BARCLAYS

April 30, 2013

Via Electronic Mail

Mr. Robert deV. Frierson
Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551
Docket No. 1438 and RIN 7100-AD-86

Re: Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies; Proposed Rule

Ladies and Gentlemen:

Barclays appreciates the opportunity to comment on the Notice of Proposed Rulemaking ("the NPR") by the Board of Governors of the Federal Reserve System (the "Federal Reserve" or the "Board") entitled Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies, intended to implement the enhanced prudential standards of Section 165 and the early remediation requirements of Section 166 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") with respect to foreign banking organizations ("FBOs") with U.S. operations.[1] In addition to this comment letter, Barclays has participated in the preparation of comment letters submitted by industry trade associations, and strongly supports the recommendations made therein, particularly the very thoughtful and detailed comments of the Institute of International Bankers (the "IIB").[2] We believe that the views and recommendations advanced in those letters collectively offer effective measures to implement Sections 165 and 166 of the Dodd-Frank Act for FBOs in a safe, sound, and effective manner.

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[1] *Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies*, 77 F.R. 76,628 (Dec. 28, 2012).

[2] These include the comment letters submitted by the IIB ("IIB Letter"), the Institute of International Finance, the British Bankers Association, the Financial Services Roundtable, the Global Financial Markets Association, and the Organization for International Investment, among others.

Barclays operates a substantial business in the United States. Our presence in the U.S. extends as far back as the 1890s, and today over a quarter of our revenues are generated in the Americas, where we employ 11,000 staff in over 20 locations.[3] Our commitment to the U.S. market was underscored in 2008 with our acquisition and support of the U.S. operations of Lehman Brothers. This acquisition, undertaken in crisis conditions, and successfully integrated into - and supported by - the Barclays Group, along with the continuing success of Barclays' North American operations, together represent the strongest possible demonstration of Barclays' commitment to its U.S. franchise. Today, our U.S. presence is led by Barclays Capital Inc. ("BCI"), a broker-dealer and futures commission merchant functionally regulated by the SEC, the CFTC, and FINRA; the New York Branch, regulated by the New York State Department of Financial Services and the Federal Reserve; and Barclays Bank Delaware ("BBDE"), a state nonmember bank supervised by the FDIC and by the Delaware Office of the State Bank Commissioner.[4] Our U.S. operations are collectively supervised by the Federal Reserve, in addition to the supervision performed by these primary regulators. The health and success of Barclays' U.S. business is unquestionably critical to the health and success of our overall group, as is by extension the health and success of U.S. markets, particularly given our role as one of the largest primary dealers supporting the implementation of U.S. monetary policy. This comment letter is written with that perspective.

Barclays strongly supports the application of enhanced prudential standards and early remediation requirements to the largest and most interconnected firms. We believe that these measures are aligned both with our internal risk management posture, and the larger interests of financial stability and macroeconomic growth. To that end, as we have made clear in prior comment letters to the Federal Reserve and other U.S. regulatory agencies, we firmly support the financial reform agenda established by the G-20 and carried out by the Basel Committee on Banking Supervision, the International Organization of Securities Commissions, the Financial Stability Board, and the international community of banking supervisors. These coordinated efforts are working to minimize the likelihood of prospective threats to financial stability and to establish the framework for a coordinated approach to cross-border regulatory oversight of large financial institutions.

Sections 165 and 166 of the Dodd-Frank Act broadly reflect this global reform agenda and the resulting enhanced prudential standards agreed to at the international level. In this respect, the statutory objectives of Sections 165 and 166 broadly mirror the enhanced prudential standards already applied to Barclays by our home regulator, the UK Prudential Regulation Authority (the "PRA").[5] These standards, applicable to financial firms headquartered in the United Kingdom,

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[3] Group Overview, *Barclays PLC Annual Report 2012*, p.2

[4] Barclays Delaware Holdings, BBDE's bank holding company, is supervised by the Federal Reserve.

[5] In April 2013, the Financial Services Authority ("the FSA") was replaced by two regulatory bodies: the Prudential Regulation Authority ("the PRA") and the Financial Conduct Authority ("FCA"). References to the PRA, given that the PRA is a relatively new regulatory body, should also be read to incorporate those

are clearly comparable to those proposed by the Federal Reserve for banks headquartered in the United States. Both the PRA's standards and the Federal Reserve's domestic proposal apply enhanced risk-based capital and liquidity standards (incorporating internationally-agreed enhancements to the Basel capital framework), credit exposure limits, and stress testing requirements, among other standards, in each case applicable on an enterprise-wide, global, consolidated basis.[6] Importantly, because PRA enhanced standards apply to Barclays on a global basis, they are equally applicable to all of our U.S. operations. These standards are developed, enhanced, and carefully monitored by the PRA on an ongoing basis.[7]

Recent public statements by Federal Reserve leaders have expressed the policy logic that the NPR's intermediate holding company ("IHC")-based framework is necessary given the experience of the recent financial crisis and the use of Federal Reserve liquidity facilities by FBOs. We understand the risk-mitigating objectives of the Federal Reserve in issuing the NPR, but we are deeply concerned that the incremental benefits are few given the extensive changes in regulatory requirements and risk management that have already taken place. The likely costs, however, are many given the design of the proposed regulation. We encourage the Board to consider how the NPR may more explicitly incorporate new post-crisis regulatory requirements, and ways in which the proposal can further support global regulatory convergence. To name just a few, these measures include enhancements to Basel capital standards, an internationally-agreed leverage ratio, new quantitative liquidity standards, derivatives regulation, clearing requirements, and a resolution framework. They also include increased rigor in day-to-day supervision by the PRA, the Federal Reserve, and the primary regulators of our U.S. subsidiaries, which, to take just two examples cited in the NPR, have included focus on maintaining a net due-to position at the New York Branch, and a required liquidity pool at BCI based on a supervisory liquidity stress.[8] In short, the context has changed, and the regulatory and risk management environment has evolved dramatically, but the NPR is not drafted so as to sufficiently take all of these improvements into account. In effect, it is drafted as if non-U.S. regulators are not considered comparable peers and as if the prospect of regulatory coordination is an unlikely prospect at best, notwithstanding enormous international effort to develop and implement a shared set of core regulatory reforms.

We support the broad policy objectives underpinning Sections 165 and 166 because we believe that enhanced prudential standards, such as those applied by the PRA, contribute to safer and

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actions previously undertaken by the FSA in its oversight of Barclays. The PRA is part of the Bank of England.

[6] *Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies*, Federal Register, Volume 77, no. 3, January 5, 2012

[7] See *The Prudential Regulation Authority's Approach to Banking Supervision*, April 2013 (http://www.bankofengland.co.uk/publications/Documents/praapproach/bankingappr1304.pdf)

[8] BCI maintains a liquidity pool consisting of unencumbered cash and U.S. Treasury and Agency securities. Supervisory liquidity stress scenarios are used to assess the appropriate level of the pool, with a buffer maintained in order to account for potential fluctuations.

sounder financial institutions and thus, critically, a reduction in systemic risk. Though we appreciate that the intent of the NPR is to improve the safety and soundness of U.S. subsidiaries, branches and agencies of larger FBOs, we believe that the NPR does not represent the most effective approach to doing so, and is inconsistent with Congressional intent as expressed in the statute. We have strong concerns that the proposed implementation of these standards is not sufficiently nuanced with respect to individual FBOs, and does not adequately account for the risk management strengths of individual FBOs or the comparability of home country supervisory regimes. If implemented, the proposal will have broad and potentially unintended consequences for FBO participation in U.S. markets, for U.S. Treasury and global financial markets, and on economic growth, as well as deleterious effects on global regulatory cooperation, and ultimately, systemic risk.

The section below offers an overview of specific concerns and suggested amendments, while the following sections are intended to provide more detail. Annex A is included to summarize capital adequacy distortions introduced by leverage ratios applied at the IHC level.

An overview of our specific concerns includes:

- **The built-in rigidity of the IHC framework, and the potential replication of that insular framework across national boundaries, is likely to lead to a global financial system that is significantly more fragmented and features significantly less meaningful regulatory cooperation.** As a banking organization providing a diverse range of global services to an equally diverse group of global clients, with many of our largest clients based in the United States, we consider the cooperation of supervisors across jurisdictions critical both to a well-functioning global regulatory framework and to the global economy and markets on which we and our clients depend.

- **The supervisory framework detailed in the NPR represents a marked departure from the Federal Reserve's longstanding and successful approach to the regulation of FBOs' U.S. operations.** The Federal Reserve has operated under the existing framework to significantly expand its oversight and apply enhancements to its supervision of U.S. operations of FBOs. The existing framework has shown itself to be adaptable, has accommodated material improvements to supervision post-crisis, and would be a more efficient construct on which to build the implementation of enhanced prudential standards than the proposed IHC-based framework.

