January 31, 2014

Office of the Comptroller of the Currency
400 7th Street, S.W., Suite 3E-218
Mail Stop 9W-11
Washington, D.C. 20219
Attention: Legislative and Regulatory Activities Division
Docket ID OCC-2013-0016
RIN 1557 AD 74

Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, N.W.
Washington, D.C. 20551
Attention: Robert de V. Frierson, Secretary
Docket No. R-1466
RIN 7100-AE03

Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
Attention: Robert E. Feldman, Executive Secretary
RIN 3064-AE04

Re: Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring

Ladies and Gentlemen:

The Clearing House Association L.L.C., the American Bankers Association, the Securities Industry & Financial Markets Association, the Financial Services Roundtable, the Institute of International Bankers, the International Association of Credit Portfolio Managers and the Structured Finance Industry Group (collectively, the "**Associations**")[1] appreciate the opportunity to comment on the notice of proposed rulemaking by the Office of the Comptroller of the Currency (the "**OCC**"), the Board of Governors of the Federal Reserve System (the "**Federal Reserve**") and the Federal Deposit Insurance Corporation (the "**FDIC**" and, collectively, the "**Agencies**"), entitled *Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring* (the "**U.S. Proposal**").[2] In connection with the international liquidity standards ("**Basel LCR**") published by the Basel Committee on Banking Supervision

[1] Descriptions of the Associations are provided in Annex A of this letter.

[2] 78 Fed. Reg. 71818 (Nov. 29, 2013).

("**Basel Committee**"),[3] the notice proposes rules (the "**Proposed Rules**") that would implement the liquidity coverage ratio ("**LCR**") for banking organizations that are mandatorily subject to the advanced approaches risk-based capital rules, their respective consolidated subsidiary depository institutions with total consolidated assets greater than $10 billion, and nonbank financial companies designated by the Financial Stability Oversight Council for supervision by the Federal Reserve that do not have substantial insurance activities (collectively, "**Covered Banks**").[4]

We believe that the Basel LCR strikes an appropriate balance between accurately capturing liquidity risk and the concerns raised by banks in their comments leading up to the Basel LCR with respect to, among others, the measurement of that risk and the scope of oversight and related compliance requirements. Consequently, we are concerned that the U.S. Proposal deviates so significantly from the Basel LCR. These deviations detract from the goals of clarity and transparency across markets, competitive equality, and minimizing opportunities for regulatory arbitrage and the potential balkanization of national markets. Moreover, in some cases the deviations are so fundamental that they would impede liquidity regulation and related disclosure as a Pillar III market-discipline tool and create substantial technological challenges for Covered Banks with international footprints. We strongly believe that the LCR as implemented in the United States for Covered Banks should deviate from the Basel LCR in significant ways when, and only when, unique circumstances impacting the liquidity risk of Covered Banks warrants the deviation.

The effects of the divergence from the Basel LCR may be exacerbated because of the interplay among the host of new regulations relating to capital, leverage and other prudential standards. Throughout the development of the Basel III framework, its U.S. implementation and the implementation of the sweeping reforms in the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**"), we have consistently urged the Agencies to consider the cumulative impact of the changes across new regulations rather than evaluating any one particular regulation in

---

[3] The Basel Committee published the international liquidity standards in December 2010 (Basel III: International framework for liquidity risk measurement, standards and monitoring (December 2010)) ("**Proposed Basel LCR**") and revised the standards in January 2013 (Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools (January 2013)).

[4] The U.S. Proposal also would include a modified LCR (the "**Modified LCR**") as an enhanced prudential standard for bank holding companies and savings and loan holding companies domiciled in the United States with at least $50 billion in total consolidated assets that are not mandatorily subject to the advanced approaches risk-based capital rules and do not have substantial insurance activities. The term "**Covered Banks"** includes banking organizations subject to the Modified LCR, and references to and discussion of the "**LCR**" include the Modified LCR to the extent the Modified LCR incorporates the LCR's terms. When referring only to banking organizations subject to the Modified LCR, we use the term "**Modified Covered Banks**."

On a related topic, we are concerned that the Agencies do not in the Preamble discuss a central aspect of the proposal—that is, the calibration of the threshold for identifying "internationally active" institutions for purposes of the LCR. Although we do not, in this letter, take a position with respect to the proper scope of "internationally active" institutions for purposes of the LCR, we urge the Agencies to examine the proper calibration of the standard and, in the final rules, explain the threshold used and the rationale behind it.

isolation. We raise this concern again here because we anticipate the LCR requirements will interact with other rules in ways that may magnify the concerns raised by the U.S. Proposal, or those in other rulemakings. This bears special consideration in the implementation of an LCR requirement in part because of the relative novelty of a common LCR requirement, but also because the costs associated with liquidity regulation are uncertain and may not be fully understood.[5]

Consistent with our support for an internationally consistent LCR, we generally are not revisiting in this letter aspects of the Proposed Rules on which international regulators have already reached agreement as embodied in the Basel LCR, notwithstanding concerns on some of those aspects addressed in prior comment letters concerning the Basel LCR. There are, however, limited areas where aspects of the U.S. Proposal that are generally consistent with the Basel LCR nonetheless raise particular substantive concerns in light of the characteristics of markets and institutions that are specific to the United States. Except where warranted by circumstances that are unique or specific to the United States as discussed more fully herein (and apart from mere clarifications), we strongly urge the Agencies to align their final LCR rules for Covered Banks (the "**Final U.S. LCR**") with the Basel LCR and address material and significant changes that the Agencies believe are conceptually sound through the Basel Committee, with the objective of achieving international consensus and consistent implementation across jurisdictions, instead of adopting an LCR for Covered Banks that differs from international standards in material and significant ways.

Part I of this letter sets forth an executive summary of our comments; Part II addresses aspects of the U.S. Proposal that differ from the Basel LCR in ways that will have a significant impact on Covered Banks and market participants that are not justified by circumstances unique to the United States; Part III addresses the calculation of net cash outflows; Part IV addresses issues with respect to high-quality liquid assets ("**HQLA**"); Part V addresses operational and other issues not otherwise raised in this letter; Part VI identifies clarifications requested regarding the Proposed Rules; and Part VII responds to certain questions posed in the preamble to the Proposed Rules (the "**Preamble**").

I. Executive Summary

We strongly believe that the Agencies and other national regulators should diverge from the Basel LCR in implementing a short-term liquidity regime at the national level for banks intended to be covered by the Basel LCR only where unique and specific circumstances in the relevant jurisdiction warrant such differences. A credible short-term liquidity standard should be based on demonstrable and quantifiable liquidity risk, resulting in as accurate a measure of true liquidity needs under stressed conditions as possible. The introduction of any industry-standard liquidity requirement has the potential to cause market distortions and impact market liquidity. A lack of uniform standards across jurisdictions only serves to heighten such issues, as well as negatively affect competitive equity among firms, especially for banks with operations in multiple jurisdictions.

---

[5] Jeremy C. Stein, Member of the Board of Governors of the Federal Reserve System at the "Finding the Right Balance" 2013 Credit Markets Symposium sponsored by the Federal Reserve Bank of Richmond, Charlotte, North Carolina (April 19, 2013) (the "**Stein Speech**").

Accordingly, we believe that divergences from the Basel LCR should be justified by unique circumstances in the relevant jurisdictions whether arising from the activities conducted by Covered Banks in those jurisdictions, the nature of their funding sources or the markets in which, and financial systems within which, they operate ("**Country-Specific Circumstances**"). Otherwise, divergence poses a significant risk of undermining the implementation of a credible, realistic and effective LCR requirement. As set forth in further detail below, we believe there are several key areas in which the Proposed Rules differ from the Basel LCR in a manner that is not warranted by Country-Specific Circumstances. In addition, there are provisions where the Proposed Rules do not adequately take into account important specific aspects of the U.S. banking system, the structure of U.S. banking organizations and applicable U.S. laws or could otherwise create other significant issues for the U.S. banking industry.

- **The net outflow calculation should be modified to reflect more realistic treatment for non-contractual behavioral flows**. We recognize the merit of the "peak day" approach (that is, "the largest difference between cumulative inflows and cumulative outflows, as calculated for each of the next 30-calendar days after the calculation date")[6] to calculating net cash outflows. However, the Proposed Rules assume that all non-contractual deposits and commitments flow out on the first day of the 30-day calculation period, in effect converting the 30-day LCR measure to a peak "day 1" measure for some (if not most) Covered Banks. We believe that an empirically-based understanding of maturity mismatches is essential before a peak day approach is implemented. The Agencies should moderate the maturity assumptions as to the outflows of non-maturity deposits and commitments, either in accordance with an empirical evaluation of maturity behaviors or, in the absence of such evaluation, on a straight-line basis during the 30-day calendar period at least until such time as sufficient data has been received by the Agencies that clearly demonstrates the appropriateness of the conservative assumptions included in the Proposed Rules. As an alternative, the Basel LCR standard of using cumulative net cash outflows over the 30-calendar day stress period could be utilized until the Agencies have conducted the aforementioned empirical analysis of maturity behaviors.

- **The Proposed Rules' daily calculation requirement should be deferred.** As discussed in Part V.A, given that the LCR for Covered Banks is not yet finalized, it simply is not possible for Covered Banks to meet the required January 2015 deadline for daily calculations and disclosures with the requisite level of confidence in their accuracy. The internal operational burdens of daily LCR reporting are very substantial and should not be underestimated, particularly in light of increasing demands placed on the relevant resources at Covered Banks due to various reform efforts, including the Basel III capital rules, stress testing, resolution plans, "5G" for some banks and, most recently, Volcker Rule compliance. It would be imprudent from a supervisory perspective to adopt a standard that, due to its sheer complexity and lack of adequate time to properly prepare, risks providing regulators and the public with potentially flawed data. It may also be appropriate for the Agencies to reconsider the need for a daily requirement to calculate the LCR versus requiring that Covered Banks have the capability to calculate their LCRs at any

[6] Proposed Rules § 30.

time. To the extent that the Agencies feel that a monthly reporting requirement raises a concern that delay in recognizing and remediating shortfalls is a material risk, we urge the Agencies to work with each Covered Bank as a supervisory matter to address those concerns.

- **The operational deposit requirements of the Proposed Rules should be more closely aligned with the Basel LCR**. We strongly urge the Agencies to more closely align the treatment of operational deposits with the Basel LCR by revising the operational deposit requirements, as described in Part II.A.2 of this letter, particularly with respect to the scope of exclusions related to prime brokerage services and correspondent banking. The U.S. Proposal would unnecessarily exclude a wide range of deposits that are clearly operational in nature, substantially narrowing the scope of deposits recognized as operational under the Basel LCR without, in our view, an analytical or empirical basis for doing so.

- **The LCR should not separately apply to subsidiary depository institutions of U.S. bank holding companies**. We strongly urge the Agencies not to impose a separate LCR requirement on subsidiary depository institutions with $10 billion or more in consolidated total assets in recognition of the typical bank holding company structure, which is largely unique to the United States, and to avoid the potential for unnecessary "trapped liquidity" in a Covered Bank's subsidiaries. Eliminating the requirement at the subsidiary depository institution level would properly recognize that liquid assets within a corporate group should, subject to other applicable regulatory requirements such as Section 23A of the Federal Reserve Act and principles of safety and soundness, be used to satisfy liquidity needs (at least in a period of stress) elsewhere in the corporate group. Should the Agencies continue to have concerns with the liquidity positions of Covered Bank holding companies' depository institution subsidiaries, we believe the concern would be better addressed with a Pillar II supervisory approach.

- **The hypothetical unwind calculation for purposes of determining the amount of HQLA should not apply to deposits of U.S. municipalities that must be secured under applicable state law**. As discussed in Part II.A.5, the treatment of secured deposits of U.S. municipalities and public sector entities ("**PSEs**") as secured funding transactions that are subject to the requirement to calculate HQLA on an unwind basis leads to substantial negative distortions in the HQLA calculation under the Proposed Rules and is unjustified as such transactions do not pose a risk of manipulation that the unwind mechanic is meant to address. Consequently, we believe that the Agencies should eliminate the unwind requirement for municipal deposits as a U.S. country-specific circumstance. The pace at which such secured deposits flow out is generally not a function of the collateral held against the deposits, and therefore we recommend a constant outflow rate of up to 15% be applied to these deposits.

- **The definition of HQLA should be broadened using objective market criteria as the baseline.** The Agencies should reconsider, among others, the assignment of mortgage backed securities ("**MBS**") issued by Fannie Mae and Freddie Mac ("**Agency MBS**") to Level 2A status, at least while Fannie Mae and Freddie Mac are under conservatorship and benefit from the senior preferred stock purchase agreements with the U.S. Treasury Department. It is undeniable that

these securities have exhibited substantially similar market and liquidity characteristics as U.S. Treasuries and are in effect explicitly guaranteed by the U.S. government, which is consistent with the eligibility requirements for Level 1 liquid assets. Should the Agencies determine that Agency MBS remain at Level 2A status, at a minimum, Agency MBS should not be subject to the 40% cap on Level 2 assets, given the depth of their market liquidity and the 15% haircut to which they would continue to be subject.

- **Net cash outflows should be revised to reflect more realistic assumptions**. In addition, a credible liquidity buffer requires a realistic calculation of net cash outflows even under hypothetical stressed conditions. Part III of this letter details specific concerns with respect to the recognition of inflows and outflow under the Proposed Rules.

While this letter generally addresses LCR related topics thematically, this Executive Summary reflects our key concerns with the Proposed Rules. In doing so, we do not intend to lessen the significance or potential impact of the other matters addressed herein, but rather to focus the Agencies on the issues we believe are of critical importance in order to develop a credible, realistic and effective short-term liquidity regime in the United States.

II. Overarching Concerns

A. The Final U.S. LCR should differ in material and significant ways from international standards adopted through the Basel process only where the differences are warranted by unique circumstances affecting the liquidity risk of Covered Banks.

We recognize that national regulators (including the Agencies), in implementing the LCR for their jurisdictions, inevitably need to make adjustments from the Basel LCR and that some of those adjustments may be material. However, we strongly believe that the Agencies and other national regulators should diverge from the Basel LCR in implementing the LCR at the national level only where Country-Specific Circumstances warrant such differences. The Agencies note a similar standard in the Preamble's comment that:

> "The [A]gencies are proposing to establish a minimum liquidity coverage ratio that would be consistent with the Basel III LCR, *with some modifications to reflect characteristics and risks of specific aspects of the U.S. market and U.S. regulatory framework, as described in this [P]reamble."*[7]

Consistent with that standard, where the Agencies believe that Country-Specific Circumstances warrant modifications as compared to the Basel LCR, it is very important that they address those circumstances and explain why they warrant modifications. With the exception of the proposed accelerated implementation schedule (discussed in Part II.A.4, below), in a number of important areas the Agencies have not done so. Equally important, where the Agencies believe that the Basel LCR is not

[7] Preamble at 71821 (emphasis added).

sufficiently rigorous, we strongly believe that they should address the reasons for that belief and set forth support for the belief as a foundation for re-opening international discussions through the Basel Committee as opposed to first deviating from international standards in applying the LCR to Covered Banks in the United States.

There are four fundamental reasons why we strongly believe that the U.S. LCR should differ from the Basel LCR in material and significant ways only where warranted by Country-Specific Circumstances.

First, the financial crisis heightened the realization that liquidity regulation is of equal importance with capital regulation as the principal essential metrics that must be presented to market participants in a transparent and consistent way in order for markets, through investor behavior, to effectively perform their fundamental Pillar III role of disciplining risk-taking. Standards among jurisdictions that differ meaningfully for reasons other than Country-Specific Circumstances substantially impede the ability of markets to perform that function.

Second, important to the Covered Banks and we expect to the Agencies and other policy makers (including legislators), competitive equality across jurisdictions requires uniform standards.[8] HQLA, because they are high quality, are inherently lower-yielding than other potential assets. Requiring banks in different jurisdictions that hypothetically have identical operations to maintain substantially different levels of HQLA would impede banks' ability to compete by having a negative impact on earnings, return on equity, and the ability to raise capital. No two banks are identical, of course, and two banks that may have substantially similar balance sheet compositions but operate in different jurisdictions might nevertheless appropriately be subject to different standards because of Country-Specific Circumstances. But, in each case, those differences should be carefully considered, analyzed and explained, and divergences from a credible international process should only be made sparingly.

Third, many Covered Banks on a consolidated basis have international footprints that include significant subsidiaries in non-U.S. jurisdictions where national regulators are adopting their own version of the Basel LCR. The management and information technology challenges of applying different standards at the level of subsidiaries whose LCR impacts are also rolled-up into the consolidated U.S. parent are substantial. Foreign banking organizations with U.S. intermediate holding companies or depository institution subsidiaries subject to the Final U.S. LCR will have similar challenges in addressing the interplay between their home country standards and U.S. standards. Moreover, application by national regulators of standards that deviate materially and significantly from the Basel LCR, as the agreed international standard, can have the impact of trapping liquidity in some jurisdictions, impeding the overall prudential objective (or at least what we believe should be the overall prudential objective)

---

[8] The Basel Committee acknowledges the issue in the Basel LCR, noting in a discussion of the scope of application the objectives of ensuring "greater consistency and a level playing field between domestic and cross-border banks." Basel LCR ¶ 164. Similarly, the Agencies, in Question 22 of the Preamble, "seek comment on all aspects of the criteria for HQLA, including issues of domestic and international competitive equality." Preamble at 71830.

of enabling banking organizations to direct liquidity to the troubled members of their corporate groups in other jurisdictions during times of stress.

Fourth, the credibility of the Basel process itself rests heavily on international consistency except where warranted because of Country-Specific Circumstances. The ability of national regulators acting through the Basel Committee to agree on and apply a common approach in contexts that are so fundamental is an important component of preventing arbitrage between different jurisdictions and their regulatory regimes.

There are four key areas where we believe that the Proposed Rules differ from the Basel LCR in a manner that is so fundamental as to implicate the concerns outlined above and where we submit the differences are not warranted by Country-Specific Circumstances: (i) the "peak day" calculation of the total net cash outflow amount required by Section 30 as compared to the Basel LCR's cumulative calculation over the stress period; (ii) the treatment of operational deposits;[9] (iii) the separate application of the LCR to each depository institution that is a Covered Bank, even if the Covered Bank is itself a subsidiary of another Covered Bank, as well as any depository institution subsidiary of a Covered Bank that has $10 billion or more in consolidated total assets;[10] and (iv) Section 50's accelerated implementation of the LCR for Covered Banks as compared to the Basel LCR's implementation schedule.

One additional aspect of the Proposed Rules warrants additional consideration in light of Country-Specific Circumstances – namely, Section 21's requirement that HQLA be calculated on an adjusted as well as an unadjusted basis. Although this approach is conceptually consistent with the Basel LCR, it warrants additional clarification and refinement in one important respect – namely, the treatment of secured deposits of U.S. PSEs at Covered Banks. Such deposits, which are a Country-Specific Circumstance, pose very little risk of manipulation for the purpose of artificially inflating on-balance sheet HQLA, but their treatment under the LCR could result in significant reductions by PSEs in their ability to provide cost-effective public services to their citizens.

