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

Re: Single-Counterparty Credit Limits for Large Banking Organizations

Ladies and Gentlemen:

The Institute of International Bankers ("IIB") appreciates the opportunity to provide comments on the recent re-proposal (the "Proposal") by the Board of Governors of the Federal Reserve System (the "Board") of single-counterparty credit limits ("SCCLs") for domestic bank holding companies ("BHCs") and foreign banking organizations ("FBOs") with $50 billion or more in total consolidated assets ("covered companies").[1]

The IIB represents internationally headquartered financial institutions from over 35 countries around the world doing business in the United States. The IIB's members consist principally of FBOs that conduct banking operations in the United States through branches, agencies and bank subsidiaries, and nonbanking operations through subsidiaries such as commercial lending firms, broker-dealers, investment advisers and insurance companies.

In today's global economy, FBOs in the United States provide valuable services that facilitate and enhance access to overseas markets for U.S. customers and serve as an important bridge to the U.S. market for foreign clients. As job creators, taxpayers and investors in American enterprise and infrastructure, and as supporters of American communities, FBOs contribute substantially to U.S. economic well-being and growth. In the aggregate, our

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1 81 Fed. Reg. 14328 (Mar. 16, 2016). The IIB commented on the Board's original SCCL proposal, which was included in the proposed enhanced prudential standards for FBOs published by the Board in December 2012 and finalized (without the SCCL component) in March 2014. See 77 Fed. Reg. 76628 (Dec. 28, 2012) ("Original Proposal"); IIB Letter, dated April 30, 2013.

members' U.S. operations have approximately $3.7 trillion in banking assets, fund 27% of all commercial and industrial bank loans made in this country and contribute to the depth and liquidity of U.S. financial markets. Our members also contribute more than $50 billion each year to the economies of major cities across the country in the form of investments, employee compensation, contributions to local and national charities, tax payments to local, state and federal authorities and other operating and capital expenditures.

I. Introduction

We continue to support the ultimate objectives of the SCCL requirement in Section 165(e) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank" or the "Dodd-Frank Act"). However, we have a number of fundamental concerns regarding the ways in which the Proposal would adapt Section 165(e) to the U.S. operations of FBOs. In our view, the Proposal would impose unnecessary and discriminatory burdens on FBOs, with negative consequences for their participation in U.S. markets. Generally, the Proposal is inconsistent with the statutory language of Section 165(e), fails to comply with the statutory mandates to take into account comparable home country standards and the principles of national treatment and competitive equality, and does not tailor the requirements of Section 165(e) in a manner commensurate with an FBO's U.S. footprint.

More specifically, we have concerns regarding the way in which the Proposal would apply an SCCL as a U.S.-specific requirement to all FBOs with $50 billion or more in global assets, regardless of the size of their U.S. operations or systemic footprint.[2] We also have concerns regarding the Proposal's application of various and sometimes inconsistent lending limits to sub-consolidated levels of an FBO's operations, compounding operational, compliance and resource challenges and complications for FBOs (challenges and complications which would not be experienced by U.S. BHCs).

These burdens are not supported by any compelling policy rationale, any meaningful analysis of the relative costs and benefits of such an approach or any discussion of how such treatment comports with the statutory mandates of Section 165. Under these statutory provisions, the Board is required to: "(A) give due regard to the principle of national treatment and equality of competitive opportunity; and (B) take into account the extent to which the foreign financial company is subject on a consolidated basis to home country standards that are comparable to those applied to financial companies in the United States."[3] The preamble to the

[2] Section 165 of the Dodd-Frank Act mandates the establishment of enhanced prudential standards expressly "to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected financial institutions." 12 U.S.C. § 5365(a)(1). Any standards promulgated under Section 165 should, in our view, be tied to the risk that a particular institution or class of institution poses to U.S. financial stability. In applying enhanced prudential standards to counter such risks, the Board may "differentiate among companies on an individual basis or by category, taking into consideration their capital structure, riskiness, complexity, financial activities (including the financial activities of their subsidiaries), size, and any other risk-related factors that the Board of Governors deems appropriate." 12 U.S.C. § 5365(a)(2)(A).

[3] 12 U.S.C. § 5365(b)(2).

Proposal does not reflect consideration of these mandates and, in our view, the more burdensome and differential application and effects of the Proposal on FBOs directly contravene them.

The Proposal would impair FBOs' participation in U.S. financial markets, and would harm U.S. businesses. FBOs are an important source of credit to U.S. businesses, as well as specialists in international banking services to customers whose activities extend beyond U.S. borders. In particular, FBOs play an important, and often unique, role in a number of areas, such as agricultural lending, syndicated lending, municipal bonds, renewable energy and natural resource lending, foreign direct investment into the United States and investments in and support for U.S. infrastructure projects. The Proposal would impose disproportionate costs on FBOs—relative to both the U.S. footprint of many FBOs and the costs that U.S. BHCs would bear—that would be detrimental to FBOs' lending activities in the United States.

II. Executive Summary of Comments and Recommendations

We have a range of concerns regarding the Proposal, many of which we raised in our comments on the Boards' Original Proposal but have not been addressed or reflected in the Proposal. Our primary concerns with the Proposal are set forth in Sections IV through XI below and include the following:

- The Proposal does not comply with the statutory mandate to give due regard to the principles of national treatment and competitive equality as FBOs are materially, disproportionately and adversely affected by the Proposal relative to U.S. BHCs.
    - There is a significant difference in scope of application, both in terms of the number and types of FBOs that would be subject to the SCCL and in terms of the multiple levels at which the SCCL applies to the U.S operations of FBOs.
    - The Proposal subjects FBOs to materially greater costs and burdens than their U.S. BHC counterparts.
    - The Proposal interferes with the safety and soundness and enterprise-wide risk management of FBOs by applying multiple, redundant and inconsistent regimes for calculating credit exposures.
    - The application of a non-compliance cross-trigger to FBOs is both discriminatory and unwarranted. No cross-trigger applies to U.S. BHCs that breach, for example, lending limits applicable to their insured depository institutions ("IDIs"). Furthermore, the provision effectively reduces the limit for the U.S. branches and agencies of an FBO in certain instances.
- The Proposal does not explain its lack of consideration of the statutory mandate to give due regard to the extent to which FBOs are subject to comparable large exposure limits under home country regulations. This is especially notable as the SCCL relates to exposures of an FBO's combined U.S. operations, limited based on the FBO's consolidated capital, and to this extent overlaps directly with home country large exposure limits adopted under standards of the Basel Committee on Banking Supervision ("Basel Committee").

- The Board also does not make the finding of "necessity" required under Section 165 to apply the SCCL to only a portion of an FBO's operations. A finding of necessity would necessarily have to include a finding that existing large exposure limits, including the federal or state lending limits applicable to an FBO's U.S. branches and agencies ("Branch Lending Limits") and comparable home country large exposure limits that currently apply to FBOs, are not sufficient.

- In the face of recent data indicating that a significant majority of the FBOs that would be subject to the Proposal have less than $50 billion in U.S. assets, the Proposal fails to heed the statutory mandate to tailor the proposal to the size and systemic footprint of FBOs in the United States. The basic scope of application of the SCCL should be tailored more appropriately, and there are other aspects of the Proposal that should be tailored to the size of an FBO's U.S. operations. Examples include:
    - A U.S. intermediate holding company ("IHC") should not generally be subject to stricter requirements based on the global size of its parent FBO.
    - The provisions applicable to an IHC parent FBO's combined U.S. operations should not undercut the tailored application of the IHC SCCL based on the size of the IHC.
    - The determination criteria for major covered companies and major counterparties are inappropriately calibrated when applied to FBOs, and should be made consistent with the use of global systemically important bank ("G-SIB") status indicators for U.S. BHCs.

- The concept of "foreign exposure" in the context of determining the size of FBOs subject to more stringent provisions is irrelevant and should be eliminated. At the very least the definition should be modified to carve out exposures to non-U.S. home office, affiliates and home country sovereign government, agencies, instrumentalities and political subdivisions.

- The concept of subsidiary aggregation is too broad and should not include merchant banking portfolio companies or certain investment funds.

- There are a number of modifications that should be made to the exposure calculations and risk mitigation provisions specific to FBOs, including providing an ability to have internal models approved for derivative exposure calculations, incorporating political subdivisions into the home country sovereign exemption, allowing home office and affiliates to be eligible protection providers and their securities to be deemed eligible collateral, relaxing the U.S. location requirements for eligible collateral and clarifying the use of qualifying master netting agreements.

- The reporting requirements for FBOs are excessively burdensome, and should be reduced to encompass only the largest exposures.

- FBOs are given insufficient time to comply with the SCCL, especially in light of the disproportionate complexity of the Proposal in relation to FBOs.