- **The proposal fails to take into account the very meaningful improvements in regulatory supervision and risk management that have been made post-crisis by FBOs, foreign and other U.S. regulators, and indeed by the Federal Reserve itself.** Taken together, these efforts have served to make the financial system more resilient to stress, including liquidity-induced stresses. Within the U.S., bank and broker-dealer operations and balance sheets are considerably more conservative today than in the conditions leading into the financial crisis.

- **The supervisory framework detailed in the NPR does not reflect either the Congressional statutory mandate in Section 165(b)(2) to account for comparable home country standards, or the efforts of global supervisors to implement an enhanced,**

coordinated approach to cross-border supervision. The NPR's insular focus on stand-alone U.S. operations does not account or adjust for the relative strength of home country regulation, the ability of the parent bank to serve as a source of strength, or the existing risk, capital, or liquidity profile of the parent bank or its U.S. operations.

- **We believe Congress was clear in its directive that regulation implementing Section 165 directly reflect an assessment of the comparability of home country standards in order to incentivize global regulatory convergence.** Application of the NPR's one-size-fits-all requirements to all FBOs effectively treats all FBOs and home country regulators the same, with no credit given to regulatory cooperation and no incentives in place to encourage regulatory counterparts in non-comparable jurisdictions to improve oversight.

- **The design of the NPR's proposed leverage ratios distorts assessments of capital adequacy when applied on a geographic, sub-consolidated basis and thereby favors certain structures and business models over others.** An assessment of capital adequacy at any level of a global firm should demonstrate that the subsidiary, or collection of subsidiaries, has enough capital to reflect risks undertaken. To achieve a robust assessment of capital adequacy, review of risk-based capital should be supplemented by a review of performance under a range of stress conditions. The design of the leverage ratios, however, distorts assessments of capital adequacy when applied on a geographic, sub-consolidated basis. IHCs with smaller U.S. bank subsidiaries relative to U.S. broker-dealer subsidiaries would appear undercapitalized when assessed by the proposed leverage ratios, even where they are well-capitalized on a risk-based basis and under stress test conditions.

- **Application of the proposed leverage ratios to U.S. subsidiaries is not comparable to standards applied to U.S. peers.** The NPR states that the application of the U.S. leverage ratio to U.S. subsidiaries provides "parity in the capital treatment for U.S. bank holding companies," but this is simply not true. Rather than achieving this objective, the NPR would introduce a new leverage requirement specific to U.S.-based subsidiary assets that is not applied to U.S. peers. This requirement would be incremental to those applicable to both Barclays and U.S. peers at their U.S. bank subsidiaries and on a global, consolidated basis and is distinctly contrary to the statutory requirement in Section 165(b)(2) that expressly requires that the rules "give due regard to the principle of national treatment and equality of competitive opportunity."

- **Distortions introduced by the NPR's proposed leverage ratios would require certain FBOs to reassess and adjust U.S. business profile, on a basis unjustified by risk.** The IHCs of several leading FBOs would, if formed today, hold broker-dealers that comprise over 90% of the IHC assets, meaning that the proposed leverage ratios, which function well as a ratio for bank subsidiaries (given the mix and nature of the assets), would effectively be applicable to broker-dealer subsidiaries. As a result, many IHCs would appear undercapitalized under the proposed leverage ratios, even where they are well-capitalized on a risk-based basis and under stress test conditions. As a result, FBOs will reassess their U.S. business presence on the basis of structure, wholly unjustified by risk.

- **Application of the leverage ratios to only the U.S. assets of U.S. bank holding companies would be similarly distortive**. Given the differences in broker-dealer business mix and associated risks, U.S. headquartered bank holding companies with primarily U.S. broker-dealer subsidiaries would not meet the proposed leverage ratio standards if they were applied on the basis of U.S.-based capital to U.S.-based assets. This would be the case even where the ratios may be met at the top-tier bank holding company, on a global, consolidated basis.

- **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**. Compliance with the leverage ratios would by design require a sharp reduction of balance sheet, rather than risk reduction. For FBOs with primary dealer broker-dealers, balance sheet is primarily consumed by securities financing activities collateralized by low-risk, liquid U.S. Treasuries and agencies. Reduction in activities across FBO primary dealers in the market for U.S. Treasury obligations, which represent 12 of the 21 primary dealers and comprise an estimated 40% of primary dealer's balance sheet capacity, is likely to reduce market liquidity in U.S. government securities, with a corresponding increase in the cost of financing across asset classes. It is also likely to increase concentration in securities financing among U.S. banks and shift activity to the unregulated shadow banking sector.

- **The rigidity of the proposed regulatory construct is likely to limit the ability of FBOs to enter or expand into U.S. markets, potentially constraining the relatively free and open nature of U.S. financial markets and having the potentially unintended consequence of increasing the concentration of the U.S. banking sector and U.S. repo markets.** The design of the IHC-based framework is likely to introduce significant market distortions unintended by Congress.

- **The proposal contains no meaningful cost-benefit analysis that would address any of the above concerns.** Given the concerns outlined above, we strongly encourage the Federal Reserve to perform a quantitative impact study to assess the impact of the proposed IHC-based framework prior to implementing any final regulation.

The suggestions set out in more detail below are intended to support the Federal Reserve's expressed objectives and align with the legislative terms of Sections 165 and 166.

An overview of our suggestions includes:

- **The IHC-based framework should be adjusted to be applicable only under limited and clearly-defined conditions, to incentivize global regulatory convergence.** Rather than applying across-the-board to all FBOs on the basis of asset thresholds, the full range of U.S. IHC-based requirements proposed in the NPR should be applicable only where, for example, the home country supervisor of a banking organization with U.S. operations has not implemented standards that are comparable to those of the Federal Reserve, or where parent capitalization is deemed to put the FBO's ability to support its U.S. subsidiaries at risk. Such an approach would have the advantages of remaining relatively aligned with the existing supervisory framework and the open nature of U.S. markets to foreign firms considering expanding their U.S. business. At the same time, this approach encourages regulatory convergence between U.S. and home country supervisors. This approach would also have the advantage of being more closely aligned with existing supervisory practice and with the legislative directive articulated in Section 165(b)(2).

- **Application of standards to U.S. subsidiaries should be based on a rigorous comparability assessment.** Rather than apply the full-range of standards to U.S. operations, individual standards should be applicable only where they are not already applied by the home country supervisor.

- **Should the final rule mandate IHCs, the mandated restructuring of subsidiaries under the IHC should be limited to the largest entities within a FBO's U.S. organization.** Application of the requirement to only the largest entities (subject to a threshold of $10 billion, for example) would limit the costs and operational risks associated with a restructuring, while achieving the micro- and macro-prudential benefits that motivated the NPR's proposed approach.

- **The combination of risk-based capital requirements and stress tests are more appropriate indicators of capital adequacy than the leverage ratios.** To avoid the distortive effects of the leverage ratios as applied to U.S. assets only, risk-based capital standards, as well as supervisory and internal stress tests, should be used to provide an accurate and robust assessment of capital adequacy and avoid the distortions of leverage ratios applied on a geographic, sub-consolidated basis.

- **Should a leverage ratio specific to U.S. assets be maintained, it should be adjusted where assets are collateralized by U.S. government, agency, and other high quality collateral such as those defined as high-quality liquid assets under the Basel III LCR**. Adjusting for high-quality collateral would avoid the distortions that would be introduced by the proposed leverage ratios and, moreover, would encourage the holding of high-quality liquid assets as collateral. Should the Federal Reserve not choose to adjust the ratios, we encourage the Federal Reserve to consider applying only the Basel III leverage ratio as most appropriate of the proposed two ratios, given alignment with the group's global Basel III leverage ratio and given that the threshold is more appropriate for those banks with larger broker-dealer activities (serving its role as a leverage backstop more appropriately, rather than being a binding constraint).

- **Barclays strongly supports the points that have been raised by U.S. banks on the calculation of single counterparty credit limits and an exemption for exposures to central counterparties**. Barclays has long been subject to large exposure limits established by our home country regulator, and while we support the application of counterparty limits, we encourage the Federal Reserve reconsider the calibration of the proposed counterparty limits subject to completion of its quantitative impact study and work currently underway at the Basel Committee.

- **In addition, single counterparty credit limit requirements should be modified to permit exemptions of all sovereigns over a certain credit quality threshold, such as those that**

meet the definition of high-quality liquid assets under the LCR. This would more appropriately account for the unique nature of sovereigns and permit foreign sovereign authorities the same liquidity-enhancing provisions granted to the U.S. government. As currently proposed, a U.S. firm with operations outside of the U.S. would only be permitted an exemption for exposures to the U.S. sovereign, but would have to limit any exposure to non-U.S. sovereigns, regardless of credit quality. An FBO would be permitted to exempt U.S. sovereign and home sovereigns from the limits, but no others.

