Institute of International Bankers
299 Park Avenue, 17th Floor
New York, New York 10171
(646) 213-1147
www.iib.org

Briget Polichene
Chief Executive Officer
bpolichene@iib.org

November 20, 2020

By Electronic Mail

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Notice of Proposed Rulemaking Regarding Amendments to Capital Planning and Stress Testing Requirements for Large Bank Holding Companies, Intermediate Holding Companies and Savings and Loan Holding Companies: Federal Reserve Docket No. R-1724 and RIN 7100-AF95

The Institute of International Bankers ("IIB") appreciates the opportunity to comment on the notice of proposed rulemaking[1] to tailor the requirements in the Board of Governors of the Federal Reserve System's ("Federal Reserve") capital plan rule. 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 international banks that operate branches and agencies, bank subsidiaries and broker-dealer subsidiaries in the United States ("international banks").

The IIB supports the Federal Reserve's efforts to align its capital plan rule with its recently revised framework for applying prudential standards to large banking organizations. We believe this effort will simplify the Federal Reserve's capital adequacy framework, result in a more effective and efficient rulebook, appropriately recognize reductions to the size and riskiness of large banking organizations, reduce compliance burdens and harmonize the Federal Reserve's regulatory and supervisory approach to firms with similar risk profiles—while continuing to serve the Federal Reserve's micro- and macroprudential aims of promoting safety and soundness at individual firms and protecting the U.S. financial system from exposure to significant risks.

In this letter we have focused our comments on the issues of particular relevance and concern to internationally headquartered banks with U.S. banking operations. Nevertheless, our members believe that there are numerous important issues that span both international and

[1] 85 Fed. Reg. 63,222 (Oct. 7, 2020) (the "Proposal").

U.S. banking organizations, and the IIB urges the Federal Reserve also to consider those issues fully.

Below we offer comments and suggestions related to the Proposal and address several questions and requests for comment in the Proposal. We stress, however, that our comments in Section VII are broadly applicable to capital planning and understanding the capital dynamics at intermediate holding companies ("IHCs"), and all of our comments should be viewed through the lens of our recommendations for a coherent and non-punitive capital framework for IHCs.

I. Further consistency is needed between the capital planning guidance in the Federal Reserve's SR Letters 15-18 and 15-19 and the tailoring framework finalized in 2019.

A. *We agree with the recent determination by the Federal Reserve that only firms subject to Category I standards should be subject to the Large Institution Supervision Coordinating Committee program.*

In 2012, the Federal Reserve established a "new framework" for supervision of large financial institutions,[2] under the auspices of the Large Institution Supervision Coordinating Committee ("LISCC"). While the LISCC framework was designed to provide "system-wide and cross-disciplinary perspectives on the supervision of firms" in the portfolio,[3] the Federal Reserve has used inclusion in the LISCC portfolio as a trigger for more stringent regulation.[4]

We agree with the recent determination by the Federal Reserve that only Category I firms should be subject to the LISCC program,[5] given the LISCC program's heightened regulatory expectations and the need to align regulatory expectations and guidance

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[2] Federal Reserve, "Consolidated Supervision Framework for Large Financial Institutions", SR Letter 12-17 (Dec. 17, 2012) ("LISCC framework").

[3] Federal Reserve, "Governance Structure of the Large Institution Supervision Coordinating Committee (LISCC) Supervisory Program", SR Letter 15-7 (April 17, 2015) ("LISCC Governance").

[4] For example, the LISCC Governance establishes the "Comprehensive Liquidity Analysis and Review" and the "Supervisory Assessment of Recovery and Resolution Preparedness", which are horizontal exercises that are binding in practice, not applicable to firms outside of the LISCC designation and not written in any formal regulation. *See* Government Accountability Office, "Applicability of the Congressional Review Act to Supervision and Regulation Letter 15-18", File No. B-331560 (Apr. 16, 2020) (finding that SR Letter 15-18, applicable primarily to LISCC and "large and complex" firms, meets the Congressional Review Act definition of a rule and no exception applies).

[5] *See* Federal Reserve, "Firms Subject to the LISCC Supervisory Program", draft SR Letter 20-XX (draft dated Nov. 6, 2020, and to be effective Jan. 1, 2021), https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20201106a1.pdf.

with the tailoring framework finalized in 2019.[6] We also strongly agree with the reasons for this change summarized by the Federal Reserve—in particular that "foreign banks with U.S. operations that have substantially decreased in size and risk over the past decade [should be] . . . supervised with other banks of similar size and risk".[7] We look forward to providing further comments, under separate cover, in response to the Federal Reserve's request regarding appropriate criteria for inclusion in the LISCC supervisory program.

A common theme through this comment letter is that the Federal Reserve and supervisory colleges have developed additional tools in order to identify those institutions that should be subject to heightened supervision, and supervisory guidance and other programs such as LISCC should be made consistent with these overarching frameworks rather than operating as standalone frameworks. In the United States, the primary tool is the framework to tailor enhanced prudential standards to firms based on size and the magnitude of certain risk-based indicators ("tailoring framework").[8] Globally, the primary tool is the Financial Stability Board's ("FSB") designation of global systemically important banks ("GSIB framework") that generally uses the same size and risk-based indicators to categorize banking organizations around the world and subject those firms to heightened capital requirements. The convergence between the methodologies in the Federal Reserve's tailoring framework and the internationally-agreed GSIB framework has established a clear set of factors that, in our view, has allowed the Federal Reserve to tailor its regulatory approach effectively, without the need for development of separate frameworks with standalone scope or applicability criteria (as had been applied in the LISCC supervisory program).

B. No firm in Category II, III or IV should be subject to the capital planning guidance for LISCC firms and large and complex firms (SR Letter 15-18).