Most of our more fundamental concerns regarding the Proposal can be addressed through a simple revision to the structure of the SCCL requirements for IHCs and FBOs. In Section III of this letter we describe a recommended approach to implementing the SCCL, which essentially involves (a) applying the SCCL to an IHC as if it were a U.S. BHC, and (b) in the context of their combined U.S. operations, requiring FBOs to comply with comparable home country requirements consistent with Basel Committee standards. In each case, this approach would align with the Board's approach to implementing the regulatory capital and stress testing components of its enhanced prudential standards in Regulation YY, would meet the Board's systemic risk supervisory objectives and would comport with the statutory requirements of Section 165 of Dodd-Frank.

III. IIB's Recommendation – Application of an SCCL to FBOs Should Be Tailored Based on Size and Systemic Footprint of U.S. Operations and Take Into Consideration Home Country Standards

Before detailing our concerns regarding the Proposal, we describe in this Part III our recommended application of the SCCL. Our recommendation is more consistent with the manner in which the Board has tailored other provisions of the enhanced prudential standards, and it specifically takes into account the required considerations under the Dodd-Frank Act, namely the principle of national treatment, the principle of equality of competitive opportunity and the extent to which FBOs are subject on a consolidated basis to comparable home country standards (as well as to existing large exposure regimes in the United States).

We recommend the following structure for the SCCL (our "Recommendation" or "Recommended Approach"):

- Applicability to an IHC
  - The SCCL should apply to an FBO's U.S. IHC, based on IHC capital, in the same manner as the SCCL applies to a U.S. BHC.
    - For purposes of any enhanced requirements based on size (*e.g.*, designation as a "major covered company"), the IHC would be treated on a separate, standalone basis.
    - The IHC would benefit from provisions in the Proposal applicable to FBOs, such as exemptions for exposures to an FBO's home country sovereign.
- Applicability to an FBO
  - Similar to the manner in which the Board has recognized home country standards of capital and stress testing and the manner in which the Board has tailored its application of enhanced prudential standards to FBOs already subject to such a regime, an FBO with total consolidated assets of $50 billion or more would be required to confirm to the Board that it meets, on a

consolidated basis, the large exposure limits established by its home country supervisor that are consistent with the Basel Committee's final standards setting out a supervisory framework for consolidated large exposure limits, as amended from time to time ("Basel Large Exposure Framework").[4]

- In the event that a home country supervisor has not established large exposure limits that are consistent with the Basel Large Exposure Framework, the FBO would be required to demonstrate to the satisfaction of the Board that it would meet large exposure limits at the consolidated level that are consistent with the Basel Large Exposure Framework were it subject to such standards.

- The Board should have flexibility in the final rule to further tailor the applicability of the SCCL to individual IHCs depending on individual circumstances, and to create exceptions where necessary.

- Existing U.S. lending limits would continue to apply to U.S. IDIs and U.S. branches and agencies.

This Recommended Approach more than adequately addresses U.S. systemic risk concerns as it ensures that a large exposure limit is applicable to all exposures in an FBO's U.S. operations. The IHC would be subject to the localized U.S. SCCL, branches would remain subject to Branch Lending Limits and all U.S. operations would remain subject to home country large exposure limits consistent with those required by the Basel Large Exposure Framework. Both the Branch Lending Limits and home country limits are, and would continue to be, based on an FBO's home country consolidated capital base, as in the Proposal's approach to an FBO's combined U.S. operations. The Recommended Approach would provide all of the protection that the Board seeks, using existing limit requirements and adding a limit for the IHC, in a manner that is far less burdensome and complex than that in the Proposal.

IIB and its members would appreciate the opportunity to speak with the Board further about how this Recommended Approach should work in practice as well as other issues raised in this comment letter.

IV. The Board Would Need To Make a Specific Finding that Applying the SCCL to Only a Portion of an FBO's Operations is "Necessary"

To the extent that the Board determines to apply the SCCL to an IHC and/or the combined U.S. operations of an FBO, it may only do so if it determines that the regulations it is promulgating are "necessary to mitigate risks to the financial stability of the United States".[5] A finding of necessity is required for the Board to set a lower SCCL requirement. Applying the SCCL to a U.S. IHC or the combined U.S. operations of an FBO is, in our view, setting a lower SCCL, since it requires either or both the measurement of the SCCL against a smaller capital

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4 Basel Committee, Supervisory framework for measuring and controlling large exposures (Apr. 2014).

5 12. U.S.C. § 5365(e)(2).

base (that of the U.S. IHC)[6] or inconsistency with the appropriate level of aggregation ("the company", meaning the FBO). We note that the statutory requirement for a finding of necessity is much more than a finding of "convenient" or "useful" or "appropriate"—the Board must find that the application of the SCCL in the manner proposed is "necessary" to administer the SCCL to an FBO and "necessary" to mitigate risks to financial stability.

A finding of "necessity" presumably would need to include a finding that existing limits applied to FBOs are not sufficient—otherwise, the SCCL would not be "necessary" for creation of an effective limit. As discussed more fully below, the Proposal would result in no less than five different exposure limits applicable to FBOs and subsets of their operations. While the principal innovation of the SCCL as it relates to U.S. BHCs is the application of a credit exposure limit at the parent company consolidated level, in most foreign jurisdictions outside the United States, large exposure limits already apply at the level of the parent (usually because the parent is itself a bank). In such structures all significant operations of the FBO are typically housed within the bank (whether or not the bank has a home country holding company), in contrast to the predominant U.S. holding company structure with significant operations outside of the bank. In fact, credit exposure limits have long been a core component of banking regulation in jurisdictions worldwide, and virtually every FBO is subject to home country credit exposure limits.[7] Also, in a renewed commitment to the consistent regulation and implementation of large exposure limits across jurisdictions, the Basel Committee issued the Basel Large Exposure Framework in 2014. Therefore, we submit that it is not necessary to apply the SCCL to FBOs in the complex and multi-layered manner proposed in order to effect a consolidated, aggregate exposure limit because such FBOs are subject to comparable exposure limits in their home jurisdictions.

Any determination that the proposed SCCL is "necessary" must also be accompanied by an analysis of the systemic importance of an FBO's U.S. operations, particularly those outside the branch network—otherwise, the SCCL would not be "necessary" to mitigate risks to financial stability. There should be no need to apply separate SCCLs to an FBO's combined U.S. operations because there is no marginal utility or benefit from limiting the combined operations if the FBO's IHC (if any) is subject to an SCCL, its U.S. branches and

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6 We acknowledge that our Recommended Approach includes the application of an SCCL to an FBO's IHC, however, our Recommended Approach would obviate the need to make a determination of necessity with regard to the combined U.S. operations (which, as discussed below, would not be possible in our view). Furthermore, our Recommendation does not relieve the Board of observing the required procedures under the statute.

7 See, e.g., European Union (see Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms, Art. 387-403); United Kingdom (see Prudential Regulation Authority, Prudential Rulebook: Large Exposures (current as of 29 April 2016); Prudential Regulation Authority, Supervisory Statement (SS16/13) Large exposures (Dec. 2013)); Canada (see OSFI Guideline B-2, Large Exposure Limits); Australia (see Prudential Standard APS 221 (updated January 2015)); China (see IMF, Peoples Republic of China: Detailed Assessment Report: Basel Core Principles for Effective Banking Supervision, IMF Country Report No. 12/78 (April 2012)); Japan (see IMF, Japan: Financial Sector Stability Assessment Update IMF Country Report No. 12/210 (Aug. 2012)).

In addition, the Basel Committee's Core Principles for Effective Banking Supervision require that jurisdictions have effective large exposure limits and related monitoring. See Basel Committee, Core Principles for Effective Banking Supervision (Sept. 2012).

agencies are already subject to Branch Lending Limits and the FBO is subject to lending limits at the consolidated level in its home jurisdiction. Without a determination that the combined U.S. operations of an FBO are likely to represent significant systemic risk to the United States in a manner different from the risks presented by entities and branches that are already subject to a large exposure limit as part of the FBO's consolidated operations, an SCCL imposed on an FBO's U.S. operations regardless of its U.S. systemic importance would not be "necessary" for the Board to administer Section 165(e).

V. FBOs are Disproportionately Affected by the Proposal Relative to U.S. BHCs

In addition to tailoring the SCCL in a manner consistent with other Board rules, our Recommended Approach addresses a significant flaw in the Proposal that runs directly counter to the requirements of the Dodd-Frank Act to promulgate rules based on the principles of national treatment and competitive equality.

Namely, the Proposal applies materially differently to FBOs than to U.S. BHCs. First, there is a significant difference in scope—both in terms of the number and types of FBOs that are subjected to the SCCL and in terms of the multiple levels at which the SCCL and related large exposure limits are applied. Second, due in large part to these differences in scope, the Proposal subjects FBOs to materially disproportionate costs and burdens that would not be experienced by their U.S. BHC counterparts.

A. *The Proposal affects a disproportionate number of FBOs relative to U.S. BHCs*

We have significant concerns regarding the scope of FBOs that would be covered by the Proposal, primarily because the Proposal would apply categorically as a U.S.-specific requirement to all FBOs with $50 billion or more in global assets, regardless of the size of their U.S. operations or systemic footprint. Because the Proposal does not calibrate the SCCL requirements based on the size or systemic importance of an FBO's U.S. operations, the number of FBOs that would be subject to the SCCL requirements would be several times larger than the number of U.S. BHCs that would be subject to the SCCL requirements. Specifically, based on recent data, only 27 U.S. BHCs would be covered by the Proposal, but 110 FBOs would have to comply with the SCCL requirements.