- **The results of the stress test and capital planning should account for the fact that the U.S. operations of FBOs are part of a broader group and should not ignore the implicit, but demonstrable and reliable, parent and affiliate support provided by that structure.** In particular, it will be important that the proposal also reflect and duly acknowledge the resilience of the consolidated banking organisation and the transferability of capital between the parent and its U.S. subsidiaries. Similarly, the Federal Reserve should not require the results of IHC stress tests to be publicly disclosed, since the results may have a distorting effect if they do not correctly account for parent and affiliate support.

- **The extraterritorial structure of the NPR's early remediation framework is inappropriate and unnecessary.** The NPR would include, as part of the early remediation framework, supervisory restrictions at the IHC that are triggered at the group level. The group-based minima proposed in the framework represent an extraterritorial requirement.

- **A final rule should consider a minimum five-year transition period upon issuance of a final rule.** Given the material implications of the proposed framework, the compliance timeframe should be extended to more closely reflect the enormous compliance and implementation burden that the NPR would impose.

The following sections are intended to provide more detail on these summary points.

I. Material and unwarranted shift in Federal Reserve supervision of FBOs

<u>Discontinuation of long-standing and successful approach to FBO supervision</u>

The NPR represents an approach to regulatory supervision that does not account or adjust for either the relative strength of home country regulation, or the capital and liquidity profile of the parent bank and its U.S. subsidiaries. In doing so, it effectively ignores the enhanced prudential standards that may already be applicable to global organizations and their U.S. subsidiaries. This material shift in framework, from an assessment of U.S. operations as part of a broader global group and in the context of home supervision, to a more limited focus on standalone U.S. operations, clearly runs counter to the Congressional directive that the Federal Reserve acknowledge the comparability of enhanced prudential standards applied by home jurisdictions to the global organization. Section 165(b)(2) specifically states:[9]

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[9] Section 165(b)(2) of the *Dodd-Frank Act*

> In applying the standards set forth in paragraph (1) to any foreign nonbank financial company supervised by the Board of Governors or foreign-based bank holding company, the Board of Governors shall –
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> (A) give due regard to the principle of national treatment and equality of competitive opportunity; and
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> (B) take into account the extent to which the foreign financial company is subject to home country standards that are comparable to those applied to financial companies in the United States.

The standards established by our home regulator, the PRA, and by the Federal Reserve are not in all ways identical, but they are in most ways comparable. We believe that this comparability forms the basis for effective and coordinated cross-border supervision that is critical to a financial market system functioning across nations.[10]

Little explicit incorporation of the substantial post-crisis improvements to supervision and risk management practices

International regulatory authorities, including the Federal Reserve, have coordinated closely over the past several years to design and implement a revised and significantly enhanced supervisory framework applicable to global banking organizations. The NPR expresses concern over the pace at which these regulatory enhancements are being implemented, but it strikes us that the Board could take the opportunity in the NPR to further incentivize and support global regulatory convergence. These developments reflect lessons learned from the recent financial crisis, and have largely been developed under the aegis of the Basel Committee and the Financial Stability Board, of which the Federal Reserve is part. To implement Section 165 in the most effective way, and to take into account Congressional mandates in Section 165(b)(2), the proposal should more explicitly incorporate these developments. Some of these efforts have included (but are not limited to):

- Significantly enhanced Basel-based capital standards (Basel 2.5 and Basel III);
- Common liquidity standards under development, including the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR);
- Framework for identifying Systemically Important Financial Institutions (SIFIs);[11]
- Regular supervisory stress testing of banking organizations;
- Resolution and recovery planning; and

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[10] This discussion is responsive to NPR Question 3.

[11] Subject to further requirements, including capital surcharges and related requirements

- OTC derivatives regulation.

Many home supervisory authorities, including our home supervisor, the PRA, apply these and related enhanced standards to banks based in their own jurisdictions. The PRA, for example, already applies enhanced liquidity standards to Barclays, which held a global liquidity pool of £171 billion at year-end 2012 (which includes liquidity risk needs for the U.S.), and Barclays has been subject to Basel 2.5 capital standards since December 2011 and is expected to be subject to Basel III requirements as of January 2014. The supervisory oversight applied by the PRA is clearly reflected in the provisions of Section 165, which direct the Federal Reserve and other authorities to apply similar enhancements to U.S. banks. That is, PRA standards applicable to Barclays on a global basis are substantially comparable – and in many instances super-equivalent – to the standards proposed in the NPR.[12]

Enterprise-wide regulation and supervision of Barclays by the UK PRA is complemented in the United States by the Federal Reserve's regulation and supervision of Barclays' U.S. operations, which in turn is supported by the regulation and supervision of our material U.S. subsidiaries by their primary functional regulators. We have worked closely with the Federal Reserve and the functional regulators of these material U.S. subsidiaries on enhancements to liquidity risk management, local capital levels, and related requirements, including a focus on maintaining a net due-to position at the New York Branch, and a required significant liquidity pool at BCI based on a supervisory liquidity stress. Barclays also submitted a U.S. resolution plan for our material U.S. legal entities to the Federal Reserve and FDIC in July 2012 as part of the first group of financial institutions to submit such plans.[13] We believe that the supervisory standards established by our home and U.S. host supervisors, together with Barclays' own internal risk management practices, have strengthened Barclays on a global, enterprise-wide basis, as well as with respect to U.S. operations more specifically.

Additionally, many banks have undertaken prudent commercial efforts to increase capital levels to reflect an enhanced post-crisis understanding of the risk of credit and market intermediation, and to increase their pools of liquidity to manage through future stress conditions. Taken together, these efforts have served to make the banking system more resilient, with enhanced capital and liquidity profiles of banks and with knock-on beneficial impact to the broader economy.

Ensuring that U.S. operations of foreign banks have robust capital and liquidity to support risks undertaken would require a different approach in cases where U.S. operations are not supported by a strong parent bank or where standards applied by the home supervisor are not comparable to U.S. standards. In such circumstances, the IHC-based framework proposed in the NPR would offer the Federal Reserve a platform to ensure that U.S. operations of such banks do not pose undue risk to the U.S. financial system. Importantly, the potential for application of the IHC-

[12] This discussion is responsive to NPR Question 3.

[13] See *Resolution Plans Required*, Federal Register, Volume 76, no. 211, November 1, 2011

based framework to such banks would serve to encourage bank executives to improve risk management and encourage foreign supervisors to apply more stringent home requirements.

The Federal Reserve has an existing successful framework upon which to build

The Federal Reserves long-standing supervisory framework has proved robust enough to accommodate material improvements to supervision post-crisis, and would be a more efficient construct on which to build the implementation of enhanced prudential standards than the proposed IHC-based framework.

The statutory mandate in Section 165(b)(2) describes the regulatory and supervisory approach to FBOs that the Federal Reserve has taken for many years.[14] For example, the Federal Reserve's historical approach to assessing the capital adequacy of FBOs with U.S. operations has placed primary emphasis on the extent to which the consolidated FBO satisfied home country capital standards that are consistent with the Basel capital framework to which U.S. banking regulators adhere. In doing so, the Federal Reserve has reflected the value of consistent international standards and the micro- and macro-prudential value of strong consolidated capital that can be deployed globally to wherever its loss-absorbing capacity is most needed. Under this existing approach, the Federal Reserve may use its authority over U.S. operations of FBOs to require foreign banks to implement changes to risk management, risk profile, governance, and other changes to U.S. operations as it deems necessary.

In the post-crisis period, Federal Reserve staff have operated under the existing framework to directly enhance their supervision of FBOs, including refining its supervisory strategy to focus more directly on revenue drivers and associated risks, increasing engagement with senior business line leaders, increasing emphasis on U.S.-specific risk management architecture, engaging in the ongoing development of a robust resolution plan for U.S. operations, and significantly increasing the size of its onsite examiners. By leveraging the flexibility of its existing supervisory framework for FBOs, the Federal Reserve has been able to successfully expand and enhance its supervisory toolkit for the U.S. operations of FBOs to address a variety of concerns highlighted by the recent financial crisis.

Suggested amendments

The IHC-based framework should be adjusted to apply only under limited and clearly-defined conditions, to be consistent with the statutory directive and to maintain important incentives for continued international regulatory convergence. The framework proposed under the NPR is less appropriately applied to those banks that already operate under robust, comparable, home-country standards and otherwise are well-managed and well-capitalized. A bank that:

[14] Federal Reserve oversight of foreign banking organizations is based on legislative authority granted under the International Banking Act of 1978 and as enhanced under the Foreign Bank Supervision Enhancement Act of 1991

- operates under a home country regime that applies standards comparable to those applied by the Federal Reserve;
- has a well-capitalized and liquid parent bank; and
- is well-capitalized and sufficiently liquid at the U.S. subsidiary level

should continue to be subject to the existing supervisory framework.