In addition to the Federal Reserve's recent determination that LISCC firms should be aligned with the tailoring framework's Category I, the Federal Reserve's supervisory approach to capital planning also needs to be aligned by leveraging those same factors to

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6 The recent determination is consistent with statements of Federal Reserve leadership over the past 12 months and should be finalized as well-considered and thoroughly reviewed. *See* Randal K. Quarles, Vice Chair for Supervision, Federal Reserve, "Spontaneity and Order: Transparency, Accountability, and Fairness in Bank Supervision" (Jan. 17, 2020) ("Spontaneity and Order"); Oversight of Financial Regulators Before the S. Comm. on Banking, Housing and Urban Affairs, 116th Cong. (May 12, 2020) (testimony of Randal K. Quarles, Vice Chair for Supervision, Federal Reserve); The Semiannual Monetary Policy Report to the Congress Before the S. Comm. on Banking, Housing and Urban Affairs, 116th Cong. (Feb. 12, 2020) (testimony of Jerome H. Powell, Chair, Federal Reserve); Institute of International Bankers, Remarks by Federal Reserve Vice Chair for Supervision, Randal K. Quarles, YOUTUBE (Sept. 23, 2020), https://www.youtube.com/watch?v=0KlVxs6Jbuo.

7 Federal Reserve Press Release, "Federal Reserve publishes latest version of its supervision and regulation report" (Nov. 6, 2020) (the "Nov. 6 Press Release").

8 12 C.F.R. part 252 (Regulation YY).

categorize firms for heightened supervisory expectations. We are encouraged that the Proposal includes a general request for comment "on all aspects of its guidance on capital planning for firms of all sizes" as part of the Federal Reserve's "ongoing practice of reviewing its policies to ensure that they are having their intended effect".[9] We note that the Federal Reserve's supervisory letter regarding capital planning for LISCC firms and large and complex firms (SR Letter 15-18)[10] is specifically identified in the supplementary materials as part of the body of stress testing and capital planning guidance for which the Federal Reserve is seeking comment.[11]

The scope of application of SR Letter 15-18 should now also be aligned with the tailoring framework. Banking organizations in Categories II, III and IV should be evaluated and supervised based on comparison with their respective regulatory peer groups, and not with the U.S. GSIBs that comprise Category I. **Only Category I institutions should be subject to both the LISCC framework and the capital planning guidance in SR Letter 15-18.**

The dispersion of the current firms that are subject to SR Letter 15-18 across multiple categories in the tailoring framework undermines the simplicity and transparency of the Federal Reserve's *supervisory* approach, while at the same time its *regulatory* approach (the tailoring framework) has become easily understood by the market. Under the current supervisory approach, firms with very different risk attributes are treated similarly (e.g., U.S. GSIBs in Category I and IHCs of LISCC FBOs in other categories), while firms with similar risk attributes are treated differently (e.g., not all FBOs in the same categories are in the LISCC portfolio). These inconsistencies undermine both the simplicity and credibility of the SR Letter 15-18 enhanced capital planning requirements. Furthermore, this outcome is inconsistent with the principle of national treatment and with Vice Chair Quarles' statements indicating that a goal of the tailoring framework is to create a level playing field between U.S. BHCs and IHCs of similar size and risk profiles.

In particular, the stringency and burdens of SR Letter 15-18 should not be applied to firms that are not in the highest category of size and risk. SR Letter 15-18 establishes supervisory expectations for the largest U.S. firms that, while appropriate for the U.S. GSIBs, impose significant additional burdens and obligations on certain IHCs that are not imposed on their U.S. peers of similar size and risk profile. Benchmarking the capital planning processes of Category III IHCs against Category I firms is not only inherently unfair, but also counterproductive because such comparisons disregard fundamental structural differences in capital planning between U.S. GSIBs (for which capital planning is a global exercise in enterprise-wide risk management) and IHC subsidiaries whose capital planning is driven by their

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[9] Proposal at 63,227.

[10] Federal Reserve, "Federal Reserve Supervisory Assessment of Capital Planning and Positions for LISCC Firms and Large and Complex Firms", SR Letter 15-18 (December 18, 2015) ("SR Letter 15-18").

[11] Proposal at 63,227.

parent FBO's enterprise-wide risk management.[12] Specifically, firms subject to SR Letter 15-18 are, among other things, expected to:

- Maintain a higher level of engagement in the capital planning process by ensuring senior management review of the firm's capital planning process quarterly, rather than semi-annually as is required under SR Letter 15-19;[13]
- Use benchmark models and subject such benchmark models to validation, to the extent the models contribute to post-stress capital estimates;[14]
- Use quantitative approaches in estimating losses and pre-provision net revenue ("PPNR"), while firms subject to SR Letter 15-19 may use either quantitative or qualitative approaches;[15]
- Project losses with respect to PPNR and model operational risk with a greater level of granularity than is expected of firms subject to SR Letter 15-19; and
- Report to senior management with a frequency that is out of sync with other regulatory frameworks, such as the recovery and resolution planning rules which, for example, do not mandate the frequency of reports to senior management.

C. Instead, FBOs and their IHCs that are in Categories II, III or IV should be subject to the large and foreign banking organizations supervisory program and the capital planning guidance in SR Letter 15-19.

Vice Chair Quarles has indicated that the removal of the FBOs from the LISCC portfolio would have "no effect" on regulatory capital or liquidity requirements for migrated firms and that such a change "would not result in a loss of insight into the activities of these firms".[16] The Federal Reserve's recent press release agrees.[17] Accordingly, limiting the application of SR Letter 15-18 to Category I firms would result in greater alignment among the Federal Reserve's recent determination, the Federal Reserve's tailoring framework and the Federal Reserve's supervisory approach, without compromising the Federal Reserve's

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[12] We elaborate on this point in Section VII below.

[13] SR Letter 15-18, p. 6.

[14] SR Letter 15-18, p. 12.

[15] SR Letter 15-18, p. 18.

[16] Quarles, Spontaneity and Order.

[17] Nov. 6 Press Release ("The portfolio move will have no effect on the regulatory capital or liquidity requirements of any firm.").

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supervisory aims or tools. **SR Letter 15-19[18] should apply to Category II, III and IV IHCs and U.S. BHCs that are required to submit capital plans annually**.

This would mean that the definition of firms subject to each SR Letter should be modified to align with the tailoring framework, and in particular (i) the size threshold and the foreign exposure threshold in SR Letter 15-18 should be removed and replaced with a Category I threshold, and (ii) and the size, foreign exposure and large and noncomplex thresholds should be removed entirely from SR Letter 15-19 and modified to align with Categories II, III and IV. In particular, the Federal Reserve should remove references to "foreign exposure" in SR Letters 15-18 and 15-19. Now that the tailoring framework has become effective, foreign exposure is no longer used as a tool to calibrate regulatory requirements. Given the Federal Reserve's ongoing practice of reviewing its policies to ensure that they are having their intended effect, references to "foreign exposure" should be removed as obsolete in order to improve the simplicity and consistency of the Federal Reserve's supervisory approach.