The additional discussion in this Part II.A addresses each of these areas in more detail.

1. We recognize the merits of a "peak day" approach to calculating net cash outflows. However, the Proposed Rules assume that all non-contractual instruments and commitments flow out on the first day of the 30-day calculation period, in effect converting the 30-day LCR measure to a peak "day 1" measure for some (if not most) Covered Banks. Development of an empirically based understanding of maturity mismatches is essential before a peak day approach is implemented. Moreover, we strongly believe that the peak day approach should be addressed first as an international standard and not just in the United States.

---

9 Proposed Rules §4(b) and related definitions in §1.

10 Proposed Rules § 1(b)(iii).

While total net cash outflows under the Basel LCR are calculated on a cumulative basis for the 30-calendar days following the calculation date,[11] the U.S. Proposal, in Section 30, provides that the total net cash outflow amount under the LCR is "the largest difference between cumulative inflows and cumulative outflows, as calculated for each of the next 30-calendar days after the calculation date," an approach we refer to herein as the "**peak day**" approach. A peak day approach inherently requires that assumptions be made as to when inflows and outflows occur on (i) liabilities and assets that do not have contractual due dates and (ii) liabilities and assets that, although they may have contractual due dates, also have options exercisable by the Covered Bank or its counterparty (e.g., a Covered Bank's extension or redemption right or a counterparty's put right). The Agencies note that the U.S. Proposal requires Covered Banks to "identify the maturity or transaction date that is the *most conservative* for an instrument or transaction… (that is, the earliest possible date for outflows and the latest possible date for inflows)."[12] The Agencies comment at some length in the Preamble on their reasons for adopting the peak day approach, stating that:

> "it is necessary because it takes into account potential maturity mismatches between a covered company's outflows and inflows, that is, the risk that a covered company could have a substantial amount of contractual inflows late in a 30-calendar day stress period while also having substantial outflows early in the same period."[13]

We agree that a peak day approach, if thoughtfully and appropriately implemented, could potentially provide a more granular measurement of daily liquidity risk than the Basel LCR's 30-calendar day cumulative approach. However, it should only be implemented as an international standard and with a full understanding (and where necessary, accommodation) of its challenges and consequences and the risks it is addressing, after reasonable empirical analysis and in a uniform manner across jurisdictions. If the peak day approach were implemented as set forth in the Proposed Rules, for some (and perhaps most) Covered Banks the LCR would effectively become a one-day calculation, with the peak day customarily being the first day of the 30-calendar day calculation period. We strongly believe that the peak day approach should not be implemented as set forth in the Proposed Rules, supported by the following three considerations.

First, the Proposed Rules' maturity provisions embed assumptions that on their face cannot be correct and would naturally overstate near-term liquidity risk. They appear to require that all non-maturity instruments and balances (including demand deposits, funding and other commitments and derivatives) and all retail deposits (irrespective of whether they are demand deposits or term deposits, and in the case of term deposits irrespective of whether the maturity is more than 30 days from the calculation date) be treated as withdrawn on the first day of each 30-calendar day rolling period.[14] Any

---

[11] Basel LCR ¶ 69.

[12] Preamble at 71834 (emphasis added). The operative section of the Proposed Rules is Section 31.

[13] Preamble at 71833.

[14] The assumption concerning first-day withdrawal of demand deposits and other non-maturity instruments and balances is reflected in column A of Table 1 in the Preamble at 71834. The Proposed Rules themselves do not

(continued…)

LCR rules addressing a peak day approach must, to be credible, address real world practicalities. One thing is certain in all events – all outflows for non-maturity instruments and balances will not and cannot occur on the first day of each 30-calendar day rolling period. Even if the unrealistic assumption were made that all funds providers would choose to withdraw non-maturity deposits on day 1 and all customers would choose to borrow the maximum amounts of their facilities on day 1 (perhaps contrary to their own commercial interests), operational limitations make it unfeasible for banks to effect such enormous transfers on day 1. To illustrate with real world examples, (i) the current supply of cash and coins maintained by a bank is based upon historical transaction data, and branches maintain a supply for business as usual ("**BAU**") activity, with replenishment limited to availability of armored cars operated by third-party service providers; (ii) with respect to non-cash transactions, branches are staffed for BAU activity and can only support a specific amount of transactions above BAU levels, ATMs are limited to specific dollar amounts by customer per day, wire transfers and ACH require two days to set up, and transactions are limited to pre-determined levels by account type; and (iii) while outflows of non-operational deposits can occur within a few days of a stress event, the timing of operational deposit outflows within a 30-day window is constrained by the ability of a customer to move an operating business and to move operating balances from a bank provider. Implementation of a credible peak day approach requires a reasonable calibration of outflows and inflows that falls between first-day and last-day extremes that cannot and would not happen.

Second, the peak day approach's exaggerated one-day outflow assumption discredits the concept of holding non-cash HQLA. No market is deep enough to absorb in one day the volume of HQLA that the one-day outflow assumption implicitly requires. It would be imprudent for a Covered Bank to put that amount of HQLA into the market in a single day, and the impact on markets would be huge. If followed to its logical conclusion, this results in an assumption that banks will be required to hold their HQLA in the form of cash because monetizing non-cash HQLA in a single day is impossible absent Federal Reserve support in the form of buying HQLA, which is inconsistent with other goals of regulatory reform.

(…continued)

clearly address this, unless the Agencies' intent is that Section 31(a)(1)(i) of the Proposed Rules, in addressing a funds provider's "option that would reduce the maturity" of a deposit, intends to encompass non-maturity (i.e., demand) deposits. We had not read paragraph 86 of the Basel LCR, which is the Basel LCR's counterpart to Section 31 of the Proposed Rules, to encompass non-maturity instruments and balances. Similarly, it is not entirely clear whether the Agencies intend that Covered Banks assume, in doing their peak day calculations under the LCR, that all retail deposits are withdrawn on day 1. However, that assumption seems to flow from Section 32's application of outflow rates to retail deposit categories irrespective of their maturities. Finally, the Proposed Rules' treatment of non-maturity assets (e.g., a Covered Banks' right to demand repayment of a loan to a corporate customer on any date—a demand note) is not clear. If we are correct that Section 31 corresponds to paragraph 86 of the Basel LCR and, accordingly, addresses only instruments having defined due dates, then we expect the Proposed Rules, like the Basel LCR, permit Covered Banks to make reasonable determinations as to the inflow dates for non-maturity assets. We would appreciate the Agencies providing guidance on this point in the Final U.S. LCR or related Preamble.

Third, there is no Country-Specific Circumstance relevant to Covered Banks that makes it more or less pressing that concerns as to daily maturity mismatches be addressed for Covered Banks as compared to banks in other jurisdictions.

Accordingly, we urge the Agencies to withdraw the Proposed Rules' peak day approach and, in their initial adoption of an LCR for Covered Banks, to conform to international standards by using cumulative net cash outflows over the 30-calendar day stress period. If the Agencies believe the peak day approach should be pursued, we strongly believe it should be developed and analyzed for application as an international standard and urge the Agencies to work with other national regulators participating in the Basel Committee process toward that end. In that connection, it is essential that the Agencies and other national regulators develop an empirically based understanding of any maturity mismatches within the Basel LCR's 30-calendar day horizon that may pose risk not otherwise addressed by other regulations, including prudent risk management strategies required by Section 165. Without that information, it is impossible to know whether the arbitrary assumptions, incremental data gathering and reporting burdens of the peak day approach are warranted by the risk that implementation of the approach would address.

Were the Agencies nevertheless to move forward with some version of a peak day approach for Covered Banks without the benefit of consensus by national regulators (including the Agencies) around a common set of parameters and assumptions, we believe it is absolutely essential that the Agencies moderate the maturity assumptions as to the outflows of non-maturity instruments and commitments. The analytically sound way to deal with the maturity assumptions is in fact to do an empirical analysis and then calibrate the outflow rates relative to historical experience if deemed necessary. Absent an empirical analysis and the availability of any better approach, we urge the Agencies to revise the Proposed Rules' peak-day methodology such that affected non-maturity instruments and commitments are assumed to produce outflows or inflows on a straight-line basis during the 30-calendar day period.

2. The U.S. Proposal's treatment of operational deposits narrows the Basel LCR's approach in important respects and, as a consequence, fails to fully and adequately recognize the scope of operational deposits generated by clearing, custody, cash management and trustee activities. We strongly believe the Agencies should make the modifications described below to more closely align their approach with the Basel Committee's standard.

The Proposed Rules' treatment of operational deposits[15] incorporates significant differences from the Basel LCR that we believe are not justified by Country-Specific Circumstances unique to the U.S. These differences – for the most part incorporated in Section 4(b)'s requirements for operational deposits – substantially narrow the scope of deposits with strong operational dependencies that the Basel LCR recognizes as operational, particularly deposits associated with the provision of core

[15] The relevant provisions are the definitions of "operational deposit" and "operational services" in §2, the operational requirements in §4(b), and the outflow rates in §§ 32(h)(3) and 32(h)(4).

safekeeping and asset administration service by banks providing custodial services. The Agencies note in the Preamble's discussion of operational deposits:

> "The criteria for a deposit to qualify as operational are intended to be restrictive because the [A]gencies expect these deposits to be truly operational in nature, meaning that they are used for the enumerated operational services relating to clearing, custody, and cash management and have contractual terms that make it unlikely that a counterparty would significantly shift this activity to other organizations within 30 days."[16]

We believe the objective articulated by the Agencies is generally appropriate. However, we also strongly believe that achieving this objective does not require the introduction of standards that materially and significantly deviate from the Basel LCR. As proposed, the U.S. LCR excludes a wide range of deposits that are clearly operational in nature and that would qualify as operational deposits under the Basel LCR. Accordingly, we strongly urge the Agencies in implementing the Final U.S. LCR to more closely align the treatment of operational deposits with the Basel Committee's standard.

Operational Requirements. The following changes should be made to Section 4(b)'s requirements for operational deposits, addressed in the order of the sub-paragraphs in Section 4(b).

Paragraph(b)(1) – written agreement. Paragraph (b)(1) specifies that the "deposits must be held pursuant to a legal binding agreement…" This language confuses the contractually binding agreement that must accompany the operational service to which the operational deposits relate, as opposed to documentation for the deposit itself. Similarly, the notion in paragraph (b)(1) of withdrawal penalties tied to changes in deposit balances as opposed to a customer's "switching" costs arising from the termination of the agreement under which operational services are provided (and the related change in operational service providers) is inapposite;[17] it rests on the incorrect assumption that operational deposit balances associated with operational services will not vary, including on a day-to-day basis. Furthermore, it is not clear whether the term "withdrawn"[18] refers to the withdrawal of deposits in the ordinary course of the bank's performance of operational services, or only to a discrete withdrawal of deposits by the customer. Periodic variances in the balances associated with operational services are a normal consequence of day-to-day operational activities and do not warrant higher outflow rates. As

---

16 Preamble at 71841.

17 In addition, in many instances, operational services cannot as a practical matter be moved within 30 days irrespective of contractual terms, notice periods and penalties due to functional barriers. We propose to work with the Agencies to develop supporting empirical data with respect to the foregoing.

18 Paragraph (b) (1) states: "The deposit must be held pursuant to a legally binding written agreement, the termination of which is subject to a minimum 30-calendar day notice period or significant termination costs are borne by the customer providing the deposit if a majority of the deposit balance is *withdrawn* from the operational deposit prior to the end of a 30-calendar day period." Proposed Rules at 71859 (emphasis added).

reflected in the Basel LCR,[19] it is the operational service that must be provided pursuant to a legally binding agreement, and the termination of that agreement must either require at least 30-days' prior notice or result in significant switching costs for the customer.[20] Accordingly, we urge the Agencies to revise paragraph (b)(1) to read as follows:

> "(b)(1) The operational services to which the deposit relates are provided pursuant to a legally binding written agreement, and either (i) termination of such agreement must be subject to a notice period of at least 30 days or (ii) significant switching costs (such as those related to transaction, information technology, early termination or legal costs) must be borne by the customer if the [BANK's] provision of operational services is terminated before 30 days."

Paragraph (b)(2) – volatility. Paragraph (b)(2) requires that there "must not be significant volatility in the average balance of the deposits." We believe this paragraph should be deleted for two reasons. First, we are unsure as to how the Agencies reconcile the concepts of "significant volatility" and "average balances". Because averages incorporate by definition variations within the prescribed calculation period, average balances are not easily reconcilable with significant volatility. As such, we are concerned that this language could disqualify deposits based on normal fluctuations in deposit balances due to the nature of the operational services provided, rather than to other factors, such as the customer's perception of the financial condition of the Covered Bank. Ordinary course changes in balances arising from the underlying operational services should not preclude treatment as operational deposits. Second, any concern that changes in operational deposit balances are not related to the underlying operational service is addressed by paragraph (b)(6)'s exclusion of "excess deposits" and is therefore not necessary here.

Paragraph (b)(4) – primary purpose. Paragraph (b)(4) requires that the customer "must hold the deposit at the [BANK] for the primary purpose of obtaining the operational services" provided by the Covered Bank. We strongly believe that the appropriate way to address purpose, and more generally the relationship between operational services and operational deposits, is to disqualify excess deposits – i.e., those that cannot be "empirically linked to the operational services".[21] We believe it would be very difficult to devise a reasonable and consistently applied additional (and hence unnecessary) standard to address this nexus based on "purpose", and we note that the Basel LCR does not have a "primary

---

19 Basel LCR ¶ 94.

20 The Basel LCR uses the term "switching costs" to accommodate that the financial disincentive for a customer changing service providers is not just a termination fee that the customer may be required to pay the old service provider but also (and we believe more significantly) encompasses the costs borne by the customer directly—"such as those related to transaction, information technology, early termination or legal costs." Basel LCR ¶ 94.

21 Proposed Rules at 71859.

purpose" test.[22] Accordingly, we strongly urge the Agencies to delete paragraph (b)(4) from the Final U.S. LCR and rely on Paragraph (b)(6) for the disqualification of excess deposits. If the Agencies believe that the excess amount standard in paragraph (b)(6) is not sufficient, then we urge the Agencies to replace paragraph (b)(4) with language that uses the same terms that the Basel Committee used in paragraphs 93 and 94 of the Basel LCR, for example: "(4) The customer is reliant on and has a substantive dependence on the [BANK] to perform the operational services and the deposit is necessary for the services."

Paragraph (b)(6) – excess amount. This paragraph, like paragraphs 96 and 97 of the Basel LCR (albeit with somewhat different language), disqualifies from operational deposit status "any excess amount" that the bank cannot demonstrate, using a "methodology" developed by the bank, is "empirically linked" to the operational services. The industry endorses this standard based on the reasonable presumption that this approach is not intended to require, as a supervisory matter, that this demonstration be made on a deposit-by-deposit or account-by-account basis. It is industry practice for banks that are significant providers of operational services to assess the composition and stability of their operational deposits on an aggregated basis, generally by customer type or service category. This reflects the normal day-to-day flow of operational activities within client accounts, which results in variability that can accurately be measured only on an aggregated basis. It would be useful, in this respect, if the Agencies were to confirm either in the Preamble or in other commentary accompanying the Final U.S. LCR that the empirical assessment of excess operational deposits is not intended to be applied on a deposit-by-deposit or account-by-account basis.

Paragraph (b)(7) – prime brokerage. We understand that the Basel Committee and the Agencies intend to exclude deposits relating to prime brokerage services from the scope of operational deposits due, among others, to concerns that "such balances… are at risk of margin and other immediate cash calls in stressed scenarios and have proven to be more volatile during stress periods."[23] The U.S. Proposal seeks to address this concern in paragraph (b)(7) by excluding from the scope of operational deposits <u>any</u> deposits provided in connection with the provision of <u>any</u> operational services to a broad range of entities – specifically "an investment company, non-regulated fund, or investment adviser."

While we understand the Agencies' concern regarding deposits arising from prime brokerage services, we believe that the proposed approach based on client type is severely flawed because it preemptively captures broad swaths of deposit activities arising from operational services that are wholly unrelated to prime brokerage services.

---

[22] The Basel LCR indicates, in ¶ 95, that qualifying operational deposits "are by-products of the underlying services provided by the banking organisation and not sought out in the wholesale market in the sole interest of offering interest income." If the intention of paragraph (b)(4) is to capture this requirement, we urge the Agencies to do so by simply reciting the Basel LCR's by-product standard in the preamble to the Final U.S. LCR and not address the point by adding a primary purpose test.

[23] Basel LCR ¶ 99; Preamble at 71841-71842.

For example, this approach would capture employee compensation payroll services provided to an investment fund complex – clearly not a prime brokerage service, even if prime brokerage services were otherwise offered to the fund complex. For banks providing custodial services, this broad approach based on client type would capture deposit balances arising out of their core safekeeping and asset administration services to, among others, U.S. mutual funds and their foreign equivalents, necessary to support the day-to-day management of investment portfolios. This includes access to global settlement and payment systems to facilitate the settlement of financial transactions. This also would include various asset servicing and cash management functions, such as processing income payments, tax reclamations, foreign currency transactions, the movement of client collateral and the facilitation of fund subscriptions and redemptions. Whereas the custody of assets is incidental to the prime broker business model, which focuses instead on the facilitation and financing of client trading activity, the custody of assets is central to the business model of banks providing custodial services. We strongly believe that this distinction must be recognized in the Final U.S. LCR, so that operational deposits derived from the provision of clearing, custody and cash management activities, as defined in the Basel LCR are not summarily disqualified as operational deposits.

We believe it is essential that the Agencies correct this overly broad exclusion by focusing on prime brokerage services rather than general client types. This approach is consistent with the Basel Committee's standard that deposits arising out of the "provision of prime brokerage services"[24] are excluded, and not all deposits arising out of operational services provided to various customer types, including U.S. mutual funds and their foreign equivalents. We have suggested below a definition of "prime brokerage services" that could be used for this purpose. Specifically, we suggest as an appropriate definition, based in part on existing regulatory standards and the language in footnote 42 of the Basel LCR, the following:

> "'**Prime brokerage services**' means a package of services provided by a [BANK] under a contractual arrangement whereby the [BANK], among other services, clears, settles, carries, and finances transactions entered into by a client with the [BANK] or a third-party entity (such as an executing broker), and where the [BANK] has a right to use assets provided by the client, including in connection with the extension of margin and other similar financing of the client, subject to applicable law."

Paragraph (b)(7) should thus specify, in a manner consistent with the Basel LCR, that "The deposit must not be provided in connection with the [BANK]'s provision of prime brokerage services."