While the absolute numbers are not by themselves determinative given the number of large FBOs operating internationally, in our view these numbers are disproportionate to the relative importance of each of these FBOs to the U.S. financial system. In particular, of the 110 FBOs that would be subject to the Proposal, 59% (65) have less than $10 billion in U.S. assets and 79% (87) have less than $50 billion in U.S. assets.

B. *The Proposal imposes limits at multiple sub-consolidated levels of an FBO in ways that do not apply to a U.S. BHC*

The Proposal's SCCL requirements also would disproportionately affect FBOs by layering multiple large exposure limits. Unlike U.S. BHCs, which would be subject only to the limits applicable to their top-tier BHCs and to their IDIs, FBOs would be required to comply with large exposure limits at several different siloed and sub-consolidated levels in their U.S. operations, in addition to the large exposure limits applicable in their home country jurisdictions.

Such treatment contravenes the general standards for adapting the Section 165 enhanced prudential standards to FBOs, which include taking into consideration comparable home country standards as well as the principles of national treatment and competitive equality.

Appropriate home country credit exposure limits, applied on a global, consolidated basis, are the most effective means of addressing the Board's concern about interconnectedness among large U.S. and foreign financial institutions, because such exposure limits capture a banking organization's full systemic scope and account for all interconnections. In contrast, the SCCL requirements in the Proposal would impose fractured and redundant credit exposure limits on multiple sub-consolidated parts of an FBO's U.S. operations. As a result of the Proposal and the existing exposure limit regulations already applicable to parts of an FBO's U.S. operations, FBOs would be required to comply with as many as five separate large exposure limits: (i) IHC-specific SCCLs based on IHC capital (if applicable); (ii) SCCLs applied to an FBO's combined U.S. operations (including U.S. branches, agencies and the U.S. IHC) based on global consolidated capital; (iii) federal and/or state lending limits applicable to an FBO's U.S. IDI subsidiaries;[8] (iv) Branch Lending Limits;[9] and (v) home country large exposure limits.[10] Our Recommended Approach would rationalize these redundant layers into a more logical combination of home country exposure limits, Branch Lending Limits and IHC SCCLs.

The treatment of U.S. BHCs is markedly different, however, with the Proposal applying the SCCL at the level of the top-tier BHC and lending limits continuing to apply at the IDI level. Importantly, U.S. BHCs that have intermediate holding companies in their structures are not required to apply the SCCL at the intermediate holding company level. This discriminatory treatment of FBOs is not only inequitable, as it puts substantial incremental burden on FBOs' U.S. operations, but it also does not comport with the principle of national treatment that the Board is required to take into consideration under Section 165.

C. *The Proposal subjects FBOs to an unnecessary and disproportionate compliance and cost burden*

The natural result of capturing an excessive number of FBOs within the ambit of the SCCL and of layering multiple redundant large exposure regimes on FBOs is an unwarranted increase in compliance burden, operational risk and related costs. The operational, procedural and cost burdens specifically related to multiple requirements for FBOs are in addition to the heightened burdens that will apply to all covered companies as a result of newly added concepts in the Proposal (such as the special purpose vehicle ("SPV") look-through approach in proposed

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8 See, e.g., 12 C.F.R. part 32 (Office of the Comptroller of the Currency's ("OCC's") lending limits rules); New York Banking Law § 103 (New York Banking Law lending limits).

9 See 12 U.S.C. § 3105(h)(2) (OCC lending limit rules apply to federal and state branches of FBOs). 12 U.S.C. § 3105(h)(3) allows the Board or State supervisors to create stricter limits.

10 See footnote 7.

§ 252.175 and the requirements to aggregate exposures on the basis of economic interdependence and certain control relationships in proposed § 252.176).

Preparing, monitoring and recordkeeping for as many as five separate large exposure regimes and calculations at multiple levels of an FBO's U.S. operations is extremely costly. Our members estimate that they will be required to dedicate significant funds and personnel hours building and monitoring systems and operations to calculate and track exposures against multiple limits. This disproportionate restriction on lending of FBOs through multiple large exposure limits and the associated compliance and operational costs could result in FBOs reducing their lending business in the United States.

The burden will be especially high in relation to the combined U.S. operations of an FBO, as the amalgamation of combined U.S. operations is not a typical or natural level for applying financial consolidation. An FBO would need to dedicate significant operational and financial resources to carve out exposures at the combined U.S. operations level (in contrast to aggregating at a single, natural consolidation or aggregation point) and develop systems accommodating the required financial information, exposure tracking and recordkeeping for an FBO's combined U.S. operations. The calculation requirement at this unnatural level of consolidation would be particularly onerous for FBOs with total consolidated assets of $250 billion or more or $10 billion or more in foreign exposures ("Large FBOs") as it would need to be performed daily.[11]

The Proposal layers these various additional exposure limit requirements on FBOs without any analysis of the additional marginal benefit or utility for protecting U.S. financial stability. In our view, the additional layers do not provide meaningful marginal benefit and could serve to obscure the Board's view of the risks and interconnectedness of the market by presenting a fractured and artificial perspective of exposures at multiple sub-consolidated levels. Given the prevalence of exposure limit regimes internationally that apply to the consolidated operations of FBOs (including to their U.S. operations), the Board should, consistent with the statutory directive of Section 165, instead begin with an assessment of FBOs' home country regimes and confirmation of compliance with such home country regimes before imposing additional SCCL requirements on FBOs' U.S. operations. Our Recommended Approach would address the exposures of U.S. operations through a more logical combination of home country exposure limits, Branch Lending Limits and IHC SCCLs rather than through a forced aggregation across the U.S. structure. Indeed, as the Proposal would use the FBO's home country consolidated capital base for the SCCL applicable to the combined U.S. operations, our Recommended Approach is consistent by applying the FBO's home country large exposure regime to these operations.

By contrast, U.S. BHCs would face none of the identified additional burdens. U.S. BHCs would be subject to lending limit requirements at only two levels (*i.e.*, at the top-tier U.S. BHC and at the IDI levels). In addition, U.S. BHCs would likely be able to leverage their consolidated and centralized accounting and risk management systems for compliance with the

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11 See further discussion of the compliance frequency below in Section X.

SCCL, as the SCCL requirements are coextensive with the scope of such systems, which are generally structured on a parent consolidated basis.

The Proposal does not include any analysis of the compliance costs resulting from the layering of multiple lending limit requirements on FBOs or assessment of the potential effect of such costs on FBOs' lending activities and their likely impact on the competitive landscape for lending in the United States. Furthermore, when coupled with the Proposal's lack of tailoring in relation to the U.S. asset size of an FBO, the costs of applying the Proposal as drafted would be outsized in relation to the size of an FBO's U.S. operations.[12]

D. *The Proposal would also interfere with the safety and soundness and enterprise-wide risk management of FBOs*

The Proposal would adversely affect the ability of FBOs to manage the risks of their international operations. Multiple, redundant and inconsistent regimes for calculating credit exposures will needlessly complicate and hinder enterprise-wide risk management. Furthermore, other legal and risk management requirements and models provide for calculation of counterparty exposures, such as capital calculation rules, margin calculations rules, restrictions on transactions with affiliates, liquidity risk management regimes and collateral management processes, all of which further complicate an FBO's risk management function, especially where the calculation methodologies diverge.

In our view, the Proposal fails to take sufficient account of specific implications of the nature of cross-border banking, where a bank can have multiple exposures to a single customer (and its related parties) in multiple countries and currencies, which may be best managed, monitored, hedged and collateralized centrally and in the aggregate through the bank's head office or, for example, a branch with the strongest relationship to that customer or the best ability to hedge in local markets and instruments. In contrast to the treatment of U.S. BHCs under the Proposal, where the Board (consistent with the Dodd-Frank Act) focuses on requiring U.S. BHCs to centralize, aggregate and monitor their total cross-entity risk, the proposed SCCLs would require FBOs to focus on an incomplete picture of their overall risk based on a contrived separation and independent aggregation of "combined U.S. operations". This result could not have been intended.[13] Incentives to move transactions offshore and the detrimental impact on

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[12] It also appears that determinations of appropriate calibration for certain thresholds in the Proposal were based primarily on effects on U.S. banking organizations. See, e.g., 81 Fed. Reg. at 14333 ("[T]he quantitative impact study Board staff conducted to help gauge the likely effects of the proposed requirements suggests that using tier 1 capital as the eligible capital base for bank holding companies with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance-sheet foreign exposures likely would increase the total amount of excess exposure among U.S. bank holding companies by approximately $30 billion." (Emphasis added)).