D. Beyond the scope of application, the Federal Reserve should republish draft versions of SR Letters 15-18 and 15-19 and seek specific comment to ensure that the underlying supervisory expectations are appropriately calibrated to the Federal Reserve's current regulatory frameworks.

Further aligning the specific expectations of SR Letters 15-18 and 15-19 with the regulatory tailoring framework would best be addressed through the notice and comment process, consistent with the procedure the Federal Reserve has recently used for other pieces of guidance related to its enhanced prudential standards.[19] We do not believe that the Proposal's "opening" of discussion on capital planning expectations such as SR Letters 15-18 and 15-19 is sufficient to fully comment on how the Federal Reserve may modify this guidance, particularly in light of other developments, such as (but not limited to) the stress capital buffer framework, that should be incorporated into these letters. Furthermore, we believe that putting SR Letter 15-19 out for notice and comment would likely result in more appropriate tailoring for the firms subject to this guidance, as further differentiation of expectations for Category IV firms should be possible (e.g., to reflect the biennial rather than annual supervisory stress testing requirements applicable to Category IV firms).

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18 Federal Reserve, "Federal Reserve Supervisory Assessment of Capital Planning and Positions for Large and Noncomplex Firms", SR Letter 15-19 (December 18, 2015) ("SR Letter 15-19").

19 *See, e.g.*, Guidance for Resolution Plan Submissions of Certain Foreign-Based Covered Companies, 85 Fed. Reg. 15,449, 15,451 (proposed Mar. 18, 2020) ("The agencies continue to evaluate the capital and liquidity guidance and expect that any future actions in these areas, whether guidance or rules, would be adopted through notice and comment procedures, which would provide an opportunity for public input.").

II. The stress capital buffer "add-on" of four quarters of dividends penalizes IHCs and should be eliminated. Adopting a definition of "common stock dividends" would therefore be unnecessary and would serve only to exacerbate this inequity.

The Proposal seeks comment on whether to incorporate a definition for "common stock dividends" in the Federal Reserve's capital plan rule. Although the Federal Reserve has not proposed a definition, one example that the Federal Reserve could adopt would define "common stock dividends" as "any payment of cash to shareholders in proportion to the number of shares they own".[20] Adopting such a definition would have significant implications for calibrating a firm's risk-based capital requirements. Under the Stress Capital Buffer Rule,[21] a planned dividend in any or all of the fourth through seventh quarters of the nine-quarter capital planning horizon must be added (the "dividend add-on") to an IHC's stress capital buffer ("SCB"), while other forms of distributions to shareholders, such as a planned share repurchase, are not.

The operative question is not whether a definition of "dividend" is necessary to clarify capital planning around the dividend add-on, but rather why is the dividend add-on necessary, especially for IHCs?

A. The Federal Reserve's underlying rationale for the dividend add-on component does not apply to IHCs and therefore it should be eliminated.

The implied underlying policy reasons for the differential treatment of dividends and share repurchases are inapplicable to IHCs. An IHC is, by definition, a subsidiary of its parent FBO. This unique feature of IHCs' organizational structure creates important distinctions between FBOs and their U.S. BHC peers. While these distinctions should provide IHCs with *more* flexibility under the stress capital buffer framework, the Federal Reserve has applied requirements that limit IHCs' flexibility and, in fact, penalize IHCs. The capital rules more generally do not take into account several of these fundamental differences. For example:

- The Federal Reserve's rationale for establishing a dividend add-on was, as we will expand upon below, based on the importance of maintaining dividends to satisfy public market expectations. This issue is wholly absent for IHCs.

- A parent FBO provides a source of strength that is wholly different from any shareholder of a U.S. BHC. An IHC's parent organization is required to undertake robust capital

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[20] Proposal at 63,227.

[21] Regulations Q, Y, and YY: Regulatory Capital, Capital Plan, and Stress Test Rules, 85 Fed. Reg. 15,576 (Mar. 18, 2020) (the "Stress Capital Buffer Rule").

planning on an enterprise-wide basis in relation to all of its parts, whereas no public shareholder of a U.S. BHC has any such responsibility.

- The flexibility undertake capital planning on an enterprise-wide basis and to rebalance capital among the subsidiaries of an FBO provides important ballast for group stability. Internal transfers are fundamentally different from group-level capital distributions. The reallocation of capital among IHCs and other subsidiaries provides a mechanism to maintain the capital strength of all subsidiaries, avoiding gaps that could lead to group fragility.[22] By contrast, distributions to public shareholders leave the organization and do not promote group stability.

Vice Chair Quarles appropriately recognized, as part of a home-host framework, the unique position of an international bank's U.S. operations as part of a larger organization.[23] But the framework described by Vice Chair Quarles has not yet led to any rebalancing of U.S. regulatory requirements. We urge the Federal Reserve to implement modifications to capital planning and other supervisory requirements through the filter of home-host balance and overall prudential objectives, rather than punitive treatment for IHCs and the erosion of group resilience.

In particular, in relation to capital and dividend planning, IHCs are significantly and negatively affected by the SCB's dividend add-on component. As a subsidiary, an IHC would typically issue a dividend or a return of capital in order to provide funds to its parent FBO to employ elsewhere. An IHC would not typically repurchase its shares as a subsidiary of an FBO. (Even if an IHC sought to repurchase shares, it would likely have to undertake an internal restructuring to ensure that, as a wholly-owned subsidiary with wide discretion to issue one share or many shares to its parent, the IHC was able to conduct a transaction that, as a technical matter, is a share repurchase.)

A focus on finding the right home-host balance requires recognizing the distinctions in the capital and liquidity profiles, and enterprise-wide dynamics, of banking organizations that are subsidiaries (i.e., IHCs) and those that are publicly traded, top-tier organizations (i.e., U.S. BHCs). Publicly traded U.S. BHCs have an incentive to maintain their dividend as a consistent, or steadily rising, amount over time. To the extent that these incentives lead to an obligation, imposed by market and investor pressure, we can understand why pre-funding of planned dividends may be prudent.[24] Vice Chair Quarles indicated that this market

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[22] Randal K. Quarles, Vice Chair for Supervision, Federal Reserve, "Trust Everyone—But Brand Your Cattle: Finding the Right Balance in Cross-Border Resolution" (May 16, 2018) ("Brand Your Cattle") (noting that "adequate flexibility for the parent to deploy resources where needed is likewise in the host regulator's interest.").

