



June 1, 2020

*Via electronic mail*

Ann E. Misback, Secretary  
Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue NW  
Washington, DC 20551

Executive Secretary, Attention: Comments  
Federal Deposit Insurance Corporation  
550 17th Street NW  
Washington, DC 20429

Re: Guidance for Resolution Plan Submissions of Certain Foreign-Based Covered Companies (FRB Docket No. OP-1699; FDIC RIN 3064-ZA15)

Ladies and Gentlemen:

The Bank Policy Institute, American Bankers Association and Securities Industry and Financial Markets Association<sup>1</sup> appreciate the opportunity to respond to the request from the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation for feedback on proposed guidance for the 2021 and subsequent resolution plan submissions by certain foreign banking organizations ("FBOs").<sup>2</sup>

We respectfully request that the Agencies reconsider the approach that they have taken in preparing the Proposed Guidance. The Proposed Guidance extends to the relevant FBOs (the "Specified FBOs")<sup>3</sup> a framework that was developed for U.S. global systemically important financial institutions ("GSIBs"). We believe that this GSIB

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<sup>1</sup> See Appendix 2 for a description of the associations.

<sup>2</sup> Board and FDIC, "Guidance for Resolution Plan Submissions of Certain Foreign-Based Covered Companies," 85 Fed. Reg. 15449 (Mar. 18, 2020) (the "Proposed Guidance").

<sup>3</sup> The Specified FBOs are Barclays PLC, Credit Suisse Group AG and Deutsche Bank AG. Proposed Guidance at 15452 fn. 21.

method 2 approach is inappropriate for FBOs and leads to distorted and incorrect results, which we discuss extensively in this letter, including Appendix 1.

First, the expectations established by the Proposed Guidance exceed those that applied to these same FBOs in prior periods, while at the same time the FBOs have reduced their activity in the United States. It is not logical that the Proposed Guidance has increased expectations in the face of the continued dramatic shrinkage of FBOs' U.S. operations. For example, in the last three years (the relevant period since the prior guidance was drafted), the asset size of the Specified FBOs has declined by 38%, and the method 1 GSIB scores have declined by an average of 29%.<sup>4</sup> Moreover, during this period, the Specified FBOs have issued material total loss-absorbing capacity ("TLAC") to their parent organizations, creating a large additional financial resource to support their local plans, and further incentivizing parent support and cooperation.

Second, the Proposed Guidance imposes requirements on the Specified FBOs that equal and, in some cases, exceed those applicable to the U.S. GSIBs, despite the fact that the U.S. operations of these FBOs are dramatically smaller and less complex than the U.S. GSIBs, and are further supported by parent company backstops. Further, the Proposed Guidance does not appear to reflect any reliance by the Agencies on the supervisory colleges and crisis management groups in which they participate and which they continue to laud for their effectiveness.

Third, we believe that the U.S. resolution planning requirements for all FBOs, including the Specified FBOs, should be much more closely tailored to the risks that they pose. There are two aspects of this consideration: First, we believe that the proposed scoping methodology does not appropriately reflect the reduced risk of the Specified FBOs and should be replaced. Second, even if the scoping methodology were to be adopted as proposed, we believe that the requirements set out in the Proposed Guidance should themselves be more tailored and proportionate to the reduced size and complexity of Specified FBOs' U.S. operations—particularly the requirements related to derivatives and trading activities and payment, clearing and settlement activities ("PCS"). In laying out requirements for FBOs, it would be helpful to have a clear identification of the concerns that the Agencies have with respect to each FBO—based on each FBO's global resolution plan and an in-depth understanding of the U.S. operations of that FBO, gained from the extensive U.S. resolution plans such FBO has submitted in prior planning cycles—and to then tie the relevant resolution planning requirements to those concerns.

## I. Executive Summary

- The scoping methodology should eliminate any reliance on method 2 GSIB scoring. Method 2 produces spurious and misleading results when applied to FBOs and should be replaced with a more appropriate methodology.
  - Method 2 dramatically overstates the systemic risk of the Specified FBOs due to flaws in the methodology that distort the outcome for FBOs. In particular, the short-term wholesale funding ("STWF") factor, which has an outsize effect on FBO method 2 scores, does not accurately reflect liquidity risk for FBOs or their systemic relevance.
  - There are vast differences between the U.S. operations of the Specified FBOs and the U.S. GSIBs; the U.S. operations of the Specified FBOs are simply not comparable to the U.S. GSIBs on any balanced reading. The substantive resolution planning requirements that were developed for the U.S. GSIBs should not be transposed to the U.S. operations of the Specified FBOs.

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<sup>4</sup> See Deloitte Q42019 POV.

- Another scoping methodology would provide much more balanced results. We suggest that the recently developed tailoring categories would provide a more consistent and appropriate representation of risk profile.
- The Proposed Guidance would require extensive information relating to the FBOs' non-U.S. derivatives and trading activities, creating issues of extraterritoriality and duplication of information; U.S. regulators should request any necessary information from home regulators under established processes.
- The Proposed Guidance subjects sub-components of the Specified FBOs to extensive PCS requirements, again creating issues of extraterritoriality and duplication of information that could be requested from home regulators.
- The final guidance should focus on the effectiveness of a contractually binding mechanism ("CBM") in mitigating risks of creditor challenges rather than the form or structure of a CBM.
  - CBMs should serve as mitigants to challenges by creditors.
  - CBMs should not be judged against each other, but should instead be judged individually by how well they satisfy the Agencies' policy objective.
  - Specified FBOs should retain the flexibility to design CBMs that meet the needs of their global resolution strategies as well as the requirements of the U.S. resolution planning requirements.
- As the Agencies continue to advance the resolution framework, additional focus should be applied to determining appropriate capital and liquidity requirements, and to the relationship between home and host country regulation.
  - We ask that the Agencies conduct a holistic assessment of prudential requirements applicable to the U.S. operations of FBOs and engage bilaterally with the Specified FBOs to consider alternative approaches to ensuring the availability of timely capital and liquidity support for the firms' U.S. operations.
  - In consideration of the extensive home country resolution planning requirements to which each of the Specified FBOs is subject, we ask that the Agencies engage bilaterally with the Specified FBOs on any concerns about the resolvability of the firms' U.S. operations and reliance on home country strategies.

**II. The scoping methodology should eliminate any reliance on method 2 GSIB scoring. Method 2 produces spurious and misleading results when applied to FBOs and should be replaced with a more appropriate methodology.**

The Proposed Guidance states that it would apply to "FBOs that are triennial filers and whose intermediate holding companies . . . have a method 2 GSIB score of 250 or more."<sup>5</sup> Method 2 was originally designed and calibrated for application to large U.S. GSIBs at the parent level; it does not produce fair or reasonable results when applied to the smaller and narrower activities of a FBO subsidiary.

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<sup>5</sup> Proposed Guidance at 15460.

The scoping methodology of the Proposed Guidance captures IHCs that are dramatically different from the U.S. GSIBs and inappropriately groups them in the same category in terms of substantive resolution planning requirements. Despite the small and declining risk posed by the Specified FBOs' U.S. operations, the Proposed Guidance subjects them to the same (or even somewhat greater) resolution planning requirements. This scoping error occurs due to certain methodological problems in the STWF calculation that escalate dramatically in the context of an FBO subsidiary. These flaws dominate and distort the overall outcome. The STWF methodology also has other shortcomings that are important in the context of the Specified FBOs.

We strongly reject the method 2 approach set out in the Proposed Guidance as inappropriate and leading to distorted and incorrect results. We would recommend utilizing the regulatory tailoring methodology instead. This is a ready-made alternative and was recently designed as a method of classifying institutions, including the U.S. operations of FBOs, for similar purposes. The use of tailoring categories would also promote the objective of simplicity and consistency.

The following sections discuss (A) the flaws of method 2, (B) the relatively low risk of the U.S. operations of the Specified FBOs and (C) potential alternatives to method 2. Further detail on the first and last of these items is included in Appendix 1.

**A. Method 2 dramatically overstates the systemic risk of the Specified FBOs due to flaws in the methodology that distort the outcome for FBOs. In particular, the STWF factor, which has an outsized effect on FBO method 2 scores, does not accurately reflect liquidity risk for FBOs or their systemic relevance.**

The preamble to the Proposed Guidance asserts that method 2 provides a “comprehensive, integrated assessment of a large bank holding company’s (“BHC”) systemic footprint,” and that a score of 250 or more suggests that a Specified FBO presents “comparable resolvability challenges” to U.S. GSIBs that are also subject to heightened expectations regarding resolution planning.<sup>6</sup> This argument is flawed because it is driven solely by artifacts in the method 2 calculation that affect FBO intermediate holding company (“IHCs”) in a dramatic and disproportionate manner as compared to BHCs. The Agencies state that the “comparably high method 2 scores of the Specified FBOs have largely been driven by reliance on short-term wholesale funding.”<sup>7</sup> This is true as a technical matter within the method 2 calculations, but it is not true as a substantive one.

Method 2 has never previously been applied to IHCs (or internationally). When this method is applied to the Specified FBOs, significant problems are exposed.<sup>8</sup> We believe that these problems are fatal to a test that looks to achieve a balanced assessment of true systemic risk. We discuss this conclusion in more detail in Appendix 1 but summarize our analysis here.