Application of the full range of NPR provisions only under limited circumstances would have the benefit of more closely aligning with the statutory mandate and being a continuation of an existing approach that has proven adaptable under stress and post-stress conditions.[15]

II. Application of capital and leverage requirements on a regional sub-consolidated basis

Barclays has been subject to Basel 2.5 standards globally since December 2011, and expects to be subject to Basel III standards as of January 2014. These standards will include the Basel III leverage ratio, which is already disclosed by Barclays prior to being formally adopted into PRA regulation. We believe that these requirements, together with stress testing conducted by internal management and by supervisors, serve to promote an effective and transparent assessment of financial institutions' global capital adequacy.

We understand the Federal Reserve's need to achieve a robust capital adequacy assessment of FBO U.S. subsidiaries. Conceptually, we think that an assessment of capital adequacy for FBOs should begin with an assessment of parent capitalization. A strong, well-capitalized parent should be available to support U.S. subsidiaries under stress conditions. In addition, the Federal Reserve should assess the adequacy of capital held in U.S. subsidiaries under risk-based standards applicable to them. This assessment should be supported by rigorous stress testing, in order to assess the adequacy of capital under current and prospective stressed conditions. A leverage ratio can serve as a complement to these risk-based measures, so long as it is a useful backstop to risk-weighted assets; however, a leverage ratio should never be designed so as to serve as a binding constraint, given the distortions this introduces.[16]

As discussed more fully below, we are specifically concerned that:

- The NPR introduces an additional leverage standard for FBOs, applicable to U.S. assets only, which is not required of U.S. bank holding companies.
- This additional requirement disadvantages FBOs with respect to U.S. peers and is inconsistent with Congress' explicit instructions to the Federal Reserve set forth in Section 165(b)(2).

[15] This discussion is responsive to NPR Question 8

[16] This discussion is responsive to NPR Question 17

- Applying the leverage ratio on a regional sub-consolidated basis will distort supervisory assessments of IHC capital adequacy, favoring certain FBOs on the basis of U.S. structure, rather than risk.

- As FBOs are important contributors to the securities financing, particularly repo, markets, we believe that a material reduction in their participation in these markets will affect funding rates and asset values in the underlying markets, including the U.S. Treasury market

- The proposal introduces a layering of capital requirements on a U.S. geographic basis, which is compounded by the fact that most U.S. subsidiaries are already subject to U.S. capital regulations by their primary regulators, and which will not yield incremental benefits for assessing capital adequacy

<u>NPR introduces additional leverage standards for FBOs that are not required of, and are not comparable to standards applicable to, U.S. bank holding companies</u>

Among the standards proposed in the NPR is a requirement that the consolidated IHC meet both the U.S. Tier 1 leverage ratio and a 'supplemental' leverage ratio based on the Basel III Tier 1 leverage ratio, in addition to risk-based capital standards also applicable to the IHC.[17]

Under existing requirements, the U.S. Tier 1 leverage ratio is applicable to U.S. bank holding companies at two levels: the U.S. subsidiary bank level and the level of the global, consolidated organization. Similarly, U.S. bank and bank holding company subsidiaries of FBOs must meet the U.S. Tier 1 leverage ratio in a consistent manner.[18] Similar to U.S. peers, Barclays PLC and other FBOs manage to a global, consolidated Tier 1 leverage ratio and will be subject to the Basel III Tier 1 leverage ratio on a global consolidated basis.[19]

The proposed application of the Tier 1 leverage ratios to the U.S. IHC introduces an additional leverage requirement to certain FBOs that is not required of U.S. bank holding companies.[20] Under the NPR, the U.S. Tier 1 leverage ratio would continue to be applicable on a consistent basis to U.S. bank subsidiaries of Barclays and U.S. peers. At the global, consolidated level, Barclays and U.S. peers will continue to be subject to leverage constraints. However, by requiring FBOs to meet additional leverage ratios at the IHC, in addition to those applicable at the bank subsidiary and the global group, the NPR subjects FBOs to an additional leverage requirement not applied to U.S. peers. This is in direct contravention of the Congressional

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[17] See NPR § 252.212

[18] For example, Barclays' U.S. bank subsidiary, Barclays Bank Delaware, reported a Tier 1 leverage ratio of 11.5% at December 31, 2012

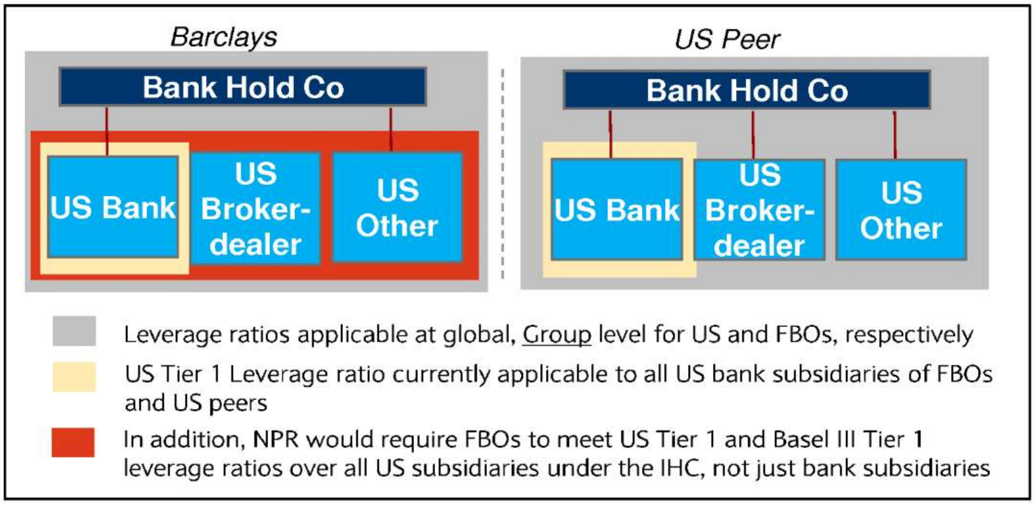
[19] On a global, consolidated basis, Barclays has managed to a Tier 1 leverage ratio on adjust gross leverage assets of 5% and will be subject to reporting and leverage constraints based on UK implementation of the Basel III Tier 1 leverage ratio

[20] This discussion is responsive to NPR Question 2

mandate set out in the statute, which instructs the Federal Reserve to "give due regard to the principle of national treatment and equality of competitive opportunity" in applying standards to FBOs.[21]

Figure 1 below illustrates the inconsistent application of additional leverage standards compared to U.S. peers.

Figure 1: Application of leverage ratios to Barclays and U.S. peer banking groups



The preamble to the NPR states that the Federal Reserve's intent in applying the leverage ratio and other U.S. bank holding company capital standards to IHCs is to "provide parity in the capital treatment for U.S. bank holding companies and the U.S. subsidiaries of foreign bank organizations on a consolidated basis."[22] In fact, the application of the leverage ratios at the level of the IHC does not introduce parity, but on the contrary introduces a geography-specific sub-consolidated requirement not applicable to U.S. peers.

The lack of parity is driven by the level at which the consolidated leverage ratios are required:

- U.S. bank holding companies are required under U.S. standards to meet the leverage ratio at the global, consolidated level. As a result, a U.S. bank holding company may account for Tier 1 capital located globally, including in jurisdictions outside of the United States.

- However, U.S. bank holding companies are not required to meet a U.S.-specific Tier 1 leverage ratio to account for only the balance sheet assets and Tier 1 capital located in the geographic U.S.

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[21] [21] Section 165(b)(2) of the Dodd-Frank Act

[22] See NPR preamble, Federal Register, Volume 77, no.249, December 28, 2012, pp. 76640

While U.S. peers are not required to meet a leverage ratio applicable to only consolidated U.S.-based capital and assets, the NPR would require such standards to be applied to FBOs. We note that several leading FBOs operate U.S. broker-dealers that account for 90% of their consolidated U.S. subsidiary assets. Were U.S. peers required to meet the same leverage requirements proposed in the NPR (i.e. applicable to only U.S.-based assets), a U.S. peer operating a U.S. broker-dealer subsidiary that comprises a majority of U.S.-based assets would appear undercapitalized, as illustrated in Table 1 below.

Table 1: Estimated leverage ratios of U.S. broker-dealer subsidiaries of the largest U.S. and foreign bank holding companies[23]

	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%

This would be the case even where the same peer would meet the leverage ratio on a global, consolidated basis.

IHC leverage ratios would distort assessments of capital adequacy

An assessment of capital adequacy at any level of a global firm should demonstrate that the subsidiary, or collection of subsidiaries, has enough capital to appropriately reflect the risks undertaken. To achieve a robust assessment of capital adequacy, an assessment of risk-based capital should be supplemented by a review of performance under a range of stress conditions. A leverage ratio may also supplement the assessment, so long as the leverage ratio serves as a robust backstop ratio, rather than a binding constraint.