[23] *See id.*

[24] Stress Capital Buffer Rule at 15,579 ("During the last financial crisis, many firms continued to make significant distributions of capital, including through dividends, without due consideration of the effects that a prolonged economic downturn could have on their capital adequacy.").

pressure to maintain constant dividends was one reason why the four-quarter dividend add-on was included in the SCB.[25] However, there is no such incentive for an IHC to pay an annuity-like return to public investors. Furthermore, there is no negative market-signaling effect on an IHC should it reduce a distribution to its parent FBO from one period to the next.[26] Indeed, the amount and timing of distributions to the parent FBO are solely a function of both U.S. and group-wide capital planning and business strategies. Distributions by IHCs are generally lumpy and irregular, as they are increased or decreased depending on the capital needs of the IHC and of the larger group. Accordingly, such distributions do not give rise to an "obligation" that would justify incorporation into the SCB because no market expectation prevents their reduction or cancellation. In this sense, an IHC's "subsidiary dividend" resembles the share repurchases that Vice Chair Quarles and the Federal Reserve sought to incentivize by eliminating them from the add-on.[27] Because of the market pressure on publicly traded BHCs not to reduce dividends, the reasoning behind the exclusion of share repurchases from the SCB appears to have been to encourage greater use of a more flexible tool that could be maneuvered up or down without adverse market implications. That is exactly what IHC subsidiary dividends are.

Further, observed experience in stress scenarios indicates that IHCs tend to reduce dividend payments while BHCs seek to maintain them.[28] This dynamic specifically stems from the absence of any market expectation that IHCs provide "income to shareholders", whereas BHCs face market expectations from investment funds that hold a BHC's shares pursuant to dividend strategies and from other shareholders that expect a steady return. If corporate dividends react to market pressure by remaining steady, rather than fluctuating up and down, then U.S. BHCs are strongly incentivized to make use of another tool, such as share repurchases, to modify distributions without triggering the same adverse market-disciplining effects. This

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[25] Randal K. Quarles, Vice Chair for Supervision, Federal Reserve, "A New Chapter in Stress Testing" (Nov. 9, 2018) ("A New Chapter") ("First, the SCB proposal would have included four quarters of dividends in a firm's SCB, in recognition of the fact that firms experience market pressure to hold dividends constant, even under stress.").

[26] The rationale for the four-quarter dividend add-on was based solely on publicly traded institutions. Amendments to the Regulatory Capital, Capital Plan, and Stress Test Rules, 80 Fed. Reg. 18,160, 18,166 (proposed April 25, 2018) ("A reduction in dividends by a publicly-traded firm could be interpreted by market participants as a signal of long-run deterioration in firm profitability, which could lead to a negative stock price reaction. Hence, even if the outlook for a publicly traded firm has significantly worsened, public pressure and competition may deter the firm from reducing dividend payments. Requiring a firm to pre-fund one year of dividends reflects the assumption that the firm will strive to maintain its current level of dividends even during times of stress."). This policy goal is wholly inapposite to IHCs.

[27] *See* Quarles, A New Chapter ("In my view, there may be ways of encouraging greater reliance on less sticky repurchases [than on dividends] while providing more flexibility in the regime . . .").

[28] For example, according to Federal Reserve research, net funding inflows from international banks to their own U.S. bank subsidiaries increased during the prior financial crisis. *See* William Goulding and Daniel E. Nolle, "Foreign Banks in the U.S.: A Primer", Federal Reserve International Finance Discussion Papers No. 1064, fig. 13b (Nov. 2012) (noting that inflows rose by 50% over pre-financial crisis levels).

method of capital distribution is functionally unavailable to IHCs, but U.S. BHCs are permitted to leave share repurchases out of the SCB. Similar to share repurchases that the Federal Reserve has sought to encourage, IHCs have more flexibility to change their capital distributions as conditions warrant, so their distributions should also be eliminated from the SCB regardless of the fact that the form may not be a share repurchase.

Therefore, the Federal Reserve's prudential concerns on this issue are addressed fully by regulatory minima together with the additional protection from stress capital buffers. Pre-funding should not be required given the fully discretionary nature of IHC dividends. We note that a U.S. BHC or IHC is already permitted to deviate from its planned dividends, without resubmission of its capital plan and without asking for approval from the Federal Reserve, if it would maintain, after the distribution, an amount of capital that does not fall below its required capital as buffered by stress losses.[29] The same should be applied to IHC dividends, and the dividend add-on should be eliminated for IHCs. Vice Chair Quarles identified the pre-funding component of the SCB as a "needless redundancy" that should be jettisoned in favor of a "comprehensive approach to ensuring that banks have sufficient capital, rather than focus[ing] on the individual elements of capital distributions".[30] In the interest of simplicity and reduction of unnecessary redundancies, an IHC should be able to determine its own dividends in a flexible manner, in whatever form it wants, and forecast whether post-distribution capital would be consistent with regulatory requirements and stress loss buffers.[31]

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[29] *See* Stress Capital Buffer Rule at 15,583. In addition, Vice Chair Quarles recognized that firms make their decisions based on knowledge of their SCB, planning their dividends and repurchases based on the CCAR results. *See also* Quarles, A New Chapter ("firms have told us that they would be able to engage in more thoughtful capital planning if they had knowledge of that year's stress test results before finalizing their distribution plans for the upcoming year. I am sympathetic to their concerns, and will ask the Board to adjust the operation of the rule so that firms know their SCB before they decide on their planned distributions for the coming year. . . . We expect firms to continue to maintain robust stress testing practices and use those results to inform their capital distribution plans, and we will continue to use the supervisory process to reinforce this expectation."). This is especially true of IHCs that have more flexibility to increase or decrease dividends without the negative market reaction.