- The method 2 score for an IHC is not an “integrated assessment”; the outcome is dominated by a single, flawed component. The STWF score comprises 92% of the total method 2 score for the

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<sup>6</sup> Proposed Guidance at 15452. The preamble notes that the “substantial majority” of such U.S. GSIBs have a method 2 GSIB score of 250 or more. *Id.*

<sup>7</sup> Proposed Guidance at 15452.

<sup>8</sup> We believe that method 2 is generally problematic, not only as applied to FBOs. We discuss the flaws of method 2 more in depth in our comment letter on the notice of proposed rulemaking for the GSIB surcharge methodology. The Clearing House, *Re: Notice of Proposed Rulemaking; Comment Request: Risk-Based Capital Guidelines – Implementation of Capital Requirements for Global Systemically Important Bank Holding Companies (79 Fed. Reg. 75,473, December 18, 2014)* (Apr. 2, 2015), available at <https://bpi.com/wp-content/uploads/2018/07/comment.pdf>.

IHCs of the Specified FBOs, as can be seen in Figure A of Appendix 1. It is the sole reason that any IHC of the Specified FBOs breaches the 250 threshold.

- The other four categories for the Specified FBO group produce systemic risk scores that are far lower for IHCs when compared to the corresponding average for U.S. GSIBs.<sup>9</sup> The IHC score components range from 4.6% to 9.3% of the U.S. GSIB score (*i.e.*, 92% to 95% lower risk).
- Unlike all the other categories, the STWF score under method 2 is driven by an unusual ratio weighting system (350 / risk-weighted assets (“**RWA**”)). The STWF weighting was specifically calibrated to achieve a balanced result among the five broad categories for the U.S. GSIB group (STWF comprised 26% of the method 2 GSIB score for that group at Q4 2019). The weighting did not consider the activities or balance sheets of other banks at the time.
- The IHC group has cut risk exposure dramatically over the last decade, leading to the large substantive reduction in systemic risk noted by Board Vice Chair Randal K. Quarles and discussed below. This reduction has included a dramatic cut in RWA. However, this RWA reduction also leads to a dramatic and unwarranted increase in the weighting ratio that is applied to the IHC group because RWA is (oddly) in the denominator of the STWF category. Because the RWA of the IHCs is now so small (6.0%) compared to the U.S. BHC benchmark group, the effective weighting for STWF is 16.7x larger for the Specified FBOs.
- Indeed, this weighting anomaly drives the STWF scores for the three Specified FBOs far above the score for almost every other systemic risk component for any bank, even ones that are 20 times larger. It is surely an unintended and incorrect outcome for a large reduction in RWA to trigger a higher systemic risk score.
- The flaws of the existing method 2 STWF approach become most visible for smaller and lower-risk entities like IHCs. In the extreme case, consider a tiny entity that only holds a single asset: \$100 of treasury bills (zero RWA). Such an entity would produce an infinite STWF weight and an infinite method 2 GSIB score, because RWA is placed in the denominator. This \$100 entity would far outrank even the largest GSIB in terms of systemic risk according to this methodology. While this is clearly an extreme case, the IHC results are affected by much of the same logic. As they have shrunk and de-risked, shifting their asset mix to holding significant (low RWA) high-quality liquid assets (“**HQLA**”), their STWF scores have been pushed up by this calculation artifact.
- Applying the method 2 STWF score to FBO IHCs also has other flaws. In the preamble to the Proposed Guidance, the Agencies explained that the “STWF factor indicates the potential for significant liquidity outflows and large-scale funding runs associated with STWF in times of stress.”<sup>10</sup> However, there are longstanding concerns about weighted STWF (“**wSTWF**”) as a measure of liquidity risk, particularly in the context of FBOs. For example, it mistakenly groups parent funding with third-party financial investors (as a high run-risk liability) despite historical

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<sup>9</sup> Under method 1, the surcharge score of a GSIB is calculated based on the following five categories of the Basel Committee’s assessment methodology: size, interconnectedness, substitutability, complexity and cross-jurisdictional activity. Method 2 is similar, except that it replaces substitutability with STWF.

<sup>10</sup> Proposed Guidance at 15452. Under method 2, the STWF score is calculated by scaling an institution’s wSTWF against its risk-weighted assets (“**RWA**”).

evidence and strong incentives to the contrary. Further, it takes no account of other factors that mitigate liquidity risk relating to STWF, including the fact that FBOs maintain HQLA in order to satisfy home-country liquidity coverage ratio (“LCR”) requirements that apply on a global, consolidated basis.

- We note that other measures of liquidity show the IHCs of the Specified FBOs to be conservatively managed. The absolute size of their STWF is 84% below the U.S. non-processing GSIB<sup>11</sup> average, as shown in Figure 2 below. The specified FBOs also maintain high levels of HQLA, and run a conservative LCR (160%) in their IHCs. This means they carry liquidity headroom (liquid assets over the 100% LCR standard) of roughly three times larger than the U.S. GSIB level.

**B. There are vast differences between the U.S. operations of the Specified FBOs and the U.S. GSIBs; the U.S. operations of the Specified FBOs are simply not comparable to the U.S. GSIBs on any balanced reading. The substantive resolution planning requirements that were developed for the U.S. GSIBs should not be transposed to the U.S. operations of the Specified FBOs.**

Historically, FBOs did have a much more prominent profile in the United States than they do today. However, the U.S. operations of the Specified FBOs are now a fraction of what they were prior to the 2008 financial crisis. In January 2020, Vice Chair Quarles noted:

Since 2010, [Barclays PLC, Credit Suisse Group AG, Deutsche Bank AG and UBS AG (the “LISCC FBOs”)] have significantly shrunk their U.S. footprint, and their U.S. operations are much less risky than they used to be. Since 2008, the size of the LISCC FBOs’ combined U.S. assets has shrunk by about 50 percent, and they have reduced the assets at their broker-dealers from a peak of \$1.9 trillion in 2008 to \$340 billion today, a reduction of over 80%. In addition, the estimated systemic impact of the LISCC FBOs today is much smaller than the U.S. GSIBs. The average method 1 GSIB score of the combined U.S. operations of the LISCC FBOs is less than a quarter of the average GSIB score of the six non-processing U.S. GSIBs.<sup>12</sup>

Figure 1 provides a snapshot of the asset size of the Specified FBOs and the six non-processing U.S. GSIBs referenced by Vice Chair Quarles (the “U.S. benchmark group”). The total exposures for the Specified FBOs are barely visible on the chart; they are just 6% of the average size of the U.S. benchmark Group.

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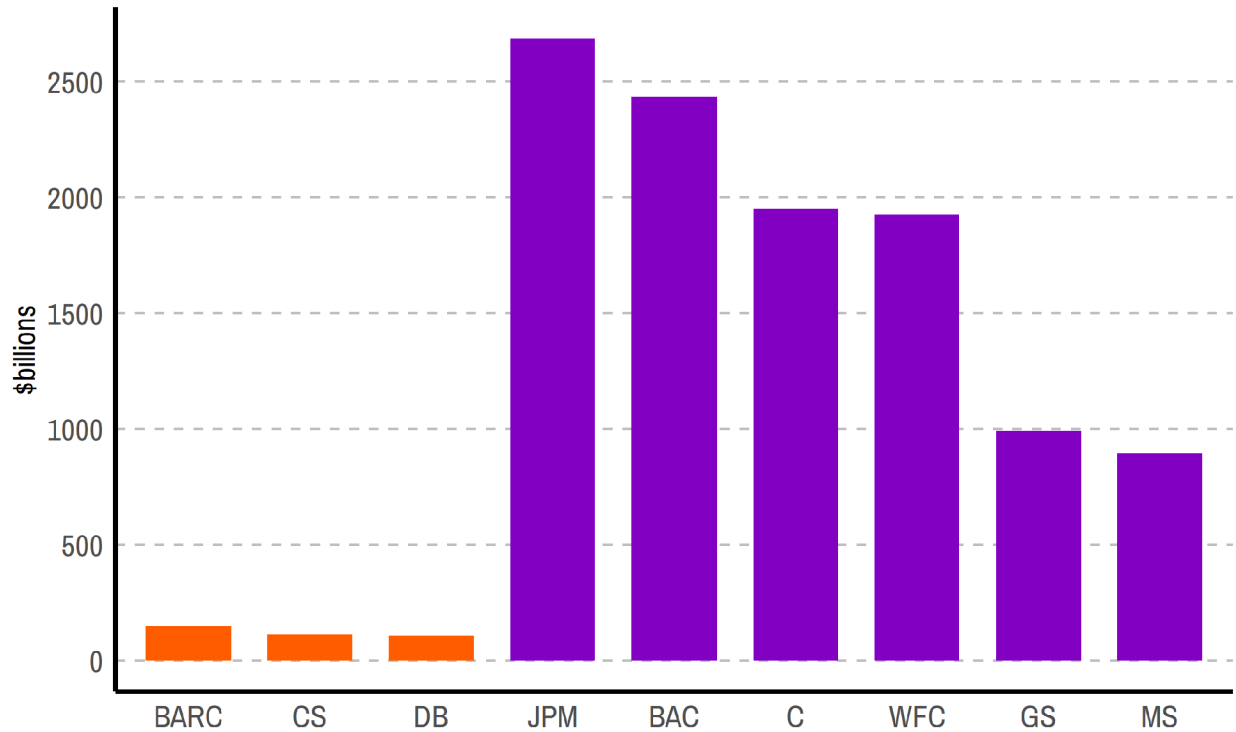
<sup>11</sup> As discussed in Section II.B of this letter, the U.S. non-processing GSIBs, or “U.S. benchmark group,” include Bank of America, Citigroup, Goldman Sachs, JPMorgan Chase, Morgan Stanley and Wells Fargo.

