

**Meeting Between Staffs of the Federal Reserve Board, the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC), and The Goldman Sachs Group, Inc.
October 6, 2016**

Participants: Mark Van Der Weide, Peter Clifford, Kevin Littler, Rena Miller, Lesley Chao, Dafina Stewart, Adam Cohen, Brian Chernoff, and Josh Strazanac (Federal Reserve Board)

Henry Barkhausen, James Weinberger, Ang Middleton, Daniel Perez, David Malmquist, and David Stankiewicz (OCC)

Greg Feder, Suzanne Dawley, Eric Schatten, Andrew Carayiannis, and Nana Ofori-Ansah (FDIC)

Elisha Wiesel, Rajashree Datta, Faryar Shirzad, and Kyle Russ (Goldman Sachs)

Summary: Staffs of the Federal Reserve Board, OCC, and FDIC met with representatives of Goldman Sachs to discuss the notice of proposed rulemaking to establish the Net Stable Funding Ratio in the United States. Specifically, Goldman Sachs' representatives discussed (1) the treatment of variation margin in the proposed rule, (2) the available stable funding factors assigned to certain brokered deposits in the proposed rule, and (3) the requirement in the proposed rule that intercompany transactions not count towards a firm's available stable funding.

Attachment



Net Stable Funding Ratio

October 6, 2016

Agenda

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- I. Derivatives securities variation margin
 - II. Legal entity considerations
 - III. Deposits
 - IV. Public disclosure
 - V. Resolution guidance

Derivatives – Funding value of securities VM

- Under the NPR, a firm can reduce its derivatives asset value after accounting for variation margin that meets conditions of the U.S. Supplemental Leverage Ratio (SLR) rule
 - Cash variation margin that meets SLR conditions can reduce bank's derivative asset value, and is therefore assigned an RSF of 0%
 - However, **securities VM cannot reduce the bank's derivative asset value**. NPR is therefore assigning a 100% RSF factor to even high-quality UST securities VM, ignoring any funding value
- **Proposal:** Allow Level 1 securities VM received to reduce a bank's derivative asset value with appropriate haircuts in line with those of unencumbered assets held on the balance sheet, when a bank has the contractual and operational ability to rehypothecate the collateral
- The current treatment should be amended because it:
 - Ignores funding value of rehypothecatable securities, which can generate funding through a variety of means including sale and repo
 - Is inconsistent in NSFR framework, which assigns a 5% RSF to UST held unencumbered
 - Is inconsistent with LCR final rule, which assigns a 0% haircut to Level 1 HQLA
- A firm's funding requirement on a derivatives receivable can vary significantly depending on the type of collateral received and collateral management strategy used

	Scenario 1	Scenario 2	Scenario 3	Scenario 4
Derivative NPV	\$1.0bn	\$1.0bn	\$1.0bn	\$1.0bn
Collateral ¹	\$1.0bn USD cash	\$1.0bn USD cash	\$1.0bn UST	\$1.0bn UST
Use of Collateral Received	Invest in \$1.0bn UST	Reverse in \$1.0bn UST	Hold UST	Repo UST for Cash with a financial counterparty for <6 months
Implied RSF	5%	10%	100%	100%
Balance Sheet Treatment	<ul style="list-style-type: none"> ■ Derivative Receivable on B/S: \$0 ■ UST Firm Inventory on B/S: \$1.0bn 	<ul style="list-style-type: none"> ■ Derivative Receivable on B/S: \$0 ■ Reverse Repurchase Agreement (with a financial counterparty) on B/S: \$1.0bn 	<ul style="list-style-type: none"> ■ Derivative Receivable on B/S: \$1.0bn ■ Unencumbered USTs off B/S: \$1.0bn 	<ul style="list-style-type: none"> ■ Derivative Receivable on B/S: \$1.0bn ■ Cash on B/S: \$1.0bn ■ Repurchase agreement on B/S: \$1.0bn

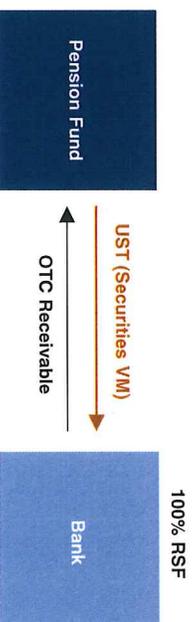
USTs given no funding value under Leverage Ratio netting in Scenarios 3 & 4

¹ Examples ignore collateral haircuts.