[30] Randal K. Quarles, Vice Chair for Supervision, Federal Reserve, "Refining the Stress Capital Buffer" (Sept. 5, 2019) ("Refining the Stress Capital Buffer") ("The second element of the SCB proposal that I believe should be removed is the requirement for banks to pre-fund the next four quarters of their planned dividend payments. The stress tests currently require banks to set aside sufficient capital today to 'pre-fund' expected capital distributions, both dividends and repurchases, for all nine quarters of the capital planning horizon. Removing the pre-funding of dividend requirement would simplify the SCB proposal. Additionally, the SCB already has a mechanism for curbing dividends and other distributions when a bank's capital ratio falls into the buffer. Requiring pre-funding of dividends is a needless redundancy.").

[31] The SCB was designed to remove regulatory distinctions that created inequity among entities subject to the rules. Randal K. Quarles, Vice Chair for Supervision, Statement in Relation to Promulgation of Stress Capital Buffer Rule (Mar. 4, 2020) ("[W]e should limit the degree to which required capital actions depend on the discretion of regulators rather than on clear and automatic rules. . . . [T]he restrictions the SCB

Although Vice Chair Quarles highlighted the add-on as a redundancy, in practice it miscalibrates capital requirements. The primary reason is that the add-on component is essentially a floor to the amount of any distribution that can be paid regardless of over-capitalization of the entity. If the dividend add-on were a true "pre-funding", an organization should be permitted to reduce its SCB by the amount of a dividend once those "pre-funded" resources are distributed to shareholders. However, the amount of any "pre-funding" is binding through the entire year during which a particular SCB is effective. The add-on is in fact a prior "replacement" of the amount that may be distributed, and therefore overstates the amount of capital that CCAR firms should hold regardless of stress testing performance. A firm should have enough capital in any quarter not to fall below minima and stress losses *after* it pays its dividend.[32] The dividend add-on is redundant because a firm is not allowed the flexibility to determine its distributions at a future point in time, but must maintain its capital above its minima, its stress losses *and* its dividend add-on, even after it pays its dividend.[33]

B. Even if the Federal Reserve were to retain the dividend add-on, it should not adopt a definition of "common stock dividends".

The definition of "dividend" suggested by the Federal Reserve is overbroad in that it would capture any pro rata distribution on shares. Under corporate law, typically companies are not permitted to distinguish between shareholders unless the shareholders own different classes of shares. Therefore, if a parent owns all common shares, it does not matter if a distribution is declared as a certain amount per share or as a "lumpy" one-time aggregate payment—the payment in either case will be deemed pro rata across all common shares.

An overbroad definition that collapses distinctions between different types of cash payments to parent FBOs would have a significant adverse impact on IHCs' capital planning. An IHC's capital planning is interlinked with its FBO parent's capital planning process, which must ensure appropriate capitalization of its subsidiaries across jurisdictions. Accordingly, a certain degree of flexibility is required to ensure that excess capital at an IHC can be redeployed

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places on capital distributions are automatic—a function of a firm's performance in the stress tests and its systemic footprint, not of regulatory discretion.").

32 The elimination of the 30% payout restriction was, in part, predicated on this concept—i.e., that, through capitalization of stress losses, a firm should be able to make its own decisions on the quantity of distributions, provided that it did not dip into that stress loss buffer. Stress Capital Buffer Rule at 15,579 (removing the 30% dividend payout ratio as a criterion for heightened supervisory scrutiny of a firm's capital plan). The pre-SCB CCAR also had this goal—i.e., once the Dodd-Frank Act Stress Test was complete, CCAR was designed to address whether, given the losses generated by the stress scenarios, a proposed dividend would cause capital to fall below the minima plus losses.

33 Vice Chair Quarles appears to have recognized this redundant penalty. *See* Quarles, Refining the Stress Capital Buffer ("Even worse, the pre-funding of dividends could lead to a conflict with the mechanics of the SCB—the SCB could call for a restriction of dividend payments even when those payments had been pre-funded.").

within the larger organization. Since many IHCs effectively cannot distribute capital through share repurchases, an overbroad definition of common stock dividends could require IHCs to pre-fund *all* distributions to their parent FBOs by incorporating these payments into their SCBs. Mandating that common stock dividends include any payment made in proportion to issued shares would thus sharply disadvantage IHCs in comparison to their U.S. BHC peers, and raise significant competitive equality and national treatment concerns. This is because a distribution out of earnings and a distribution that constitutes a return of capital are treated differently from an accounting and corporate law perspective, even though they both are cash distributions and the return of capital is not technically a stock buyback.

The definition cited in the Proposal would effectively eliminate corporate and accounting distinctions by mandating that a wide range of capital actions be classified as dividend payments subject to "pre-funding" through the SCB. A number of these capital actions are not "dividends" from a corporate law or accounting perspective, and represent, similar to a share repurchase, a return of capital or a "retirement" of a capital instrument. Therefore, the only real possibility that an IHC has to make an excluded share repurchase is by adhering to the long-standing distinction in corporate and accounting rules between a dividend and a return of capital. This is another reason why the dividend add-on should be eliminated. However, if it is not, then, **as wholly-owned subsidiaries of their foreign parents and without public shareholders, IHCs should be able to determine how to classify capital distributions in accordance with corporate law and accounting rules, and exclude those that are not dividends under those long-standing, well-understood rules.** This approach would recognize that, as sole shareholders of their IHCs, FBOs have discretion over corporate governance matters of their subsidiaries within regulatory boundaries.[34] Unilaterally changing the definition as it applies to U.S. subsidiaries could entrench and aggravate the penalty on subsidiary organizations such as IHCs, create needless confusion within a global organization and complicate its capital planning process.

III. The Federal Reserve should revise the threshold for the global market shock and large counterparty default components of the CCAR supervisory stress tests to apply only to firms subject to Category I standards.

The proposal would eliminate the term "large and noncomplex bank holding company" in the Federal Reserve's rules and guidance and replace it with "firm subject to Category IV standards".[35] This change would impact the definition of those firms subject to the global market shock ("GMS") and large counterparty default ("LCD") components of

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[34] Financial Stability Board, Market Fragmentation: Updates on Ongoing Work (Oct. 14, 2020), https://www.fsb.org/wp-content/uploads/P141020-2.pdf; Quarles, Brand Your Cattle.

[35] Proposal at 63,229.

supervisory stress tests, although it would not (at least currently) change its scope of application in practice.