<sup>12</sup> Randal K. Quarles, Board Vice Chair for Supervision, *Spontaneity and Order: Transparency, Accountability, and Fairness in Bank Supervision* (Jan. 17, 2020), available at <https://www.federalreserve.gov/newsevents/speech/quarles20200117a.htm>.

Figure 1:

## Total Assets

4Q2019



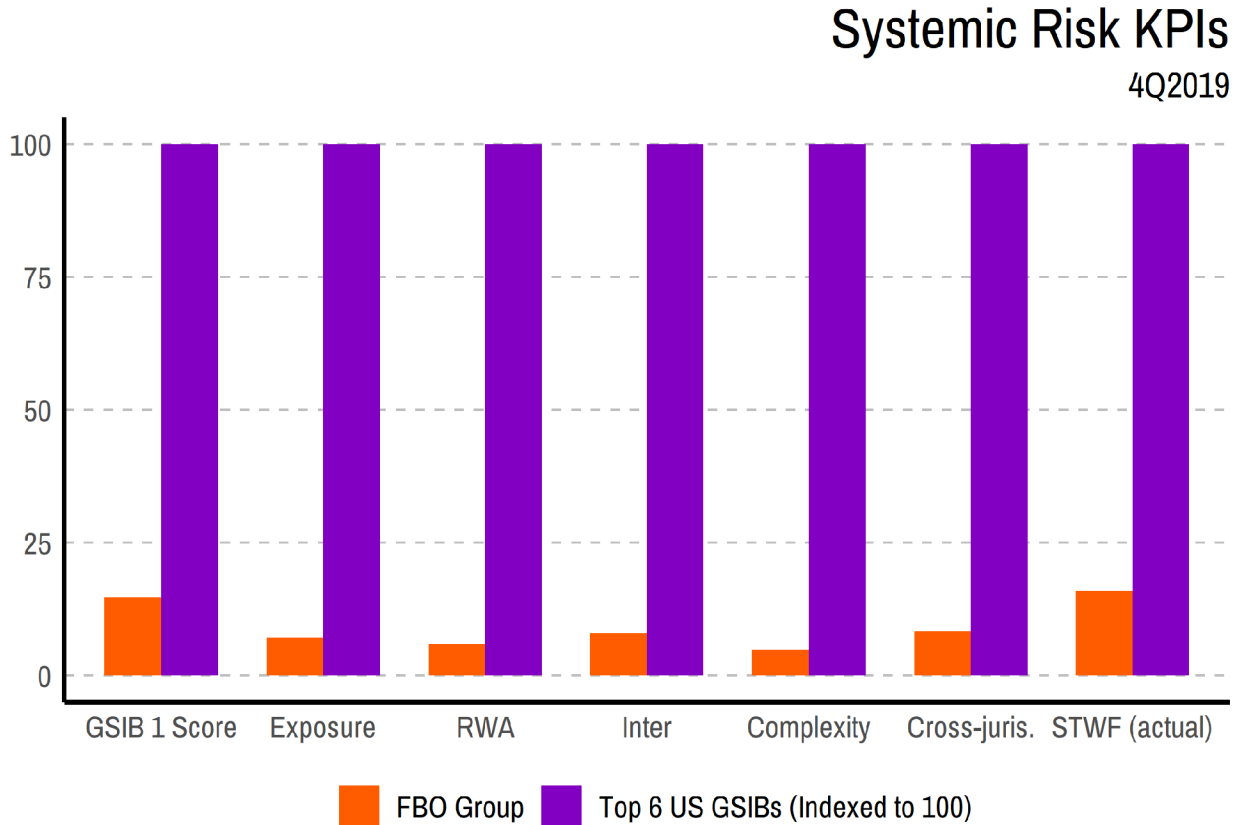
Source: Federal Reserve Board, FR Y-9C, Consolidated Financial Statements for Holding Companies

The Agencies note that “a single indicator may not account for other factors that are relevant to the resolvability of an FBO.”<sup>13</sup> A broad range of KPIs is set out in Figure 2. This figure compares the average result for the IHCs of the Specified FBOs with the average for the U.S. benchmark group, based on Q4 2019 data. This broader cut of risk KPIs further illustrates the dramatic gulf between the FBO group and the U.S. benchmark group in terms of scale and risk. The results of each KPI for the U.S. GSIBs is indexed to 100, and the results for the FBOs are scaled accordingly, for comparability across KPIs.

<sup>13</sup>

Proposed Guidance at 15452.

Figure 2:



Source: Federal Reserve Board, FR Y-15,  
Banking Organization Systemic Risk Report

It is clear that the IHCs of the Specified FBOs are dramatically less risky across a broad range of underlying systemic risk KPIs: method 1 GSIB score, exposure, RWA and the five underlying method 2 component indicators.<sup>14</sup> For example, the average method 1 GSIB score for the IHCs of the Specified FBOs is now only 14.6% that of the U.S. benchmark group as of year-end 2019, and most statistics are below 10%. Based on any reasonable interpretation of this broad range of statistics, the Specified FBOs simply do not belong in the same risk class as the U.S. GSIBs. However, the Proposed Guidance presumes the opposite view due to the method 2 anomaly; it mistakenly asserts that the Specified FBOs present “comparable resolvability challenges” to U.S. GSIBs, and uses this argument to group the Specified FBOs into the same category as the U.S. GSIBs.<sup>15</sup>

The Specified FBOs have de-risked rapidly, and are now at a point that they can, and should, join those U.S. firms that are not subject to the Guidance for § 165(d) Resolution Plan Submissions by Domestic Covered Companies (“**Domestic Guidance**”).<sup>16</sup> The scoping methodology should reflect those substantive factors, and not be used to create a new category of IHCs that are mistakenly viewed as comparable in terms of systemic risk to much

<sup>14</sup> The STWF indicator in Figure 2 is the actual weighted STWF, not the “score” used in method 2. This strips out the dramatic effect of the idiosyncratic “weighting ratio,” which produces a distorted method 2 GSIB score and is discussed extensively in the Appendix to this Letter.

<sup>15</sup> See Proposed Guidance at 15452. The preamble notes that the “substantial majority” of such U.S. GSIBs have a method 2 GSIB score of 250 or more. *Id.*

<sup>16</sup> See 84 Fed. Reg. 1449.



larger U.S. GSIBs. There is no justification for imposing the full panoply of U.S. resolution requirements to institutions that are categorically smaller and less risky—particularly when those institutions are already subject to an equally robust global resolution planning requirement.

**C. Another scoping methodology would provide much more balanced results. We suggest that the recently developed tailoring categories would provide a more consistent and appropriate representation of risk profile.**

For the above reasons, method 2 GSIB scoring is simply not a reasonable method to categorize IHCs. Creation of a new and poorly applied scoping metric also creates an inconsistency with the just-announced tailoring rules specifically developed to assess the risk of large banking organizations, and is also inconsistent with Vice Chair Quarles' emphasis on reciprocity and cross-border cooperation.<sup>17</sup> Further, it creates a poorly conceived risk grouping—one that closely resembles the just de-commissioned Large Institution Supervision Coordinating Committee ("LISCC") category. This could set a very poor precedent for future regulation.

The most obvious solution would be to rely upon the regulatory tailoring categories established to determine the application of enhanced regulatory requirements. Specifically, we would recommend that the Proposed Guidance apply only to FBOs that qualify as Category 2 firms based on IHC assets. The Board has acknowledged that the tailoring "approach provides a simple framework that supports the objectives of risk sensitivity and transparency."<sup>18</sup> The tailoring rules that were finalized last year were designed to tailor application of prudential regulations to more closely match the risk profile of each bank, an indication of supervision reflecting the impact of de-risking. It is difficult to understand why the Agencies would use a different regime for resolution planning than for the other enhanced regulatory standards also established by Section 165(d) of the Dodd-Frank Act.

If the Agencies decide to retain some idiosyncratic GSIB scoring method, they could choose several alternatives to address the issues mentioned, such as capping the share of any component at a given percentage. We discuss this further in Appendix 1.

Even if the scope of institutions subject to the Proposed Guidance were not to be modified, the substantive requirements of the guidance should be adjusted to better reflect the reduced size and complexity of the Specified FBOs' U.S. operations.

**III. The Proposed Guidance would require extensive information relating to the FBOs' non-U.S. derivatives and trading activities, creating issues of extraterritoriality and duplication of information; U.S. regulators should request any necessary information from home regulators under established processes.**

The Proposed Guidance would require extensive information relating to the FBOs' non-U.S. derivatives and trading activities. The Proposed Guidance defines "U.S. derivatives and trading activities" to include activities "booked directly into a non-U.S. affiliate."<sup>19</sup> This definition contradicts the Title I Rule under which the Proposed

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<sup>17</sup> See Randal K. Quarles, Board Vice Chair for Supervision, *Trust Everyone—But Brand Your Cattle: Finding the Right Balance in Cross-Border Resolution* (May 16, 2018) ("**Brand Your Cattle Speech**"), available at <https://www.federalreserve.gov/newsevents/speech/quarles20180516a.htm>.