Paragraph (b)(8) – correspondent banking. Similar to our concern with the scope of the exclusion relating to prime brokerage services, paragraph (b)(8)'s implementation of the Basel LCR's exclusion of deposits arising out of correspondent banking[25] potentially casts an excessively broad net and deviates from the Basel LCR. Paragraph (b)(8), by referring to deposits where "the respondent

---

[24] Basel LCR ¶ 99.

[25] Basel LCR ¶ 99 and note 42.

temporarily places excess funds in an overnight deposit with" the bank, is a broader exclusion than the Basel LCR's exclusion. The Basel LCR defines correspondent banking (and related deposits that are not operational) as "arrangements under which one bank (correspondent) holds deposits owned by other banks (respondents) and provides payment and other services in order to settle foreign currency transactions."[26] The Proposed Rules do not expressly limit correspondent banking services to foreign currency settlement and would cover a much broader range of deposits that are truly operational in nature. We therefore ask the Agencies to clarify that paragraph (b)(8) applies only to deposits provided in connection with correspondent banking services where the bank provides payment and other services to settle foreign currency transactions, consistent with the Basel LCR. If the Agencies exclude from operational deposit status a broader scope of correspondent banking deposits, the expenses for banks in taking on those deposits (resulting from the liquidity costs associated with the higher applicable outflow rate) have the potential to severely limit core cross-border and domestic clearing services that enable safe and efficient routing of payments both globally and domestically. Such treatment could result in significant limitations on services available to individuals trying to send money across borders and higher costs for such services.

As the Agencies are aware, correspondent banking is a critical service that banks provide to other, usually smaller, financial institutions, and is not limited to settling foreign currency transactions. In the correspondent-respondent relationship, a respondent bank relies on the expertise and efficiency of a correspondent bank to provide essential services, such as operational functions, lending, capital and liquidity management, information technology ("**IT**"), and international payments.[27] The respondent bank clients of a correspondent bank often do not have sufficient resources to engage in a particular service or product without the support of a correspondent bank. Accordingly, respondent banks have a critical dependency on the correspondent bank for correspondent services, and that critical dependency is what makes the deposits stable and warrants their inclusion in operational deposits to the extent they meet Section 4's other criteria for operational deposit status.

Clarification of Definitions of Operational Deposits and Operational Services. In general terms, the U.S. Proposal seeks to mirror the Basel Committee's determination that the types of deposits that are considered operational, and hence entitled to a more favorable outflow rate, are those arising out of

---

[26] Basel LCR ¶ 99 note 42.

[27] In particular, these services involve the following activities and supervisory metrics: **operational functions** such as electronic item processing, image cash letter check clearing, safekeeping, wires, ACH, ATM networking lockbox, and credit cards; **capital** through bank holding company financing; **lending** through the facilitation of participation loans, bank holding company loans, and letters of credit; **liquidity** through the provision of federal fund lines of credit used to facilitate payments in the form of checks, DTC, securities transactions, and government remittances; **risk management and technology** through community bank system redundancy, backup facilities, hot sites, cold sites, imaging, and access to state-of-the-art technology; **international operations and payments,** including foreign item clearing, supplying foreign currency, foreign exchange, and international letters of credit.

clearing, custody and cash management activities.[28] As a drafting matter, the Agencies propose to implement these provisions by including in the U.S. Proposal definitions of both "operational deposit" and "operational services."[29] Although we believe that the Agencies' approach, for the most part (and except as otherwise discussed in this letter), captures the appropriate scope of operational deposits and services, we believe there are a handful of important clarifications and modifications that should be incorporated into the definitions.

First, with respect to the definition of "operational deposit," we recommend that the Agencies clarify the several capacities in which a bank may act as a service provider. This would involve the addition of the terms "agent or administrator" after the phrase "third-party intermediary" in the definition. We also suggest that the agencies replace the word "required" with the word "necessary" at the beginning of the definition of operational deposit in order to make clear that the deposits are functionally necessary as opposed to contractually required. Accordingly, the revised definition of "operational deposit" under the Final U.S. LCR should be:

> "'***Operational deposit***' means unsecured wholesale funding that is necessary for the [BANK] to provide operational services as an independent third-party intermediary, agent or administrator to the wholesale customer or counterparty providing the unsecured wholesale funding. In order to recognize a deposit as an operational deposit for purposes of this part, a [BANK] must comply with the requirements of § __.4(b) with respect to that deposit."

Second, with respect to the definition of "operational services," we request that the Agencies clarify the scope of covered services to better reflect the day-to-day activities performed by banks engaged in custodial activities not otherwise addressed in the Proposed Rules. This involves:

- including at the end of paragraph (6) the phrase "and foreign exchange transactions";
- including in the lead in to the definition an explicit reference to "'trustee' services"; and
- adding four new sub-categories of enumerated services, namely "administration of investment assets", "collateral management services" and "corporate trust services".

Accordingly, the revised definition of "operational services" under the Final U.S. LCR should be:

> "'***Operational services***' means the following services, provided they are performed as part of cash management, clearing, custody, or *trustee* services: (1) Payment remittance; (2) Payroll administration and control over the disbursement of funds; (3)

---

[28] Proposed Rules §3.

[29] Proposed Rules §3.

Transmission, reconciliation, and confirmation of payment orders; (4) Daylight overdraft; (5) Determination of intra-day and final settlement positions; (6) Settlement of securities transactions *and foreign exchange transactions*; (7) Transfer of recurring contractual payments; (8) Client subscriptions and redemptions; (9) Scheduled distribution of client funds; (10) Escrow, funds transfer, stock transfer, and agency services, including payment and settlement services, payment of fees, taxes, and other expenses; (11) Collection and aggregation of funds; (12) *Administration of investment assets*; (13) *Collateral management services*; and (14) *Corporate trust services*."

3. It is very important that, in fashioning the Final U.S. LCR, the Agencies recognize the typical bank holding company structure, which is specific to the United States, and avoid the potential for unnecessary "trapped" liquidity in a Covered Bank's subsidiaries. The Proposed Rules' application of the LCR to each depository institution that is subject to the advanced approaches (even if it is a subsidiary of a Covered Bank), and each depository institution subsidiary of an advanced approaches holding company having $10 billion or more in consolidated total assets, as well as certain other aspects of the Proposed Rules' treatment of inflows and outflows among and between subsidiaries and a holding company, have the potential to result in that outcome.

The Proposed Rules expand on the Basel LCR's provisions dealing with corporate groups and the interplay among their affiliates in important and inappropriate respects.

First, where the Basel LCR provides that the LCR "should be applied to all internationally active banks on a consolidated basis" and contemplates that corporate groups may include subsidiaries that are subject to the LCR but does not specify a standard for application of the LCR to subsidiaries, the Proposed Rules provide that (i) any depository institution that is subject to the advanced approaches is a Covered Bank, even if the institution is a subsidiary of a holding company that itself is a Covered Bank, and (ii) any depository institution subsidiary of an advanced approaches holding company having $10 billion or more in consolidated total assets itself is subject to the LCR**.**

Second, the Proposed Rules expand, we believe largely as a matter of clarification, on the Basel LCR's discussion of calculation of inflows and outflows between and among subsidiaries and between subsidiaries and the parent Covered Bank for purposes of calculating its consolidated LCR, principally in Sections 32(h)(2), 32(m) and 33(h) of the Proposed Rules. These provisions of the Proposed Rules may nonetheless adversely impact intragroup funding capabilities for a Covered Bank, including by unnecessarily trapping liquidity in certain subsidiaries.

The corporate structure of banking organizations in the United States is unique as compared to most other countries, with U.S. banking groups – and, we believe, all of the advanced approaches entities that would be subject to the LCR by virtue of the proposed $250 billion/$10 billion total consolidated assets or foreign exposure thresholds – operating through a holding company structure, with the bank holding company having multiple subsidiaries, including in many cases multiple bank subsidiaries. The reasons for this common structure derive from the historical provisions in U.S. banking

laws (albeit now largely removed) prohibiting banks from branching across state lines and imposing divisions between banking and other financial services (including securities and insurance). This common structure for U.S. financial groups as compared to banks in other countries is, we believe, a Country-Specific Circumstance that should be taken into account in fashioning a Basel III-based LCR in the United States. We strongly believe that the bank holding company structure in the United States, with its deeply embedded intragroup funding model, warrants special consideration by the Agencies in their treatment of corporate groups, including some differences from the Basel LCR.

Addressing in order each of the topics identified at the beginning of this Part II.A.3:

First, we urge the Agencies to reconsider whether the objective of prudent liquidity risk management for bank holding companies that are advanced approaches Covered Banks subject to the full LCR ("**Covered Bank Holding Companies**") is meaningfully advanced by requiring that depository institution subsidiaries of Covered Bank Holding Companies that themselves are subject to the advanced approaches or have $10 billion or more in consolidated total assets, be subject to the LCR. We strongly believe it is not. Adding an additional subsidiary-level calculation imposes an incremental layer of conservatism on the significant conservatism inherent in the LCR's acutely stressed assumptions and would trap liquidity in the subsidiary without allowing the strength of the holding company structure to prevail. Such an approach is inconsistent with a global funding model and is more likely to increase microprudential and systemic liquidity risk than to promote liquidity risk management. Entities subject to the LCR or other liquidity requirements[30] inevitably will be incentivized to maintain buffers above their own minimum liquid asset requirements, both in order to avoid supervisory concerns and sanctions and to address concerns that market participants may attach exaggerated significance to the entity approaching or temporarily falling below its minimum requirement. The fact that many Covered Bank Holding Companies' consolidated assets are held predominately in their subsidiary depository institutions demonstrates further that requiring calculation of the LCR separately at the parent and the subsidiary depository institution is unnecessary to further the purposes of the LCR.

Trapped liquidity – whether in U.S. depository institution subsidiaries, other U.S. subsidiaries (e.g., broker-dealers) or non-U.S. subsidiaries[31] – is a major concern. If liquidity were the only issue and sound liquidity risk management practices were to prevail, liquid assets within a corporate group could be used to satisfy liquidity needs (at least in a period of stress) anywhere in the corporate group and irrespective of which entity in the corporate group experiences the stress and needs the liquidity. In a holding company structure, a natural way to implement that flexibility would be to rely on the holding company as the natural repository for liquid assets, with the holding company having the ability to place liquid assets in subsidiaries as and when needed.

---

30 *See* the discussion in Parts III.L and IV.F of liquidity requirements applicable to broker-dealers and derivatives clearing organizations.

31 Section 22(f)'s requirement, discussed in Part III.D of this letter, reflects the Agencies' concern with this issue insofar as trapping HQLA outside of the United States is concerned.

Imposing an automatic requirement that certain depository institution subsidiaries of Covered Bank Holding Companies are subject to the LCR, particularly as to depository institutions in the United States, is unnecessary, and its liquidity-trapping consequences raise both prudential and management concerns. Covered Bank Holding Companies, like all bank holding companies, historically had been expected as a matter of regulatory policy, and as a result of Dodd-Frank are now required by statute, to act as a source of strength for their depository institution subsidiaries. We are aware of no basis for concern that the source of strength doctrine is limited to capital resources and does not include liquidity resources.

Should the Agencies continue to have concerns with the liquidity positions of Covered Bank Holding Companies' depository institution subsidiaries, we believe the concern could adequately be addressed with a Pillar II supervisory approach that would not have the negative liquidity trapping and inefficiencies posed by a separate application of the LCR to these subsidiaries. Such a supervisory approach would take into account HQLA that a Covered Bank Holding Company has committed to contribute or loan to depository institution subsidiaries upon request.[32] For example, assume a depository institution has a net cash outflow amount of $100 in its stand-alone LCR calculation. In this case, such institution could rely on a combination of (i) HQLA that it and its consolidated subsidiaries own directly (both central bank deposits and HQLA – eligible securities) and (ii) liquidity that its parent Covered Bank Holding Company has committed to provide.[33] Such an approach would permit the Covered Bank Holding Company to maintain at its level resources that could be directed to appropriate subsidiaries in times of need and would be consistent with the identification of defined liquidity groups and waivers permitted in other jurisdictions if certain conditions are met.[34]

Second, we believe the Agencies should re-examine the treatment in Sections 32(h)(2), 32(m) and 33(h) of funding provided by and among a Covered Bank (including a Modified Covered Bank) that is a holding company and its subsidiaries or between subsidiaries. In particular:

- We believe the Agencies' objectives should be, as to a Covered Bank (whether a parent bank holding company or a subsidiary depository institution that itself is subject to the LCR), to specify that the Covered Bank (i) does not treat as an outflow (applying the appropriate outflow rate) funding where the provider of the funding

---

[32] If a Covered Bank Holding Company were to make a loan of HQLA (whether cash or securities) to a depository institution subsidiary for this purpose, such loan would be taken into account by the subsidiary in its net cash outflow calculation in the same manner as any other loan from the Covered Bank Holding Company.

[33] If the Agencies are concerned that a depository institution may overly rely on its parent for HQLA, the Final U.S. LCR could require that the depository institution maintain a minimum absolute amount or percentage of HQLA in its own or its subsidiaries' name.

[34] *See* the UK Prudential Regulatory Authority's BIPRU §§12.8.7 to 12.8.21, addressing intra-group liquidity modifications, available at http://fshandbook.info/FS/html/handbook/BIPRU/12/8. The European Banking Authority's Capital Requirements Directive IV and Capital Reporting Regulations allow for similar waivers from application of the LCR to a subsidiary entity if a top-tier bank holding company is subject to the LCR and certain other conditions are met.

(i.e., the creditor) is a subsidiary of the Covered Bank, (ii) symmetrically with the treatment of outflows owing to subsidiaries, does not treat as an inflow amounts owing to the bank (as the provider of the funding – i.e., the creditor) from a subsidiary of the bank, and (iii) does not treat as an outflow or inflow from the bank funding provided by one consolidated subsidiary of the bank to another consolidated subsidiary of the bank.

- In order to implement those objectives, the language in Section 32(h)(2), beginning with the word "including," should be deleted. It is inconsistent both with the objectives outlined above and with Section 32(m)(1). Accordingly, Section 32(h)(2) would provide in the Final U.S. LCR: "100 percent of all unsecured wholesale funding that is not an operational deposit and is not included in paragraph (h)(1) of this section."

4. The Agencies should not accelerate the implementation of the LCR for Covered Banks as compared to the Basel LCR's implementation schedule unless an empirically based understanding of the HQLA of Covered Banks under the Agencies' Final U.S. LCR shows that an accelerated timeframe is warranted based on the status of Covered Banks' compliance.

One of the areas in which the U.S. Proposal is more stringent as compared to the Basel LCR is the accelerated implementation timeframe. Under the U.S. Proposal, Covered Banks would be required to comply with the LCR by maintaining a minimum LCR of 80% by January 1, 2015 and 100% by January 1, 2017. By contrast, under the Basel LCR, a Covered Bank would not be required to maintain a 100% LCR until January 1, 2019. And, although the Basel LCR provides that the phase-in begins on January 1, 2015, the scheduled phase-in on that date begins with a 60% LCR, not an 80% LCR.[35] The Agencies cite as the basis for this acceleration "the strong liquidity positions many U.S. banking organizations and other companies that would be subject to the proposal have achieved since the recent financial crisis."[36]

To the extent Covered Banks are in fact in substantial compliance with the LCR requirement in substantially the form it will be implemented in the United States, that fact may be a Country-Specific Circumstance that justifies early implementation. At this point, however, such a determination would be premature as data collected to date from Covered Banks has been based on the requirements reflected in the Basel LCR. Based on the substantial differences between the U.S. Proposal and the Basel LCR discussed in this Part II and in other parts of this letter, the Covered Banks' distance from compliance with the LCR, if implemented in accordance with the Proposed Rules, may be materially different than those reflected in the data that has been collected. Due to the significant nature of certain of the divergences from the Basel LCR, including, for example, application of the LCR requirement on a standalone basis to subsidiary depository institutions with $10 billion or more in

---

35 Basel LCR ¶10.

36 Preamble at 71821.

consolidated assets, calculation of the LCR under the peak day approach, and the requirements surrounding operational deposits, we expect that the shortfall of Covered Banks may well exceed the Agencies' estimate of $200 billion.

In recognition of these deviations from the Basel LCR, we request that the Agencies defer any accelerated implementation until an empirically based understanding of the differences between the Basel LCR and the U.S. Proposal has been developed. Once that analysis has been completed and the Covered Banks' true distance from compliance (if any) can be accurately gauged, the Agencies can then determine whether accelerated implementation is justified based on the Covered Banks' degree of compliance.

5. The treatment of secured deposits of U.S. municipalities and PSEs as secured funding transactions may impair the ability of Covered Banks to provide this critical service.

(a) The calculation of HQLA for purposes of the LCR should not apply to the hypothetical unwind of deposits of U.S. municipalities that must be secured under applicable state law.

Under the U.S. Proposal, the amount of HQLA for purposes of the LCR is based on the assumed unwind of "any secured funding transaction, secured lending transaction, asset exchange, or collateralized derivative transaction that matures within 30-calendar days of the calculation date and where the [BANK] and the counterparty exchange HQLA."[37] The Basel LCR has a similar requirement with respect to "short term secured funding, secured lending and collateral swap transactions involving the exchange of any HQLA…"[38] The stated purpose of this mechanism is generally "to prevent a covered company from having a substantial amount of transactions that would create the appearance of a significant Level 1 liquid asset amount at the beginning of the 30-day stress period, but would unwind by the end of the 30-day stress period."[39] The core focus of this issue as set forth in the U.S. Proposal appears to be "certain repurchase and reverse repurchase transactions"[40] – presumably due to the fairly ready ability to finance higher quality HQLA on the balance sheet through posting lower quality HQLA to a counterparty given the depth and scope of the U.S. repurchase/reverse repurchase market. The Basel LCR echoes this concern as it explicitly references "short term securities financing transactions"[41] in this context. While we acknowledge that there may be transactions and arrangements which could give rise to this issue, we urge the Agencies also to recognize that certain

---

37 Proposed Rules, §§21(f)(1), (2) and (3).

38 Basel LCR ¶ 48; Basel LCR Annex 1, ¶ 4.

39 Preamble at 71832.

40 *Id*. at 71831.

41 Basel LCR ¶ 48; Basel LCR Annex 1, ¶ 1.

other arrangements which would seemingly be covered by a literal reading of the Proposed Rules do not in fact pose any material risk of a Covered Bank "manipulat[ing] its HQLA portfolio."[42]

In particular, we do not believe that deposits of U.S. municipalities that under applicable state law[43] must be collateralized with liquid assets by the relevant depository institution should be covered by the unwind mechanism of Section 21(f) because these deposits are fundamentally different in nature than typical secured funding transactions normally entered into by banks and pose very little risk of manipulation for purposes of the LCR and the pool of HQLA. As recognized in the Federal Deposit Insurance Act (the "**FDIA**"),[44] the laws of various states require that the deposits of certain municipalities and other PSEs must be "secured or collateralized" by the insured depository institution which holds such deposits. The amount of such deposits in the U.S. is significant, totaling approximately $443.6 billion as of September 2013.[45] These types of secured deposit arrangements are a critically important component of the suite of banking products provided by the banking industry to PSEs. Under a literal reading of Section 21(f) of the Proposed Rules, these secured deposits could be deemed "secured funding transactions" from the perspective of the Covered Bank which would mature within 30 days based on the maturity assumptions of Section 31[46] because such arrangements are generally demand deposits. Accordingly, we request that, if the Agencies determine to apply the unwind requirement of Section 21(f) to all secured funding transactions, at a minimum, the Final U.S. LCR exclude such secured deposits from this calculation for the reasons discussed below.