[13] In early 2008, even before the peak of the international financial crisis, the Board and other key international bank supervisors had noted that a significant contributing factor to the losses occurring at major financial firms was the inability to centralize, communicate and understand risk across the entire organization. See Senior Supervisors Group, Observations on Risk Management Practices During the Recent Market Turbulence (Mar. 6, 2008) ("Firms that tended to deal more successfully with the ongoing market turmoil through year-end 2007 adopted a comprehensive view of their exposures. . . . [F]irms that performed well . . . generally shared quantitative and qualitative information more effectively across the organization. . . . In contrast, the existence of

cross-border, enterprise-wide risk management under the Proposals' application of the SCCLs would run counter to the Board's (and other supervisors') efforts to promote enterprise-wide risk management.

Applying the SCCL to an FBO's combined U.S. operations results in adoption of duplicative, yet less effective, risk management systems and increased operational and system costs that could far outweigh any potential financial stability benefits. Diversion of resources and management attention away from refining tested systems designed to manage an FBO's credit risk and towards the development and maintenance of systems with no relevance to the economic or risk profile of the FBO's global operations and no demonstrated marginal utility from the perspective of U.S. financial stability would, in our view, be inappropriate.

E. *The application of a non-compliance cross-trigger to FBOs is discriminatory and should be eliminated*

While the language has been revised since the Original Proposal, the Proposal appears to still include a "cross-trigger" provision that would prevent additional credit transactions by any of an FBO's combined U.S. operations if the U.S. IHC's SCCL to a particular counterparty were breached. Specifically, the Board has included a cure period in proposed § 252.178(c) that would delay an enforcement action for non-compliance with the SCCL by 90 days, as long as the FBO or U.S. IHC uses reasonable efforts to return to compliance. While these revisions clearly intend to provide time-limited relief for FBOs, they do not appear to address the cross-trigger that would impose a restriction on further credit transactions at the combined U.S. operations level in the event the limit is breached at the U.S. IHC level. Our Recommended Approach would not include a non-compliance cross-trigger and would apply an FBO's home country large exposure limits to the combined U.S. operations.

Like the Original Proposal, the Proposal provides neither an explanation for the cross-trigger nor analytical or evidentiary support for it. The Proposal also does not include a similar SCCL cross-trigger for U.S. BHCs that would impose restrictions with respect to credit exposures of a U.S. BHC as a result of the breach of an exposure restriction at its subsidiary IDI (*e.g.*, a breach of the OCC lending limits by a national bank subsidiary). Currently, breaches of legal lending limits applicable to an IDI subsidiary of a U.S. BHC would not prevent a sister bank, an affiliated broker-dealer or its parent BHC from increasing its exposure to such a counterparty, and the Proposal appropriately does not change this fact (assuming the additional exposure at affiliated organizations does not, in the aggregate, exceed the proposed SCCL). Indeed, one of these entities may specifically increase its exposure even when the lending limits are breached at the IDI level, in order to avoid losing an opportunity (or, indeed, a relationship) with a creditworthy and profitable customer.

Furthermore, this provision is contrary to the typical operations of internationally active banks, whether they are headquartered in the United States or abroad. Subsidiaries of international banks almost uniformly seek the services of a local (or sometimes "nearby") branch

organizational 'silos' in the structures of some firms appeared to be detrimental to the firms' performance during the turmoil").

when the subsidiary would not be able to take on a large exposure, but its parent bank would be. In other words, a "spillover" from the local subsidiary is almost always likely to be picked up by the parent bank, in order to preserve the customer relationship (particularly when the parent bank can also provide services that the local subsidiary cannot in order to preserve that relationship). Given the dynamic nature of exposure under the SCCL (which includes derivatives and securities financing transactions, the exposure value of which may change daily), FBOs' U.S. operations should not need to manage themselves to undue constraints for fear that their total credit operation will be shut down because the IHC has inadvertently or even negligently breached the SCCL with regard to a counterparty. U.S. BHCs and FBOs routinely use global strategies to alleviate pressure on individual subsidiary operations under their large exposure limits by absorbing coverage of credit exposures at a higher level in the organization that is typically subject to larger limits and hence has extra credit extension capacity. There is no reason why the SCCL should impede this common global practice, provided that the higher level organization is within its consolidated large exposure limits.

Linking an FBO's lending abilities to the separate compliance of a U.S. IHC with separate, and much smaller, lending limits, artificially lowers the *de facto* lending limits of the FBO. The SCCL applicable to the U.S. branches and agencies of an FBO are linked to the capital base at the FBO's consolidated level and, therefore, will certainly be larger than the SCCL for the U.S. IHC. This larger limit is, in fact, the reason why the branch network, in accordance with common business practice, should step in and absorb the extra credit exposure when the IHC may be approaching or may even have breached its limit. The larger limit is also clearly established to not be dependent upon the smaller capital of the IHC, yet the cross-trigger provision would, in fact, add such a dependency and contingency.

The cross-trigger creates significant incentives for FBOs to shift banking, lending and derivatives activities to overseas branches in order to avoid the potential sudden curtailment of activity that could result from the operation of the cross-trigger. The cross-trigger may also have a chilling effect on FBO lending in the United States, especially in sectors in which FBOs are particularly active such as agriculture and renewable energy, and therefore concentrating risk in U.S. BHCs by potentially removing competitors in such markets. It could not have been intended by the Board to make it more costly and difficult for clients to obtain, and for FBOs to provide, credit by virtue of this provision and disrupt long-established global banking and risk management practices. Therefore, we submit that the consequences for exceeding an entity's SCCL should be limited to the entity (or group of entities) in breach, just as the consequences of breaching the lending limits applicable to U.S. IDI subsidiaries of FBOs do not extend a restriction to the U.S. branches of FBOs under current lending limit regulations.

VI. Additional Aspects of the Proposal that Should be Tailored to an FBO's U.S. Size and Systemic Impact

A. *A U.S. IHC should not be subject to stricter requirements based on the global size of its parent FBO*

Unless the SCCL's application to FBOs is tailored as in our Recommended Approach, the Proposal would have even more pronounced negative effects on Large FBOs. The lack of calibration of the requirements to Large FBOs' U.S. operations would affect FBOs disproportionately, particularly those FBOs with relatively small IHCs or combined U.S. operations. (As noted above, a significant majority (59%) of the FBOs subject to the Proposal have less than $10 billion in U.S. assets.) In addition, layering the SCCL on the combined U.S. operations (including the IHC) and then separately on the IHC serves only to reduce or eliminate flexibility that the IHC may have had if it were treated on an individual basis, as in our Recommended Approach.

Certain parts of the Proposal appear to have been designed to address the issues that arise in the context of the overlap between the combined U.S. operations and the IHC of an FBO. For example, the interaction of proposed §§ 252.170 and 252.172 appears to allow an IHC:

- more time to come into compliance if the IHC independently does not cross the $250 billion asset / $10 billion foreign exposure threshold, even if its parent FBO does (see proposed § 252.170(c)); and
- to have a higher capital base (*i.e.*, capital and surplus instead of Tier 1 capital) or percentage limit (*i.e.*, 25% in contrast to 15%) apply if it does not separately cross the appropriate thresholds, even if its parent FBO does (see proposed §§ 252.172(a)-(c)).

However, these benefits are undercut by the complexity of layering multiple SCCL requirements on the U.S. operations of an FBO:

- The compliance timing benefit is operationally negated by requiring the IHC and its subsidiaries to prepare systems and procedures to be able to report into the combined U.S. operations of an FBO that is subject to the more stringent compliance timeframe.
- Similarly, the ability of a smaller IHC to comply and report on a quarterly basis is also negated if its parent FBO has more than $250 billion in assets or more than $10 billion in foreign exposure. This is particularly troublesome as the compliance requirement drastically increases to daily and reporting frequency increases to monthly.[14] (See proposed § 252.178(a).)
- If the IHC is a subsidiary of, and therefore part of the combined U.S. operations of, an FBO that has more than $250 billion in assets or more than $10 billion in foreign exposure, but would not cross those thresholds itself, then the IHC apparently would

[14] While we recognize that compliance by the IHC as part of the combined U.S. operations would entail compliance based on the parent FBO's capital base, the operational burden of complying and reporting with greater frequency would eclipse most if not all of this purported flexibility. Our recommended reporting approach, described in Section X below, would likely alleviate much of this potential burden, however.

not benefit from an exclusion from the SPV and fund "look through" mechanism in proposed § 252.175.[15]

Indirectly eliminating the flexibility that otherwise would be granted by various provisions of the Proposal results from the complexity of layering the SCCL on various subsets of an FBO's operations. In contrast, a U.S. BHC that meets the criteria for an exception or less stringent rule would not have that benefit taken away from it by another provision of the Proposal. This discriminatory treatment is inconsistent with the Board's mandate to consider the principles of national treatment and competitive equality under Section 165. Furthermore, this treatment would appear inconsistent with the manner in which the Board has applied other enhanced prudential standards. For example, even an IHC that meets or exceeds the $250 billion in total assets or $10 billion in foreign exposures threshold (*i.e.*, the advanced approaches thresholds under the U.S. capital rules) can opt out of using the advanced approaches for calculating its risk-based capital requirements.[16] In this context, while it appears that the Board's aim was to provide some relief to the IHC from excessive compliance burdens, the way in which the SCCL would apply in practice would interfere with this goal.