<sup>18</sup> Prudential Standards for Large Bank Holding Companies, Savings and Loan Holding Companies and Foreign Banking Organizations, 84 Fed. Reg. 59032, 59036 (Nov. 1, 2019).

<sup>19</sup> Proposed Guidance at 15467 fn. 37.

Guidance must operate.<sup>20</sup> The Title I Rule specifies that FBO resolution plans shall include information, including resolution strategies, with respect to the “subsidiaries, branches and agencies, and identified critical operations and core business lines, as applicable, that are *domiciled in the United States* or conducted in whole or material part in the United States.”<sup>21</sup> Requiring an operational unwind strategy for the prime brokerage business as a whole, for example, requires the U.S. plan to provide a strategy for transactions booked outside the United States; this requirement exceeds the general scope of the Title I Rule, bringing into the U.S. resolution plans the resolution of entirely non-U.S. entities. Furthermore, requiring the development of a plan for the resolution of a non-U.S. affiliate of the FBO contradicts the previous understanding of the Title I Rule that the U.S. resolution plan is not required to assume the failure of non-U.S. affiliates.<sup>22</sup> The Agencies should not be able to impose by guidance something that exceeds the scope of the rule itself.

For resolution planning purposes, the focus should be on what is booked in the United States. Transactions booked outside the United States are under the purview of non-U.S. regulators, and would generally be addressed in the global resolution plan as well as home country requirements on solvent wind-down analyses. The Agencies can request information from those regulators through existing supervisory information sharing mechanisms or through the crisis management groups, consistent with the message of cross-border cooperation expressed in the preamble to the Proposed Guidance.<sup>23</sup> Moreover, transactions booked outside the United States would not be within the purview of U.S. resolution authorities in a resolution scenario. At a minimum, the examination should be limited to the aspects of those transactions that may affect the U.S. resolution process.

We recognize that, historically, non-U.S. regulators have expressed concerns that remote booking by U.S. entities can create issues for their resolution responsibilities insofar as non-U.S. entities do not have traders to assist with unwinding the trades. However, these concerns are being addressed, and are more appropriately addressed, in global resolution plans and solvent wind-down requirements undertaken by the home authorities. In any event, the

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<sup>20</sup> 12 CFR Parts 243, 381.

<sup>21</sup> 12 CFR Parts 243.5(a)(2), 381.5(a)(2). Although the Title I Rule also refers to business conducted “in material part” in the United States, we do not believe this was meant as a *carte blanche* for the Agencies to require information be provided about non-U.S. affiliate operations. The preamble to the original Title I Rule release explains that “[a] foreign-based covered company is required to provide information regarding its U.S. operations, an explanation of how resolution planning for its U.S. operations is integrated into the foreign-based covered company’s overall contingency planning process, and information regarding the interconnections and interdependencies among its U.S. operations and its foreign-based operations.” 76 Fed. Reg. 67323, 67327. Therefore, the focus, with respect to non-U.S. operations, should only be on understanding the interconnections and interdependencies with U.S. operations.

<sup>22</sup> Under the Title I Rule, a covered company must describe its plan for a “rapid and orderly resolution.” 12 CFR Parts 243.5(c), 381.5(c). For FBOs, a “rapid and orderly resolution” means “a reorganization or liquidation of . . . the subsidiaries and operations of such foreign company *that are domiciled in the United States* . . . under the Bankruptcy Code.” 12 CFR Parts 243.2, 381.2. Further, the “Guidance for 2013 § 165(d) Annual Resolution Plan Submissions by Foreign-Based Covered Companies that Submitted Initial Resolution Plans in 2012” clarified that permissible resolution strategies could include “[a] Bankruptcy of the parent holding company or U.S. parent, as may be applicable, and a limited number (if any) of Material Entities; or . . . [t]he Bankruptcy of one or more Material Entities within the Covered Company, and the Covered Company is compartmentalized in a manner that mitigates the risk that such Bankruptcy(ies) would result in other Material Entities entering resolution regimes.”

<sup>23</sup> See Proposed Guidance at 15451 (“Resolution of the U.S. operations of a firm domiciled outside the United States with significant global activities . . . will require substantial coordination between home and host country authorities. The agencies identified three areas in the 2018 feedback letters (legal entity rationalization; PCS; and derivatives booking practices) where enhanced cooperation between the agencies and each firm’s home regulatory authorities would maximize resolvability under both the U.S. and home country resolution strategies. The agencies will continue to coordinate with non-U.S. authorities regarding these and other resolution matters . . .”).

U.S. resolution proceeding would not be burdened with the responsibility of completing this process; rather it is an operational issue for the home country.

**IV. The Proposed Guidance subjects sub-components of the Specified FBOs to extensive PCS requirements, again creating issues of extraterritoriality and duplication of information that could be requested from home regulators.**

The Proposed Guidance subjects the U.S. subsidiaries of the FBOs to requirements that are essentially the same as, and in some ways more extensive than, the requirements for payment, clearing and settlement activities (“PCS”) that apply to U.S. GSIBs.<sup>24</sup> The Proposed Guidance requires that the PCS framework address relationships that include “indirect relationships” with FMUs, including “a firm’s . . . *non-U.S.* affiliate and branch provision of . . . key clients of the firm’s U.S. operations with access to an FMU or agent bank.”<sup>25</sup> This analysis of the relationships between non-U.S. entities and U.S. customers is addressed through the resolution planning process applicable to the applicable non-U.S. branches and affiliates. While U.S. regulators may request information regarding the impact of the failure of foreign affiliates on the U.S. operations of the FBO, the resolution of the foreign affiliates is not within the scope of the Title I Rule.

There are better, more efficient mechanisms for the Agencies to obtain the relevant information. U.S. and non-U.S. authorities can share information and rely more on work done at the parent level, which will also have the virtue of reflecting the views of the regulators that will have the ability to affect the process by which the foreign operations are resolved. Again, this kind of cooperation would be consistent with the message conveyed by Vice Chair Quarles and referenced in the preamble of the Proposed Guidance.

**V. The final guidance should focus on the effectiveness of a CBM in mitigating risks of creditor challenges rather than the form or structure of a CBM.**

The Proposed Guidance poses a number of questions about CBMs and the relative merits of different approaches. In finalizing the guidance, the Agencies should not prescribe the form of a CBM or limit the ability of Specified FBOs to continue to evolve their approaches to mitigating the risk of creditor challenges in hypothetical bankruptcy proceedings for their IHCs. The final guidance should remain focused on whether a Specified FBO has sufficiently mitigated such risks considering the particular structure of and resolution strategy for the U.S. operations. In doing so, the Agencies should be mindful of how the circumstances of the Specified FBOs differ from those of the U.S. BHCs and facilitate the FBOs in developing structures and strategies that support their global resolution strategies while addressing the concerns of the Agencies as host regulators.

**A. CBMs should serve as mitigants to challenges by creditors.**

The purpose of a CBM is to support the ability of an IHC to downstream loss-absorbing capacity notwithstanding the bankruptcy proceeding of the U.S. entity subject to the U.S. resolution planning requirements. In compliance with the Board’s internal TLAC requirements, the IHCs of Specified FBOs maintain specified levels of loss-absorbing resources by issuing equity and debt instruments that comply with the internal TLAC eligibility

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<sup>24</sup> For instance, the *Framework* subsection includes a requirement that the Specified FBOs “address the potential impact of any disruption to, curtailment of, or termination of . . . direct and indirect relationships on the firm’s U.S. material entities, identified critical operations, and core business lines.” See Proposed Guidance at 15463; Domestic Guidance at 1452. There is also a *Capabilities* subsection that does not appear in the Domestic Guidance. See Proposed Guidance at 15464–65; Domestic Guidance at 1453.

<sup>25</sup> Proposed Guidance at 15463.

requirements. The proceeds of these issuances are either down-streamed to subsidiaries, thereby “prepositioning” the loss-absorbing capacity at subsidiaries, or retained at the IHC as “contributable resources” that can be deployed to subsidiaries as and when needed to address financial distress. As part of their resolution strategies, the Specified FBOs are required to develop an approach to balancing the allocation of loss-absorbing capacity between prepositioned and contributable resources.<sup>26</sup>

Under the global resolution strategies of the Specified FBOs, these resources would be used to prevent the insolvency or resolution of any of the U.S. entities. Any losses at a U.S. operating entity would be absorbed by the foreign parent first by the additional equity capital required to be maintained at that entity under the TLAC framework. Additional losses could be up-streamed by the parent forgiving debt or down-streaming additional capital. Prepositioned and contributable resources can also be drawn upon to bolster liquidity within the U.S. operations. None of the resolution plans developed by the Specified FBOs contemplates the separate resolution of U.S. subsidiaries.

