties. Accordingly, we believe that there is no compelling policy rationale to use SCCL as a tool to impose further restrictions on inter-bank deposits, especially since some level of non-term deposits is necessary to support basic payment and settlement activities in the wider economy. To the contrary, we believe that careful attention should be

[11] 12 C.F.R. § 249.32(h)(5).
[12] 12 C.F.R. §§ 217.10(a)(4) (leverage ratio); 217.10(a)(5), 217.11(c) (Supplementary Leverage Ratio). Similarly, the Board's GSIB capital proposed rulemaking would impose higher risk-based capital requirements on large banking organizations that accept wholesale deposits, even when the LCR already effectively prevents the banking organization from utilizing the deposits as a funding source. *See* 12 C.F.R. § 217.403(c)(5)(ii)(B)(2) (proposed).
[13] BCBS, Net Stable Funding Ratio ¶ 25(a).

paid to maintaining inter-bank payment and settlement capacity in light of the severe balance sheet constraints placed on deposit-taking banks under new capital and liquidity standards.

d. Other risk considerations

In practice, only a handful of U.S. banks currently have the balance sheet capacity and operational capabilities necessary to support multi-billion dollar payment and settlement flows in multiple jurisdictions around the world on a daily basis. If SCCL resulted in firms being unable to maintain deposit relationships with these banks, they would have to develop new relationships with numerous alternative institutions with much smaller balance sheets and less operational experience. While it is prudent for firms to maintain back-up and alternative deposit relationships that are tested regularly, forcing all payment and settlement activities out of the most experienced banks with the deepest capacity would likely introduce greater operational and funding risk into financial markets as firms seek to manage dozens of deposit relationships with highly fragmented cash balances.

e. Tri-party reform

Tri-party reform represents one of the major accomplishments of the post-crisis reform agenda. Although tri-party reform involves various complex elements, one basic component has been a reduction in intraday credit support provided by clearing banks. This decline in intraday credit support, however, has necessarily resulted in firms placing greater deposits at clearing banks—and clearing banks being willing to accept such deposits—to help ensure that appropriate liquidity supports transactions. A bluntly calibrated SCCL that forces firms to remove deposits from clearing banks, or has the practical effect of incentivizing clearing banks to cease accepting such deposits, could undermine this achievement in tri-party reform.

4. Risk management standards for deposit relationships

If the Board adopted a two-tier SCCL framework, we believe that it would be appropriate to consider robust risk management parameters for the higher non-term deposit limit. The higher limit could be conditioned on firms meeting various operational and risk management standards, such as active testing of alternative deposit relationships and robust documentation requirements, and the higher limit could be tailored to deposits that directly support payment and settlement activities. We would welcome an opportunity to discuss specific risk management practices with Board staff to address any concerns related to a two-tier SCCL framework.

5. Alternative recommendation

We recommend that the Board adopt a two-tier SCCL framework, which balances the need for payment and settlement system functionality with recognition that deposit exposures are credit exposures.

Section 165(c) of Dodd-Frank, however, would permit the Board to simply exempt certain non-term deposits from the SCCL framework entirely, since the statute gives the Board broad discretion to develop appropriate exemptions to SCCL.[14] While our primary recommendation is for adoption of a two-tier SCCL framework, we note that the Board could instead consider a tailored SCCL exemption from the definition of "credit transaction" for non-term deposits that meet minimum operational and risk management standards and support specific activities, while retaining a single-tier SCCL framework.[15] Even if such deposits were exempted, the Board could require firms to report significant overnight deposits, consistent with other supervisory reporting practices in the Basel Framework.[16]

6. Conclusion

We respectfully urge the Board to consider our recommendations in this letter and would welcome an opportunity to answer any questions. Please contact at if discussion of the points in this letter would be helpful.

Sincerely,

Carter McDowell

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SFIMA

[14] Dodd-Frank § 165(c)(6).
[15] *See* 12 C.F.R. § 252.92(n) (proposed).
[16] Basel Framework ¶ 15.