Currently, 6 of the 8 U.S. BHCs in Category I are subject to the GMS, and all 8 are subject to the LCD, while no U.S. banking organization in Categories II or III is subject to the GMS or the LCD. The other 5 firms that are subject to the GMS and LCD are IHCs in Category III. There are 5 other IHCs and U.S. banking organizations in Category III that are not subject to the GMS or the LCD.

As with the composition of the LISCC portfolio, application of the GMS and LCD is inappropriately calibrated. Firms in the portfolio range from U.S. BHCs subject to the most stringent standards that "have the potential to pose the greatest risks to U.S. financial stability" to a group of IHCs that are far smaller, have lower levels of international activity and do not pose the same challenges to resolve in a highly stressed scenario.[36] By scoping in several IHCs in this latter category, and not scoping in any of their peer U.S. BHCs in Category III, the current threshold is unfairly targeted at certain IHCs and does not reflect important differences between subject IHCs and subject U.S. GSIBs in terms of the size, risk profile and systemic importance of their trading activities:[37]

- *Size.* Chart A in the Appendix provides more detailed information illustrating the magnitude of the differences between the IHCs and U.S. BHCs subject to the GMS in terms of the size of their trading activities and total assets.

- *Risk Profile.* Important differences are apparent in the relative riskiness of the trading asset portfolios of IHCs as compared to U.S. BHCs that are subject to the GMS. Chart B in the Appendix illustrates that, on average, U.S. Treasury and other U.S. government-guaranteed securities account for a significantly larger portion of IHCs' trading assets than U.S. BHCs' trading assets.

- *Systemic Importance.* As illustrated in Chart C in the Appendix, when looking at the Federal Reserve's own criteria for determining systemic risk of U.S. activities, the trading activities of the IHCs subject to the GMS do not present comparable risk to those of U.S. BHCs.

We think that the disparate treatment of IHCs under the GMS and LCD is apparent from the Charts in the Appendix. The order of magnitude of these differences raises significant questions regarding a key rationale of the GMS and LCD as components of CCAR—obtaining comparable

[36] Prudential Standards for Large Bank Holding Companies, Savings and Loan Holding Companies, and Foreign Banking Organizations, 84 Fed. Reg. 59,032, 59,035 (Nov. 1, 2019).

[37] We highlighted a number of reasons why this scoping was inherently unfair in our comment letter regarding the GMS. *See* IIB Letter to the Federal Reserve (Aug. 8, 2017). We do not repeat all of those reasons here, but incorporate them by reference.

stress testing results for companies with similar trading exposures and business models. Therefore, the IHCs should be removed from the GMS and LCD requirements of CCAR, and those more stringent shocks should be applied only to Category I institutions.

IV. Category IV firms should be provided until mid-March to notify the Federal Reserve of a decision to opt-in to a supervisory stress test in an off-year.

Under the tailoring framework, Category IV firms are subject to biennial supervisory stress testing. The Proposal would permit these firms to elect to participate in a supervisory stress test in an off-year, and a firm would need to notify the Federal Reserve by December 31 of the year preceding the year in which it opts into a supervisory stress test. The Federal Reserve should provide Category IV firms until mid-March of its opt-in year to make such a notification, which would allow those firms additional time to evaluate their capital positions and engage in a thorough capital planning process that meets the Federal Reserve's expectations in the capital plan rule. This approach would also balance the Federal Reserve's important interest in effectively managing and conducting supervisory stress tests by ensuring it has at least two weeks of notice regarding participating firms prior to the capital plan submission deadline of April 5.

V. The Federal Reserve should clarify that the newly proposed sub-schedules that would incorporate the effects of business plan changes in Schedules A and C of the FR Y-14 will incorporate the effects of only material changes to business plans

The Proposal would require new sub-schedules for the FR Y-14A Schedule A (Summary) and Schedule C (Regulatory Capital Instruments)—one of which would incorporate the effects of business plan changes, while the other would exclude the effects of business plan changes. The Proposal states that firms would be required to submit one version of the schedules "that incorporates the effects of business plan changes, as well as a version of these schedules and items that does not incorporate these effects."[38] However, Proposal's description and explanation of these reporting form changes consistently describes the additional information sought as "*material* business plan changes."[39] We therefore respectfully request that the Federal Reserve clarify in the final rule, reporting forms and instructions that such sub-schedules to Schedules A and C of the FR Y-14 will only incorporate the effects of *material* changes to business plans. If the Federal Reserve does in fact require that all (rather than only material) business plan changes be reported on these sub-schedules, we respectfully request a one-year delay in the requirement to submit these new sub-schedules until December 31, 2021 because, absent a materiality qualifier, firms will incur significant additional administrative burden in establishing new systems to capture the required data.

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[38] Proposal at 63,226.

[39] Proposal at 63,223, 63,226 and 63,227 (emphasis added).

VI. The Federal Reserve should recalibrate the iTLAC and long-term debt requirements for IHCs of global systemically important FBOs.

The IIB supports the Federal Reserve's recent efforts to modestly recalibrate TLAC requirements and better align its rules with the practice of other regulators around the world. In particular, we are encouraged by the technical amendments to the TLAC buffer calibration for IHCs that the Federal Reserve finalized on October 20, 2020.[40]

However, further modifications are necessary, given the differential treatment of IHCs and their peer organizations in the same tailoring framework categories—namely that most or all of the IHCs are subject to iTLAC, but their peer U.S. BHCs are not subject to the TLAC requirements at all. We note that Vice Chair Quarles indicated that the Federal Reserve is generally considering recalibrating the iTLAC requirements for IHCs toward the lower end of the TLAC standards established by the FSB and/or streamlining the elements of the resolution loss absorbency regime, which include both TLAC and long-term debt ("LTD") requirements.[41] We have yet to see these changes proposed.

We believe the Federal Reserve should prioritize further simplification and streamlining of the iTLAC and LTD. As discussed in detail in our prior comment letters on the Federal Reserve's proposals related to TLAC,[42] we strongly urge the Federal Reserve to make additional modifications to the iTLAC and LTD requirements applicable to IHCs of global systemically important FBOs ("Covered IHCs"). These modifications should include, but not necessarily be limited to:

- Downward recalibration of the TLAC requirements applicable to Covered IHCs to reflect more accurately the risk profile and particular tax and structural considerations relevant to Covered IHCs generally;

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[40] Regulatory Capital Treatment for Investments in Certain Unsecured Debt Instruments of Global Systemically Important U.S. Bank Holding Companies, Certain Intermediate Holding Companies, and Global Systemically Important Foreign Banking Organizations; Total-Loss Absorbing Capacity Requirements (Oct. 20, 2020), https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20201020a1.pdf ("TLAC Holdings Rule").