Notwithstanding their global resolution strategies, a Specified FBO is required under the U.S. resolution planning framework to develop strategies based on the assumption that at least its IHC enters U.S. bankruptcy proceedings. The purpose of a CBM is to mitigate the risk that, in the hypothetical bankruptcy proceeding for the IHC, creditors of the IHC cannot challenge the down-streaming of loss-absorbing capacity by the IHC and thereby impede the continued operation or unwind of the U.S. operations of the FBO as contemplated in the U.S. resolution plan. The CBMs developed to date draw on different aspects of the U.S. Bankruptcy Code to protect down-streamed resources from potential claw-back by creditors of the IHC. The public sections of the U.S. resolution plans for each of the Specified FBOs provide an overview of the CBMs they have put in place and the CBMs have been included in the U.S. resolution plans submitted to the Agencies, along with detailed supporting materials.

**B. CBMs should not be judged against each other, but should instead be judged individually by how well they satisfy the Agencies’ policy objective.**

The Agencies should focus on considering how effective each CBM is at satisfying the Agencies’ articulated policy objective, not on which CBM is better at mitigating the risks of particular creditor challenges as contemplated by the first question on CBMs. The “Support Within the United States” part of Section IV, Governance Mechanisms, of the current and Proposed Guidance requires Specified FBOs to identify potential state law and bankruptcy law challenges to an IHC providing support for its subsidiaries and present a detailed legal analysis of how these challenges could be mitigated. The FAQs in the Appendix address CBMs as a potential mitigant and rightly decline to constrain the approaches taken. Instead, the FAQs direct filers to ensure that whatever approach is taken is “appropriate for the firm’s U.S. resolution strategy, including adequately addressing relevant financial, operational, and legal requirements and challenges.”

The Agencies should continue to focus the assessment of CBMs against their articulated policy objective. A comparison of the relative merits of the CBMs, as prompted by the first question on CBMs, may raise interesting academic questions but is not meaningful when considered in isolation from the goal they are designed to achieve. The relevant analysis should be whether a Specified FBO’s CBM sufficiently mitigates the risks of creditor challenges

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<sup>26</sup> We note that the design of a CBM is not relevant to the balance of prepositioned resources versus contributable resources, as implied by the second question on CBMs. Rather, a CBM ensures that all such loss-absorbing capacity is available for use by the relevant subsidiaries to absorb losses during a stress event, regardless of whether such resources were prepositioned well in advance of the contemplated bankruptcy proceeding or contributed on the eve of such proceeding.

to enable the effective deployment of loss-absorbing capacity during stress or a bankruptcy proceeding for the IHC, taking into account the Specified FBO's structure, operations and resolution strategy.

In considering whether the Agencies' policy outcome has been satisfied, the Agencies should keep in mind the broader context particular to the Specified FBOs:

- All of the Specified FBOs have global single-point-of-entry ("SPOE") resolution strategies that do not contemplate the insolvency of their IHCs or any other U.S. entities. The required assumption of a separate insolvency or resolution of a U.S. subsidiary is something that the Specified FBOs and their resolution authorities are actively planning to prevent, as the Agencies are aware from participating in Crisis Management Groups for the Specified FBOs. Accordingly, the bankruptcy proceedings the Specified FBOs are required to consider and the related risks that would be mitigated by the CBMs are hypotheticals that are not anticipated to occur under real-world conditions, even under the severe stress scenarios used for U.S. and for home-country resolution planning purposes.
- All of the Specified FBOs have complied with the internal TLAC requirements, including the issuance of qualifying long-term debt instruments. The IHCs of the Specified FBOs are all "non-resolution" IHCs under the Board's internal TLAC rules, meaning that all of the internal TLAC equity and debt instruments are required to be (and have been) issued to non-U.S. affiliates. As the sole ultimate investor in the internal TLAC issued by its IHC subsidiary, a Specified FBO (or its resolution authority) would have every incentive to recapitalize or restructure its U.S. operations to avoid the costs, inefficiencies, operational burdens and negative reputational consequences of a bankruptcy proceeding for its IHC or any other U.S. subsidiary.
- As required by the Board's internal TLAC rule, all internal TLAC in the form of long-term debt can be converted to equity by the Board outside of insolvency or resolution proceedings. The purpose of this trigger is to enable the Board to recapitalize an IHC and prevent the need for a bankruptcy proceeding. This trigger is designed to address the contingency the Specified FBOs are required to plan for—that an FBO parent is unable or unwilling to support its U.S. operations in times of financial distress.

Accordingly, the bankruptcy proceeding the U.S. resolution plans are required to consider would occur only if the Specified FBO (or its resolution authority) disregarded its global resolution strategy and the economic incentives associated with its investment in the U.S. operations and failed to provide support for the U.S. operations, and the Board declined to remedy the situation by exercising its option to convert internal TLAC in the form of long-term debt to equity to avoid a U.S. bankruptcy proceeding. The threshold for determining whether a CBM put in place by a Specified FBO sufficiently mitigates the risk of creditor challenges should therefore be materially lower for the Specified FBOs than for the U.S. BHCs, for whom a bankruptcy proceeding for their BHCs is the primary strategy. The benefits of enhanced protection from creditor challenges must be weighed against the burdens imposed on the FBO and the reality that the risks mitigated would arise only in a scenario that is a contingency to a contingency to the scenario anticipated by both the U.S. and home-country regulators.

The CBMs put in place by the Specified FBOs are more than sufficient to address the policy goals articulated by the Agencies, even disregarding the broader context described above. As required by the current resolution planning requirements, each Specified FBO has provided substantial legal analysis supporting the effectiveness of its particular CBM in mitigating the risk of creditor challenge. Before imposing any more generally

applicable requirements on CBMs, we would encourage the Agencies to engage in bilateral dialogue with the Specified FBOs to discuss the extensive legal analysis of the existing CBMs prepared by the FBOs.<sup>27</sup>

**C. Specified FBOs should retain the flexibility to design CBMs that meet the needs of their global resolution strategies as well as the requirements of the U.S. resolution planning requirements.**

The Final Guidance should not dictate the form or structure of a CBM but rather should enable continued flexibility in satisfying the Agencies' policy objective. So long as a CBM sufficiently mitigates the potential risks of creditor challenges, a Specified FBO should be free to choose the approach that works best for its global and U.S. resolution strategies and its particular structures and operational requirements. Such flexibility allows the Specified FBOs to develop approaches that minimize the disincentives for Specified FBOs to support their U.S. operations in distress caused by requirements or structures that impede the flow of excess capital or liquidity above regulatory minima. It also allows for the development of alternative structures over time, including to address changes in the structure or operations of the Specified FBOs or their U.S. operations, or the regulatory requirements or expectations of home or host regulators.

**VI. As the Agencies continue to advance the resolution framework, additional focus should be applied to determining appropriate capital and liquidity requirements, and to the relationship between home and host country regulation.**

**A. We ask that the Agencies conduct a holistic assessment of prudential requirements applicable to the U.S. operations of FBOs and engage bilaterally with the Specified FBOs to consider alternative approaches to ensuring the availability of timely capital and liquidity support for the firms' U.S. operations.**

We believe that there is a need for a holistic assessment of prudential requirements applicable to FBOs. There has been, in recent years, a layering of requirements upon one another. The Agencies should conduct an assessment of liquidity and the cumulative effect of various requirements, including resolution liquidity execution need ("RLEN") and the net stable funding ratio ("NSFR"), as well as the interplay and duplication of TLAC and resolution liquidity adequacy and positioning ("RLAP"). A rationalization of these requirements would reduce the burden that they collectively impose and would likely improve their effectiveness. [For instance, in consideration of the reduced systemic risk of the Specified FBOs, the Agencies should consider removing RLAP and resolution capital adequacy positioning ("RCAP") expectations for those firms.]

The Proposed Guidance also includes references to the concepts of prepositioning and flexibility,<sup>28</sup> which were introduced by Vice Chair Quarles in his "Brand Your Cattle" speech. That speech described the sizeable benefits of a balanced approach for home-host relationships, and improved outcomes for bank resilience. However, the Proposed Guidance considers these issues only in the domestic context, not the international context for which they were originally developed. The Proposed Guidance therefore retains the current expectations for heavy resource pre-placement in the United States, which effectively exceed requirements for similarly sized U.S. firms. The high effective level of U.S. preplacement requirements has created an imbalanced result. This corrodes flexibility at the international level and also sets a poor precedent for resource trapping in other jurisdictions. We urge the Agencies to reconsider their position on these topics in line with the thoughtful and balanced logic of Vice

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<sup>27</sup> We note that the regulators indicated they would engage in such dialogue in the December 20, 2019 feedback letters to certain FBOs ("The Agencies will continue to consider the policy implications of [the CBM] and anticipate further engagement with [the FBO] on the matter.").

<sup>28</sup> Proposed Guidance at 15461.

Chair Quarles' "Brand Your Cattle" speech. Progressive U.S. leadership on this issue could help improve international bank resilience, and could be especially important if the stress of the COVID-19 pandemic continues.

Further, we urge the Agencies to engage with the Specified FBOs to consider alternative approaches to ensuring the availability of timely capital and liquidity support for their U.S. operations, as raised by the fourth question on CBMs. These alternatives should include some combination of the following options: reductions in internal TLAC requirements, the use of internal TLAC to satisfy Comprehensive Capital Analysis and Review ("CCAR") demands, elimination of the requirement that a specified portion of internal TLAC be in the form of long-term debt, the possibility of parent guarantees or capital contribution commitments satisfying a portion of internal TLAC requirements, the elimination of the requirement to assume the bankruptcy of a U.S. entity so long as the global resolution strategy supports that assumption, and other changes that allow FBOs to harmonize their U.S. resolution planning with their global resolution planning.