Our Recommended Approach would address this specific issue by limiting application of U.S. SCCL to the IHC.

B. *"Foreign exposure" as a threshold for applicability of Large FBO rules is irrelevant and should be eliminated or significantly modified*

The Proposal applies the more stringent Large FBO requirements to FBOs with assets of $250 billion or more or $10 billion or more in total on-balance-sheet foreign exposures. However, neither the rule text nor the preamble provide any guidance regarding how "foreign exposures" should be calculated for an FBO.[17] We assume that the FFIEC 009 calculation methodology is to apply. Under this form, the calculation of foreign exposures of a U.S. bank or U.S. BHC reflects the bank's or BHC's claims on and liabilities to foreign residents.[18] The calculation looks at the BHC's exposures from the perspective of its U.S domicile and location and from the perspective of its operations abroad.

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15 Again, while we recognize that the IHC would be part of the combined U.S. operations and would be using the parent FBO's capital base to measure compliance with this provision, the real burden in relation to this requirement is the need to put in place valuation, measurement and due diligence processes to calculate compliance with the look-through provision. The reason for the large threshold appearing in this provision of the Proposal was specifically to avoid having to place such a burden on smaller operations.

16 12 C.F.R. § 252.153(e)(2).

17 We note that the term "foreign exposures" is not defined in either of the Proposal's definition sections (proposed §§ 252.71 or 252.171) or in either of the "applicability" sections where the term "total consolidated assets" is defined (proposed §§ 252.70 and 252.170). In addition, the phrasing of the foreign exposure threshold applies it to the FBO (see proposed § 252.170(a)(2) for the first of several instances of this usage), thus exacerbating confusion as to how the measure is supposed to apply to the whole entity.

18 See Instructions for the Preparation of Country Exposure Report (FFIEC 009) (Dec. 2013) ("FFIEC 009 Instructions").

The FFIEC 009 report does not even apply to an FBO, unless it owns a U.S. entity that is a reporter under the form, and even then it applies only to the reporting entity. Furthermore, neither the form nor the definition applies to U.S. branches or agencies of FBOs. Therefore, it is unclear how this methodology would be applied to a foreign-based institution, such as an FBO, or even to its U.S. operations. Because of the substantial difficulties in applying the existing foreign exposure calculation methodology to FBOs, we submit that an FBO's foreign exposures should not be considered a trigger for application of the Large FBO requirements, and the Proposal's provisions that employ the term "foreign exposures" in relation to an FBO should be deleted.[19]

If the Board determines not to eliminate this threshold, whether an FBO meets the threshold or not should be determined based solely on those entities within an FBO's organization that would otherwise be reporters under the FFIEC 009. The calculation should not be applied to an FBO's overall operation or even aggregate U.S. operations, as such a calculation would be yet another burden (*i.e.*, calculation of foreign exposure to entities or operations to which the FFIEC 009 does not apply) placed on the U.S. operations of an FBO that would not otherwise be applicable but for the Proposal. Nevertheless, because of the issues described above, the Board would still have to clarify the calculation methodology to ensure that it could be workable and employed consistently amongst covered entities.

The Board should modify any such calculation methodology such that the U.S. operations' or U.S. IHC's exposures to the FBO, the FBO's parent or to any of its affiliates (including exposures of its IHC and subsidiaries to its U.S. branches) are excluded from the calculation. Including such exposures in the calculation would not be appropriate. As noted in Section V.D, as part of their enterprise-wide risk management, FBOs engage in a variety of transactions with affiliates to distribute risk to the geographic areas best suited to manage and hedge such risk. Including exposures to the FBO's parent or affiliates in the foreign exposures calculation would penalize FBOs for adhering to established risk management practices, which may in turn discourage and disrupt such practices. Since the majority of such exposures would result from practices meant to manage and reduce risk, counting them as foreign exposures would also grossly overstate the true risk levels of the FBO's cross-border exposures. Furthermore, a U.S. banking organization applying the FFIEC 009 Instructions would generally be analyzing and capturing third-party foreign exposures. The U.S. operations of an FBO, however, would unfairly have to take into account all of its intragroup exposure to non-U.S. entities. We do not believe that the FFIEC 009 report or the use of "foreign exposure" as a threshold was intended to be triggered by intragroup risk movements.

In addition, the Board should clarify that exposures of an IHC or of an FBO's reporting entities to the FBO's home country sovereign (including its agencies, instrumentalities

[19] The original purpose of the foreign exposure threshold in connection with the capital regulations was to assist U.S. regulators in identifying those U.S. banking organizations that are sufficiently active internationally so as to warrant consistent application to them of international and Basel Committee standards. However, in the quest for thresholds generally to define larger or more systemically important banks, the foreign exposure measure has been applied in the recent enhanced prudential standards rulemakings to the operations of FBOs and IHCs without considering whether such application is relevant, effective or appropriate or can even be operationally effected.

and political subdivisions)[20] are also excluded from the foreign exposures calculation. As the Board has recognized in providing an exemption for such exposures from the SCCL requirement, FBOs may be required to have exposures to their home country sovereigns. Therefore, counting such exposures as foreign exposures would be unduly punitive for FBOs. The Board appears to have acknowledged that exposures of the IHC and other U.S. entities to the FBO's parent, affiliates and home country sovereign should not be included in the foreign exposure calculation, as indicated in footnote 10 of the Board's Staff Memo accompanying the Proposal. Nevertheless, such exclusions do not appear in the text of the proposed rule or in the Proposal's preamble.[21]

Similarly, exposures to a U.S. branch of an FBO should not be included in the foreign exposures calculation for purposes of the SCCL for any U.S. BHC subject to Subpart H of the Proposal or for an FBO's U.S. operations or IHC. The instructions accompanying FFIEC Form 009 deem any exposure to a U.S. branch of an FBO to be guaranteed by the FBO's parent and, as a result, to be a foreign exposure.[22] Including these exposures would distort incentives for all banks to have exposures to the U.S. branches of an FBO, by making such exposures potentially a trigger for significantly more stringent SCCL requirements, on top of those capital and similar rules that are already triggered by foreign exposure.

Also, to the extent that the foreign exposure calculation is retained in the context of an FBO, and to the extent that the Board believes that certain governance arrangements (described more fully in Section VII.B below) in relation to funds result in such funds being "controlled" by an FBO's U.S. operations under the criteria in the Bank Holding Company Act (the "BHCA"), foreign exposure of such funds should not be aggregated with that of the IHC or the combined U.S. operations. Governance control over the economic stakes of other investors does not result in economic exposure of the FBO, as principal, of the type that warrants inclusion of the fund's underlying exposures in the foreign exposure calculation.[23]

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[20] See also Section VIII.B.

[21] In other contexts, the term "foreign exposure" is used in relation to exposures of an FBO or IHC to create a threshold for more stringent requirements. See, e.g., the liquidity coverage ratio (12 C.F.R. § 249.1(b)(1)(ii)), the Net Stable Funding Ratio proposed rules (proposed § 249.1), or the U.S. implementation of Basel III (definition of advanced approaches banking organization in 12 C.F.R. § 217.100(b)(1)(i)(B)(2) as made applicable to an IHC through 12 C.F.R. § 252.153(e)(2) (but subject to Fed-approved opt out in 12 C.F.R. § 252.153(e)(2)(i)(C)). We submit that the use of the FFIEC 009 calculations in these contexts is also inappropriate, and we would be happy to discuss with the Board a broader set of modifications that would eliminate their use for FBOs and IHCs, or at least modify them significantly to eliminate intragroup and home country sovereign exposures as discussed above.

[22] See FFIEC 009 Instructions at 34.

[23] See discussion in Section VII below in relation to eliminating certain funds from the gross exposure calculation for an FBO under the Proposal.

C. *Determination of Major Covered Company and Major Counterparty for FBOs and U.S. IHCs*

In addition to the lack of tailoring for the size of an FBO's U.S. operations, we are also of the view that the determination criteria for major covered company status and major counterparty status are inappropriately calibrated.

i. *Major FBOs should be identified based on their G-SIB status*

The Proposal, similar to the Original Proposal, relies solely on the size of the institution for the classification of an FBO or a U.S. IHC as a "major" covered company. Yet, the Proposal moves away from reliance on total asset size with respect to U.S. BHCs and instead bases the classification of a U.S. BHC as a major covered company on the identification of a U.S. BHC as a U.S. G-SIB, which represents a much narrower universe of institutions.

A G-SIB determination is based on indicators that correlate to an institution's systemic importance other than size. The methodology for identifying a G-SIB under the Board's regulation, in addition to size, takes into account interconnectedness, cross-jurisdictional activity, substitutability (with respect to the functions performed by the institution) and complexity.[24] Furthermore, in the G-SIB determination, each factor is given equal weight, which confirms that size alone is not a factor that is considered more important than the others in measuring systemic importance.

Basing the classification of FBOs and U.S. IHCs as major covered companies on size alone grossly overstates their true systemic impact on the U.S. financial system. The effect of this methodology is amplified when coupled with the lack of calibration of the SCCL generally for the size of the U.S. operations, as detailed in Section V above. Instead, the definition of major covered company imposes the most stringent aspects of the SCCL in a manner that is completely divorced from the relative systemic importance of the FBO to U.S. financial stability.