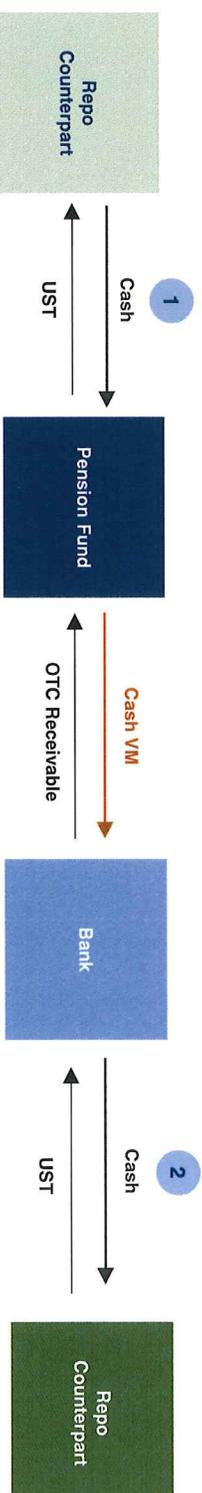
Derivatives – Funding value of securities VM

Potential impact

- NPR could incentivize increased interconnectivity among market participants and gross up firm's balance sheets
- Certain end users (such as pension funds) currently post securities collateral as variation margin on derivative contracts with banks. For example, they use USTs that deliver an investment return on the pension fund portfolio



- Many end users are constrained in their ability to post cash variation margin and may be negatively impacted by the exclusion of high quality securities collateral, such as USTs
- These end users may have to hold higher cash buffers or rely on the repo market as new entrants to transform their assets into cash collateral, and take on substantial new liquidity positions
- Under the proposed NSFR:
 - 1 Counterparties with securities collateral would have to execute additional secured funding transactions to convert securities to eligible cash collateral
 - 2 Banks would then have to execute additional transactions (e.g., reverse repos) for collateral management



Legal Entity Considerations

Calculation of Excess ASF

- In calculating the firm's consolidated ratio, the NPR allows a consolidated company to include "excess" ASF from subsidiaries only "to the extent the consolidated subsidiary may transfer assets to the top-tier [BANK], taking into account statutory, regulatory, contractual, or supervisory restrictions"
- The preamble requires that a consolidated subsidiary's **excess ASF should not include intercompany transactions that are netted on the consolidated firm's GAAP balance sheet**
- There are two examples of interpretations for how to calculate excess ASF, which differ in how capital held at a consolidated subsidiary is treated
 - Not including the consolidated subsidiary's capital in the ASF calculation (example 2) effectively implies that the subsidiary would be able to operate without any regulatory capital and have no restrictions on returning regulatory capital to the parent company
 - In addition if regulatory capital were excluded from the calculation, it would directly conflict with the proposal's requirement to consider Regulation W, which is based on a subsidiary's capital stock, and its restrictions on the transferability of returning assets to the top-tier holding company

Example 1:

NSFR (recognizing regulatory capital restrictions)

Bank subsidiary		Assets		RSF	Liabilities		ASF
	Loans (intercompany)	\$40	Capital				\$30
	Loans (external)	\$100	Deposits (external)				\$100
	Total	\$100	Total				\$130
			Excess ASF				\$30

Firm		Total ASF	Trapped ASF	Total ASF - Trapped ASF	Total RSF	NSFR ((Total ASF - Trapped ASF) / Total RSF)
		\$330	\$30	\$300	\$300	100 %

Example 2:

NSFR (ignoring regulatory capital restrictions)

Bank subsidiary		Assets		RSF	Liabilities		ASF
	Loans (intercompany)	\$40	Capital				\$30
	Loans (external)	\$100	Deposits (external)				\$100
	Total	\$100	Total				\$100
			Excess ASF				\$0