[41] *See* Quarles, Brand Your Cattle ("However, in light of our experience with these structures, I believe we should consider whether the internal TLAC calibration for IHCs could be adjusted to reflect the practice of other regulators without adversely affecting resolvability and U.S. financial stability. The current calibration is at the top end of the scale set forth by the FSB, and willingness by the United States to reconsider its calibration may prompt other jurisdictions to do the same, which could better the prospects of successful resolution for both foreign G-SIBs operating in the United States, and for U.S. G-SIBs operating abroad. Alternatively, it may be possible to streamline the elements of our resolution loss absorbency regime, which include both TLAC and long-term debt requirements.").

[42] IIB Letter to the Federal Reserve (June 25, 2018); IIB Letter to the Federal Reserve (Feb. 19, 2016).

- Elimination of the Tier 1 leverage-based TLAC requirement entirely, or at a minimum, for Covered IHCs that are subject to the supplementary leverage ratio (i.e., in Category III); and
- Modification of the formal LTD requirement, which is above and beyond the standards established by the FSB. Potential proposals could include reduction or elimination of this requirement, or providing credit for LTD in other ways (such as increased flexibility with regard to other capital or liquidity requirements, or further credit toward required capital buffers).

We believe that these modifications would result in TLAC and LTD requirements that reflect the Federal Reserve's overall goal of recalibrating these requirements to reduce inconsistencies, complexity and burdens, and would result in greater alignment with the tailoring framework given that the current requirements treat Covered IHCs and U.S. BHCs in the same categories differently despite similar risk profiles.[43]

VII. Capital planning at IHCs is negatively affected by the lack of adherence to a balanced framework that recognizes the significant and ameliorating differences exhibited by IHCs and their parent organizations. The Federal Reserve has expressed support in concept for appropriate flexibility for IHCs, but we have not seen it adopted in practice.

The Proposal included a broad request for comments with respect to the general capital planning architecture currently in place. We believe the Federal Reserve has been taking steady and important steps towards a more balanced treatment of different sectors via the tailoring framework, and the continued efforts (including the Proposal) to align other rules and guidance with that framework. As the most recent example, the Federal Reserve appropriately removed the four FBOs from the LISCC portfolio. Tailoring has been implemented carefully, without jeopardizing the prudential objectives of the post-crisis reforms.

However, in our view, the Federal Reserve has not yet tackled the issues of home-host balance, internal fragmentation and the best way to regulate subsidiaries. Vice Chair Quarles set out the appropriate framework for addressing this issue through finding "a balance of *flexibility* for the parent bank and *certainty* for local stakeholders".[44] The Vice Chair noted that a tailoring framework should provide "adequate flexibility for the parent to deploy resources where needed" and that this is "likewise in the host regulator's interest". These principles point to both the necessity of local resource preplacement requirements and importance of moderation in their calibration. One early example of this was the FSB's (and the Federal Reserve's)

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[43] *See, e.g.*, TLAC Holdings Rule at 34 (noting one purpose for recent amendments to TLAC requirements is to reduce compliance burdens and eliminate duplicative requirements).

[44] Quarles, Brand Your Cattle.

establishment of iTLAC requirements, which were set at a discount to external TLAC requirements in order to create internal flexibility and to recognize the presence of the parent as a source of strength.[45]

However, the layers of U.S. regulations currently imposed on IHCs have resulted in IHCs being subject to the highest effective requirements in the U.S. system. Despite being far smaller than their U.S. GSIB or large regional bank peers (see Figure 1 below), the large FBOs have capitalized their IHCs at a significant premium to U.S. firms. The average common equity tier 1 ratio of IHCs in Categories II or III is over 1.5x higher than their domestic peers, and iTLAC ratios are similarly outsized. Indeed, the large U.S. regional banking organizations that are in Category III are not subject to *any* TLAC requirement. These outcomes indicate the current regulatory framework is falling short of the stated goal of achieving such a "balance" so as to provide "adequate flexibility" for the redeployment of group resources. As the Vice Chair has acknowledged, high requirements in the United States can also lead to similar demands by other host regulators. Such a "tragedy of the commons" can make banking groups less resilient on an enterprise-wide basis, ultimately hurting both home and host jurisdictions.[46] In short, while Vice Chair Quarles recognized the unique position of an international bank's U.S. operations as part of a larger organization in the tailoring framework, that recognition has not translated into enough areas where the capacity for parent support, and the nature of a subsidiary, are recognized.

Figure 1

Average of Group ($bn / %)	Large US GSIBs (6)	Large US Regionals Category II/III Banks (5)	Major IHCs Category II/III IHCs (6)
Average Assets	2,039	386	225
Average RWA	1,066	242	103
CET1 Ratio	12.2%	11.3%	17.8%
Tier 1 Capital Ratio	13.9%	13.1%	19.9%
Total Capital Ratio	16.7%	15.3%	21.8%
Tier 1 Leverage Ratio	7.4%	8.4%	9.3%
TLAC Ratio *	28.3%	15.3%	27.6%

* TLAC is not required or disclosed for US BHCs below the GSIB level, so we use Total Capital as a proxy.

45 *See* Quarles, Brand Your Cattle (implying that the modest nominal discount for iTLAC currently allowed in the U.S. rules would be reconsidered with an eye towards an even lower requirement).

46 *See* Wilson Ervin, "Understanding 'ring-fencing' and how it could make banking riskier", Brookings Center on Regulation and Markets (Feb. 7, 2018) (finding that for a hypothetical bank with four equally sized subsidiaries, the risk of group failure could increase by 5x or more if extensive ring-fencing were required).

Capital requirements for IHCs that are not appropriately calibrated to their smaller size and smaller risk have unsurprisingly corresponded to a decline in the participation of FBOs in the U.S. economy and capital markets. As noted in Section I, we support the removal of the four FBOs from LISCC because they "have substantially decreased in size and risk over the past decade".[47] But the root cause of this decrease is linked to the additional costs imposed to maintain U.S. operations that are redundant with costs already imposed by home country regulators on the organization as a whole. This has unfortunately reduced the diversity of the U.S. marketplace for financial services.