The design of the leverage ratios introduces distortions in assessments of capital adequacy when applied on a geographic, sub-consolidated basis, as proposed in the NPR. While the leverage ratios function well as a backstop ratio for bank subsidiaries given the mix and nature of their assets, the leverage ratios would suggest that U.S. broker-dealer subsidiaries are significantly undercapitalized, even where this does not bear out under stress conditions.

To illustrate the consequences of applying a non-risk-sensitive leverage ratio to an FBO's U.S. operations regardless of business mix, Table 2 offers a generic example of two subsidiaries: a banking subsidiary with a balance sheet comprised of a loan book (typically risk weighted at 100%) and a broker-dealer subsidiary with a balance sheet comprised primarily of highly-liquid cash trading and securities financing.

Table 2: U.S. Tier 1 leverage ratio impact

[23] 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.

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 2 illustrates the distortive effects of the leverage ratios. Comparing the adequacy of capital supporting the risk profiles of the two entities, we note:

- Both entities exceed Tier 1 risk-based capital minima, with comparable ratios at 10%; and
- Both entities exceed Tier 1 risk-based capital minima on a post-stress basis, at 7% for the bank and 8% for the broker-dealer.

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 and primarily reflect balance sheets. In effect, a U.S. geographic leverage ratio favors the growth of U.S. bank subsidiaries relative to U.S. broker-dealers.

<u>Applying the leverage ratio on a sub-consolidated basis will have the unintended consequence of driving FBOs to fundamentally reconsider their U.S. business presence on a basis of structure, wholly unjustified by risk</u>

The U.S. business profiles of FBOs exhibit substantial diversity; certain FBOs operate primarily U.S. broker-dealer activities, while others operate primarily through U.S. banking subsidiaries. FBO business profiles, as noted in the preamble to the NPR, exhibit this diversity because of prior decisions to enter certain U.S. markets based on business opportunities that mapped most effectively to their global organizations. Indeed, U.S. financial markets have historically been open to FBOs seeking to expand offerings in the United States. This openness has benefited U.S. consumers and corporations by increasing competition among financial services institutions, so long as the FBO's U.S. subsidiaries complied with regulatory requirements applicable to them. Per the preamble to the NPR:

> *"As a result of this flexibility granted to foreign banking organizations in the United* States, the current population of foreign banking organizations is structurally diverse. Some foreign banking organizations conduct U.S. banking activities directly through a branch or agency; others own U.S. depository institutions through a U.S.- based bank *holding company; and still others own a U.S. depository institution directly."*[24]

[24] See NPR preamble, Federal Register, Volume 77, no. 249, December 28, 2012, pp. 76629

The IHCs of several leading FBOs would, if formed today, hold broker-dealers that comprise over 90% of the IHC assets, meaning that the proposed leverage ratios would effectively be applicable to U.S. broker-dealer subsidiaries. As a result, many IHCs would appear undercapitalized under the proposed leverage ratios, even where they are well-capitalized on a risk-based basis and under stress test conditions. The consequence of this distortion is that FBOs whose U.S. operations consist primarily of broker-dealers will be driven to reassess their U.S. business presence on a basis wholly unjustified by risk.

- An FBO with a large U.S. bank subsidiary relative to its broker-dealer subsidiary will be minimally impacted as the U.S. bank subsidiary must already meet the U.S. ratio
- An FBO with a large U.S. broker-dealer and smaller U.S. bank subsidiary will be highly impacted: highly-collateralized lending arrangements receive a low Basel risk-weight, but this type of arrangement is treated exactly the same as highly risky lending as there is no adjustment for risk

In addition to the IHC restructuring that will be required of all FBOs (but not U.S. bank holding companies), FBOs whose U.S. operations consist primarily of broker-dealer operations will be required to materially reduce the amount of low-risk, but balance sheet consumptive, assets that are booked in the U.S. The likely outcome will be a substantial reduction in broker-dealer activities, such as securities financing, including repo, relative to banking activities. Further, FBOs that are considering entry into the U.S. market by establishing independent broker-dealer operations will face an effective barrier to entry. The resulting lack of competition engendered by FBO withdrawal from these types of activities will present knock-on impacts to the repo market and the markets for underlying collateral, in particular the market for U.S. Treasury obligations.

Leverage ratio impact on secured financing, including the repo market

FBO broker-dealers are important participants in the U.S. securities financing markets, constituting over 40% of balance sheet capacity in the $2.3 trillion dollar repo market.[25] A diverse and robust repo market is critical to the efficient and effective functioning of the underlying cash markets. Indeed, this is particularly the case for the U.S. Treasury market where the repo markets facilitate Federal Reserve open market operations, as well as price discovery for the underlying cash markets. Robust repo and securities lending markets allow broker-dealers to offer sizeable liquidity without needing to fund inventories in every security and facilitate settlement and covering of short positions.[26] Repo markets also enable the posting of collateral in a cost-effective manner, key to fulfilling the Title VII goals of the Dodd-Frank Act. Almost 80%

[25] Sources include SNL Financial, company filings, and 2012 FOCUS report filings.

[26] Indeed the Federal Reserve recognizes the importance of providing liquidity to these markets through the provision of specials liquidity in the SOMA securities lending program.

of the $2.3 trillion repo market represents government collateral (Treasuries, MBS, and Agencies).

By applying a leverage ratio designed for depository institutions to a broker-dealer model, the current proposal has the unintended consequence of forcing the re-think of business models of many FBOs, particularly those with a large broker-dealer presence and smaller retail banking operations. This is likely to result in both a material reduction in repo market liquidity and further concentration of the repo market among existing U.S. money center banks. Further concentration of these markets will have the effect of increasing systemic risk, while decreasing liquidity in the repo markets will have a direct impact on underlying asset prices. Fontaine and Garcia note that "funding liquidity predicts a substantial share of the risk premium of Treasury bonds" and that "the impact is large and pervasive through crisis and normal times".[27] Higher funding costs resulting from shrinking repo activity will boost the U.S. Treasury's borrowing costs.

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 Treasuries[28] 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.

Finally, the largest users of the repo market are primary dealers, and the ability to finance inventory in a cost-effective manner is key to primary dealer operations. We estimate that primary dealer inventories (of government securities, corporate bonds, and ABS) total approximately $345 billion. While some portion of that amount is financed by other means, we are concerned that any material reduction in repo market liquidity may have a negative impact on primary dealers' ability to facilitate Treasury purchases. Moreover, over 80% of the repo done by U.S. money market funds is with primary dealers – and a substantial amount of this collateral belongs to non-U.S. institutions. Reducing the size of the repo market means that money market funds – with $2.5 trillion in assets of which roughly one-third is invested in repo – will scramble to find some amount of replacement investments. In the current environment where banks are shrinking balance sheets, reducing repo market activity further is likely to push money funds towards increasing their unsecured bank exposures. In turn, this might boost the overall risk profile of money fund assets.

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[27] Fontaine, Jean-Sebastien and Garcia, René, Bond Liquidity Premia (June 30, 2009). Review of Financial Studies, (2012) 25 (4):1207-1254; EFA 2009 Bergen Meetings Paper.

[28] http://www.federalreserve.gov/releases/h41/current/h41.pdf

[29] http://www.federalreserve.gov/monetarypolicy/files/fomcminutes20130320.pdf

Layering of U.S. capital requirements

Most positions booked in U.S. subsidiaries of FBOs are already subject to (i) existing U.S. requirements imposed by the subsidiaries' primary U.S. regulator and (ii) capital standards established by home country supervisory authorities on a global, group-wide basis. In effect, the consolidated calculation of capital adequacy that Barclays would be required to perform for an IHC would be incremental to the requirements already established by U.S. supervisory authorities for our principal U.S. subsidiaries.[30] These would also be incremental to the enhanced capital requirements applied by the PRA under its Basel–based framework on a group-wide basis inclusive of exposures held in U.S. entities.[31] The multiple regimes of capital requirements to which Barclays U.S. positions would be subject are illustrated in Table 3 below.

Table 3: Multiple capital requirements

Exposure	Entity	Already required		IHC requirements (incremental)	
		UK	US	US	
Loan	US bank subsidiary	UK Basel II and, when finalized, Basel III	US Basel I and, when finalized, US standardized rules and Basel III	US Basel II advanced approaches	
Cash bond	US broker-dealer subsidiary	UK standardized market risk capital requirements (Barclays subject group-wide to Basel 2.5)	SEC Net Capital; CFTC; and FINRA	US Collins Amendment Floor	US Basel 2.5 standards for market risk

The further layering of capital requirements on a U.S. geographic basis does not have incremental benefits for assessing capital adequacy that could not otherwise be achieved using existing requirements. Instead, the regional calculations introduce significant challenges for capital management given both the range of U.S. requirements already established and reported, and several key distinctive attributes of the U.S. requirements. Capital calculations under the regimes of multiple jurisdictions leads to significant infrastructure and compliance costs and the additional IHC capital requirements proposed by the Federal Reserve would unjustifiably disadvantage FBO IHCs that will be subject to multiple sets of both home and U.S. capital methodologies for their U.S. operations.