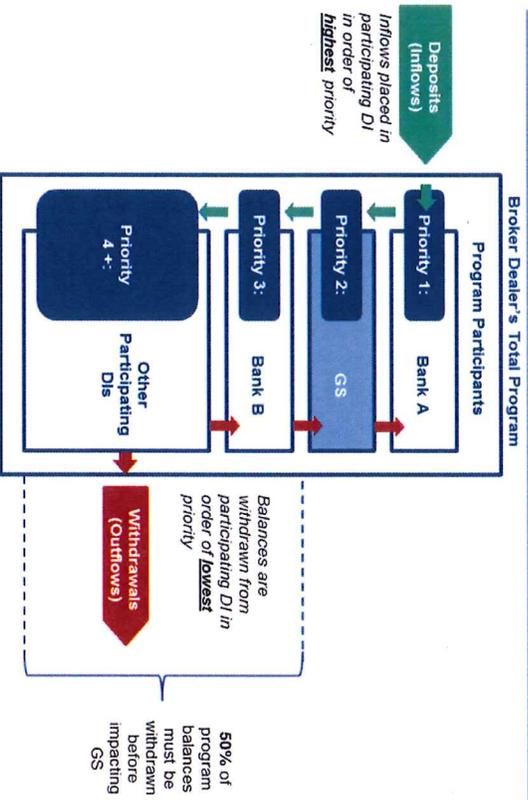
Firm		Total ASF	Trapped ASF	Total ASF - Trapped ASF	Total RSF	NSFR ((Total ASF - Trapped ASF) / Total RSF)
		\$330	\$0	\$330	\$300	110 %

Deposits

Non-Affiliate Brokered Sweep Deposits

- Under the NPR, 90% ASF is given to fully-insured, affiliate brokered sweep deposits and 50% ASF to non-affiliated brokered sweep deposits (regardless of deposit insurance coverage)
- In many cases, broker dealers provide contractual preferential treatment to non-affiliated banks
- For example, a bank placed near the top of a broker dealer sweep program's priority list would realize outflows only after a certain percentage of the program's balances are withdrawn

Illustrative Example



Proposed requirements for non-affiliate deposit sweeps to qualify for 90% ASF

Deposit Feature

- Firm would be prioritized ahead of other participating DIs in each broker's program by at least 50% of the total program size which would require a substantial outflow of deposits to occur before the firm realizes an outflow
- Firm can provide evidence that there would be at least 50% of balances prioritized below GS under each broker dealer's program
- Contractual specification evidencing firm's priority in the overall program of each broker dealer
- Contracts with sizable programs and long term in nature (> 1 year)

- Proposal:** Apply 90% ASF, regardless of affiliate status, to fully-insured deposits where a bank's structural priority results in no deposits outflows from the program unless 50% of the broker program balances are withdrawn

Deposits

Brokered Certificates of Deposits with Contractual Maturities Greater than 1 Year

- Under the NPR, a 90% risk factor is given to term retail deposits maturing greater than 1 year
 - This is inconsistent with the Basel rule that explicitly recognized 100% ASF for term deposits > 1 year
 - Funding with contractual remaining maturity > 1 year should receive 100% ASF
- Term deposits have specific contractual features that are not susceptible to franchise or reputation risks

Proposed requirements for CDs to qualify for 100% ASF

Deposit Feature

- Contractual Restrictions
 - Contractual specification that do not allow early withdraws prior to maturity (except for estate features)
 - Additionally, contractual specification that document brokers are not required to maintain a secondary market for the deposits, thus clients have no expectation that the firm will redeem the deposit prior to contractual maturity date
- Historical Evidence
 - Firm must demonstrate that they do not allow a client to redeem term deposits prior to maturity (other than estate features), even during a period of stress

- **Proposal:** Deposits with > 1 year term should receive 100% ASF, consistent with Basel NSFR, subject to meeting the above two criteria

Public Disclosure

- Under the proposed disclosure requirements, covered companies are required to disclose their NSFR on a spot basis at quarter-end
- Disclosure of a bank's average NSFR over the quarter would give market participants and regulators a more appropriate view of a firm's funding position over time, as spot metrics may vary across business dates
- Disclosure of a quarterly average would also be more consistent with other public liquidity disclosures, namely, the Agencies' proposed LCR disclosure requirements
- **Proposal:** Public disclosure of average NSFR each quarter