First, secured municipal deposits are significantly different in nature than other types of secured funding transactions where banks, at their discretion, seek funding to finance their trading securities inventory from money market funds and other broker-dealers in the wholesale funding markets. From the perspective of a depository institution, secured municipal deposits are fundamentally first and foremost *deposits* where the customers, in this case various municipalities, seek to place their funds on deposit at the bank. Moreover, these deposits tend to be stable, exhibiting relatively low volatility, and institutions use more stable portfolio collateral (as opposed to trading assets) to secure these types of balances. While literally "secured funding" for purposes of the Proposed Rules, municipal deposits are simply not the type of transactions susceptible to the risk of manipulation that the U.S. Proposal and the Basel LCR apparently were focused on in this context as discussed above. In addition, as discussed further below, empirical evidence indicates that, even during times of macroeconomic stress affecting the banking industry such as the 2008 financial crisis, secured deposits of PSEs generally experience only low withdrawal rates. Given the major differences between municipal deposits, on the one hand, and more traditional securities financing transactions, on the other hand, we do not believe these deposits pose the HQLA overstatement risks identified by the U.S. Proposal. It is exceedingly difficult to accept

---

42 Preamble at 71831.

43 *See e.g.*, Ohio R.C. §§ 135.18, 135.181 and 135.37; 72 P.S. §§ 505 and 3836-1 *et seq.*

44 *See* 18 U.S.C. 1831(m)(4).

45 Based on data available from SNL Financial LC.

46 *See also*, Proposed Rules at 71862.

that a Covered Bank would deliberately attempt to raise greater amounts of municipal deposits in an effort to increase the amount of higher quality HQLA on its balance sheet for LCR purposes. These deposits are an integral part of a particular line of business and the effect on the HQLA calculation is an incidental consequence of the unwind formula and a potential overly-literal reading of Section 21(f) of the Proposed Rules. To the extent the Agencies have any residual concerns regarding manipulation risk with respect to secured deposits, these could be more than adequately dealt with through the supervisory and examination process for Covered Banks, as well as under the liquidity related provisions of the Federal Reserve's forthcoming enhanced prudential supervision rules implementing Sections 165 and 166 of Dodd-Frank.[47]

Second, discouraging Covered Banks from providing secured deposit services to U.S. municipalities and other PSEs appears contrary to public policy goals. If secured deposits are indeed required to be unwound for purposes of the HQLA calculation, institutions subject to the Proposed Rules may have a strong incentive to stop offering these products for PSEs altogether because of the highly negative impact on their LCR calculations (as illustrated by the example in Annex B, *infra*). Without ready and cost effective access to banking services to manage their funds and operational deposits, many U.S. municipalities could have substantial practical difficulties in continuing to provide critical public services to their citizens, meeting their payroll for public servants and more generally paying their day-to-day bills. We firmly believe this was not an intended consequence of the U.S. Proposal.

Third, the prevalence of U.S. state laws requiring that the deposits of U.S. municipalities and other PSEs be collateralized clearly constitutes a Country-Specific Circumstance. Although, as discussed above, we do not believe that either the U.S. Proposal or the Basel LCR were intended to address these types of secured deposit arrangements for purposes of the unwind calculation set forth therein, we nevertheless recognize that the Basel LCR language could technically be read to cover these as "secured funding."[48] However, even if the United States were somehow to be deemed to be departing from the text of the Basel LCR, we submit that doing so in the case of secured deposits by U.S. municipalities and other PSEs is amply warranted as a Country-Specific Circumstance reflecting "characteristics and risks of specific aspects of the U.S. market."[49]

The example in Annex B, infra (using the illustrative methodology set forth in Part II.A.5.c of the Preamble), of the Proposed Rule's HQLA calculation concretely demonstrates the significant and, in our view, unjustified potential decrease on a Covered Bank's adjusted HQLA amount if secured municipal deposits are actually required to be unwound for purposes of that calculation.[50] In this example, the

---

47 *See* 77 Fed. Reg. 594 (Jan. 5, 2012); 77 Fed. Reg. 76628 (Dec. 28, 2012).

48 *See* Basel LCR ¶112.

49 Preamble at 71821.

50 In reality, of course, municipal depositors bear very little risk with respect to these deposits because they are, in fact, collateralized.

hypothetical unwind of the Covered Bank's secured municipal deposits[51] would result in a *negative* HQLA amount for purposes of calculating the LCR despite the fact that the institution in this example actually has ample liquidity in the form of Level 1 assets and unencumbered Level 2 assets (net of applicable haircuts). For the reasons stated above, this is clearly an ill-advised result within both the LCR framework and from a public policy perspective.

If the Agencies nevertheless determine to subject secured municipal deposits to some form of unwind mechanic for purposes of the HQLA calculation under Section 21 of the Proposed Rules, we urge that the Final U.S. LCR permit the use of the applicable LCR outflow assumption under Section 32 of the Proposed Rules, subject to the proposed maximum of 15% and irrespective of the type of collateral being utilized as described in Part II.A.5.b below, when performing the unwind calculation. For example, when calculating the unwind amount, a Covered Bank should be permitted to assume that only up to 15% of the secured deposit is withdrawn. We believe this treatment would be justified as a Country-Specific Circumstance because secured municipal deposits in the U.S. context are a fundamentally different type of secured funding due to the particular requirements of U.S. state law and an unwind of such deposits for purposes of the HQLA calculation would presumably only occur if and to the extent the deposit is withdrawn and a resulting outflow of cash and increase in HQLA, if any, occur. While imperfect, utilizing these outflow assumptions for purposes of the unwind calculation would serve to somewhat ameliorate the impact of this issue. Thus, applying the equivalent run-off factor to the HQLA secured funding transaction unwind calculation would provide for symmetry between the two calculations where each is logically predicated on an unwind or outflow, as applicable, occurring.

(b) Secured municipal deposits should be assigned a lower outflow rate of no more than 15%.

Under Section 32(j) of the Proposed Rules, the assigned outflow rates for secured municipal deposits range from 0% to 100% depending on and to the extent of the type of assets, including HQLA, which collateralizes the secured funding transaction in question. However, bank call report data suggests that, even during the financial crisis for the quarters ending December 31, 2007 through September 30, 2009, peak secured municipal deposit run-off rates generally did not exceed approximately 15%.[52] We believe this data is reflective and this behavior is a justified and rational outgrowth of the protected status of secured deposits under the FDIA in case of the resolution of the relevant depository institution, as well as the U.S. state laws that limit the type of collateral that may be pledged to secure these deposits. Thus, we urge the Agencies to assign an outflow rate of no more than 15% for purposes of the Final U.S. LCR to all secured deposits of U.S. municipalities and other PSEs as a Country-Specific Circumstance due to applicable U.S. state laws in this area and the relevant provisions of the FDIA.

---

[51] We also note that the issue of potentially negative HQLA amounts resulting from the application of the Section 21 calculations can also arise from the unwind of other types of secured funding transactions.

[52] We would be happy to work with the Agencies to develop and refine this empirical analysis.

B. As in other areas of regulatory reform, it is exceedingly important that the Agencies analyze the interplay between implementation of the LCR in the United States and other regulatory initiatives – particularly proposed changes to the Basel III-based supplementary leverage ratio – that may work at cross-purposes with each other.

A key challenge for the Agencies and other regulators, including securities and commodities regulators within the United States as well as banking and other functional regulators in other countries, has been to anticipate and accommodate the interaction among and between macroprudential initiatives. As they pertain to U.S. banks, the scope of the reforms required by Dodd-Frank's legislative mandates, are extraordinary and unprecedented since the 1930s. The importance of meeting this challenge, both for regulators and those subject to these regulations, has been discussed in nearly all of our prior commentary on the major capital, liquidity, commodities and securities reforms.[53] Among the initiatives that most substantially and directly affect, or are affected by, the Proposed Rules are (i) the Basel Committee's recently finalized, and the Agencies' outstanding proposed, amendments to the Basel III supplementary leverage ratio (addressed in our comment letters and data studies referred to in footnote 53), (ii) the Commodity Futures Trading Commission's (the "**CFTC**") recently issued final rules relating to liquidity requirements for derivatives clearing organizations, discussed below in Part III.N. and (iii) liquidity rules proposed by the Securities and Exchange Commission ("**SEC**") for broker-dealers and security-based swap dealers using the alternative net capital definition, discussed below in Part IV.F. Each of these initiatives works at cross-purposes with the LCR by, directly or indirectly, encouraging or requiring banks or their subsidiaries to hold assets or incur liabilities or commitments that would have the impact of, all else being equal, lowering a Covered Bank's LCR.

We urge the Agencies, at the least, to be mindful of these competing pressures as they consider our comments on the Proposed Rules, and to work with the SEC, CFTC and other relevant regulators to ensure that collectively they have a common understanding of the interplay and tensions between and among their regulatory initiatives.

III. Net Cash Outflows

A. The Agencies' Final U.S. LCR should follow the Basel LCR's approach to the undrawn portion of multi-purpose commitments and should not default to treatment as a liquidity facility.

---

[53] *See*, *e.g.*, letter and empirical data study from The Clearing House Association to the Federal Reserve, the FDIC and the OCC regarding Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and Their Subsidiary Depository Institutions (October 21, 2013), The Clearing House Association, *Assessing the Supplementary Leverage Ratio* (September 20, 2013) available at https://www.theclearinghouse.org/publications/2013/20130920-supplemental-leverage-ratio-study; letter from the American Bankers Association, Financial Services Roundtable and Securities Industry and Financial Markets Association to the Fed, the FDIC and the OCC regarding Proposed Supervisory Guidance on Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and their Subsidiary Insured Depository Institutions (October 21, 2013).

Section 32(e)(2) of the Proposed Rules would treat the undrawn amount of a commitment that has aspects of both credit and liquidity facilities as a liquidity commitment. Under paragraph 128 of the Basel LCR, by contrast, the undrawn amounts of a commitment that exceed the amount of debt issued by the customer (or the proportionate share, if a syndicated facility) maturing within a 30-calendar day period that is backstopped by the facility is treated as a committed credit facility. As a consequence of the Proposed Rules' default classification as a liquidity facility as opposed to a credit facility, undrawn amounts under multi-purpose committed facilities are subject to higher outflow rates under the U.S. Proposal than under the Basel LCR in almost all cases.

The Agencies do not explain in the Preamble the concern that prompted this divergence from the Basel LCR. We believe that the outflow rates assigned to both committed credit and liquidity facilities already are conservative, with outflow rates that are many times the actual drawdown rates experienced by stressed banks during the recent financial crisis.[54] The conservatism built into the assigned outflow rates should be adequate to accommodate even the crisis scenario underlying the LCR. In addition, this treatment of multipurpose committed facilities may undermine some of the very goals of the LCR and other related regulatory efforts. The default to treatment as a liquidity facility may lead to a shift in the market towards specifying the purpose of a facility or limiting the use of proceeds to ensure that a committed facility may be treated as a credit rather than a liquidity commitment. Although a market shift in this direction may help address LCR compliance considerations for Covered Banks, such a shift could be detrimental from a safety and soundness and financial stability perspective because greater specificity in the purpose of a facility could in fact limit much needed flexibility in times of market stress. We believe that the conservatism already built into the outflow rates for credit facilities sufficiently accommodates draws on multipurpose committed facilities regardless of the purpose for which a customer may actually draw on the facility under the market stress scenario reflected in the LCR.

B. An outflow rate for the undrawn amount of committed credit and liquidity facilities extended to certain special purpose entities ("SPEs") should be applied on a "look-through" basis to the underlying customer of the Covered Bank.

The 100% outflow rate assigned to the undrawn amount of all committed credit and liquidity facilities extended to SPEs under Section 32(e)(1)(vi) of the Proposed Rules is overly broad.[55] The 100% outflow rate could curtail the ability of Covered Bank customers to provide cost effective financing to their customers and impair Covered Banks' ability to diversify the funding of their customers' daily business, with consequences for such customers' potential to invest in new growth initiatives and create jobs. We request that the Agencies reconsider the assumption of a 100% drawdown rate for committed credit and liquidity facilities for all SPE facilities and instead apply an outflow rate on a look-through basis to the underlying customer for transactions in which an SPE acts as a borrower under a

---

[54] *See* The Clearing House Association, *The Basel III Liquidity Framework: Impacts and Recommendations* (Nov. 2, 2011).

[55] *See also* our comments in Part IV.I of this letter regarding the scope of the definition of SPE.

securitization credit facility to finance the receivables owned by a corporate entity (a "**bank customer securitization credit facility**"), consistent with the proposal submitted by the Securities Industry & Financial Markets Association ("**SIFMA**") and the Structured Finance Industry Group ("**SFIG**") in their comment letter on the Proposed Rules (the "**SIFMA/SFIG Letter**").[56] That is, the outflow assumption for such transactions should be based on the outflow rate under the Proposed Rules for a credit commitment to the corporate customer that formed the SPE—50% for depository institutions, depository institution holding companies or foreign banks; 40% for regulated financial companies, investment companies, non-regulated funds, pension funds, investment advisers or identified companies; and 10% for other wholesale customers. Only bank customer securitization credit facilities that meet the specific criteria detailed in the SIFMA/SFIG Letter, which are designed to ensure that a credit facility is in fact a substitute for, or complement to, a traditional revolving credit facility that the bank would otherwise extend to the underlying customer, would be assigned an outflow rate on this "look through" basis.

As described in greater detail in the SIFMA/SFIG letter, application of a uniform 100% outflow rate to all SPEs would have a detrimental impact on the pricing and availability of working capital that Covered Bank customers access through bank customer securitization credit facilities.

C. A Covered Bank's notional balances under Fannie Mae and Freddie Mac loan standby programs ("GSE standby programs") should be treated as inflows.

The Proposed Rules would not permit a Covered Bank to include inflows that it expects, or is contractually entitled to receive, within the next 30 calendar days from forward sales of mortgage loans, or any credit or liquidity facilities extended to the bank, under GSE standby programs. Based on the nature of the commitments provided by Fannie Mae and Freddie Mac under GSE standby programs and the creditworthiness of Fannie Mae and Freddie Mac themselves, we recommend that the Final U.S. LCR permit each Covered Bank to include 100% of its notional balances[57] under GSE standby programs as an inflow.

A participant in a GSE standby program provides a list of eligible loans retained on the participant's balance sheet to Fannie Mae or Freddie Mac and pays a fee to receive the option to sell a loan to Fannie Mae or Freddie Mac to create Agency MBS pass-throughs and a guarantee to reimburse the participant for losses on the loans subsequent to when the loans are included in the standby program but prior to the time they are securitized. Unlike a warehouse facility which involves the

---

[56] We also share the concerns expressed in the SIFMA/SFIG Letter regarding the potential effects of the U.S. Proposal on securitization markets. In this regard, we support the proposals in the SIFMA/SFIG Letter that a structured transaction that meets the definition of "traditional securitization" under the Agencies' regulatory capital rules should not be treated as an outflow (i) if the Covered Bank does not consolidate the issuing entity on the bank's balance sheet or (ii) if consolidated, does not provide credit or liquidity support to the transaction.

[57] By "notional balances," we mean the principal amount of the loans subject to the forward sale. Under the GSE standby programs, the cash purchase price customarily is the principal amount of the sold loans.

counterparty risk of a non-government-sponsored enterprise and the potential that loans will not close or will have incomplete loan documents, the GSE standby programs include only closed and funded loans with the liquidity option provided directly by Fannie Mae and Freddie Mac. Since the terms and conditions are established when the loans enter the standby program, these loans are always eligible to be delivered to Fannie Mae and Freddie Mac regardless of credit deterioration, and thus offer on-demand liquidity. Fannie Mae and Freddie Mac do not require external funding to convert the loan to a security.

D. The outflow rates for a Covered Bank's debt securities and structured securities should be established by the Covered Bank, reflecting that Covered Banks may take different approaches to addressing franchise risk.

Section 32(i) of the Proposed Rules includes a requirement that a Covered Bank recognize the outflow associated with its own debt securities where the Covered Bank is the "primary market-maker" in its own securities.[58] We recognize that during times of market stress, a Covered Bank, as the primary market-maker in its own debt securities, may decide to provide liquidity to the market and, therefore, repurchase its debt or structured securities without an offsetting transaction. We believe, however, that the outflow rates of 3% of all debt securities and 5% for all structured securities are too high. Although these outflow rates may seem low in isolation, when the amount of outstanding securities of a Covered Bank is taken into account (which may increase as a result of other regulatory initiatives), even a small outflow rate may result in a material outflow number, which we do not believe is realistic. It would be more appropriate to allow each Covered Bank to make its own determination regarding its likely response to reputational risk rather than mandating a uniform approach. At a minimum, however, the 3%/5% outflow rates should be reduced.

Although the Basel LCR recognizes that for issuers with an affiliated dealer or market-maker there may be a need to include an amount of the outstanding debt securities (unsecured and secured, term as well as short-term) with maturities greater than 30 calendar days to cover the potential repurchase of such securities,[59] we note that other jurisdictions have not proposed a similar outflow rate for a Covered Bank acting as a primary market-maker in its own securities.[60] Even if the Agencies determine that some outflow rate is appropriate, there are factors that support lower outflow rates. The actual volume of repurchases may be lower than the proposed outflow rates would suggest because many investors will not want to have their securities repurchased at a price that reflects the stressed environment in which repurchases would occur, which may in turn entail recognition of a significant

---

58 Proposed Rules §32(i).

59 Basel LCR ¶ 140. Basel LCR ¶ 86 also provides that "supervisors should take into account reputational factors that may eliminate a bank's ability not to exercise" an option, with a non-binding market-making function being the equivalent of an option.

60 *See* Office of the Superintendent of Financial Institutions Canada, Draft Guideline: Liquidity Adequacy Requirements—Liquidity Coverage Ratio (November 2013) ¶ 120.

loss. In addition, investors often acquire structured securities as a hedge, which may make them less inclined to be willing to liquidate the positions.