Finally with respect to the capital standards, we note that it is not immediately clear how the NPR's debt to equity limit of 15:1 for IHCs deemed to pose a 'grave threat' to U.S. financial

[30] BBDE, for example, is required to meet standards established by the FDIC and by the Federal Reserve for its holding company. Requirements for BCI are established by the SEC, CFTC and FINRA.

[25] The group Core Tier 1 ratio under Basel 2.5 standards was 10.9% at year-end 2012. In addition to those requirements applicable to Barclays under these standards, additional capital for risks potentially not captured under the Pillar 1 measure is held under Pillar 2 as per PRA requirements.

stability should interact with the leverage requirement. It is also unclear how such a restriction for a firm in this position could be achieved to the extent it was not previously compliant.

Suggested Amendments

U.S-specific capital adequacy should be assessed using risk-based capital ratios and supplemented by stress tests, to avoid the distorting effects of the leverage ratios at the sub-consolidated level. Stress tests applied to U.S. subsidiaries offer management and the Federal Reserve a critical understanding of capital adequacy in addition to that offered by risk-based capital ratios. Critically, stress tests 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 capital ratios. Stress tests thus have become a cornerstone of supervisory policy, providing vital additional insight for assessments of risk management and capital adequacy. Given the negative consequences of the proposed leverage ratios discussed above, we propose that Federal Reserve assessments of U.S. subsidiary capital adequacy should be primarily founded on risk-based capital ratios and the results of stress tests for FBO U.S. subsidiaries instead of a leverage requirement.

Should a leverage ratio specific to U.S. subsidiary assets be maintained, it should be adjusted where assets are collateralized by U.S. government, agency, and other high quality collateral such as those defined as high-quality liquid assets under the Basel III LCR. Should the Federal Reserve determine that a leverage ratio is required to be applied on a regional sub-consolidated basis to FBO U.S. subsidiaries, at a minimum it should be adjusted for U.S. Treasury, agency, or other highly liquid, high-quality instruments, or assets that are collateralized by those instruments. This approach avoids unnecessarily reducing the availability of financing and liquidity in the markets for such instruments and thereby increasing costs for the U.S. government and other issuers of those instruments. Should the Federal Reserve not choose to adjust the ratios, we encourage the Federal Reserve to consider applying only the Basel III leverage ratio as most appropriate of the proposed two ratios, given alignment with the group's global Basel III leverage ratio and given that the threshold is more appropriate for those banks with larger broker-dealer activities which generally have highly liquid, lower-risk assets on their balance sheets than depository institutions (serving its role as a leverage backstop more appropriately, rather than being a binding constraint).

III. Mandatory restructuring under an IHC

A principal element of the framework proposed in the NPR is the requirement that FBOs with U.S. subsidiary assets in excess of $10 billion restructure all U.S. subsidiaries under an IHC. While we can appreciate the appeal to the Federal Reserve of applying a uniform structure to U.S. subsidiaries of FBOs, the restructuring contemplated in the NPR imposes unnecessary costs and operational burdens, is not required to achieve the objectives expressed in the NPR, and therefore should not be a uniform requirement for FBOs under the final rule.

The mandated restructuring of U.S. subsidiaries of FBOs is not contemplated in either Section 165 or Section 166 of the Dodd-Frank Act. The establishment of an IHC is expressly contemplated by the Dodd-Frank Act in instances in which a systemically important nonbank financial firm is part of a larger organization including commercial (non-financial) activities.[32] In such instances, the logic of establishing an intermediate holding company to separate and consolidate financial activities subject to oversight from non-financial, commercial activities is compelling. However, Congress did not elect to mandate an IHC structure in Sections 165 and 166. Given that U.S. operations of FBOs are already subject to oversight by the Federal Reserve and material legal entities are subject to supervision by their primary regulators, any such requirement was and is unnecessary.

Indeed, the objectives expressed by Congress and reaffirmed in the NPR can be achieved without the burdens imposed by mandatory restructuring under an IHC. Capital, risk, and liquidity profiles can be assessed on a 'virtual' basis, supported by revisions to the local reporting architecture, and complemented by information collected from the primary supervisors of an FBO's material legal entities. Similarly, supervisory assessments can be further supported by stress tests applied to U.S. subsidiaries on an individual or collective basis.[33]

Suggested Amendments

As described above, the Federal Reserve can effectively monitor the capital, risk and liquidity of the U.S. operations of FBOs without imposing the unnecessary cost and burdens of a mandatory restructuring. At the very least, we suggest a tailored approach that requires an IHC only under formally-established conditions and limited in scope to material legal entities, as discussed below. With respect to potential tax costs of the IHC, Barclays supports the industry initiatives explained in the IIB letter.

The IHC requirement should be adjusted to be applicable only under limited and clearly-defined conditions, to incentivize global regulatory convergence. As currently proposed, the Federal Reserve will require FBOs to form a U.S. IHC based strictly on whether U.S.-based subsidiary assets exceed $10 billion. The Federal Reserve could instead limit the mandatory requirement of an IHC to circumstances in which either an FBO is unable to demonstrate a comparable home country supervisory regime, or an FBO's U.S. subsidiaries are deemed to be otherwise inadequately capitalized or managed. Such an approach would have the advantages of remaining relatively aligned with the existing supervisory framework and the open nature of U.S. markets to foreign firms considering expanding their U.S. business. At the same time, this approach would encourage regulatory convergence between U.S. and home country supervisors. This approach would also have the advantage of being more closely aligned with existing supervisory practice and with the legislative directive articulated in Section 165(b)(2).[34]

[32] See Dodd-Frank § 113, 167, and 626

[33] This discussion is responsive to NPR Questions 1, 3, 8, and 10

[34] This discussion is responsive to NPR Question 8.

Should the final rule mandate IHCs, the mandated restructuring of subsidiaries under the IHC should be limited to the largest entities within a FBO's U.S. organization. In circumstances in which an IHC is required, we encourage the Federal Reserve to revisit the structure and composition of the IHC. Many of an FBO's merchant banking investments, for example, have historically not been reportable to banking supervisors, consistent with the minimal risk to the bank or financial system associated with such investments. Moving these investments into the IHC would trigger significant restructuring and other costs for the FBO and its stakeholders that are not otherwise justified by any supervisory or financial stability benefits. Only entities over which the FBO has practical control and that pose a material threat to financial stability of the U.S. should be migrated into the IHC structure. Application of the requirement to only the largest, practically controlled subsidiaries(subject to a threshold of $10 billion, for example) would limit the costs and operational risks associated with a restructuring, while achieving the micro- and macro-prudential benefits that motivated the NPR's proposed approach.[35]

IV. Risk management and risk committee requirements

Barclays recognizes the importance of robust risk management governance to ensure that the risks undertaken in the course of banking activities are identified, measured, monitored and actively managed on an ongoing basis. Risk management objectives should incorporate a clear formulation of risk appetite and formalize the relationship of the expressed risk appetite with the business profile and strategy. Business strategy should, in turn, be well supported by an effective risk infrastructure, subject to independent review and challenge, and tested under a range of adverse conditions. At Barclays, an effective risk management framework and strong risk culture is critical to our business and firmly aligned with our strategy.

Our commitment to strong risk management is as applicable on a global enterprise-wide basis as it is to the activities we undertake in the United States. We therefore appreciate the objective of the NPR to ensure that the U.S. operations of FBOs are subject to robust risk management oversight. In particular, we consider that the NPR appropriately offers FBOs the flexibility to incorporate the U.S. risk committee as part of the enterprise-wide risk committee. Alignment with the group's enterprise-wide risk committee will ensure that oversight of the risks to U.S. operations are closely aligned with the firm's overall risk appetite and business objectives, while also ensuring that U.S.-specific risks are appropriately monitored and controlled.

<u>Suggested Amendments</u>

Risk committee requirements. The final rule should grant FBOs flexibility in determining whether the requirements to be undertaken by the U.S. risk committee are best served by a risk committee of the board, a management committee or other independent risk management function, as long as the board of directors has specifically delegated responsibility to that body.

[35] This discussion is responsive to NPR Question 10.