A major FBO should be defined as an FBO that meets both of the following criteria: (i) The FBO is a G-SIB, as determined annually by the Financial Stability Board (the "FSB"), and (ii) the FBO is required to have an IHC in its U.S. operations. This approach, in our view, appropriately calibrates the SCCL to the potential impact of an FBO on U.S. financial stability. In addition, as noted above, an IHC should continue to not be treated as a major covered company unless the IHC independently crosses a threshold linked to systemic significance, regardless of the size of its parent bank.

Relying only on the size of the FBO or U.S. IHC to classify it as a major covered company would affect a disproportionate number of FBOs. At the $500 billion level, the heightened major covered company restrictions, as proposed, would apply (based on recent

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[24] See 12 C.F.R. § 217.404; Basel Committee, Global systemically important banks: updated assessment methodology and the higher loss absorbency requirement (July 2013).

data) to 39 FBOs (only 22 of which have been recognized as G-SIBs[25]), while the same restrictions would apply only to the eight U.S. G-SIBs. Furthermore, of the 39 FBOs with over $500 billion of total worldwide assets, 17 have under $50 billion of U.S. assets and four have under $10 billion in U.S. assets.

There is no principled reason for subjecting U.S. BHCs to the heightened requirements applicable to major covered companies based on their G-SIB status, which involves a multifaceted determination of their systemic significance, while casting a much broader net over FBOs or U.S. IHCs based on a one-dimensional assessment, such as size. The Board certainly fails to provide adequate explanation for this divergence, and it is another example of how the Proposal differently and disproportionately affects FBOs.

ii. Major FBO counterparties should be identified based on the international G-SIB list

The same divergence is evident in the Proposal's methodology for defining a major counterparty. In contrast to the certainty afforded by determining the status of a U.S. BHC as a major counterparty by reference to its designation as a U.S. G-SIB, a major covered company must apparently conduct its own assessment of an FBO to determine if the FBO would meet the criteria for G-SIBs set out by the FSB and the Basel Committee. If this divergence is intended to require independent review and investigation by major covered companies with respect to transactions with FBOs, it will create a level of uncertainty that is unwarranted and would put FBOs at a disadvantage as compared to major U.S. BHC covered companies. It could make some FBOs less competitive in being able to enter into transactions if a covered company were to determine that the costs of the required investigation into the FBO's status exceed the benefits of entering into the transaction. This result plainly runs contrary to the principle of national treatment and competitive equality.

A similar issue has been highlighted by the industry in the context of the Total Loss Absorbing Capacity ("TLAC") proposal by the Board.[26] In the TLAC context, our understanding is that the scope of the requirement is intended to align with the Basel Committee and FSB's annual list of international G-SIBs. We assume a similar alignment is intended in the Proposal.

VII. The Concept of Subsidiary Aggregation is Too Broad

A. *Merchant banking portfolio companies should be excluded from aggregation*

The SCCL casts a wide net of aggregation over the exposures that an FBO should consider as part of its SCCL, and captures companies over which the FBO does not have sufficient control to either manage such companies' exposures or obtain the information

25 See FSB, 2015 Update of List of Global Systemically Important Banks (G-SIBs) (Nov. 3, 2015).

26 80 Fed. Reg. 74,926 (Nov. 30, 2015). IHCs of FBOs are subject to the internal TLAC requirement if the FBO determines that the organization qualifies as a G-SIB under the FSB and Basel Committee's framework for identifying G-SIBs.

necessary for such aggregation. The Proposal would apply the SCCL to an FBO covered company on a consolidated basis, including all companies that are directly or indirectly controlled by the FBO pursuant to the criteria established under the BHCA. The preamble text notes that aggregation is not required for companies held under section 2(h)(2) of the BHCA. This comports with the exclusion of 2(h)(2) companies from the requirement to be transferred to an FBO's IHC[27] and from the definition of "combined U.S. operations" of an FBO.[28] This is a logical result, because FBOs would face substantial difficulties in conducting the necessary due diligence and quantitative aggregation to consolidate the exposures of such companies.

Yet, the Proposal does not provide a similar exclusion from aggregation of the exposures of an FBO's merchant banking portfolio companies, despite the fact that an FBO would face the same challenges in aggregating portfolio companies' exposures. Under the rules governing investment in merchant banking portfolio companies,[29] FBOs that qualify as financial holding companies are prohibited from routinely managing or operating any portfolio company in which the FBO has invested under its merchant banking authority. Therefore, an FBO does not and cannot have the requisite level of involvement in the daily operations of a portfolio company to be able to control the company's exposures to third parties and have real-time and accurate information regarding such exposures. Therefore, we submit that the exposures of merchant banking portfolio companies should be excluded from aggregation.

B. *Certain funds should be excluded from aggregation*

The BHCA definition of control may also capture exposures within funds as a result of an FBO's ownership interests in an investment fund during a temporary seeding period or as a result of the governance structure of the fund. However, given mere governance control, or given a seed investment that is intended to be temporary, such funds do not expose an FBO to their underlying risks in a manner that should be captured by the SCCL requirements.

In particular, depending upon customary governance structures in the local jurisdiction, a sponsor FBO may also appoint the directors or act as the corporate director, trustee and/or managing member of a fund. Under the Volcker Rule, the relevant regulatory agencies provided an exemption from the definition of "banking entity" to address governance structures in foreign jurisdictions.[30] A similar exemption would be appropriate in the final SCCL rule to avoid aggregating exposures due to accepted foreign governance structures.

Furthermore, in a number of contexts the Board has recognized the importance

27 12 C.F.R. § 252.153(b).

28 12 C.F.R. § 252.2(e).

29 See 12 C.F.R. §§ 225.170-177.

30 See FAQ 14 under the Volcker Rule in which the Volcker agencies recognized other governance structures abroad and stated that Staffs of the agencies would not advise that a foreign public fund be deemed a controlled banking entity solely by virtue of its relationship with the sponsoring banking entity where the foreign public fund meets the requirements of sections 248.10(c)(1) and 248.12(b)(1) of the Volcker Rule. Board, *Volcker Rule: Frequently Asked Questions*, Question 14 (June 12, 2015).

and practicalities of a fund seeding period. Given the temporary nature of the seeding period,[31] such exposures are more properly excluded from the SCCL so as to avoid introducing unnecessary volatility into the framework or discouraging FBOs from sponsoring funds.

VIII. Exposure Calculation Issues that Affect FBOs

A. *FBOs should be given an avenue to rely on internal models*

The Proposal provides greater flexibility for all covered companies (including FBOs) to use, for the exposure calculations of their derivative positions, internal models approved for risk-based capital purposes as an alternative to the current exposure methodology ("CEM"). However, from a practical perspective, FBOs would not be able to derive tangible benefit from this option.

As an initial matter, many U.S. IHCs have total assets of less than $250 billion or less than $10 billion in foreign exposures (*i.e.*, the threshold for use of the advanced approaches under the U.S. regulatory capital rules), even if the U.S. IHC's FBO parent uses the internal models methodology in its home country. More importantly, a U.S. IHC either is not subject to the advanced approaches[32] or is permitted to opt out of the advanced approaches, with the approval of the Board, for purposes of calculating its exposures under the U.S. risk-based capital rules, even if the IHC crosses the size threshold for the advanced approaches.[33] The ability to opt out of the advanced approaches was specifically designed to address concerns regarding the costs of developing models for U.S. IHCs. The combined U.S. operations of an FBO are also unable to benefit from the use of advanced approaches models for SCCL purposes because there is no U.S. approval process in place for internal models used at an FBO's unconsolidated level, such as the FBO's combined U.S. operations.

The inability to benefit from the option to use internal models would create a significant disadvantage for FBOs as compared to U.S. BHCs because, in effect, most if not all FBOs would be required to use the CEM for calculating derivative exposures. The Board recognizes in the Proposal that the CEM may not fully take into account derivatives correlations and netting benefits and thus is likely to significantly overstate credit risk. This will put FBOs at a significant competitive disadvantage as their capacity to extend credit will be artificially constrained by the fact that they are compelled to use a more conservative methodology than their U.S. BHC competitors. The inability of FBOs to use internal models for the exposures of their combined U.S. operations or U.S. IHCs may also create a disconnect between the exposure

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31 See FAQ 16 under the Volcker Rule in which the Volcker agencies recognized that the seeding period for an entity that is a registered investment company or foreign public fund may take some time, for example, three years. The Volcker agencies stated that Staffs of the agencies would not advise that a registered investment company or foreign public fund be treated as a controlled banking entity during a seeding period. Board, *Volcker Rule: Frequently Asked Questions*, Question 16 (July 16, 2015). See also Board letter, dated June 24, 1999, re: First Union Corp.

32 12 C.F.R. § 252.153(e)(2)(i)(A) and (B).