Since the assumptions underlying the LCR are unique, we believe there is no historical data available to demonstrate the degree to which a Covered Bank that acts as primary market-maker in its own securities would provide liquidity to the market under those assumptions. Furthermore, given the stress scenario reflected in the LCR, a Covered Bank may well be as or less likely, rather than more likely, to buy back its securities. It is also important to be mindful that the effect of an outflow rate that is applied to all issued debt and structured securities may be even more pronounced in light of other regulatory initiatives that are likely to result in Covered Banks' being required to issue more debt.[61]

Finally, the scope of debt securities subject to Section 32(i) should be modified to apply an outflow rate only to senior unsecured debt of the Covered Bank in which it is the primary market-maker. Excluding subordinated debt is appropriate because of the regulatory capital implications that the repurchase of such debt securities would have for the Covered Bank. With respect to structured securities, to the extent that a Covered Bank's offering documents disclose that it is not obligated to provide liquidity for such securities, the securities should not be subject to an assumed outflow rate.

E. The approach to determining maturities under the Proposed Rules is overly conservative in certain respects and should be modified to reflect more realistic and rational outcomes.

1. Covered Banks and their wholesale counterparties should be assumed to act rationally with respect to exercising a right to reduce the maturity of an instrument, and wholesale counterparties should be assumed to abide by their contractual obligations.

The Preamble provides that, under Section 31 of the Proposed Rules, a Covered Bank must "identify the maturity or transaction date that is the most conservative for an instrument or transaction in calculating inflows and outflows (that is, the earliest possible date for outflows and the latest possible date for inflows)."[62] We understand the reasons for the conservative approach to determining maturities, but certain of the assumptions in Section 31 are completely at odds with actions a Covered Bank or its wholesale counterparties would take, even under (and, in some cases, especially under) the stress assumptions underlying the LCR. To align the maturity assumptions more closely with realistic outcomes, a Covered Bank should be permitted to assume that it and its counterparties will act rationally when determining whether to exercise a right to reduce the maturity of an instrument and should therefore have the option to include more realistic assumptions in its LCR calculation.

---

61 *See, e.g.*, Daniel K. Tarullo, Member, Board of Governors of Federal Reserve System, Speech at Peterson Institute for International Economics: Evaluating Progress in Regulatory Reforms to Promote Financial Stability (May 3, 2013) (addressing need for certain bank holding companies likely to be resolved under Title II to increase loss absorbency).

62 Preamble at 71834.

Furthermore, it should be assumed that wholesale counterparties will abide by applicable notice periods.

Although we agree that a conservative approach to determining maturities is appropriate, a conservative approach should not require a Covered Bank to assume that it or its counterparties do not act in a prudent or rational manner, taking into account the interests of its shareholders and in keeping with any fiduciary requirements. Other than stating that a Covered Bank should take the most conservative approach, the Preamble does not explain the rationale for requiring that a Covered Bank assume that its counterparties will exercise rights to reduce the maturity of an instrument at the earliest possible date and that the Covered Bank will not exercise its options to reduce the maturity of an instrument at the earliest possible date. This approach does have the benefit of simplicity, and may be useful as a default approach, but it does not reflect the dynamic liquidity management engaged in by Covered Banks and the commercial realities of market participants acting in a prudent manner. As discussed in Part II.A.1, these maturity assumptions will almost certainly result in overstated liquidity requirements for Covered Banks, which may have adverse market effects while also potentially contributing to highly inaccurate peak day calculation results, as previously discussed.

Furthermore, permitting a Covered Bank to develop its own assumptions that are based on realistic outcomes rather than mandating that all Covered Banks use the most conservative assumptions for determining whether it or its counterparty will exercise a right to reduce the maturity of an instrument is unlikely to result in an understated liquidity requirement. Any concerns with the maturity assumptions that a Covered Bank makes in this regard may be addressed through the supervisory process.

In determining maturities, a Covered Bank should not be required to disregard a contractual notice period with respect to an option as would be required under Section 31(a)(1)(iii). Wholesale counterparties should be assumed to be sophisticated counterparties that can understand and do in fact abide by contractual terms relating to notice periods. We do not believe that during the recent financial crisis wholesale counterparties even routinely asked for notice periods to be waived, much less that they were in fact waived. Taking into account the more acute stress scenario underlying the LCR, we would anticipate that even if the incidence of wholesale counterparties requesting a waiver were to increase, a Covered Bank would be less likely to grant such a waiver.

Finally, for many types of instruments notice periods cannot be waived (and certainly not in full) because the notice period provides the needed time to make the arrangements for payments to be made. For example, for many instruments, including debt securities, notice periods are necessary to ensure that operational arrangements can be put in place on behalf of the necessary contractual parties, such as paying agents and depositories. In some cases, a notice period ensures sufficient time for the performance of any actions or valuations required to make a payment. Waiver of notice periods, therefore, is unlikely as a practical matter regardless of any other pressures a Covered Bank may face.

2. A Covered Bank's right to redeem long-term debt after the lapse of the applicable no-redemption period (customarily five or ten years after initial

issuance) should not be considered an option that a Covered Bank would be assumed to exercise.

Section 31(a)(2)(i) of the Proposed Rules requires that, if a Covered Bank has an "option" that would "extend the maturity" of an obligation it has issued, the Covered Bank must assume that it will not exercise that option. We do not believe that this requirement is meant to require a Covered Bank to assume the exercise of its right to redeem long-term debt after the initial no-redemption period (customarily five or ten years after initial issuance) has lapsed. Exercise of an early redemption right shortens, not extends, the maturity. However, because a Covered Bank could be viewed as extending the maturity of its long-term debt by not exercising its right to redeem long-term debt that is currently redeemable, we request that the Agencies clarify the treatment either in the Final U.S. LCR or the accompanying preamble.

The Basel LCR does not explicitly address normal redemption provisions. Rather, the Basel LCR focuses on options that are exercisable at the investor's discretion and notes that, as to options exercisable at the issuer's discretion, "supervisors should take into account reputational factors that may limit a bank's ability not to exercise an option."[63] The Basel LCR provides further that if the market expects liabilities to be redeemed early, banks and supervisors likewise should assume such behavior and include such liabilities as outflows.

Even applying the same rationale regarding market expectations to redeem long-term debt, there is no reason to require a Covered Bank to assume the exercise of such a redemption right. There is no market expectation that a bank will exercise a redemption right on its long-term debt unless interest rates at the time the redemption right is exercisable are lower than the interest rate on the redeemable long-term debt. Moreover, a bank's exercise of a redemption right on its long-term debt would not be linked, and would not likely be seen by the market as being linked, to its liquidity position. A Covered Bank generally would include a redemption right in its long-term debt instruments, after lapse of the applicable no-redemption period (with the length of that period dependent upon market conditions at the time of initial issuance), to allow for the flexibility to redeem its debt in a declining interest rate environment in order to avoid paying an interest rate that is higher than the prevailing rate. Applying an assumption that the debt would be redeemed and therefore subject to outflow within the LCR period could force a bank to choose between unfavorable liquidity treatment under the Final U.S. LCR and the normal, commercial flexibility to adapt to a changing interest rate environment.

F. Operating expenses, such as salaries, should be excluded from outflows.

Section 32(l) of the Proposed Rules provides for a 100% outflow for all other amounts payable by the Covered Bank to counterparties under legally binding agreements that are not otherwise specified in Section 32. The Preamble notes that this "would include contractual payments such as salaries."[64] By contrast, the examples of "other outflows" provided in paragraph 141 of the Basel LCR

---

[63] Basel LCR ¶ 86.

[64] Preamble at 71843.

include "outflows to cover unsecured collateral borrowings, uncovered short positions, dividends or contractual interest payments" and specifically excludes from this category operating costs. The Basel LCR's exclusion of operating costs from outflows is consistent with its exclusion from inflows[65] related to non-financial revenues. This consistent treatment makes sense – the Basel LCR is focused on net cash outflows from financial transactions, which are the transactions that are most likely to have an immediate effect on a Covered Bank's liquidity in a stress scenario. The U.S. Proposal, however, as noted, would include operating costs as outflows but would also exclude inflows from non-financial revenues because such inflows are not specifically enumerated in Sections 33(b)-(f) and therefore would be excluded under Section 33(g).

The Preamble does not explain the reason for this divergence from the Basel LCR, and we are not aware of any particular concerns regarding the operating costs of Covered Banks that would warrant their treatment as outflows. Indeed, Section 20(e)(6) of the Proposed Rules seems to assume operating costs would not be included in outflows because it excludes from a Covered Bank's HQLA amount any HQLA "designated to cover operational costs." We recommend adhering to the Basel LCR because it appropriately excludes such operating expenses, which are unlikely to change a Covered Bank's liquidity position materially within the LCR timeframe. Furthermore, because the systems used to track operating costs generally are separate from those a Covered Bank would use to track the outflows from its financial transactions, Covered Banks may need to expend considerable resources to adapt their systems to include outflows from operating costs with other outflows. Covered Banks have not undertaken these adaptations because the Basel LCR and the current quantitative impact study reporting template do not require the inclusion of these costs.[66] We question whether the costs of making these adaptations are warranted by the likely negligible benefit to understanding the total demands on a Covered Bank's liquidity.

G. The calculation of collateral outflows relating to derivative transactions should take into account potential collateral inflows that may offset collateral outflows. In addition, a Covered Bank should be permitted to calculate net outflows from derivative transactions using an alternative approach that would also replace the requirement to treat the absolute value of the largest 30 consecutive day cumulative net mark-to-market collateral outflow or inflow over the preceding 24 months as an outflow with a forward-looking approach.

In addition to the calculation of net derivative cash outflow amounts under Section 32(c) of the Proposed Rules, a Covered Bank must calculate certain collateral outflow amounts relating to its derivative transactions under Section 32(f). The methodology for calculating collateral outflow amounts from derivative transactions will likely result in a significant overstatement of the liquidity risk profile of a Covered Bank's derivative portfolio that is well in excess of historical experience. To address this overstatement, a Covered Bank should be permitted to recognize collateral inflows instead of only

---

65 Basel LCR ¶160.

66 *See* Basel Committee, Basel III Monitoring Workbook (version 2.6.3).

collateral outflows either by including potential inflows under Section 33 or by calculating the outflow net of mitigating inflows. In addition, we recommend that, as an alternative, Covered Banks should be permitted to calculate net outflow amounts from derivative transactions, including the related collateral outflow amount under Section 32(f)(6), under an alternative approach that is based on a forward-looking measure that incorporates market and related net collateral impacts. For Covered Banks that elect to use this alternative approach, it would replace the outflow calculations under Section 32(c) and Section 32(f)(6) and the inflow calculation under Section 33(b).

The overstatement of a Covered Bank's liquidity risk arises from the asymmetrical treatment of outflows and inflows, the potential for duplicative outflows, and the failure to take into account risk mitigating actions a Covered Bank may take.

The provisions of Section 32(f) that are the key drivers of this overstatement include the following:

- *Section 32(f)(2)*. Section 32(f)(2) requires a Covered Bank to recognize as an outflow 20% of the fair value of any non-Level 1 asset posted to the Covered Bank as collateral. This requirement to recognize an outflow potentially overstates liquidity risk of potential changes in market value of collateral across a derivative collateral portfolio because a Covered Bank is not permitted to calculate the outflow on a net basis reflecting amounts of non-Level 1 assets posted to it. At a minimum, this requirement should be revised to permit a Covered Bank when calculating its net outflow to use the net amount of collateral on a security-by-security basis and should only be required to include an outflow for each security where it is has net posted collateral.[67]

- *Section 32(f)(5)*. The assumptions underlying the collateral substitution requirements in Section 32(f)(5) do not reflect that a counterparty's right to substitute non-HQLA collateral is generally subject to a significant increase in haircut that is designed to mitigate the liquidity risk associated with the substitution. As a result, Covered Banks' experience is that such substitutions are infrequent. Furthermore, this approach introduces an asymmetry by ignoring that a Covered Bank could reuse the collateral posted to it by posting such collateral to another counterparty to secure its own derivative liabilities. Given the infrequency of collateral substitution and the mitigating actions a Covered Bank may take, we do not believe that collateral substitution involves sufficient liquidity risk to warrant inclusion as an outflow, and certainly not at the outflow rates prescribed in the Proposed Rule.

---

[67] For example, if a Covered Bank has received $100 of XYZ security (that is not eligible as HQLA Level 1) as collateral securing a derivative asset and in turn posts $120 of XYZ security to secure other derivative liabilities, the firm would calculate outflows on the $20 of XYZ that it posts on a net basis.

- *Section 32(f)(6).* Section 32(f)(6) treats the absolute value of the largest 30 consecutive day cumulative net mark-to-market collateral outflow or inflow over the preceding 24 months ("**look-back**") as an outflow. This look-back requirement is designed to capture cashflow movements, which are not reflected in the calculations under Section 32(c) and Section 33(b). This selection of the 30-day period with the largest mark-to-market collateral movement, however, is unrelated to the Covered Bank's derivatives portfolio at the time it is calculating its LCR. The look-back is more correlated with historical absolute volatility of collateral cashflows and the historical volatility of the underlying derivatives transactions than a forward-looking estimate of the potential collateral inflows and outflows in a period of market-wide stress. In addition, the collateral outflows may be related to closing out derivatives positions rather than the result of increased liquidity risk.

Although further development would be required for many Covered Banks to implement a forward-looking approach, we recommend that the Agencies consider providing Covered Banks the ability to use an alternative method of calculating derivative and collateral net outflows on a forward-looking basis. We note that the Basel LCR describes a similar 30-day outflow assumption based on a 24-month look-back but explicitly provides in the same paragraph that "[s]upervisors may adjust the treatment flexibly according to circumstances."[68] European regulators have considered implementing a flexible approach, in particular by allowing banks to model derivatives collateral outflows on a forward-looking basis, rather than through a look-back.[69]

The alternative approach suggested here would involve the determination of an appropriate market shock, which could be derived from approved models used by a Covered Bank. The largest U.S. banking organizations have been developing stress scenarios for capital planning purposes since the financial crisis, which could be used in this effort. Covered Banks would need to overlay the collateral impact of such a market shock, taking into account market movements on a counterparty-by-counterparty basis and the terms of the agreement with such counterparties relating to collateral.

This forward-looking approach has the advantage of forcing banking organizations to dynamically evaluate changing market conditions, and avoids reliance on older data that may over- or under-estimate liquidity risks from preceding years with very different market conditions. Such a forward-looking approach, which we think is consistent with the "flexible" language of the Basel LCR,

---

68 Basel LCR ¶ 123.

69 European Banking Authority, Consultation Paper, Draft Regulatory Technical Standards: On additional liquidity outflows corresponding to collateral needs resulting from the impact of an adverse market scenario on the institution's derivatives transactions, financing transactions and other contracts for liquidity reporting under Article 411(3) of the Draft Capital Requirements Regulation (CRR) (May 23, 2013), available at: http://www.eba.europa.eu/documents/10180/205409/Draft-CP-on-RTS-on-additional-collateral-outflows---final-to-be-published.pdf.

would result in more rigorous analysis of market conditions and, ultimately, better liquidity management.

H. Foreign exchange ("FX") transactions that are considered derivatives under the Proposed Rules that offset or are part of the same swap arrangement should be treated as a single transaction with offsetting cash flows rather than as separate outflows and inflows or the inflows from such transactions should not be subjected to the inflow cap.

The definition of "derivative transaction" in Section 3 of the Proposed Rules includes "foreign currency exchange transactions with a contractual settlement or delivery lag that is longer than the lesser of the market standard for the particular instrument or five business days." Under the Proposed Rules, a Covered Bank's net derivative outflow is the sum of payments and collateral that a Covered Bank provides to a counterparty net of payments and collateral received from the counterparty to the extent the transactions are subject to a qualifying master netting agreement.

Certain FX spot, FX forwards and FX swaps[70] would meet the definition of "derivative transaction" under the Proposed Rules because of the timing of their contractual settlement or delivery and therefore must be included as inflows and outflows, except to the extent that the transactions are subject to a qualifying master netting agreement. Since such FX transactions are not generally subject to qualifying master netting agreements, they would be required to be included in a Covered Bank's calculation of its derivative outflows on a gross basis. As a result, even though each FX transaction has a corresponding offsetting transaction, the inflow from the offsetting transaction would nonetheless be subject to the 75% cap on inflows. To address this concern, FX transactions that either offset each other or are part of a swap should be treated as a single transaction because they are ultimately part of the same trade and create offsetting cash flows.

These FX transactions do not have the same liquidity risk characteristics of many other types of derivatives (e.g. credit default swaps, interest rates swaps, etc.), as contractual outflows are perfectly offset by a same day spot or forward transaction or another currency of equal value. Although these transactions may create some element of credit risk, that concern is adequately addressed in risk-based capital requirements. Furthermore, the usage of CLS Bank[71] by many market participants and the short term nature of these agreements minimize settlement and mark-to-market risk.

---

[70] An FX swap resembles a collateralized borrowing/lending arrangement and consists of a FX spot and FX forward transaction executed simultaneously. For example, Party A borrows from Party B USD at the spot rate and lends the same value in Euro to Party B. When the contract expires, Party A returns USD to Party B at the forward rate, and Party B returns Euro to Party A where the forward rates are meant to capture the cost of borrowing. The return of the currency at the expiration of the contract is the "far leg" of the transaction.

[71] Continuous linked settlement (CLS) is a settlement system for foreign exchange run by the CLS Bank International.

Subjecting inflows from an FX transaction that directly offset the outflows of another FX transaction to the 75% inflow cap does not accurately reflect the liquidity risk of these FX derivatives. Ultimately, given the large volume of these low-risk FX transactions and their widespread use in the marketplace, the 75% cap would materially impact Covered Banks, including those with very limited cash inflows from other lines of business, such as derivatives trading generally. The result is that Covered Banks would have to hold additional HQLA to cover outflows above the inflow cap, even though the outflow is offset. The intent of the inflow cap is to ensure that Covered Banks hold at least some HQLA and are not wholly reliant on inflows from financial transactions.[72] We do not believe, however, that the inflow cap should capture offsetting low-risk FX transactions.

We therefore request an adjustment to the treatment of these types of FX transactions, either by treating the two transactions as a single transaction (that is, on a net basis) or not subjecting the inflows to the 75% inflow cap.

I. Assets held by a Covered Bank for customers on a segregated basis pursuant to regimes for the protection of customer trading assets, such as Exchange Act Rule 15c3-3, should be considered separately from the assets and funding obligations of the Covered Bank for purposes of the LCR. The Proposed Rules should recognize the release of segregated balances as inflows and not subject such releases to the 75% cap on inflows.

Unlike the Basel LCR, the Proposed Rules do not expressly address the treatment of balances held in segregated accounts in accordance with Exchange Act Rule 15c3-3. We believe it is appropriate to treat such segregated accounts separately from the assets and funding obligations of the Covered Bank under the LCR in recognition of the separate framework to which these assets are subject under customer trading asset protection regimes, such as Rule 15c3-3,[73] and, in particular, not subject the release of such assets to the 75% cap on inflows.

Exchange Act Rule 15c3-3 is an SEC rule requiring segregation of customer assets that is designed to protect a customer's assets that are held by a broker-dealer by placing limits on the broker-dealer's use of such customer assets.[74] Under the rule, a broker-dealer must calculate on a weekly basis the amount of each customer's cash, securities, or other assets that must be subject to lock-up (the

---

[72] Preamble at 71833.