- B. In consideration of the extensive home country resolution planning requirements to which each of the Specified FBOs is subject, we ask that the Agencies engage bilaterally with the Specified FBOs on any concerns about the resolvability of the firms' U.S. operations and reliance on home country strategies.**

We do not believe that the Proposed Guidance reflects the internationally agreed approach to home and host authority responsibility with regard to resolution planning. With respect to a U.S. GSIB, the U.S. regulators are responsible for evaluating and regulating all aspects of resolvability for the entire organization, particularly where the resolution plan for a U.S. GSIB is a U.S.-led single point of entry ("SPOE") resolution. Non-U.S. host regulators have an interest in local operations and interconnections with home country operations, but they should not extend beyond that nexus in terms of local planning requirements.

The situation with respect to FBOs is precisely the reverse. The relevant home country regulatory authority for each of the Specified FBOs holds global responsibility for resolution planning and coordination, and each has adopted extensive and intensive resolution planning requirements that address all of the subjects addressed by the Agencies' rules. Clearly, both by statute and as a prudential matter, the Agencies must be satisfied as to the resolvability of the FBOs' U.S. operations. However, the existence of the extensive home country regulatory frameworks provides a substantial base from which the U.S. resolution planning process should begin.<sup>29</sup> Because the U.S. operations constitute a part of a larger whole, the granularity and stringency of the Proposed Guidance is largely duplicative of home country requirements and is not necessary to achieve the objectives of the Title I planning exercise.<sup>30</sup>

We ask that the Agencies engage with the Specified FBOs so that the firms may understand the Agencies' (i) residual concerns about the resolvability of the firms' U.S. operations and (ii) concerns about relying on the home country strategy. The Proposed Guidance reflects a continued emphasis on a separate U.S. strategy instead of supporting a global SPOE strategy for FBOs, in which any U.S. strategy is part of the bigger picture. The United States has "branded its cattle," but contrary to Vice Chair Quarles' vision, the Proposed Guidance is not "create[ing]

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<sup>29</sup> Cf. 12 USC § 5365 (requiring that, in applying standards to foreign-based BHCs, the Board shall "(1) give due regard to the principle of national treatment and equality of competitive opportunity; and (2) take into account the extent to which the . . . foreign-based bank holding company is subject on a consolidated basis to home country standards that are comparable to those applied to financial companies in the United States.").

<sup>30</sup> We would also note that, the Agencies' pursuit of an extraterritorial approach sets a precedent for non-U.S. regulators to demand similar requirements of U.S. GSIBs; this would conflict with the natural jurisdiction of the Agencies.

the possibility of trust” and cooperation.<sup>31</sup> The Proposed Guidance instead further hardwires a separate U.S. strategy.

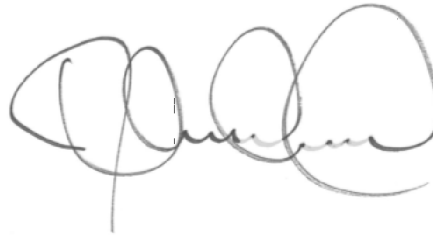
\* \* \*

Thank you for the opportunity to present these views and recommendations in written form. We would welcome the opportunity to participate in future stakeholder workshops and meetings as part of the assessment work being undertaken.

Sincerely,



Lauren Anderson  
Associate General Counsel &  
Senior Vice President  
Bank Policy Institute



Justin Underwood  
Senior Director, Banking Policy  
American Bankers Association



Carter McDowell  
Managing Director &  
Associate General Counsel  
Securities Industry Financial Markets Association

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<sup>31</sup> Brand Your Cattle Speech.



## Appendix 1: Issues Associated with Using Method 2 to Categorize FBOs

The Proposed Guidance employs a new scoping methodology to categorize FBO IHCs: Any IHC with a method 2 GSIB score of 250 or more would be subject to heightened resolution planning expectations in line with U.S. GSIBs. This methodology has implications for both the specifics of the Proposed Guidance and, worryingly, as a potential scoping precedent for future rulemaking.

The Agencies assert that using the method 2 composite is appropriate because:

- (1) It would provide a “single, comprehensive, integrated assessment of a large bank holding company’s systemic footprint” and all five components of a method 2 score are “important factors in considering resolvability”; and
- (2) An IHC having a method 2 score of 250 or above would suggest that such IHC presents “comparable resolvability challenges” to U.S. GSIBs, a substantial majority of which also have method 2 scores of 250 or more.<sup>32</sup>

Method 2 produces spurious and misleading results for FBOs and should not be used for scoping purposes. The method dramatically overstates the systemic risk of the Specified FBOs due to certain calculation artifacts. In particular, the STWF factor has an outsized effect on method 2 scores for FBOs and does not accurately reflect liquidity risk for FBOs or their U.S. operations. We believe that these problems are fatal to a test that looks to achieve a fair assessment of true systemic risk.

Method 2 has not previously been applied to IHCs or to FBOs. Indeed, the parameters of method 2 were specifically calibrated to fit the U.S. GSIBs only. Applying method 2 as a scoping methodology supplants the tailoring rules—created just last year to sort IHCs and BHCs into risk categories—creating an inconsistent and duplicative sorting mechanism. In particular, the new scoping methodology erroneously creates a new group that looks a lot like the LISCC category that is currently planned for retirement; it captures three of the four LISCC IHCs and just excludes the fourth.

- I. **Method 2 dramatically overstates the systemic risk of the Specified FBOs due to flaws in the methodology that distort the outcome for FBOs. In particular, the STWF factor, which has an outside effect on FBO method 2 scores, does not accurately reflect liquidity risk for FBOs or their systemic relevance.**
  - A. **Method 2 is not an “integrated assessment” for FBOs; it overstates the systemic risk of the Specified FBOs due to calculation artifacts that distort a single component (STWF), which then dominates the method 2 score.**

The preamble to the Proposed Guidance asserts that method 2 provides a “comprehensive, integrated assessment of a large bank holding company’s systemic footprint,” and that a score of 250 or more suggests that a Specified FBO presents “comparable resolvability challenges” to U.S. GSIBs.<sup>33</sup> We disagree: The method 2 score is not an “integrated assessment” because the outcome is dominated by a single, flawed component. The STWF score comprises 92% of the total method 2 score for the IHCs of the Specified FBOs and is the sole reason that any such IHC breaches the 250 threshold.

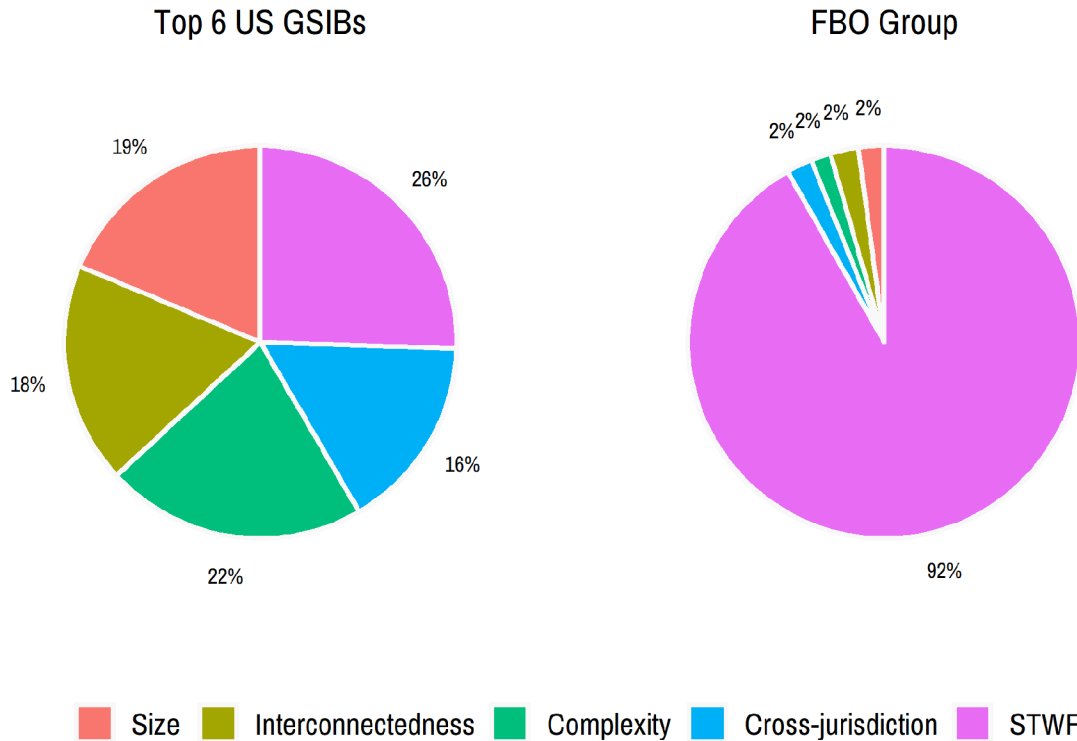
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<sup>32</sup> Proposed Guidance at 15452.