In addition, the final rules should not prescribe that the risk committee include an independent member whose lack of familiarity with the day-to-day running of the business may inappropriately handicap their effectiveness. FBOs should be able to ensure risk management independence by more appropriate measures, including, for example, an autonomous reporting line directly to the CEO or board level.[36]

Role of the CRO. We appreciate the value in having a single risk officer responsible for overseeing the risk management framework for U.S. operations and liaising with the Federal Reserve. Identifying the appropriate mandate and reporting structure for this officer, however, may vary depending on the profile of an FBO's U.S. activities. For example, the most qualified officer to adopt the role of U.S. chief risk officer ("CRO") may already have a global CRO role or may oversee the activities that primarily drive U.S. presence, such as investment banking. The best qualified candidate may already be an officer of the bank, and it may be advantageous to allow the individual to maintain a global scope and balanced view by continuing their current duties alongside those of the U.S. CRO.[37]

U.S. risks should be considered in global context. Finally, we note that focus on U.S.-specific risks should not be overly narrow, as this detracts from the overall quality of enterprise risk management and creates an unbalanced view of risks undertaken. By way of example, investment banking activities are typically undertaken in the broker dealer subsidiary. U.S. securities law requires that securities business conducted in the U.S. be booked in the broker-dealer, which typically results in a long inventory position of cash securities used to provide services to clients. In order to manage the financial risk of this inventory, these positions are often hedged with derivative transactions such as credit default swaps ("CDS"). However, the booking of OTC derivatives, such as CDS, in a broker-dealer is prohibited. Since for FBOs the booking entity for CDS may be outside of the IHC, the result would be a potential distortion of the actual financial risk being undertaken by the FBO. It may also distort capital requirements, stress testing results, and other risk analytics undertaken purely at the IHC level.

V. Single counterparty credit limits

Barclays has long operated under large exposure limits, the requirements of which are largely analogous to the proposed single counterparty credit limits (the "SCCL").[38] As a general matter, given the intent of limiting counterparty exposure, Barclays supports the application of similar requirements to U.S. banks. However, and critically, Barclays strongly supports the points that have been raised by U.S. banks on the calculation of SCCL and the need for an exemption for

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[36] This discussion is responsive to NPR Questions 57-63 and 65-66

[37] This discussion is responsive to NPR Question 67

[38] See Prudential Sourcebook for Banks, Building Societies, and Investment Firms (BIPRU), Section 10, *Large Exposures Requirements* (http://fshandbook.info/FS/html/handbook/BIPRU/10)

exposures to central counterparties. We view the quantitative impact study to be undertaken by the Federal Reserve as an important step, and we are hopeful that it will lead to a more nuanced and accurate risk-based approach.

In addition to the many points highlighted by U.S. banks and industry trade associations following the issuance of the proposed rule for U.S. banks last year, we would like to underscore in particular the need for a risk-based framework in the context of sovereign exposures. Currently U.S. banks only benefit from an exemption for U.S. sovereign and agency exposures. FBOs, by contrast, would benefit from an exemption for both U.S. sovereign and home country sovereign exposures. However, these requirements would create material implications for foreign sovereign liquidity where both FBOs and their U.S. peers are transacting in obligations outside their home markets. To permit foreign sovereign authorities the same liquidity enhancing provisions which have been granted to the U.S. government, the SCCL requirements should be modified to permit exemptions of all sovereigns over a certain credit quality threshold.[39]

Finally, the NPR should require the limits be applied to U.S. operations on the basis of global, enterprise-wide capital only, rather than to both the IHC and U.S. operations. As detailed in the IIB Letter, exposure limits applicable to the IHC based on IHC capital inappropriately put the FBOs at a disadvantage to the U.S. banks by applying the limits on a regional, rather than a global, basis, and disregarding offshore hedges and other offsets. We also echo the IIB's practical concerns about the negative impact the regional limits will have on FBO's ability to engage in proper credit risk management, given the cross-default provisions included in the NPR.[40]

Suggested amendments

Barclays strongly supports the points that have been raised by U.S. banks on the calculation of single counterparty credit limits and an exemption for exposures to central counterparties. Barclays has long been subject to large exposure limits established by our home country regulator, and while we support the application of counterparty limits, we encourage the Federal Reserve reconsider the calibration of the proposed counterparty limits subject to completion of its quantitative impact study and work currently underway at the Basel Committee.

In addition, single counterparty credit limit requirements should be modified to permit exemptions of all sovereigns over a certain credit quality threshold, such as those that meet the definition of high-quality liquid assets under the LCR. This would more appropriately account for the unique nature of sovereigns and to permit foreign sovereign authorities the same liquidity-enhancing provisions granted to the U.S. government. As currently proposed, a U.S. firm with operations outside of the U.S. would only be permitted an exemption for exposures to the U.S. sovereign, but would have to limit any exposure to non-U.S. sovereigns, regardless of

[39] This discussion is responsive to NPR Question 39.

[40] This discussion is responsive to NPR Question 35.

credit quality. An FBO would be permitted to exempt U.S. sovereign and home sovereigns from the limits, but no others.

VI. Stress testing requirements on a sub-consolidated basis

We acknowledge the need for the Federal Reserve to ensure that U.S. subsidiaries are appropriately capitalized on a post-stress basis, so that it can be assured that U.S. subsidiaries will not require support in times of stress. However, the stress test and capital planning must take into account the fact that FBOs are global enterprises, monitored by their home country supervisors, who, alongside U.S. regulators, analyze the resiliency of the FBO's U.S. operations on a regular basis. Barclays is subject to a regular stress test applied to the group by the PRA, which informs the formal Pillar 2 assessment applied to Barclays. The stress test requirements applied by the PRA are clearly comparable to those required of U.S. banks. Where an FBO's home supervisory regime is considered equivalent to the U.S. regime, there would be considerable risk management benefits associated with relying on the home supervisory regime to set the scenarios and timing for stress testing.

It is optimal to conduct a stress test on an FBO's U.S. subsidiaries as part of a stress test on the consolidated FBO, as opposed to conducting standalone stress tests on the consolidated U.S. subsidiaries. In order to assess fully the resilience of the IHC to adverse scenarios, it is also important to understand the resilience of the consolidated banking organisation and the transferability of capital between the parent and the U.S. subsidiaries. In addition, exposures and their associated hedges sometimes reside in different legal entities – and, in the proposed construct of an IHC, may reside on different sides of the boundary of an IHC. Conducting stress tests in the context of the consolidated FBO would enable the recognition of associated offsetting risks that is necessary for an accurate picture of the safety and soundness of the institution. Finally, given these complexities, the fact that any potential IHC is unlikely to have external equity investors, and the potential for confusion amongst FBO investors in parsing sub-consolidated numbers without appropriate context, publication of stress test results for IHCs should not be required.

<u>Suggested amendments</u>

The results of the stress test and capital planning should account for the fact that the U.S. operations of FBOs are part of a broader group and should not ignore the implicit, but demonstrable and reliable, parent and affiliate support provided by that structure. In particular, it will be important that the proposal also reflect and duly acknowledge the resilience of the consolidated banking organisation and the transferability of capital between the parent and its U.S. subsidiaries. Similarly, the Federal Reserve should not require the results of IHC stress tests to be publicly disclosed, since the results may have a distorting effect if they do not correctly account for parent and affiliate support.[41]

[41] This discussion is responsive to NPR Question 16

VII. Liquidity risk management

The NPR appropriately highlights the importance of robust liquidity risk management. As evidenced during the recent crisis, a highly liquid, unencumbered pool of assets is critically important to offset the risk of liquidity stress conditions. Reflecting its commitment to managing potential liquidity risk, and in compliance with the prudential oversight of the PRA, Barclays had a liquidity pool of £171 billion at year-end 2012 (including anticipated liquidity risk needs in the U.S.). Barclays is engaged with its U.S. regulators on an ongoing basis to ensure a robust U.S. liquidity risk profile, including the maintenance of a net due-to position with respect to the branch network, and the maintenance of a liquidity pool in BCI.

The standards proposed in the NPR are both aligned with those already applied by the PRA to Barclays on a group-wide basis and reflective of Barclays' internal liquidity risk management policies and procedures. On an enterprise-wide basis, Barclays is required to hold sufficient liquidity to meet liquidity stress tests established by the PRA under the internal framework that establishes the firm's liquidity risk appetite. These stress tests (which include idiosyncratic, market-wide, and combined stresses) inform the size of the liquidity pool held by Barclays, which is the absolute gross size of unencumbered liquid assets held, primarily in the form of high quality government debt and cash held at central banks.[42] The enterprise-wide stress testing process is a daily process conducted across all branches and major legal vehicles, both on a stand-alone and consolidated basis, and the group liquidity risk appetite is approved by the Board and shared with the PRA.

While Barclays looks to the PRA to provide prudential oversight of the stress tests that are used to manage liquidity on an enterprise-wide basis, Barclays is also fully engaged with U.S. regulators. In addition to ongoing engagement with the Federal Reserve on its liquidity profile, Barclays has implemented a comprehensive, conservative framework for its U.S. broker-dealer under the auspices of the SEC, with the resulting liquidity risk mitigated by a BCI-domiciled liquidity pool.