[73] We refer only to Exchange Act Rule 15c3-3 in this letter but the same analysis would apply to comparable regimes for the protection of customer trading assets in other jurisdictions, such as the U.K. client money protection rules.

[74] According to Securities Exchange Act Release no 34-55431 (March 9, 2007), "[u]nder the rule, a broker-dealer must, in essence, segregate customer funds and fully paid and excess margin securities held by the firm for the accounts of customers. The intent of the rule is to require a broker-dealer to hold customer assets in a manner that enables their prompt return in the event of an insolvency, which, in turn, increases the ability of the firm to wind down in an orderly self-liquidation and, thereby avoid the need for a proceeding under the Securities Investor Protection Act of 1970."

"**reserveable amount**"), which is generally the net amount the broker-dealer owes to the customer (that is, the excess of customer credits over customer debits). The reserveable amount is placed into the segregated account, where the funds are not assigned to specific customers but are instead pooled funds. When the broker-dealer recalculates the reserveable amount, the decrease in the net amount the broker-dealer owes the customer, if any, would be released from the segregated account.

Broker-dealer customer protection rules are themselves versions of liquidity rules—in their case, ensuring that broker-dealers have sufficient liquid assets to meet their obligations to customers. It is important that the Agencies accommodate the necessary interface between broker-dealer protection rules and the LCR and, in particular, do not put Covered Banks with broker-dealer subsidiaries in a disadvantaged position merely from their compliance with customer protection rules. We urge the Agencies to recognize the unique nature of these segregated accounts, consistent with the Basel LCR.[75]

As we understand the Proposed Rules, deposits maintained by broker-dealers and assets in the segregated account held under Exchange Act Rule 15c3-3 are treated as two distinct flows. Deposits are treated as an outflow, and the release of assets from the segregated accounts (that is, the reduction of the reserveable amount) is an inflow, recognizing the decrease in the amount of assets that must be held subject to the lock-up. That is, as customer deposits are withdrawn from the broker-dealer, funds are released from lock up to offset that outflow.

Treating these as distinct outflows and inflows would subject the inflow from the release of segregated balances to the 75% cap under Section 33 of the Proposed Rules. The inflows from the release of segregated balances are not primarily a means of covering liquidity needs, just a reflection of the outflows of deposits back to the customer.

The most straightforward way to address this issue would be to apply the outflow rate under Proposed Rule Section 32(h) to customer assets maintained by the broker-dealer net of the amount held in the segregated account. Alternatively, the inflows from the segregated account should be excluded from the cap of inflows.

J. Provisions of the Proposed Rules relating to prime brokerage activities should be modified to create a more credible liquidity requirement for the provision of these services.

A number of Covered Banks offer prime brokerage services as part of their overall business to a wide range of investors, including pension funds, insurance companies, endowment funds, and hedge funds (and many hedge funds in turn manage funds for such investors). The U.S. Proposal directly addresses some aspects of the prime brokerage business and not others, including aspects of prime brokerage that were directly addressed in the Basel LCR. In addition, certain of the provisions that are

[75] Basel LCR ¶ 155 specifically provides that "Banks may also recognize in this category inflows from the release of balances held in segregated accounts in accordance with regulatory requirements for the protection of customer trading assets, provided that these segregated balances are maintained in HQLA."

most relevant to the prime brokerage business do not appear to take into account the totality of inflows and outflows related to a prime broker's liquidity and therefore would likely overestimate the potential net outflows. We believe the following changes or clarifications to the Proposed Rules are necessary to develop a credible liquidity buffer for these activities:

- Application of a 50% outflow rate should not be limited only to customer short positions that are closed where the customer's position is covered by another customer's non-HQLA collateral, as is currently the case under Section 32(j)(v) of the Proposed Rules. Instead, the presence of other methods of covering short positions ("**internal coverage**") should be recognized, including hedges to customer swaps and securities that are specifically created by the prime broker to cover the customer short positions.

- The 50% inflow rate in Section 33(f)(v) of the Proposed Rules should be applied to collateralized margin loans that are not secured by HQLA regardless of the maturity of the loan, subject to portfolio constraint requirements described below.

- The cap of inflows to 75% of outflows should not apply to inflows from loans of securities to the Covered Bank that cover customer short positions.

As discussed below, these changes are appropriate in light of the overnight or short-term nature of the financing provided by prime brokers, contractual terms designed to mitigate liquidity risk, and recent changes in the funding practices of the prime brokerage businesses of Covered Banks. Specifically:

- A significant portion of the prime brokerage business consists of short-term secured financing in the form of margin loans and the loan of stock to prime brokerage customers to effect short positions. The short-term nature of prime brokerage allows for a dynamic adjustment of margin requirements and other terms to take into account changes in the credit profile of counterparties and dislocations in the funding markets.

- Contractual terms, including under term margin agreements, require the maintenance of a materially balanced portfolio, with increasing margin requirements and a reduction in leverage or financing depending on the level of asymmetry between long and short positions.

- Prime brokers, in response to management and regulatory focus, have decreased reliance on certain forms of overnight funding, increased the term profile of secured funding to finance customer positions, and emphasized greater internalization of funding needs.

1. The outflow rate for closing a customer short position should be 50% regardless of the type of internal coverage.

Section 32(j)(1)(v) of the Proposed Rules assigns a 50% outflow rate to all funds received from secured funding transactions that are customer short positions where the customer short positions are covered by other customers' non-HQLA collateral. As noted in the Preamble, this provision recognizes that under the applicable contractual terms customers will not be able to close all short positions without also reducing leverage, which would offset some part of the liquidity outflow. We assume that customer short positions that are not covered by other customers' non-HQLA collateral are treated as secured fundings and subject to an outflow rate of 100% under Section 32(j)(1)(vi) of the Proposed Rules.

We appreciate the Agencies' recognition that the contractual terms governing a customer's prime brokerage relationship will lead to a corresponding decrease in leverage when a customer's short position is closed out. However, there is a wide variety of internal coverage mechanisms available to a prime broker, which we believe would be appropriate to recognize in the Final U.S. LCR. Although there are liquidity risks inherent in internalizing customer and firm long and short positions, limiting the scope of permissible (that is LCR-favored) coverage in this way does not recognize the interdependence between the positions taken to cover customer short positions and the customer short positions themselves. In many instances, for example, the firm's long positions correspond to positions taken by the firm to hedge client swap positions (in the case of synthetic prime brokerage) or positions that were specifically created to cover the customer short position. Furthermore, a uniform outflow rate for customer short positions across all types of coverage would recognize the benefit of covering short positions using diverse forms of coverage and remove the incentive to rely too heavily on the form of coverage that provides a better LCR result. We believe liquidity risk management overall would be improved by treating each risk management tool more equally. As noted, prime brokers have been focusing on diversifying forms of internalization of funding needs in response to management and regulatory focus.

To the extent the Agencies are concerned that recognizing all types of internal coverage would introduce additional liquidity risk, we believe that a 50% outflow rate should address such concerns. We understand that the Agencies reduced the outflow rate associated with closing a customer short position to reflect a customer's offsetting reduction in leverage (consistent with contractual terms), but we believe that the actual reduction in leverage would be largely symmetrical, resulting in an inflow that is much closer to 100%. This is because, in practice, the contractual terms make significant asymmetries uneconomic from the customer perspective. As a result, the 50% outflow rate should be sufficient to capture both the risk that a customer's offsetting inflows are not symmetrical and the risks related to the internal coverage.

2. Collateralized term margin loans that are not secured by HQLA should be treated as inflows regardless of the maturity of the loan.

The LCR is based on a 30-day time horizon.[76] As a result, any inflows that are contractually due beyond 30 calendar days are excluded from inflows. This structure does not take into account,

[76] Proposed Rule §§ 30 and 31.

however, that financings under term margin loans that, even though they may have a term that extends beyond the 30 calendar day time horizon, are designed to be treated instead as overnight transactions that are due on demand if the conditions of the term margin loan are not satisfied.

Term margin loans almost universally include a portfolio constraint or similar requirement, which requires the client to maintain a specified ratio of short positions to long positions and imposes margin requirements that increase based on how much financing is provided on a net basis to such client. These provisions serve to limit the prime broker's net term funding to the client. If the client closes out its short positions, then some or all of the client financing would need to be reduced in accordance with the terms of the agreement. If such provisions are included in the agreement, there would be no scenario that would result in a client's short positions being closed or reduced while the margin loans are still subject to a term without a corresponding reduction in the margin loan.

As noted above, the U.S. Proposal already recognizes this structure explicitly by assigning an outflow rate of 50% under Section 32(j)(1)(v) of the Proposed Rules when closing a customer position. We request clarification in the Final U.S. LCR, either in the rule itself or the accompanying preamble, that term margin loans with the portfolio constraint requirements described above are not considered to be contractually due beyond 30 calendar days. This would better reflect the fact that when calculating margin loan inflows and internal coverage outflows, prime brokers would give effect to contractual provisions that would require symmetrical adjustment to both the financing provided and the short coverage received from the client.

3. The cap on inflows should not apply to inflows from loans of securities to the Covered Bank that cover customer short positions.

The definition of "secured funding transaction" in Section 3 of the Proposed Rules provides that lending stock to clients to effectuate short positions should be treated as secured funding, and such stock lending would therefore be subject to the outflow rates in Section 32(j). Frequently, a Covered Bank will source the securities needed to enter into the customer short positions by borrowing them from third-party lenders and posting cash or other collateral. If the customer closes its short position by buying back the security that it had previously sold short and returning that security to the Covered Bank, the Covered Bank would return the security back to the lender and receive back cash or other collateral it had previously posted and would not have a net outflow. Since the transactions offset, the inflow from the lender in this circumstance should be treated on a net basis and not subject to the cap on inflows.

Similar to collateral outflows relating to derivative transactions, discussed in Part III.G, where inflows are from transactions that are entered into directly to offset a transaction, and that transaction creates an outflow, however, we believe it is appropriate to exclude both the transactions, essentially treating the outflow and the inflow on a net basis (and without regard to the 75% Cap). That treatment is appropriate where these positions, taken together, are the equivalent of a matched book. Although

the Basel LCR does not address these particular circumstances, we believe they are substantially similar to other paired transactions that the Basel LCR would exclude from both inflows and outflows. [77]

K. The outflow rate assigned to partially insured retail deposits should reflect the benefit of such partial insurance rather than being treated as uninsured deposits.

In contrast to the Basel LCR, the U.S. Proposal limits stable retail deposits to retail deposits entirely covered by FDIC deposit insurance. As a result, retail deposits that are only partially insured cannot count at all as stable retail deposits and therefore cannot even partially benefit from a more favorable outflow rate.[78] In dealing with the exact same issue, the Basel LCR allows for the bifurcation of the insured and uninsured portion of retail deposits, treating deposit balances up to the deposit insurance limit as fully insured and therefore as stable retail deposits and treating any amount in excess of the deposit insurance limit as less stable retail deposits. As an analytical matter, we don't believe there is a Country-Specific Circumstance that justifies this departure from the Basel LCR, especially since the issue of deposit insurance that functions based on specific dollar caps as in the U.S. is explicitly addressed in the relevant portion of the Basel LCR.[79]

Nevertheless, we recognize that the Agencies have indicated that this treatment of partially insured deposits may be justified based on experience during the recent financial crisis where "to the extent that retail depositors whose deposits partially exceeded the FDIC's insurance limit withdrew deposits from a banking organization, they *tended* to withdraw not only the uninsured portion of the deposit, but the entire deposit."[80] While the Agencies have not made the data underlying this assertion public, we do note that the Agencies explicitly indicate this empirical observation represents at best a "tendency" and is not universal or nearly universal as is embodied by the absolute prohibition against assigning a more beneficial outflow rate for partially insured deposits. Thus, although the empirical data from the financial crisis may indeed support an outflow rate for partially insured deposits that may be higher than that for fully insured deposits, we do not believe it is analytically justified to depart from the Basel LCR and assign partially insured deposits an outflow rate of 10% that is the same as that for deposits without the benefit of any deposit insurance. Simply put, a 3% outflow rate for the entire deposit may be too low but a 10% outflow rate completely ignores the greater stability offered by partial insurance. We urge the Agencies to share their underlying data with respect to this issue with the industry and other interested observers. We look forward to working with the Agencies to further

---

[77] Basel LCR ¶ 146 provides that, in the event a firm has borrowed securities and either sold such securities short or on-lent them as part of a matched repo book, such firm would exclude both the inflows from the unwind of the securities borrow and related outflow to purchase the security that would need to be delivered to unwind such securities borrowing transaction.

[78] Specifically, partially insured retail deposits are disqualified from being assigned a 3% outflow rate under Section 32(a)(1) and instead are classified with all other retail deposits and assigned a 10% outflow rate pursuant to Section 32(a)(2).

[79] *See* Basel LCR ¶ 75, footnote 34.

[80] Preamble at 71835 (emphasis added).

examine and discuss such data and, if necessary, engage in further quantitative data gathering in order to determine the correct and empirically justified outflow assumption for partially insured deposits or portions thereof.

L. We appreciate the Agencies' effort in the Proposed Rules to address brokered deposits, including brokered sweep arrangements and reciprocal brokered deposits – categories of funding that are unique to the United States. However, we believe that several important adjustments should be made to the Proposed Rules' treatment of brokered deposits.

Brokered deposits, including brokered sweep deposits and reciprocal brokered deposits, are unique to the United States as a significant funding source for depository institutions, and hence their treatment for LCR purposes is without question a Country-Specific Circumstance. This is particularly true as the Basel LCR naturally does not mention or refer to brokered deposits. Based on the role of brokered deposits as an important funding source for U.S. depository institutions, however, U.S. banking regulations address them in a number of respects – most importantly, in the provisions of the Agencies' prompt corrective action regulations that preclude depository institutions that fall out of well-capitalized status from accepting new brokered deposits or renewing outstanding brokered deposits when they mature[81] and the FDIC's regulations dealing with pass-through insurance treatment for brokered deposit sweep arrangements.[82]

The Agencies have addressed brokered deposits principally through four definitions in Section 2 of the Proposed Rules – "brokered deposit," "brokered sweep deposit," "reciprocal brokered deposit" and, in the definition of "retail deposit," the exclusion of brokered deposits from retail deposits – and in the specified outflow percentages set forth in Sections 32(g) and 32(h) of the Proposed Rules. Although we appreciate the Agencies' consideration of brokered deposits, we believe their treatment in the Proposed Rules should be revised in several important respects in the Final U.S. LCR.

First, Section 32(g)(2) applies a 10% outflow rate to brokered deposits of retail customers maturing later than 30-calendar days from the calculation date. The other type of funding to which the Proposed Rules apply an outflow rate notwithstanding that the funding matures after the LCR's 30-calendar day time horizon is retail deposits, with the applicable outflow rate for retail deposits of different types (including depending on whether or not they are fully insured) applying irrespective of the contractual term. In the Preamble's discussion of retail deposits, the Agencies note that "retail depositors withdrew term deposits at a similar rate to deposits without a contractual term."[83] The Preamble's discussion of brokered deposits does not specifically address the reason for applying an outflow rate to brokered deposits maturing after the LCR's 30 calendar day time horizon, other than to

---

81 *See* 12 C.F.R. 303.243.

82 *See* 12 C.F.R. 330.5(b).

83 Preamble at 71835.

note that the Agencies "consider brokered deposits for retail customers to be a more volatile form of funding than stable retail deposits."[84]

We strongly believe that no outflow rate should be applied to brokered deposits maturing more than 30 calendar days after the calculation date. In the case of non-brokered retail deposits, we agree with the Agencies that an outflow rate should be applied to retail deposits irrespective of contractual term. As to those deposits, under some circumstances depository institutions may be incentivized to permit early withdrawals upon request of retail customers in order to maintain the customer relationship. The same reasoning and concern does not apply to brokered deposits for two reasons. First, brokered deposits may customarily be withdrawn before the contractual maturity date only upon death or incapacity; it is highly unusual for the terms of a brokered deposit to provide for early withdrawal upon payment of a withdrawal penalty. Second, the issuing depository institution customarily has no ongoing relationship with the depositor providing funds of the type that incentivizes the depository institution to permit early withdrawal when not permitted; there is no "maintain the relationship" incentive.

Second, Section 32(g)(1) applies a 100% outflow rate to brokered deposits of retail customers that mature 30 calendar days or less from the calculation date and that are not reciprocal brokered deposits or sweep deposits. This category of deposits would include deposits obtained through the marketing of an "affinity group."[85] Deposits obtained through some affinity arrangements have the same characteristics as "stable retail deposits." In addition to having full deposit insurance, affinity deposits may be held in transactional accounts (e.g., money market accounts or savings accounts) that permit the customer to access funds using a debit card or check, as well as set up automatic bill pay. Customers holding affinity deposits with the bank also may have other relationships with that bank or its affiliates. The Agencies have repeatedly recognized, both in reference to brokered deposits (as in the FDIC's *Study on Core Deposits and Brokered Deposits*)[86] and in reference to retail deposits more generally (as in the Preamble) that having multiple relationships with a bank (or an affiliate of the bank) lowers the probability that the customer will withdraw the deposit during a stressed environment.

Therefore, we urge the Agencies to apply the same outflow rate as is applied to stable retail deposits (3%) to brokered deposits obtained through affinity marketing arrangements (such as those described in prior FDIC Advisory Opinions) with the same characteristics as "stable retail deposits," as

---

[84] Preamble at 71840.

[85] For purposes of section 29 of the FDIA, which is used as the basis for the definition of "brokered deposits" in the Proposed Rule, the FDIC classifies an affinity group as a "deposit broker" when the affinity group does not itself place the deposit, but facilitates the placement of deposits through active marketing on behalf of the bank, for example, by permitting the bank to include deposit solicitations in mailings by the affinity group. Typically, the affinity group receives a fee for deposits obtained through the marketing arrangement. *See e.g.,* FDIC Advisory Opinion No. 92-79 (Nov. 10, 1992).

[86] FDIC, Study on Core Deposits and Brokered Deposits, submitted to the Congress pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (July 8, 2011), at p. 50 and 56.

that term is defined in Section 3 of the Proposed Rules. Alternatively, we would encourage the Agencies to apply an outflow rate comparable to other brokered deposits where the Agencies conclude the customer is likely to have an established relationship with the customer, for example, in the case of reciprocal brokered deposits, which the Agencies proposed be subject to a 10% or 25% outflow rate depending on whether the deposit amount was fully insured.[87]

Third, Section 32(g)(5) addresses brokered sweep deposits of retail customers or counterparties[88] and provides for a 10% outflow rate for such deposits sourced from a customer or counterparty of a consolidated subsidiary of the depository institution or a common parent (a so-called "**affiliate sweep**" arrangement).[89] This 10% outflow rate is not prescribed by the Basel LCR. We recommend that the Agencies adopt a 3% outflow rate for this category of deposits in the Final U.S. LCR, consistent with the 3% outflow rate for stable retail deposits in Section 32(a)(1) of the Proposed Rules.