<sup>33</sup> Proposed Guidance at 15452. The preamble notes that the “substantial majority” of such U.S. GSIBs have a method 2 GSIB score of 250 or more. *Id.*

Figure A:

## G-SIB Method 2 Score, 4Q2019



Source: Federal Reserve Board, FR Y-15, Banking Organization Systemic Risk Report

The Agencies note that the “comparably high method 2 scores of the Specified FBOs have largely been driven by reliance on short term wholesale funding.”<sup>34</sup> This is true only as a technical matter within the method 2 calculations, but is not true as a substantive one.

For the IHCs of the Specified FBOs, the other four method 2 categories produce systemic risk scores that are far lower than the corresponding average for the U.S. benchmark group. The IHC score components range from 4.6% to 8.3% of the U.S. GSIB score (*i.e.*, 92% to 95% lower risk), as seen in Figure A.

**B. The unusual weighting system used in the method 2 STWF score calculation was calibrated specifically for the U.S. GSIBs; when applied to FBOs, certain flaws are exposed that mischaracterize the risk of FBOs.**

Unlike the other method 2 categories, the STWF score is driven by an unusual ratio weighting system (350 / RWA). This results in a reasonably balanced outcome among the five broad categories for the U.S. GSIBs (STWF comprises 26% of the method 2 GSIB score for that group as of Q4 2019). In fact, the STWF weighting was specifically calibrated to achieve a balanced result among the various indicators for the U.S. GSIBs. The activities or balance sheets of other entities (such as the IHCs of the Specified FBOs) were not considered at the time of calibration. This system does not produce reasonable STWF results for IHCs and the flaws in STWF calibration dominate and distort the outcome for the Specified FBOs.

<sup>34</sup>

The Specified FBOs have cut risk exposure in their IHCs dramatically over the last decade, leading to the large substantive reduction in systemic risk noted by Vice Chair Quarles. This reduction has included dramatic cuts in RWA. However, this RWA reduction also leads to a dramatic and unwarranted spike in the weighting ratio that is applied to the IHC group because RWA is (oddly) in the denominator of the STWF scoring calculation.<sup>35</sup> Because the RWA of the IHCs is now so small (6.0%) compared to the U.S. benchmark group, the effective weighting system for a unit of STWF is 16.7x larger for the Specified FBOs than for the U.S. benchmark group.

Consider how the weighting factor of “350 / RWA” was developed: The preamble to the GSIB surcharge rule states that the STWF “conversion factor was intended to weight the short-term funding amount such that the short-term wholesale funding score receives an equal weight as the other systemic indicators within method 2 (*i.e.*, 20 percent), and is calibrated based on estimates of short-term wholesale funding levels at the eight bank holding companies currently identified as GSIBs.”<sup>36</sup> As can be seen in Figure A, this weighting remains broadly balanced for the U.S. GSIBs for which it was calibrated. However, it fails completely when applied to a new group of entities (*e.g.*, the Specified FBOs).

Indeed, this weighting anomaly is so extreme that it drives the STWF scores for the three Specified FBOs above nearly every other systemic risk component score for any bank—even ones 20 times larger. It is surely an unintended and incorrect outcome for a large reduction in RWA to trigger a dramatically higher systemic risk score.

If the STWF score were weighted like any other systemic risk component (based on absolute amounts relative to the industry score), the average method 2 score of the Specified FBOs would drop dramatically.<sup>37</sup> It would drop from the current average of 317 to an average of 51, a much more appropriate outcome when the actual risks of the Specified FBOs are clearly evaluated. This result is 9.3% of the average score of the U.S. benchmark group—consistent with the outcomes of method 1 and other risk KPIs set out in Figure 2 of this letter.

The flaws of the existing method 2 approach to calculating STWF become more visible when applied to smaller and lower-risk entities like IHCs. In the extreme case, consider a tiny entity that holds a single asset: \$100 of treasury bills (zero RWA). Such an entity would produce an infinite STWF weight and therefore an infinite method 2 GSIB score because it divides by zero. This \$100 entity would outrank even the largest GSIB in terms of systemic risk based on a simple application of method 2. While this is clearly an extreme case, the IHCs are affected by the same flawed logic. As the FBOs have shrunk and de-risked, shifting their asset mix to holding lower-risk HQLA, their STWF scores have been inflated by ever smaller RWA figures and severely distorted.

A visual explanation of this issue is set out in Figure B. The figure shows that the IHC group is dramatically lower in both funding risk and RWA than the U.S. benchmark group. The IHC group carries only 6% of the RWA and 16% of the STWF. Both these statistics are generally considered to be positive drivers of systemic risk on a standalone basis. But the method 2 STWF scoring is based on the ratio between these two factors, so the IHC group is penalized harshly because it has even lower RWA than STWF. Because the weighting factor was calibrated to

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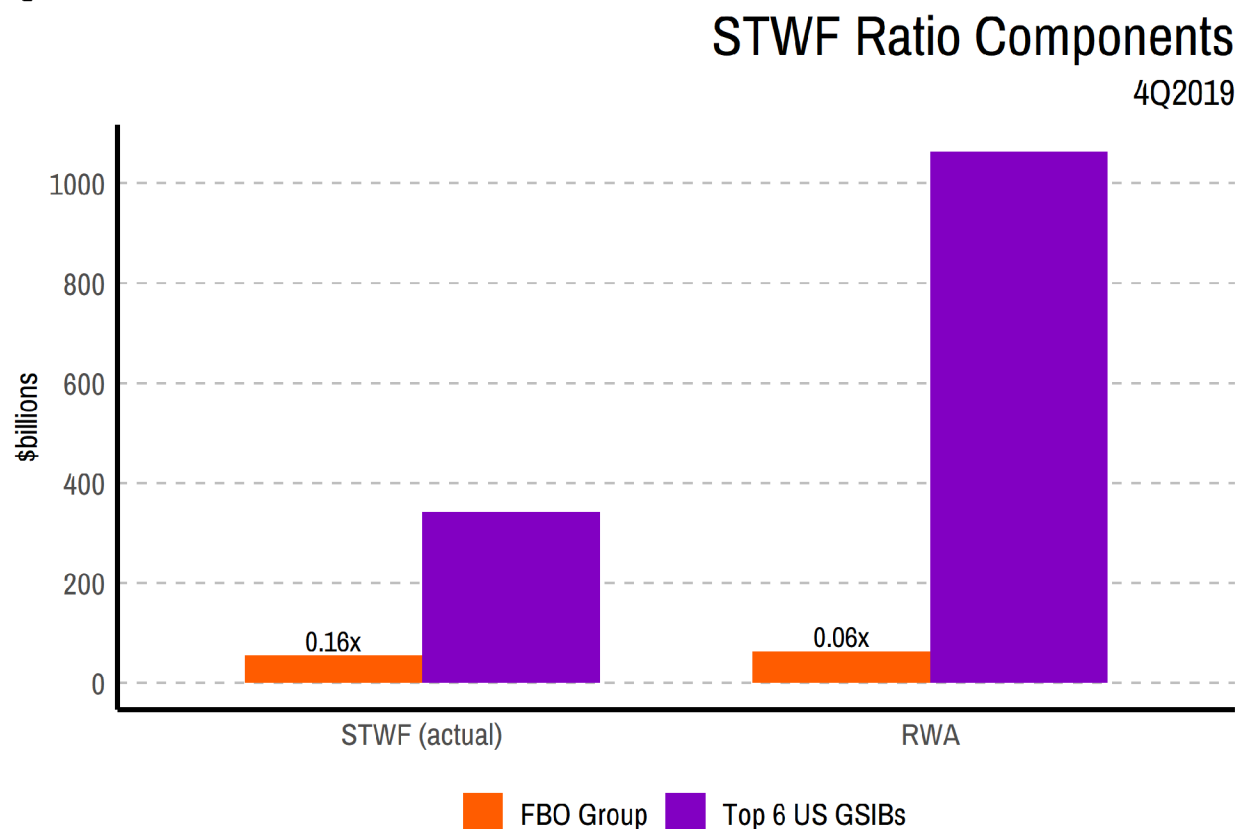
<sup>35</sup> In the original explanation of the RWA denominator, the Agencies noted that denominator effects would be cancelled out in ultimate usage, because the purpose of the GSIB surcharge was to generate a factor that would then be multiplied by RWA when calculating a capital buffer. That explanation does not apply in this scoping exercise.

<sup>36</sup> 80 Fed. Reg. 49082, 49100. Under the proposal, to arrive at its STWF score, a GSIB would have multiplied the ratio of its weighted STWF amount over its average RWA by a fixed conversion factor (175). The conversion factor accounted for the fact that, in contrast to the other systemic indicators that comprise a GSIB’s method 2 score, the STWF score does not have an associated aggregate global indicator. The conversion factor was intended to weight the STWF amount such that the STWF score receives an equal weight as the other systemic indicators within method 2 (*i.e.*, 20%) and is based on estimates of STWF funding levels at the eight BHCs identified as GSIBs.

<sup>37</sup> We chose a fixed conversion factor that would maintain the score of the U.S. benchmark group at the same average level.

achieve a balanced result for U.S. GSIBs, based on the far larger RWA of the U.S. benchmark group, this method escalates the STWF score for the FBOs in a way that is fundamentally misleading.