2017 Resolution Plan

Treatment of Pledged Assets under LCR

- **Background:** The resolution strategy of most US G-SIBs involves recapitalization of the operating subsidiaries prior to the parent's entry into bankruptcy so that the operating subsidiaries remain outside of proceedings
 - The 2017 Resolution Plan Guidance requires firms to consider mitigants to creditor challenges to the parent providing capital and/or liquidity support prior to the bankruptcy filing, including “the effectiveness of a contractually binding mechanism (CBM)”
 - To address the guidance that firms consider entering into a CBM, GS (and some other banks that file resolution plans) have been working with external counsel
 - Pursuant to the CBM, the parent would be contractually obligated to provide capital and **liquidity support (such as contribution of HQLA)** to certain material entities when trigger events leading up to a bankruptcy filing occur
 - If such an agreement were put in place, the parent's obligations to provide support pursuant to the CBM would be secured by assets to be contributed, including HQLA
- **LCR Rule Considerations**
 - “. . . [E]ligible HQLA must meet all of the following criteria: (1) The assets are unencumbered in accordance with the following criteria: (i) The assets are free of legal, regulatory, contractual or other restrictions on the ability of a Board-regulated institution to monetize the assets; and (ii) The assets are not pledged, explicitly or implicitly, to secure or to provide credit enhancement to any transaction” 12 C.F.R. § 249.22(b)(1)
- **Question:** If an asset of Group Inc. is pledged to a subsidiary pursuant to a CBM, may such asset be treated as unencumbered for purposes of identifying eligible HQLA under the LCR Rule?

Appendix

Legal Entity Considerations

Calculation of Excess ASF

- In calculating the firm's consolidated ratio, the NPR allows a consolidated company to include "excess" ASF from subsidiaries only to the extent a subsidiary can transfer the ASF taking into account restrictions (e.g., statutory, regulatory, contractual, or supervisory restrictions)
- "For available stable funding of a legal entity that is a consolidated subsidiary of a [BANK], including a consolidated subsidiary organized under the laws of a foreign jurisdiction, the [BANK] may include the available stable funding of the consolidated subsidiary in its ASF amount up to:
(1) The RSF amount of the consolidated subsidiary, as calculated by the [BANK] for the [BANK]'s net stable funding ratio under this part; plus
(2) Any amount in excess of the RSF amount of the consolidated subsidiary, as calculated by the [BANK] for the [BANK]'s net stable funding ratio under this part, to the extent the consolidated subsidiary may transfer assets to the top-tier [BANK], taking into account statutory, regulatory, contractual, or supervisory restrictions, such as sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371c and 12 U.S.C. 371c-1) and Regulation W (12 CFR part 223)."¹
- "Examples of restrictions on transfers of assets that a covered company would be required to take into account in calculating its NSFR include sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371c and 12 U.S.C. 371c-1); the Board's Regulation W (12 CFR part 223); any restrictions imposed on a consolidated subsidiary by state or Federal law, such as restrictions imposed by a state banking or insurance supervisor; and any restrictions imposed on a consolidated subsidiary or branches of a U.S. entity domiciled outside the United States by a foreign regulatory authority, such as a foreign banking supervisor."²
- Footnote 89 of the preamble requires that a consolidated subsidiary's excess ASF should not include intercompany transactions between consolidated subsidiaries that are netted on the consolidated firm's GAAP balance sheet
- "ASF amounts associated with a consolidated subsidiary, in this context, refer to those amounts that would be calculated from the perspective of the covered company (e.g., in calculating the ASF amount of a consolidated subsidiary that can be included in the covered company's consolidated ASF amount, the covered company would not include certain transactions between consolidated subsidiaries that are netted under GAAP). For this reason, an ASF amount of a consolidated subsidiary that is included in a covered company's consolidated NSFR calculation may not be equal to the ASF amount of the consolidated subsidiary when calculated on a standalone basis if the consolidated subsidiary is itself a covered company."³

¹ 81 Fed Reg. 35169

² 81 Fed Reg. 35155

³ 81 Fed Reg. 35155, FN 89.