We believe that the Agencies, as part of their normal supervisory processes, have access to data from Covered Banks demonstrating that outflow rates for this category of deposits during the financial crisis were much closer to the 3% outflow rate for stable deposits than the 10% outflow rate in the Proposed Rules. Fully-insured affiliate brokered sweep deposits display exceptional stability through normal and stressed conditions across a range of economic environments. That stability is logical, given that these deposits typically represent cash balances connected to retail investors' securities accounts with broker-dealer affiliates of banking organizations, which are generally buttressed by long-standing relationships between the customer and the banking organization's customer-facing subsidiaries. In the United States, such retail brokerage arrangements are subject to an extensive array of customer protection rules which minimize customer withdrawals in periods of market uncertainty, and cash balances swept to the affiliated banking organization are covered by FDIC insurance up to applicable limits. Indeed, in times of market uncertainty, broker-dealers' customers often liquidate securities holdings and leave proceeds in cash positions, which has the effect of making such deposits at the banking organization even stickier. Finally, the key criteria that define this category of brokered deposits – a contract between the customer and the banking organization or a subsidiary or affiliate of

---

87 Preamble at 71840.

88 In the discussion of brokered sweep deposits under this subsection Third and under subsection Fourth, below, we are addressing only such deposits of retail customers or counterparties and not of wholesale customers or counterparties, and only such deposits that are fully-insured, notwithstanding that we do not repeat those qualifications with each reference to brokered sweep deposits.

89 Although we refer to such arrangements as "affiliate sweep" arrangements, the Proposed Rules actually refer only to entities that are consolidated subsidiaries of a common parent rather than affiliates. We submit that a relationship between two affiliated entities represents a sufficient nexus between the parties to warrant a 10% outflow rate assuming the other requirements are met. Accordingly, if the distinction between affiliate and non-affiliate sweep arrangements is maintained, we request that the term "affiliated financial company" rather than "consolidated financial company" be used, with the term "affiliate" defined as any company that controls, is controlled by, or is under common control with, another company as the term "control" is defined for purposes of the Bank Holding Company Act.

the banking organization, and full deposit insurance coverage – are very similar to the criteria defining "stable retail deposit" in the Proposed Rules.[90]

Fourth, Section 32(g)(6) assigns a 25% outflow rate to brokered sweep deposits where the funds are sourced from a customer or counterparty of a third-party (a so-called "**non-affiliate sweep**" arrangement). We believe that the Proposed Rules' assumption that non-affiliate sweeps are significantly less stable than affiliate sweeps is not well-founded and that, at the least, non-affiliate sweeps should have applied to them an outflow rate not higher than the 10% outflow rate that the Proposed Rules would apply to affiliate sweeps.

The characteristics of non-affiliate sweeps that make them stable largely overlap with the characteristics of affiliate sweeps that explain the stability of affiliate sweeps. They include the transactional nature of securities accounts from which the swept funds originate and the fact that the customer funds swept to banks arise out of a relationship between a retail customer and a financial institution (in this case, the relationship between an individual retail customer and a broker-dealer at which the customer maintains a brokerage account, which is likely to be a non-transitory relationship like the customer's relationship with its bank and in many cases including other services); the customer protections discussed above; and the similarities to retail stable deposits discussed above.

The Agencies do not discuss or address (including through the provision of data) any characteristics of affiliate versus non-affiliate brokered sweep deposits that support such a significantly different treatment between the two. We do not believe the characteristics of non-affiliate sweeps as compared to affiliate sweeps support a higher outflow rate for non-affiliate sweeps and are not aware of any data supporting a higher outflow rate for such sweeps. Accordingly, we urge the Agencies to assign non-affiliate sweeps the same outflow rate as affiliate sweeps or, at the least, if the Agencies adopt our recommended 3% outflow rate for affiliate sweeps (discussed under Third above), assign non-affiliate sweeps the 10% outflow rate that the Proposed Rules assign to affiliate sweeps.

Moreover, were the Agencies to decide to apply different outflow rates to affiliate and non-affiliate sweeps, we urge the Agencies to differentiate between non-affiliate sweep arrangements that contractually obligate the broker to sweep a minimum amount to the bank (so-called "**structured sweeps**"). In addition to the guaranteed balance, these types of sweep arrangements likely involve long-term relationships between the retail customer and the broker-dealer. Accordingly, we urge the Agencies to assign a 3% outflow rate to these structured sweeps, irrespective of whether the Agencies differentiate between affiliate and non-affiliate sweeps more broadly.

---

[90] *See* Proposed Rules § 3. As in Section 32(g)(5), "stable retail deposits" require that the deposit be fully covered by deposit insurance. In addition, while Section 32(g)(5) refers to the existence of a "contract" between the customer and the banking organization, the "stable retail deposits" standard refers to the existence of either a "transactional account" or "another established relationship" with the banking organization that "would make deposit withdrawal highly unlikely during a liquidity stress event."

Fifth, the Agencies note in the Preamble, without drawing a distinction between reciprocal brokered deposits that originate from wholesale as opposed to retail customers, that "[r]eciprocal brokered deposits generally have been observed to be more stable than typical brokered deposits because each institution within the deposit placement network typically has an established relationship with the retail customer or counterparty making the initial over-the-insurance limit deposits that necessitates placing the deposit through the network."[91] The Proposed Rules define the term "reciprocal brokered deposit" consistently with the definition of the same term in the FDIC's insurance assessment rules[92] and, in Sections 32(g)(3) and (4), assign a 10% outflow rate to such deposits of retail customers where the entire amount is covered by deposit insurance and 25% where the entire amount is not covered by deposit insurance. Section 32(h)(1)(ii)(B) of the Proposed Rules, on the other hand, assigns a 40% outflow rate to all reciprocal brokered deposits of wholesale customers, irrespective of whether or not they are insured.

We urge the Agencies to reconsider the distinction drawn in the Proposed Rules between fully-insured reciprocal brokered deposits of retail customers (assigned a 10% outflow rate) and fully-insured reciprocal brokered deposits of wholesale customers (assigned a 40% outflow rate). We believe that the same factors contribute to the stability of wholesale and retail reciprocal brokered deposits—principally that they generally arise from established relationships between depositor and the banks that are their relationship banks, and those relationship banks set the interest rates on these deposits consistent with interest rates in their local markets.

In the absence of either conceptual reasons for expecting, or data supporting the conclusion, that the incremental stability observed for reciprocal brokered deposits is limited to such deposits that originate with retail customers, we urge the Agencies in the Final U.S. LCR to assign the same outflow rates to wholesale reciprocal brokered deposits that they assign to retail reciprocal brokered deposits. If the Agencies are reluctant to take that step because it would result in fully-insured wholesale reciprocal brokered deposits having a lower outflow rate than other fully-insured wholesale deposits, we urge the Agencies at the least to reflect in the Final U.S. LCR the stability characteristics of reciprocal brokered deposits originating with wholesale customers by assigning such deposits the same outflow rates that apply to non-brokered deposits—i.e., 20% if fully-insured and 40% if not fully-insured.

M. The Agencies' Final U.S. LCR should extend recognition of deposit insurance regimes to include non-U.S. regimes that meet certain criteria.

The U.S. Proposal limits the definition of "deposit insurance" to deposit insurance provided by the FDIC under the FDIA and does not recognize other deposit insurance schemes. As a result, only FDIC-insured deposits may qualify as "stable retail deposits" or benefit from lower outflow rates provided in other parts of the Proposed Rules for amounts covered by deposit insurance (for example, reciprocal brokered deposits, broker sweep deposits and certain wholesale funding outflow amounts).

---

91 Preamble at 71840.

92 §327.8(q) of the FDIC's regulations, 12 C.F.R. 327.8(q).

Although we note the Agencies' concern that foreign deposit insurance systems vary widely and feature uneven coverage and deposit insurer powers,[93] we believe the Agencies can and should develop a framework for recognizing certain non-U.S. deposit insurance systems.

The Basel LCR establishes a framework for identifying "effective deposit insurance schemes" and permits a 3% run-off rate to be assigned to stable retail deposits fully insured by a deposit insurance scheme that meets the "effectiveness" requirement and is a scheme that is prefunded by periodic levies on banks with insured deposits, has ready access to additional funding (such as a government guarantee), and the insurance segment is available to depositors quickly once the scheme is triggered.[94] These criteria would address the very concerns raised by the Agencies in the Preamble and should help identify deposit insurance regimes that are truly comparable to FDIC insurance. Specifically, we believe it would be appropriate to expand the definition of "deposit insurance" to include non-U.S. deposit insurance regimes where (i) the insurance regime is prefunded by levies on the institutions that hold insured deposits; (ii) the insurance regime is backed by the full faith and credit of the national government; (iii) the obligations of the national government are assigned a 0% risk weight under the Agencies' risk-based capital rules; and (iv) depositors have access to their funds within a reasonable time frame. The criteria would be expanded from the Basel LCR framework to include the requirement that the obligations of the national government are assigned a 0% risk weight under applicable regulatory capital standards to enhance the credibility of the requirement that the insurance regime be backed by the full faith and credit of the national government.

N. The Agencies should establish an outflow rate for commitments provided to central counterparties ("CCPs") that fulfill CCPs' liquidity maintenance obligations under the Principles for Financial Market Infrastructures ("PFMIs").

The PFMIs require CCPs to establish and maintain sufficient liquidity resources.[95] As more CCPs around the world comply with the PFMIs, we expect CCPs to establish new or expand existing liquidity arrangements. In countries where CCPs have direct access to central bank borrowing windows, CCPs may choose to meet the PFMI liquidity requirements through such central bank access; in the United States, where CCPs do not have normal course access to Federal Reserve Bank borrowing facilities, we expect CCPs to establish liquidity arrangements commercially, including through committed repurchase facilities with U.S. banking organizations.

The Basel LCR does not address PFMIs or CCP liquidity arrangements more generally. As a result, we believe that the Basel LCR may not have contemplated the range and types of liquidity

---

93 Preamble at 71836.

94 Basel LCR ¶ 76.

95 The CFTC recently finalized rules to require systemically important Derivatives Clearing Organizations ("**DCOs**"), which are CCPs that have registered with the CFTC, to establish and maintain specified liquidity resources. The CFTC rulemaking, while only applicable to a subset of DCOs, is intended to implement the PFMIs and is illustrative of the PFMI requirements that will be applicable to CCPs more broadly.

arrangements that CCPs likely will establish to comply with the PFMIs, or the range and types of country-specific CCP liquidity arrangements that exist, such as central bank borrowing window access and commercial liquidity facilities. Accordingly, we think it is appropriate for the Agencies to consider the interaction of CCP liquidity requirements in the United States with the LCR, including by modifying outflow assumptions in the Final U.S. LCR to reflect Country-Specific Circumstances.

We believe that the Proposed Rules do not anticipate CCP liquidity arrangements, which are generally designed as "back-up" liquidity resources to be used only when CCPs' balance sheet cash, initial margin and default fund cash resources are insufficient to meet CCPs' short-term liquidity requirements. Indeed, Section 32(e) of the Proposed Rules does not prescribe drawdown assumptions for committed credit or liquidity facilities to CCPs, even though the CFTC's final rule imposing liquidity standards on DCOs specifically contemplates DCOs establishing committed lines of credit and committed repurchase agreements. As a result, we are concerned that Section 32(e)(1)(vii) of the Proposed Rules (the residual outflow category) might apply to these arrangements, resulting in 100% outflow treatment which is far in excess of historical drawdown rates. Such high drawdown rates, if applied, may materially increase the costs of clearing, impeding efforts to move more uncleared transactions to CCPs.

We believe that the Final U.S. LCR should be modified to assign low drawdown rates to committed facilities for CCPs that are secured by HQLA and designed for use only when the CCP exhausts other liquidity resources. At a minimum, the Agencies should clarify that commitments to CCPs that have not been designated as systematically important financial market utilities by the Financial Stability Overnight Council pursuant to Title VIII of Dodd-Frank ("**non-FMU CCPs**") are treated no worse than commitments to "regulated financial companies" for purposes of LCR outflow assumptions.

More generally, however, we believe that the Agencies should conduct an empirical analysis of historic drawdown rates to more accurately calibrate drawdown assumptions for commitments to CCPs. There is no prescribed drawdown rate in the Basel LCR for non-FMU CCPs, and we think that further study of this issue is warranted, including with respect to calibration of FMU outflow rates.

IV. HQLA

A. The definition of HQLA in the Proposed Rules should be broadened using objective market criteria as the baseline. Accordingly, HQLA should accurately reflect the deep liquidity of Agency MBS markets and include certain high-quality securitization exposures and obligations of U.S. municipalities.

The Proposed Rules narrow the scope of eligible HQLA from the Basel LCR and, in some cases, ignore unique characteristics of the U.S. markets. We support a rigorous definition of HQLA to help ensure the credibility of the LCR. To that end, we believe that inclusion in HQLA should be determined based on objective criteria for market liquidity and creditworthiness. The further HQLA eligibility deviates from objective market standards, the more the LCR will dictate which markets are favored or disfavored rather than serving as a reflection of the actual liquidity of markets. This approach reinforces

the favored status of certain assets and acts as a significant disincentive to the creation or development of markets for assets that are not HQLA-eligible yet have the very liquidity and market characteristics embodied in both the Basel LCR and the Proposed Rules. Moreover, it should be anticipated that the markets for non-HQLA-eligible assets will experience a reduction in liquidity. This reduction in liquidity may occur even in markets for assets that are not typically part of a Covered Bank's excess liquidity because certain outflow assumptions are based on the HQLA level of posted collateral. The effect on outflow rates will likely drive market participants to HQLA-eligible or higher-level HQLA, adding to the liquidity pressures in markets for disfavored assets. This narrowing of HQLA-eligible assets may also contribute to a generally recognized issue with a LCR requirement—an increase in the potential for liquidity hoarding, which may be particularly acute in times of stress.[96] To help alleviate such concerns, in addition to broadening the scope of HQLA-eligible assets as discussed above, we support the proposal of the OCC to help mitigate the risk of liquidity hoarding by allowing the LCR to fall within a range of 90% to 100%.[97]

Using objective market criteria as the baseline for inclusion as HQLA, we believe that:

- Agency MBS should be included as Level 1 assets;
- Private label residential mortgage-backed securities ("**RMBS**") that meet the same market criteria as corporate debt securities should be afforded Level 2B treatment;
- Obligations of U.S. municipalities should be considered Level 2A assets;
- A framework for including covered bonds as Level 2B assets should be established in the Final U.S. LCR; and
- Asset-backed securities that meet the same market criteria as corporate debt securities should qualify as Level 2B assets.

1. Agency MBS should be treated as Level 1 liquid assets, at least for so long as Fannie Mae and Freddie Mac remain under conservatorship.[98]

---

96 *See*, *e.g.*, Preamble at 71855, Stein Speech.

97 Preamble at 71855.

98 We also were disappointed that the Agencies chose not to recognize unused borrowing capacity from the Federal Home Loan Banks ("**FHLB**") either by including the unused amount of assets pledged to the FHLB in the definition of HQLA or as a potential inflow in the denominator. For purposes of the outflow calculation under Section 32(j)(1), we assume that, as a U.S. government-sponsored enterprise with a 20% risk weight under the Agency's risk-based capital regulations, FHLB advances secured by assets other than Level 1 or Level 2A assets would carry a 25%, rather than a 100%, outflow rate based on the non-HQLA collateral that typically secures FHLB advances.

Under Section 20(b)(1) of the Proposed Rules, Agency MBS are assigned Level 2A treatment.[99] We strongly urge the Agencies to reconsider this treatment of Agency MBS, particularly in light of the current status of Fannie Mae and Freddie Mac, which is a Country-Specific Circumstance. Both Fannie Mae and Freddie Mac have been operating under the conservatorship of the Federal Housing Finance Agency since September 2008. In addition, they have both entered into senior preferred stock purchase agreements with the U.S. Treasury Department pursuant to which the Treasury is obligated to maintain the net worth of each entity. As a result, the obligations of these entities effectively enjoy an explicit guarantee of the U.S. government, which is consistent with the eligibility requirements for Level 1 liquid assets under Section 20 of the Proposed Rules and should be afforded treatment as Level 1 liquid assets on that basis.[100] At a minimum, however, if Agency MBS continue to be treated as Level 2A liquid assets, they should not be subject to the 40% cap. The 15% haircut to which they would continue to be subject should more than address any concerns regarding the relative liquidity of these assets.[101]

Since the markets for Agency MBS are deeper and more developed than the markets for comparable securities in non-U.S. jurisdictions, U.S. Agency MBS should be afforded more favorable treatment than their non-U.S. equivalents. There are currently over $4 trillion in outstanding Agency MBS, with an average daily trading volume in 2013 of almost $230 billion.[102] Furthermore, Agency MBS securities exhibit all the required characteristics of Level 1 assets except for the 0% risk weight. Although we recognize that the requested Level 1 treatment for Agency MBS is a more favorable treatment than the Basel LCR would accord, the trading and market behavior of these securities warrants a different treatment because Agency MBS exhibit greater liquidity than several Level 1 assets.

---

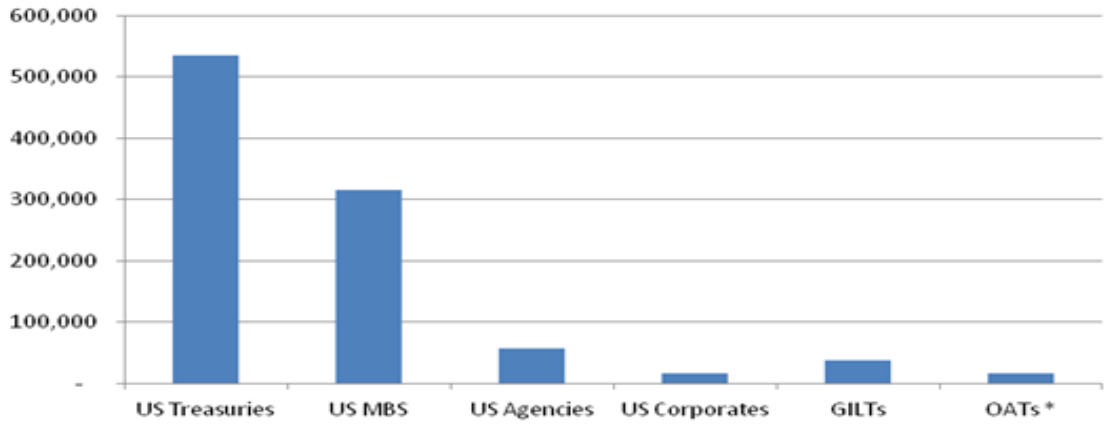
99 A Level 2A liquid asset includes a security issued by, or guaranteed as to the timely payment of principal and interest by, a U.S. government-sponsored entity that is (i) investment grade as defined under 12 C.F.R. Part 1 and (ii) senior to preferred stock. Under the Proposed Rules, "GSE" also includes the Federal Home Loan Bank System.