Figure B:



Source: Federal Reserve Board, FR Y-15, Banking Organization Systemic Risk Report

**C. The wSTWF factor has other significant flaws when applied to FBOs.**

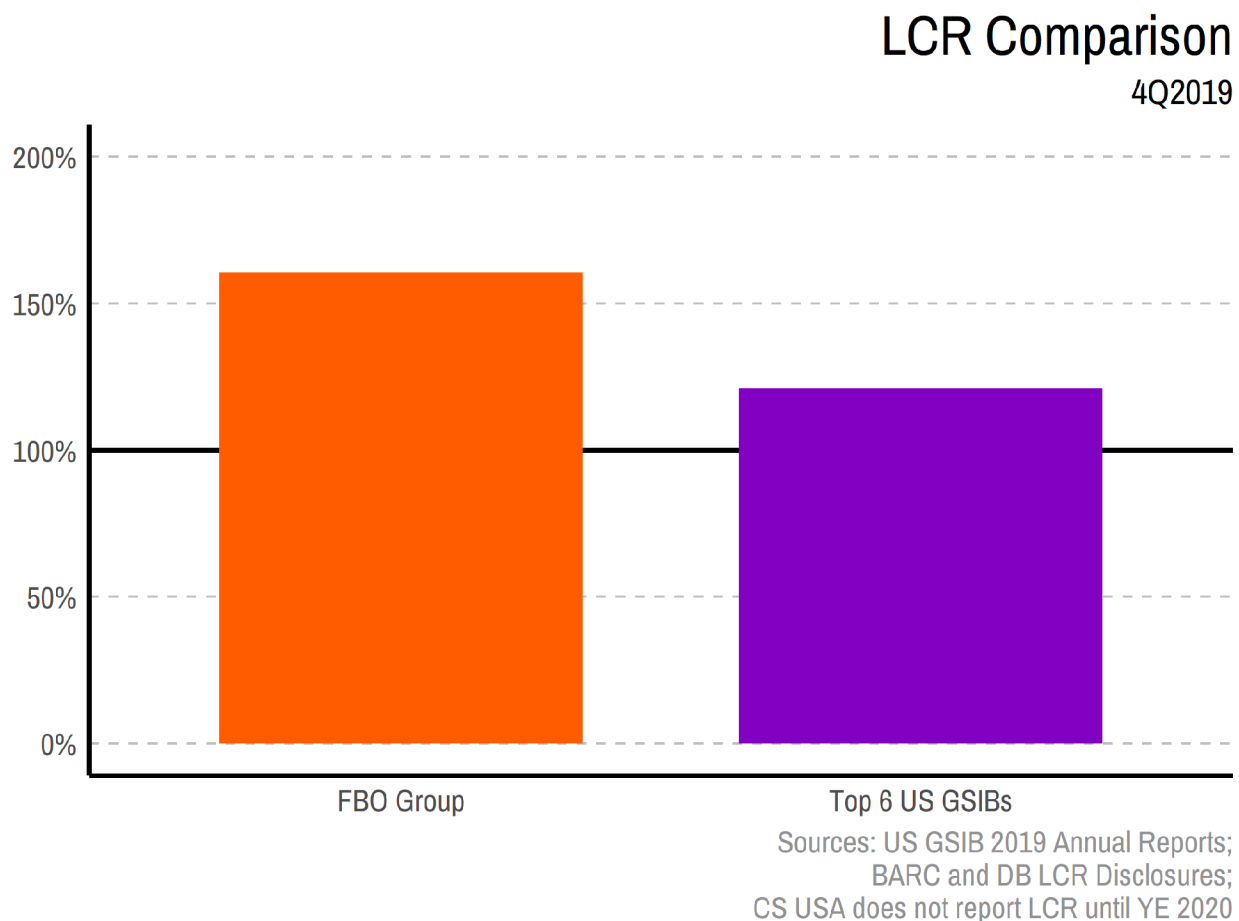
Applying the method 2 STWF score to FBO IHCs highlights other flaws as well. In the preamble to the Proposed Guidance, the Agencies explain that the “STWF factor indicates the potential for significant liquidity outflows and large-scale funding runs associated with STWF in times of stress.”<sup>38</sup> However, there are significant problems with using wSTWF as a measure of liquidity risk.

First, wSTWF focuses on liabilities and does not adequately consider the tenor, liquidity and other characteristics of the assets funded by those liabilities. Liquidity risk is fundamentally about the appropriate matching of assets and liabilities. Funding short dated assets like HQLA or supply chain finance with STWF is often a lower risk strategy than funding them with a mismatched tenor. This type of net position does not pose significant risk even in the case of a “run”; a bank under stress could easily meet claims that are invested in HQLA. These activities do not pose significant overall liquidity concerns, and are common in the business models of the Specified FBOs.

<sup>38</sup> Proposed Guidance at 15452. Under method 2, the STWF score is calculated by scaling an institution’s wSTWF against its RWA.

The LCR is perhaps the most widely used liquidity metric and provides a good test for this type of asset-liability comparison. Figure C shows that average LCR of the IHCs is 160%,<sup>39</sup> well above the average of 121% for the U.S. benchmark group. The figure shows that the modest amounts of wholesale funding issued by the Specified FBOs are well covered by HQLA and do not pose any special systemic threat. Indeed, the IHCs actually carry roughly triple the headroom over the 100% LCR benchmark than the U.S. benchmark group.

Figure C:



Second, the categorization of the inter-affiliate transactions in the wSTWF calculation is problematic for FBOs, which often invest global dollar liquidity in their U.S. entities. However, the wSTWF system categorizes parent deposits as a highly weighted (*i.e.*, highly runnable) class because the parent is categorized as a “financial investor.” The concern that reliance on STWF from non-U.S. affiliates creates a high “run risk” for the U.S. operations is misplaced. FBOs have strong reputational and economic incentives to maintain funding in their U.S. operations, and the history of support is strong. FBOs have substantial investments in their U.S. subsidiaries and, in many cases, these investments have been increased greatly since the 2008 financial crisis in terms of both capital requirements and the new TLAC requirements. These considerations provide a very strong incentive for FBOs to support their subsidiary operations and make them fundamentally different from a third-party investor.

Overall, the relevant risk measures show the Specified FBOs to be conservatively managed with respect to liquidity. The absolute size of STWF, as shown in Figure 2 of this letter, is 84% below that of the U.S. benchmark group. The LCR statistics show the Specified FBOs run a conservative net profile, and regulators have numerous

<sup>39</sup> Credit Suisse USA does not report LCR until YE 2020; however, on a global basis, the firm reports a conservative LCR of 198% (as at YE 2019).

other tools to address this risk. The liquidity profile of the Specified FBOs simply does not present the disproportionate concern suggested by their method 2 scores.

**II. Another scoping methodology would provide much more balanced results. We suggest that the recently developed tailoring categories would provide a more consistent and appropriate representation of risk profile.**

For the many reasons set out above, method 2 is not a fair or reasonable method to categorize IHCs. As discussed in Section II.C of this letter, we would recommend that the Proposed Guidance apply only to FBOs that qualify as Category 2 firms based on IHC assets under the regulatory tailoring methodology.

If the Agencies decide to retain some GSIB scoring method, they could choose several alternatives to address the issues mentioned.

- They could cap the STWF component as a share of the total. Caps have been used elsewhere to prevent anomalies in GSIB surcharge scoring (benefitting several U.S. GSIBs that have a larger role in the payment system).<sup>40</sup>
- A system indexed to absolute STWF would avoid the strange ratio effects exposed by the IHC group calculations. For example, a revised score could be indexed to outright STWF (with the BHC benchmark kept overall at current values). This would produce fair values for the IHCs and properly reflect their small amount of total short-term funding.
- Method 1 does not show the anomalies of method 2 when applied to FBOs; it was designed for international institutions and agreed to by the United States. If method 1 produced a result of 130 or greater, the institution could be legitimately grouped with the GSIBs, per Basel standards.

Any of these methods could be used to produce a result that groups the FBOs in a much more balanced way. Any of these would avoid the severe anomalies displayed by method 2 that result in a mischaracterization of the Specified FBOs.

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<sup>40</sup> The substitutability scores of a few U.S. GSIBs were seen to be disproportionately large, and the Bank for International Settlements capped them to prevent a disproportionate impact on the overall measure of systemic risk, saying that “the substitutability category had a greater impact on the assessment of systemic importance than was intended.” See Basel Committee, *Global systemically important banks: updated assessment methodology and the higher loss absorbency requirement* (July 2013), p.1, available at <http://www.bis.org/publ/bcbs255.pdf>.

## Appendix 2: Description of the Associations

### **The Bank Policy Institute**

The Bank Policy Institute is a nonpartisan public policy, research and advocacy group, representing the nation's leading banks and their customers. Our members include universal banks, regional banks and the major foreign banks doing business in the United States. Collectively, they employ almost 2 million Americans, make nearly half of the nation's small business loans, and are an engine for financial innovation and economic growth.

### **The American Bankers Association**

The American Bankers Association is the voice of the nation's \$18.6 trillion banking industry, which is composed of small, regional, and large banks that together employ more than 2 million people, safeguard \$14.5 trillion in deposits, and extend more than \$10.5 trillion in loans. Learn more at [www.aba.com](http://www.aba.com).

### **The Securities Industry and Financial Markets Association**

The Securities Industry and Financial Markets Association is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate for legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association ("GFMA"). For more information, visit <http://www.sifma.org>.