The existing SEC broker-dealer stress test model for BCI appropriately applies the same treatment for internal flows as for external flows. The proposed bifurcated treatment of internal and external flows under the net stressed cash flow calculation is inconsistent with the global client coverage requirements for a business that executes across different legal entities. For example, in some instances a subsidiary may receive funding from its non-U.S. parent to fund activity with an external counterparty. In this instance, the funding serves a specific purpose (to provide funding to a U.S. subsidiary to support external flows), but under the proposal the IHC

[42] In addition, at December 31, 2012, based on the revised Basel standards, Barclays exceeds the Basel III Liquidity Coverage Ratio (LCR), with an estimated LCR of 126%, and the Basel III Net Stable Funding Ratio (NSFR), with an estimated NSFR of 104%

would have to hold liquidity for the internal outflow (net internal stress) separately for the liquidity required for external stress, so instead of offsetting, the risks are additive.[43]

Finally, the final rule should clarify that excess liquidity above and beyond stress requirements at an entity within the IHC (such as a broker-dealer) should be available to offset flows elsewhere in the IHC (i.e. a bottom-up stress view rather than a top-down view).

VIII. Extraterritorial reach of early remediation requirements

The early remediation framework proposed in the NPR would impose remediation triggers based on both IHC capital and group capital thresholds. For example, Level 2 (Initial Remediation) actions are triggered on the basis of capital thresholds when:[44]

- IHC risk-based capital ratios minima are exceeded by less than [200-250] basis points or where any leverage ratio minima are exceeded by less than [75-100] basis points;

or

- Group risk-based capital ratio minima are exceeded by less than [200-250] basis points or where any leverage ratio minima are exceeded by less than [75-100] basis points.

While monitoring of group capital strength may form a reasonable assessment of the parent's ability to serve as a source of strength, the incorporation of leverage minima into the framework effectively imposes extraterritorial requirements on the parent that are otherwise not incorporated into global agreement. The preamble suggests that the Basel III capital conservation buffer is similar in design, but we note that the capital conservation buffer is based on risk-based, rather than leverage, minima.[45] While Barclays manages to a leverage standard and will be subject to the Basel III leverage ratio, an effective requirement under the early remediation framework to hold a buffer above leverage standards is a clear and unwarranted extraterritorial requirement that should not be included in the final rule.[46]

Suggested amendments

The extraterritorial structure of the NPR's early remediation framework is inappropriate and unnecessary. The NPR would include, as part of the early remediation framework,

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[43] This discussion is responsive to NPR Questions 24, 25, and 34.

[44] See NPR § 252.282

[45] See NPR preamble, Federal Register, Volume 77, no. 249, December 28, 2012, pp. 76671, footnote 123

[46] This discussion is responsive to NPR Question 19. We note that the final rule implementing the Collins Amendment was clear that U.S. capital rules would not be extended to the parent organization, although they might be evaluated on a case-by-case basis. See *Risk-Based Capital Standards: Advanced Capital Adequacy Framework – Basel II; Establishment of a Risk-Based Capital Floor*, Federal Register, Volume 76, no. 124, June 29, 2011(at 37622-37623)

supervisory restrictions at the IHC that are triggered at the group level. The group minima proposed in the framework represent an extraterritorial requirement and should be omitted from the final rule.

IX. Transition period

As emphasized in earlier sections of this letter, any material revisions to the structure of U.S. subsidiaries of an FBO will require a substantial operational effort to comply with the full range of regulation. In addition to the structural and operational restructuring required to form and manage an IHC, we note the following substantive incremental requirements proposed to apply to the U.S. operations of an FBO include:

- Additional capital, liquidity, and leverage compliance and reporting requirements
- Bespoke capital and liquidity stress testing
- Risk management architecture revisions, and
- Single counterparty limits and exposure reporting.

In effect, FBOs will be required to become compliant in a 'big bang' manner with all of these standards, within a timeframe that would be a challenge for meeting any one of these individual standards on their own. Such a 'big bang' compliance effort implies significant operational, legal, tax and other complexities that require time to identify, resolve, and manage.

We recognize, of course, that the Federal Reserve intends to apply standards to FBOs within a reasonable timeframe that minimizes unnecessary market disruption. We note, however, that comparable standards have been proposed with compliance timeframes more closely reflective of the compliance effort required. For example, the Basel III framework phases in over a six-year period, while the UK ICB requirements (while not finalized) would phase in requirements over a similar time period.

Finally, we note that since the rulemaking is currently in the proposal and comment period, the issuance of a final rule is prospective and will compress the compliance timeframe further. For example, if a final rule is issued in the fourth quarter of 2013, FBOs would have a year and a half to comply with the proposed effective date of July 1, 2015.[47]

[47] This discussion is responsive to NPR Questions 4-5

Suggested amendments

We recommend that the Federal Reserve adopt a minimum five-year transition period upon the issuance of a final rule.

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We appreciate the Federal Reserve's consideration of the views set forth in this letter and welcome the opportunity to discuss any part of this letter in greater detail.

Yours sincerely,

Hugh E McGee III

Hugh (Skip) E. McGee III
Chief Executive Officer
Barclays Americas

ANNEX A: GEOGRAPHIC LEVERAGE RATIOS AND CAPITAL ADEQUACY

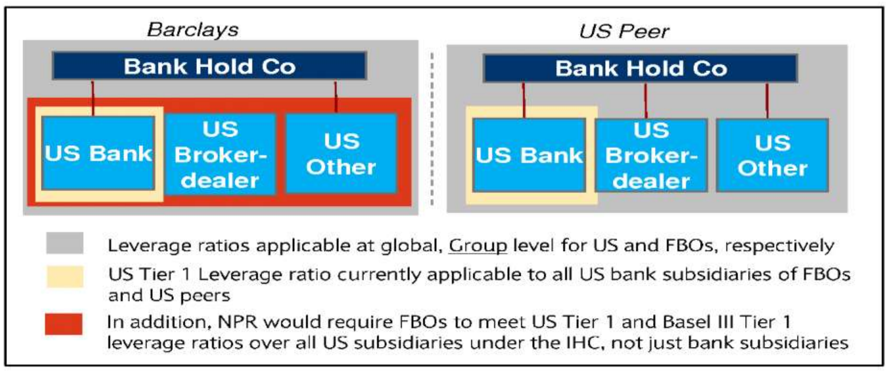
The NPR would require the consolidated IHC to meet both the U.S. Tier 1 leverage ratio and a 'supplemental' leverage ratio based on the Basel III Tier 1 leverage ratio, in addition to risk-based capital standards also applicable to the IHC. The proposed leverage ratios would:

- Introduce additional, geography-specific leverage requirements not applicable to U.S. peers;
- Distort assessments of IHC capital adequacy; and
- Require IHCs with a primarily U.S. broker-dealer presence to reassess U.S. presence on a basis wholly unjustified by risk.

(1) Introduction of additional leverage requirements not applicable to U.S. peers

- The preamble states that the intent in applying the leverage ratios to IHCs is to introduce 'parity' with U.S. bank holding companies ("BHC"). In fact, applying leverage ratios to the IHC introduces an additional requirement not applicable to U.S. peers, as illustrated below:

Application of leverage ratios to Barclays and U.S. peer banking groups (simplified)



- IHC leverage requirements and consolidated U.S. BHC requirements are <u>not comparable</u>. U.S. BHCs may account for Tier 1 capital located globally, including in jurisdictions outside of the U.S. A U.S. BHC that meets the ratios on a global, consolidated basis may not meet the same ratios if applied solely to U.S. capital and assets, particularly those BHCs that operate a U.S. broker-dealer subsidiary that comprises the majority of U.S.-based assets.

(2) Proposed leverage ratios would distort assessments of capital adequacy

- The following table illustrates the consequence of applying a leverage ratio on a geographic basis to an FBO's U.S. subsidiaries using a generic example of two subsidiaries:

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)

- 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.

Proposed capital adequacy assessment for consolidated U.S. subsidiaries

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. bank subsidiaries meet capital requirements applied by primary regulators?	☑
	Does the FBO and U.S. subsidiaries meet a positive assessment in categories 1-4?	Yes

- If an FBO does not meet a positive assessment for all categories, the FBO would be required to remediate deficiencies.

(3) 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 <u>as there is no adjustment for risk</u>
- The likely outcome will be a substantial reduction in broker-dealer operations, such as securities financing, including repo, relative to banking activities.
- 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 comprises a majority of U.S.-based assets would appear undercapitalized, <u>even where the same peer might meet the ratios on a global, consolidated basis</u>
- In effect, a U.S. geographic leverage ratio favors the growth of U.S. bank subsidiaries relative to U.S. broker-dealers, but on a basis wholly unjustified by risk