33 12 C.F.R. § 252.153(e)(2)(i)(C). See, e.g., Board letters to MUFG Americas Holdings Corporation and HSBC North America Holdings Inc., each dated December 11, 2014.

methodology that an FBO uses in its home jurisdiction and in the United States, bringing unnecessary complexity to managing risk at the FBO's U.S. operations. Furthermore, making FBOs (but not their U.S. counterparts) wait until the possible adoption of the standardized approach to counterparty credit risk ("SA-CCR") so that all institutions may operate based on one approach is also not an appropriate response, as it will merely result in another material divergence in treatment from that applicable to U.S. BHCs.

To allow FBOs to enjoy the full benefit of the intended addition of a models methodology in the Proposal, the final rules should provide an avenue for FBOs to obtain approval for internal models they intend to use in calculating their SCCL exposures. However, before U.S. BHCs are approved to use their internal models for risk-based capital (and consequently SCCL) purposes, they are required to complete a satisfactory trial period (*i.e.*, "parallel run" process) which can take years. It would not be efficient for FBOs to be subject to the same process, as this would be a costly and duplicative effort that would likely delay the benefits that FBOs should be able to obtain. Instead, provided that FBOs are subject to rigorous approval processes for their internal models in their home country jurisdictions, the Board should establish a process to recognize, through deference to home country regulators, the internal models employed by an FBO, should an FBO's IHC or combined U.S. operations wish to use them to calculate their exposures for purposes of the SCCL. This approach is also consistent with the principle of giving due regard to comparable home country treatment, which the Board is required to consider in the context of Section 165 rulemakings for FBOs.

B. *A "home country sovereign entity" should include the sovereign's political subdivisions*

The Proposal appropriately exempts exposures of an FBO's combined U.S. operations and U.S. IHC to its home country foreign sovereign. While this is a useful exemption for FBOs, we respectfully request that the Board clarify that the scope of the term "home country sovereign entity" includes such sovereign's political subdivisions. We see no principled reason to treat political subdivisions differently from agencies and instrumentalities.

Moreover, the Proposal creates some ambiguity with respect to the intent behind this exclusion. First, the definition of a "U.S. state" as a component of the "counterparty" definition explicitly includes political subdivisions. In addition, while the rule text excludes "political subdivisions" from the definition, the preamble to the Proposal explicitly includes them in the definition of "foreign sovereign entity."[34] Given the lack of rationale for carving out political subdivisions from this definition and the inconsistency between the rule text and the preamble, we respectfully request that the Board confirm that political subdivisions are included in the definition of "sovereign entity" in relation to the home country sovereign exposure exemption.

34 See 81 Fed. Reg. 14331.

C. *Exposures to supranational entities and multilateral development banks should be excluded*

Exposures to certain supranational entities and multilateral development banks should be exempted from the SCCL. The Proposed Rule currently excludes exposures to foreign sovereigns with a zero percent risk weight from the definition of counterparty.[35] Certain supranational organizations, including the Bank of International Settlements, the European Central Bank, the European Commission, the International Monetary Fund and multilateral development banks,[36] are granted a zero percent risk weight under the risk-based capital rules.[37] Exempting these supranational entities and multilateral development banks from the SCCL would be consistent with the current exemption for foreign sovereigns, because such entities pose little risk of default. Further, the Proposed Rule also exempts exposures to the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, and provides the Board with the power to exempt other government-sponsored entities which are given a 20% risk weight under the risk-based capital rules.[38] If government-sponsored entities with higher perceived risk are exempted from the SCCL, then supranational entities and multilateral development banks with zero percent risk weight should be exempted as well.

IX. Risk Mitigation Issues

A. *The definition of eligible protection provider inappropriately excludes an FBO's home office and its affiliates*

The Proposal continues to diverge sharply from credit risk management practices and other systems that both U.S. and non-U.S. banking organizations have developed over many years in close collaboration with their supervisors to foster enterprise-wide risk management. Guarantees, swaps and other derivative transactions between the branches and affiliates of a banking organization are a common method of managing and distributing risk to the geographic locations best suited to hedge those risks. This practice is not unique to FBOs—U.S. banks and BHCs also undertake these risk management activities globally.

The exclusion of an FBO's home office and its non-U.S. affiliates from the definition of "eligible protection provider" would hinder effective enterprise-wide risk management practices, with significant negative concomitant effects on the safety and soundness of an FBO's consolidated operations. For example, an FBO that lends, through its U.S. branch,

35 See proposed § 252.171(e).

36 See 12 C.F.R. § 217.2 ("Multilateral development bank (MDB) means the International Bank for Reconstruction and Development, the Multilateral Investment Guarantee Agency, the International Finance Corporation, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the European Investment Fund, the Nordic Investment Bank, the Caribbean Development Bank, the Islamic Development Bank, the Council of Europe Development Bank, and any other multilateral lending institution or regional development bank in which the U.S. government is a shareholder or contributing member or which the Board determines poses comparable credit risk.")

37 12 C.F.R. § 217.32(b).

38 See proposed § 252.177(a)(1); 12 C.F.R. § 217.32(c).

to a local subsidiary of a customer based in the FBO's home country may be most effectively and efficiently able to hedge credit exposures to that customer in its home country, where the head office will likely have access to a more liquid third-party market for purchase of protection on the customer. As another example, an FBO may run its global derivatives trading business out of its head office or out of an international financial hub, such as London, Hong Kong or Singapore. Operations outside of such trading hub would typically hedge transactions with local customers by backing such transactions to the global trading hub. Having the U.S. operations negotiate one-off master agreements with third parties to obtain appropriate hedges would be inefficient and would likely undercut the benefits of netting or other portfolio effects obtained through hedging with the global trading hub.

Relatedly, the final rule should explicitly recognize the purchase of loan participations (funded or unfunded) by offshore branches or affiliates of the FBO as a risk mitigating technique for SCCL purposes. All banking organizations, including U.S. banking organizations, support local operations in their quest to fulfill large customer credit needs by purchasing participations into the parent bank (which likely has greater cash resources and a larger lending limit). In particular, an IHC, with its smaller capital base and limit under the proposed SCCL, would be significantly impaired in its ability to compete if it could not receive a reduction in its exposure to a counterparty for participations sold to the U.S. or non-U.S. branches and affiliates of the FBO.

Indeed, it is unclear why an offshore third-party protection provider should be viewed as more likely to pay its obligations to unrelated U.S. operations during a time of stress than offshore parties that are, in fact, related to the U.S. operations. This, for example, is at odds with the recognition by the Board of the risk mitigating effects that can result by allowing a U.S. branch of an FBO to recognize netting under qualifying master netting agreements ("QMNAs") that cover both the U.S. branch and offshore operations.[39] Furthermore, it is also unclear why a rule about the exposure to risk of a third-party counterparty default should be informed by a concern over risks posed by an affiliated party, particularly when that affiliated party is outside of the calculation group for the exposure limit. In addition, there is no analogous exclusion from the definition of "eligible protection provider" for U.S. BHCs.

In our view, an FBO's U.S. operations, including the IHC, should be able to purchase swaps, guarantees and similar protection from, and sell participations to, offshore affiliates in order to mitigate the exposures that count toward the SCCL. At a minimum, the Board should grant an exception from the exclusion for certain types of pre-paid protection (*e.g.*, pre-paid CDS or funded participations) and collateralized guarantees, which would bear no correlation to the credit risk of the protection provider.

B. *Eligible collateral should include debt or equity securities issued by an affiliate*

The Proposal would exclude from the definition of "eligible collateral" debt or equity securities (including convertible bonds) that are issued by an affiliate of the U.S. IHC or by any part of the combined U.S. operations of the FBO. Such a requirement does not appear in

39 See Section IX.D below.

the definition of "eligible collateral" under the Proposal for U.S. BHCs. Thus, a U.S. BHC covered company appears to be permitted to take collateral in the form of securities issued by it or any of its subsidiaries.

In addition to being discriminatory, this aspect of the Proposal would appear inconsistent with the basic approach of the SCCL requirements and many of the other enhanced prudential standards developed by the Board, which treat IHCs and FBOs' combined U.S. operations as stand-alone top-tier entities. In addition, however, Section 165(e) does not include within its mandate the goal of limiting the U.S. operations' exposure to its offshore affiliates. Therefore, if the collateral otherwise meets the definition of eligible collateral, then its value should serve to offset the exposure to a customer or counterparty. Ability to monetize or offset collateral in the case of a counterparty default should not normally be affected by the fact that the collateral is in the form of securities issued by the non-defaulting entity or one of its affiliates.

C. *The location of eligible cash collateral should not be limited to the United States and security interest requirements should be clarified*

Under the Proposal, "eligible collateral" is required to be on deposit, if it is cash collateral, with the U.S. IHC, a U.S. branch, a U.S. agency or any part of the U.S. operations. In addition, the Proposal requires that the U.S. IHC or "any part" of the U.S. operations "has a perfected, first priority security interest" in the collateral. The Proposal's artificial line separating an FBO's U.S. and non-U.S. operations with regard to collateral management would interfere with effective enterprise-wide risk management.