We respectfully request that the Federal Reserve consider how best to rebalance the interests of home and host country regulators. We suggested one specific approach in Section II regarding IHC dividends and elimination of the dividend add-on for IHCs. The flexibility to rebalance capital among the subsidiaries of an FBO provides important benefits for group stability, and such internal transfers are fundamentally different from group level capital repayments to public shareholders. The reallocation of capital among IHCs and other subsidiaries provides a mechanism for the group to maintain all subsidiaries at a strong level, avoiding stress at local subsidiaries (including in the United States) and promoting prudential objectives for the global financial system (including U.S. financial stability).

Another avenue to recognize the difference between standalone firms and subsidiaries could be to explicitly consider the prudential benefits of iTLAC. While iTLAC has been imposed by U.S. regulation, it also provides a tangible manifestation of parent support. The capital resources required by iTLAC provide a large, additional layer of financial protection that addresses many of the stated objectives of the enhanced supervisory expectations that apply to IHCs. Last month, the Federal Reserve recognized the risk-reducing nature of this aspect of the regulatory framework as providing "sufficient amounts of equity and eligible long-term debt to improve [the] ability to absorb significant losses and withstand financial stress and to improve . . . resolvability in the event of failure or material distress".[48] IHCs have historically benefitted from parent support in times of need. The iTLAC rules effectively require international GSIBs to "prepay" or "collateralize" this support through pre-positioning resources in the United States to address the risk of failure. Therefore, this support is not merely contingent or based on "strength" or willingness of the parent. U.S. BHCs in the very same tailoring framework categories, by contrast, are both less able to draw on their public shareholders for support and are not required to receive a "prepayment" of support in the form of TLAC. Accordingly, U.S. BHCs of the same size and risk profile of IHCs do not face the same restrictions regarding how to deploy capital within their organizations. Therefore, iTLAC should be recognized at the

[47] Nov. 6 Press Release.

[48] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, Net Stable Funding Ratio: Liquidity Risk Measurement Standards and Disclosure Requirements (Oct. 20, 2020) at 10 n. 10 https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20201020b1.pdf.

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IHCs, and they should be provided more flexibility, and subject to less burden, than U.S. BHCs that are in the same tailoring framework categories.

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We would appreciate the opportunity to discuss these issues with you at your earliest convenience, particularly because a number of our comments are long-standing issues we have had with the regulatory and supervisory framework applicable to IHCs, and a number of our recommendations span capital planning issues beyond the specifics of the Proposal (as requested by the Federal Reserve). We would welcome discussing additional examples of differential treatment caused by, and the beneficial attributes of, the subsidiary structure that are highlighted in Section VII, with a goal of more broadly acknowledging the unique posture of IHCs and how the Federal Reserve's supervisory and regulatory approach may provide greater flexibility, including in relation to capital planning, for IHCs and their FBO parents.

We appreciate your consideration of our comments on the Proposal. If we can answer any questions or provide any further information, please contact the undersigned (646-213-1147, bpolichene@iib.org) or our General Counsel, Stephanie Webster (646-213-1149, swebster@iib.org).

Very truly yours,

Briget Polichene

Briget Polichene
Chief Executive Officer

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APPENDIX

CHART A

Chart A below illustrates the magnitude of differences between IHCs' trading assets and liabilities and their total assets as compared to U.S. BHCs.

Covered BHCs and Covered IHCs:
Total Assets and Total Trading Activity
(Source: FR Y-9C filings, average of quarters ended 9/30/19, 12/31/19, 3/31/20 and 7/30/20)

DB USA CORPORATION
CREDIT SUISSE HOLDINGS (USA), INC.
UBS AMERICAS HOLDING LLC
BARCLAYS US LLC
HSBC NORTH AMERICA HOLDINGS INC.
MORGAN STANLEY
GOLDMAN SACHS GROUP, INC., THE
WELLS FARGO & COMPANY
CITIGROUP INC.
BANK OF AMERICA CORPORATION
JPMORGAN CHASE & CO.

- 1,000,000,000 2,000,000,000 3,000,000,000

Total Trading Activity (Trading Assets + Trading Liabilities) ($000) Total assets ($000)

APPENDIX

CHART B

Chart B below illustrates the greater weighting of IHCs' trading assets toward low-risk U.S. Treasury and government-guaranteed obligations as compared to U.S. BHCs.

Covered BHCs and Covered IHCs: Trading Assets

(Source: FR Y-9C filings, average of quarters ended 9/30/19, 12/31/19, 3/31/20 and 7/30/20)

DB USA CORPORATION
CREDIT SUISSE HOLDINGS (USA), INC.
UBS AMERICAS HOLDING LLC
BARCLAYS US LLC
HSBC NORTH AMERICA HOLDINGS INC.
MORGAN STANLEY
GOLDMAN SACHS GROUP, INC., THE
WELLS FARGO & COMPANY
CITIGROUP INC.
BANK OF AMERICA CORPORATION
JPMORGAN CHASE & CO.

0 100000000 200000000 300000000 400000000 500000000 600000000

U.S. Treasury Securities and Govt Obligations, Residential Pass-throughs/MBS and Commerical MBS Issued or Guranteed by the U.S. Govt.

Trading assets

APPENDIX

CHART C

Chart C below illustrates the significantly lower scores attributed to IHCs' "total trading and AFS securities" component of the complexity risk-based indicators in comparison to those of U.S. BHCs.

Covered BHCs and Covered IHCs: Total Trading and AFS Securities Component of Systemic Indicator Score

(Source: Q4 2019 FR Y-15 filings, FSB Denominators & Exhange Rate)

UBS AMERICAS HOLDING LLC
DB USA CORPORATION
BARCLAYS US LLC
HSBC NORTH AMERICA HOLDINGS INC.
CREDIT SUISSE HOLDINGS (USA), INC.
CITIGROUP INC.
GOLDMAN SACHS GROUP, INC., THE
WELLS FARGO & COMPANY
MORGAN STANLEY
BANK OF AMERICA CORPORATION
JPMORGAN CHASE & CO.

0 5 10 15 20 25 30 35 40

Contribution to Systemic Indicator Score (in basis points)