Many U.S. and global financial institutions manage their counterparty exposures on a global consolidated basis, with centralized collateral management and global master netting agreements. For example, under a global master netting agreement with a multi-branch credit support annex, one non-U.S. branch of an FBO may hold all the collateral pledged by the counterparty, even though multiple branches of the FBO (including the U.S. branch) interact with that counterparty. The branches rely on both internal netting across branches of the same FBO legal entity and the collateral held on their behalf by one or more branches of the same FBO legal entity. Counterparties grant security interests for the benefit of all of the branches in the bilateral netting agreement. If the counterparty has consented to the security interest in favor of the U.S. operations, and the security interest is otherwise perfected under applicable law, it should not matter that collateral is held in custody or on deposit by a separate non-U.S. affiliate of the U.S. operations for the benefit of the U.S. operations. Therefore, collateral that meets these criteria should be recognized as a valid mitigant to exposures held by the U.S. operations, and the FBO should be permitted to take into account collateral held at a non-U.S. branch for the benefit of its U.S. operations.

Similarly, the Proposal's rule text concerning the security interest requirement should be clarified, as it is unclear what is meant by "has" a security interest. Provided that the security interest is executed in any manner effective under applicable commercial law to grant and create a security interest in favor of the IHC or U.S. operations for purposes of the relevant exposure, the IHC or U.S. operations should be able satisfy the requirement, even if another entity or branch holds the security interest. As a common example, another entity or branch may act, in the context of centralized collateral management, as the collateral agent for multiple entities within an affiliated group, and may be the entity that "has" the security interest, but other entities may benefit from that security interest provided that the security has also been granted in favor of the other entities under applicable law. Therefore, the final rule should be clarified to recognize such arrangements.

The Proposal discriminates against FBOs and their U.S. operations. The proposal would violate the core principle of national treatment and competitive equality to the extent it prohibits FBOs from counting collateral while U.S. BHCs are permitted to count collateral, hedges, netting agreements and other arrangements from any part of their global operations—even if maintained in a foreign jurisdiction under foreign law in an entity subject to regulation by a foreign regulator. If neither (i) the fact that perfection of a security interest is accomplished by a separate entity, under foreign law, subject to regulation by a foreign regulator, nor (ii) the placing of cash collateral on deposit at an affiliated non-U.S. bank, presents a U.S. financial stability concern to the Board with regard to U.S. BHCs, it should not be a concern with regard to the U.S. operations of FBOs, as there is no practical difference.

This disparity should be solved by allowing FBOs to hold cash collateral outside of the United States and by clarifying that the U.S. operations may benefit from security interests in their favor but granted through a non-U.S. entity or branch. By penalizing FBOs that keep collateral or maintain collateral agents outside of the United States, the proposed SCCLs would push FBOs to maintain collateral and collateral documentation locally or to move credit exposures offshore, even if the collateral and/or credit exposures are more effectively and efficiently managed in another location or managed jointly.

D. *U.S. branch netting under QMNAs that cover offshore operations should be permissible*

The Original Proposal created a level of uncertainty whether the U.S. branches of an FBO's combined U.S. operations would be able to benefit from the existence of QMNAs that cover the entire FBO legal entity (including both onshore and offshore branches and agencies). We recognize that, in the Proposal's preamble, the Board has attempted to clarify this point further by confirming that the U.S. branches of an FBO can rely on a QMNA to net exposures even when the QMNA covers exposures of the FBO outside its U.S. branch and agency network.[40] We wish to clearly state our understanding of Proposed § 252.173(a)(11)(ii): The

[40] The preamble states that by allowing a U.S. branch or agency the choice between using the gross exposure or the exposure at default calculation set forth in the Board's capital rules to calculate derivatives exposures to a counterparty, an FBO "would be able to rely on a qualified [*sic*] master netting agreement to which the U.S. branch or agency is subject that covers exposures of the foreign banking organization outside of the U.S. branch and agency network." 81 Fed. Reg. 14347. Proposed § 252.173(a)(11)(ii) states that for a derivative transaction "[b]etween an entity within the combined U.S. operations of [an FBO] and a counterparty that is subject to a qualifying master netting agreement between an entity within the combined U.S. operations and the counterparty: (A) The derivative transaction shall be valued at an amount equal to either (1) the exposure at default amount calculated under any of the methods that the covered company is authorized to use under the Board's Regulation Q (12 CFR part 217, subparts D and E) to value such transactions (provided that the rules governing the recognition of collateral set forth

Proposal provides an FBO a choice between (i) recognizing the benefits of netting under QMNAs (even when U.S. exposures may be net against those booked at non-U.S. branches and agencies) by using the exposure at default calculation as prescribed by Subparts D and E of the U.S. risk-based capital rules or (ii) calculating the combined U.S. operation's derivative exposures on a gross basis. We do not understand this provision to require a "one-time" choice—FBOs may change the method of calculation during the life of the QMNA, and may choose different options for different QMNAs.

While we welcome the clarification made by the Board on this point, we note that there is a discrepancy between statements in the Proposal's preamble and the Proposal's rule text. The rule text states that netting may be taken into account by using derivative valuation methods "under any of the methods that the covered company is authorized to use under the Board's Regulation Q (12 CFR part 217, subparts D and E)".[41] However, the preamble states that "[w]hen calculating a U.S. branch or agency's gross credit exposure to a counterparty for a derivative contract that is subject to a [QMNA], [an FBO] could choose . . . to use the exposure at default calculation set forth in the Board's advanced approaches capital rules (12 CFR 217.132(c))".[42] We respectfully request that the Board clarify that FBOs are permitted to recognize the netting benefits of QMNAs not only by relying on the EAD calculation under the advanced approaches capital rules, but, in the alternative, under the standardized approach in Subpart D of the Board's risk-based capital rules (*i.e.*, using netting permitted by CEM).

X. <u>Reporting by FBOs</u>

The Board should provide relief to FBOs by exempting from the stringent SCCL-specific monitoring and reporting requirements under the Proposal all exposures of their combined U.S. operations (if the final rule were to apply to the combined U.S. operations) and of their IHCs that fall below a specified minimum threshold. The amount of employee and systems resources of the FBO community, as well as of the Board, that would be required to perform all of the necessary calculations, recordkeeping and reporting would not be commensurate with the benefit (if any) obtained by looking into small exposures. Requiring SCCL-specific monitoring and reporting in these circumstances would seem to serve no meaningful purpose. To better balance the costs and benefits of SCCL-specific monitoring and reporting, we believe it is appropriate for FBOs, based on reasonable estimation procedures, to calculate and report only those exposures that exceed 10% of the appropriate SCCL capital base, as such exposures are more likely to represent material contingencies for an FBO. Under the Basel Large Exposure Framework, reporting would be required only for the largest 20 counterparty exposures and for those exposures that exceed 10% of the applicable capital base.[43] For FBOs moreso than U.S. BHCs, consistency with the reporting and recording requirements of Basel Large Exposure

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in this subpart shall apply); or (2) the gross credit exposure amount calculated under § 252.173(a)(10) of this subpart."

41 Proposed § 252.173(a)(11)(ii)(A)(1).

42 81 Fed. Reg. at 14347.

43 <u>See</u> Basel Large Exposure Framework at 4.

Framework is important because of the multiple layers of SCCL to which FBOs are being made subject.[44]

XI. Insufficient Compliance Periods

The Proposal subjects Large FBOs to a one-year compliance timeframe, which is insufficient to account for the onerous operational changes required generally of FBOs. FBOs are subject to disproportionate complexity due to the multiple large exposure limits applicable to multiple sub-consolidated levels of the FBO under the Proposal and other regulations, especially as the SCCL requires aggregation at an unnatural, unconsolidated level of the combined U.S. operations. Our members indicate that the Proposal will require modification to, or establishment of, multiple operational and recordkeeping systems in each business line. In addition, FBOs are in the process of significant reorganization and restructuring at the request of the Board, further increasing the complexity of implementing operational systems for monitoring and reporting into an evolving structure. Furthermore, any operational modifications and systems updates that would be required will also require understanding of any reporting forms or templates that the Board produces in relation to the reporting requirements. In light of these significant operational complexities, all FBOs should be given at least two years from the date of publication of a final reporting template for the SCCL for compliance with the final rules. Due to the recent and ongoing reorganization and aggregation of entities into an IHC, we believe that this runway to compliance is required even under our Recommended Approach; however, if our Recommend Approach is not adopted, the additional complexity of aggregating exposures at the level of the U.S. operations would require even more additional time for compliance.

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We appreciate your consideration of our comments. Please contact the undersigned (646-213-1147; smiller@iib.org) or our General Counsel, Richard Coffman (646-213-1149; rcoffman@iib.org), if we can provide any additional information.

Sincerely,

Sarah A. Miller

Sarah A. Miller
Chief Executive Officer

cc: Michael S. Gibson
Mark E. Van Der Weide
Jack P. Jennings
Kwayne Jennings
Jordan Bleicher
Scott G. Alvarez
Laurie Schaffer

[44] Of course, any reporting required by the Board should be consistent with data confidentiality and privacy requirements in other jurisdictions.