100 *See* the SIFMA/SFIG letter for additional discussion of the proposal and supporting data.

101 If the Agencies determine not to treat Agency MBS as Level 1 assets as we propose, and decline to remove the 40% cap as we propose in the alternative, we would support the Agencies' conducting a market-based study that would establish additional haircuts for the amount of Agency MBS in excess of the 40% cap.

102 Data available at http://www.sifma.org/uploadedFiles/Research/Statistics/StatisticsFiles/SF-US-Agency-MBS-SIFMA.xls?n=44617 and http://www.sifma.org/uplodatedFiles/Research/Statistics/StatisticsFiles/SF-US-SF-Trading-Volume-SIFMA.xls?n=28157.

Average Daily Turnover ($mm) – 3 Year Lookback[103]



In addition, the market for Agency MBS is considerably more liquid than the market for Ginnie Mae MBS, which do qualify as Level 1 assets. During the financial crisis, Agency MBS trading volumes were 9.75 times higher than Ginnie Mae MBS in the second half of 2008.[104]

The Agency MBS market allows banks to provide deep liquidity and credit to the housing market. Covered Banks currently are holders of significant amounts of outstanding Agency MBS, as are Federal Reserve Banks. If the Proposed Rules' treatment of Agency MBS is adopted, the result may be a reduction in the willingness of Covered Banks to hold these securities or accept them as collateral, which could have a direct effect on the U.S. housing and real estate finance market. The effect on this market is compounded by the changes made to the risk-based capital rules and the proposed supplementary leverage ratio.[105] Furthermore, the securitization of mortgage loans transforms a credit product into a liquid rates product, which makes these securities an attractive component of a bank's asset-liability management investment portfolio.

---

[103] As used in the graph, "U.S. MBS" means "Agency MBS" as used elsewhere in this letter. Data in graph is derived from New York Federal Reserve, available at http://www.newyorkfed.org/markets/gsds/search.html#; Finance Agency of the Federal Republic of Germany, BUND Fact Sheet, January 2014, available at http://www.deutsche-finanzagentur.de/fileadmin/Material_Deutsche_Finanzagentur/PDF/Aktuelle_Informationen/bund_fact_sheet.pdf; Japan Securities Dealers Association, Statistics, available at http://www.jsda.or.jp/en/statistics/bond-market/index.html; United Kingdom Debt Management Office, Gilt Market, available at http://www.dmo.gov.uk/rpt_parameters.aspx?rptCode=D4J.1&page=about; Agence France Tresor, Average Daily Turnover on OATs and BTANs, available at http://aft.gouv.fr/rubriques/volume-d-activite_109.html; Investment Industry Association of Canada, Bond Market Secondary Trading, available at http://iiac.ca/wp-content/uploads/Bond-Market-Q-EN.pdf.

[104] *See* SIFMA/SFIG Letter for a graph depicting trading volume data of Agency MBS and Ginnie Mae MBS provided by a major MBS trading platform.

[105] 78 Fed. Reg. 62018 (Oct. 11, 2013); U.S. Proposal.

2. Private label RMBS should be treated as Level 2B liquid assets to the extent they meet the requirements that publicly traded corporate debt must meet.

Under the Proposed Rules, Covered Banks are not expressly permitted to include RMBS assets as part of their stock of HQLA. By contrast, under the Basel LCR, RMBS are included as Level 2B liquid assets subject to a 25% haircut if they meet certain ratings criteria.[106]

We are concerned about the potential market effects of the exclusion of RMBS from treatment as a Level 2B asset and believe, consistent with the proposal described in the SIFMA/SFIG Letter on the Proposed Rules, that certain RMBS should be eligible for Level 2B status if they meet the criteria enumerated below. Such eligible RMBS backed exclusively by mortgages that meet the definition of a "qualified mortgage" under the federal Truth in Lending Act ("**TILA**"), and the regulations adopted thereunder,[107] should qualify as Level 2B assets subject to a 25% haircut. All other eligible RMBS would be Level 2B assets subject to the 50% haircut applicable to other Level 2B liquid assets. Only RMBS that meet the following criteria should be eligible for Level 2B treatment. Specifically, as described in greater detail in the SIFMA/SFIG Letter, the RMBS:

- is a security registered for offer and sale under the Securities Act of 1933 or, if exempt from such registration, is eligible for resale in reliance on Rule 144A under the Act;
- is a senior security that has a risk weight of 20% or less under the Agencies' standardized approach risk-based capital rules;
- the eligible primary underlying exposures for which consist solely of one-to-four family residential mortgage loans that are not higher-risk consumer loans or non-

---

[106] We note as well that corporate debt securities are only includable as Level 2B assets subject to a 50% haircut, as compared to Level 2A assets subject to a 15% haircut under the Basel LCR. Furthermore, the Basel LCR's 15% haircut on Level 2A liquid assets and 50% haircut on Level 2B liquid assets is premised on the notion that HQLA may be disposed of at the end of the 30-calendar day LCR time horizon, consistent with the Basel LCR's cumulative approach versus the Proposed Rules' peak day approach discussed in Part II.A.2, and the haircuts must accommodate price volatility over the 30-calendar days. The peak day approach's daily calculation rests on the notion that HQLA may be liquidated immediately, obviating the need to establish haircuts that accommodate price movements over a 30-calendar day period. If the Agencies – or national regulators more generally, as recommended after further deliberation through the international process – were to adopt the peak day approach, we believe that the existing 15%/50% haircut levels are excessive for that approach and should be revisited.

[107] Section 129(C)(a) of TILA and 12 C.F.R. Part 1026.43(c) require lenders to make a "reasonable and good faith determination" that a borrower has the ability to repay a residential mortgage loan. The "qualified mortgage" definition and regulations provide lenders with a presumption of compliance with TILA's ability-to-repay rules.

traditional mortgage loans (as such terms are defined in Appendix C to Subpart A of 12 C.F.R. pt. 357);

- constitutes a "traditional securitization" exposure under the Agencies' risk-based capital rules; and

- is sponsored by an entity the obligations of which have a proven track record as a reliable source of liquidity in repurchase or sales markets during stressed market conditions demonstrated by (i) the market price of the RMBS or equivalent securities of the sponsor declining by no more than 20% during a 30-calendar day period of significant stress or (ii) the market haircut demanded by counterparties to secured lending and secured funding transactions that are collateralized by the RMBS or equivalent securities of the sponsor declining no more than 20 percentage points during a 30-calendar day period of significant stress.

We believe inclusion of the high-quality RMBS described above as Level 2B assets is important to avoid detrimental effects on the residential mortgage market. If these assets do not carry any liquidity "benefit" for LCR purposes, Covered Banks will have less incentive to be active participants in the RMBS market to the detriment of the residential mortgage market, with possible consequences for the broader U.S. economy.

3. The deep, liquid markets for obligations of U.S. municipalities strongly support their inclusion as HQLA.

Under the Proposed Rules, municipal securities, including debt securities issued by state or local governments, agencies and authorities, do not qualify as HQLA as "the agencies believe, at this time, these assets are not liquid and readily-marketable in U.S. markets and thus do not exhibit the liquidity characteristics necessary to be included in HQLA under this proposed rule."[108] With nearly $3.7 trillion of securities and loans outstanding,[109] municipal securities serve as a critical cornerstone for financing of the U.S.'s capital investment in public services and infrastructure and are an important part of the U.S.'s capital markets. We support the position adopted in the comment letter on municipal securities submitted by SIFMA ("**SIFMA Municipals Letter**") and believe that municipal securities should be treated as Level 2A liquid assets. Municipal securities meet the requirements for HQLA outlined in the U.S. Proposal and in some respects are safer and more liquid than assets recognized as HQLA in the Proposed Rules.

The Preamble describes the characteristics of assets that qualify for inclusion as HQLA, such as assets that are "easily and readily valued" and "lower risk", "do not incur sharp price declines", benefit

---

[108] Preamble at 71827.

[109] Board of Governors of the Federal Reserve System, Flow of Funds, Balance Sheets, and Integrated Macroeconomic Accounts, Third Quarter 2013, Table L.211, page 98.

from "active outright and repurchase markets at all times with significant diversity in market participants as well as high volume", and may be "pledge[d] at a central bank as collateral for intraday liquidity needs and overnight liquidity facilities."[110] As discussed in the SIFMA Municipals Letter, municipal securities exhibit all of these qualities. The municipal market is liquid with a diverse mix of participants, including retail and institutional investors as well as over 1,650 registered dealers,[111] and price quotes are readily available from dealers on almost any transaction. The municipal trading market is also robust, with a higher daily turnover rate in 2012 than the turnover rate for corporate bonds.[112] Furthermore, based on historical performance, municipal securities are arguably more price-stable and do not experience any greater loss of liquidity during periods of stress than other securities which are considered HQLA under the Proposed Rules. For example, the cumulative ten-year default rate for BBB-rated municipal securities is 0.3% while BBB-rate corporate bonds exhibit a 4.74% cumulative ten-year default rate.[113] Finally, Covered Banks may use municipal bonds as collateral for discount window advances as well as to offset risks associated with extensions of daylight credit of master account activity.[114]

In addition, the Proposed Rule's treatment of municipal securities is inconsistent with the treatment recommended by the Basel Committee. Under the Basel LCR, "marketable securities representing claims on or guaranteed by sovereigns, central banks, PSEs or multilateral development banks" are treated as Level 2A liquid assets where PSEs include governmental entities other than a central government including U.S. state and local governments.[115] U.S. municipal securities meet the criteria outlined in the Basel LCR and any departure from the Basel LCR is not warranted by Country-Specific Circumstances. Therefore, the Agencies should align their treatment of municipal securities with the Basel LCR and assign municipal securities to Level 2A.

4. The Final U.S. LCR should establish a framework for including covered bonds as Level 2B liquid assets.

---

110 Preamble at 71823-24.

111 Municipal Securities Rulemaking Board, "MSRB Registrants," www.msrb.org/msrb1/pqweb/registrants.asp.

112 Based on the average daily trading volume in relation to total volume outstanding, in 2012 0.35% of total outstanding municipal securities traded each day versus 0.24% of outstanding corporate bonds. *See* Board of Governors of the Federal Reserve System, Flow of Funds, Balance Sheets, and Integrated Macroeconomic Accounts, Third Quarter 2013 Table L.212, page 99 (based on $11.1 trillion of corporate bonds outstanding on December 31, 2012 from data on "Nonfinancial corporate business" and "Financial sectors" including sub-investment grade).

113 BNY Mellon Wealth Management, "Muni Bond Defaults, Bankruptcies and Bondholder Protections," August 2013, page 1.

114 Federal Reserve System, "Federal Reserve Collateral Guidelines," January 2, 2013, page 3.

115 Basel LCR ¶ 52.

Similar to the treatment of obligations of U.S. municipalities, the Preamble notes that covered bonds would be unlikely to qualify as HQLA currently because the Agencies believe that at this time these assets are not liquid and readily marketable in U.S. markets and therefore would not have the liquidity characteristics of HQLA. Under the Basel LCR, by contrast, covered bonds rated at least AA- are included as Level 2A liquid assets with a 15% haircut. We understand that the U.S. market for covered bonds is not a highly developed market and, therefore, deviation from the Basel LCR is appropriate as a Country-Specific Circumstance. We believe it is important, however, to establish a framework in the Final U.S. LCR for recognizing covered bonds as HQLA even though currently the markets are not developed enough to support their inclusion as HQLA. Accordingly, we support the criteria described in the SIFMA/SFIG Letter for including covered bonds as HQLA to the extent that they meet liquidity criteria consistent with those established by the Agencies for publicly traded corporate debt securities. We note that the SIFMA/SFIG proposal is to include covered bonds as Level 2B liquid assets (rather than Level 2A liquid assets as under the Basel LCR) in recognition of the state of development of the U.S. covered bond market. We believe it is nonetheless important to create a framework because markets can develop rapidly, and may be more likely to do so when there is a clear regulatory incentive. Furthermore, this recognition of covered bonds may be another means to help encourage the return of private capital to the residential mortgage market.

5. Asset-backed securities ("ABS") that have the same liquidity characteristics as publicly traded corporate debt securities should qualify as Level 2B liquid assets.

We support the proposal in the SIFMA/SFIG Letter to include as Level 2B liquid assets ABS that meet the liquidity criteria required for publicly traded corporate debt securities. In light of the high degree of liquidity of ABS that meet the criteria outlined in the SIFMA/SFIG Letter, we believe it is appropriate to include such securities. Investors and banks, including Covered Banks, should be encouraged to continue to invest in the ABS market, as decreased investment in ABS may decrease the availability of financing to bank customers. Inclusion of ABS will help support a broader and more diverse HQLA pool, which is important to help avoid the potential market distortions discussed above and promote economic growth more generally.

B. Certain of the criteria for Level 2B assets are too narrow and exclude certain liquid markets.

1. The definition of "publicly traded" is too narrow as it applies to corporate debt securities.

Although we appreciate the need for a rigorous definition of each component of HQLA, certain criteria for inclusion as Level 2B assets would exclude assets that are as liquid as qualifying assets. In particular, the scope of corporate debt securities that may be included as Level 2B assets is too narrow because the definition of "publicly traded" would exclude a substantial portion of corporate debt securities and only common equity securities traded on the S&P 500 currently are eligible despite indices in other jurisdictions that include equities that are liquid and readily marketable.

Many corporate debt securities are not listed on a national securities exchange as would be required under the "publicly traded" definition. Unlike equity securities, corporate debt securities are not typically listed on a national securities exchange. Instead, corporate debt securities generally are issued to institutional investors under the SEC's Rule 144A and trade in well-established, active, and liquid secondary markets. Rather than require that the corporate debt securities themselves be publicly traded, we would propose that the issuer of such corporate debt be a publicly traded company with common equity that meets the publicly traded requirement. This modification would not undermine the liquidity characteristics of eligible corporate debt and would reflect the realities of the U.S. corporate debt market.

2. The Agencies should recognize a greater scope of equity indices in the criteria for Level 2B assets for purposes of secured lending outflows.

The Proposed Rules employ HQLA classifications in two ways: first, to determine the pool of available liquidity resources (i.e., the LCR numerator); second, to determine the appropriate outflow rates that apply to secured lending transactions (i.e., the LCR denominator). We believe that the Agencies should expand Level 2B HQLA recognition for purposes of the LCR denominator, even when those assets are not recognized as HQLA in the LCR numerator, as failure to do so would result in anomalous LCR results for reliable secured lending transactions with low liquidity risk profiles.

We believe that the Agencies drafted the HQLA Level 2B criteria with a principal focus on the LCR numerator to ensure that banking organizations have a reliable pool of high quality liquid assets available to meet funding needs in both normal and stressed conditions. Accordingly, Section 20(c)(2) of the Proposed Rules limits Level 2B common equity securities to shares included in the S&P 500; common equity shares recognized by local regulatory authorities, but only where the shares are held in the foreign jurisdiction; and shares in other indices, if the Covered Bank demonstrates to the satisfaction of the Agencies that the indices in question are as liquid and readily marketable as equities included in the S&P 500.

Although these criteria may help to reinforce the reliability of a Covered Bank's LCR numerator, the criteria may produce exaggerated outflows when applied to secured lending transactions captured in the LCR denominator. The LCR applies run-off rates to secured lending transactions based on the collateral; transactions secured by Level 2B HQLA receive a 50% run-off rate, while transactions secured by non-HQLA receive a 100% run-off rate.[116] Until such time as a Covered Bank obtains the Agencies' approval to treat common equity shares in foreign indices as Level 2B HQLA, the Covered Bank would be required to apply a 100% outflow rate to secured lending transactions collateralized by such securities. This treatment would apply even where the Covered Bank has no plans to include the securities in its liquidity resource pool (the numerator), and where the secured lending transactions (the denominator) are subject to market and credit risk arrangements that establish a liquidity risk profile comparable to secured lending transactions that receive a 50% outflow rate under the Proposed Rules.

---

[116] Proposed Rule § 32(j)(1)(v), (vi).

The distinction between the roles of HQLA in the LCR numerator and denominator is significant, and the Agencies should consider a narrow expansion of the Level 2B HQLA category for purposes of secured lending run-off rates in the denominator. Such a narrow expansion should be based on a list of reliable global indices that commonly support secured lending transactions and which have demonstrated reliability in stressed market conditions. This approach would give market participants certainty when structuring secured financing transactions – rather than requiring them to wait for Covered Banks to seek approval for foreign common equity securities, including exchange traded funds, to qualify as Level 2B HQLA on an ad hoc basis for purposes of the LCR numerator – and would be consistent with the underlying Level 2B standards described in the Basel LCR framework.[117] Annex C to this letter includes a list of global indices in major markets that commonly support secured lending transactions, which would be appropriate for inclusion in the Level 2B criteria for the limited purpose of determining the outflow rate for secured lending transactions.

C. The "liquid and readily marketable" criteria applicable to most classes of HQLA-eligible securities should be expanded to take into account indicators of liquidity that are unrelated to secondary markets and should be modified to address certain operational issues.

The U.S. Proposal includes a definition of "liquid and readily marketable" that would apply to HQLA-eligible securities other than those issued or guaranteed by the Treasury. In order to demonstrate that a security is liquid and readily marketable, a Covered Bank would need to show that such "security is traded in an active secondary market with: (1) more than two committed market makers; (2) a large number of non-market maker participants on both the buying and selling sides of transactions; (3) timely and observable market prices; and (4) a high trading volume."[118]

This definition focuses exclusively on secondary cash markets. In practice, however, Covered Banks have other avenues of monetizing securities other than outright sales, including through repo transactions and posting as collateral securing over-the-counter or exchange-traded derivative transactions. The Basel Committee recognized these and other mechanisms for monetizing assets in its "Guidance for Supervisors on Market-Based Indicators of Liquidity" (the "**Basel Liquidity Guidance**").[119]

In addition, we note that the definition would appear to require a security-by-security analysis that incorporates data on market makers and market participants, as well as trading volumes. This could be a significant exercise taking into account the fact that, because the HQLA classification affects both the securities included in the numerator as well as certain outflows in the denominator, virtually all of a Covered Bank's securities positions would need to be systemically identified and "tagged" as to whether they meet the criteria. Covered Banks with significant trading operations could have millions of individual securities positions.

---

117 *See* Basel LCR ¶ 54(c).

118 Proposed Rule § 3.

119 Basel Committee, Guidance for Supervisors on Market-Based Indicators of Liquidity (Jan. 2014).

We believe that a more qualitative approach to identifying securities that meet the liquid and readily marketable standard may be appropriate to address these concerns. We would be pleased to work with the Agencies during the period leading up to the time full compliance with the LCR is required to develop an approach that takes into account the Basel Liquidity Guidance and includes a more efficient approach to identifying qualifying securities.

D. The Final U.S. LCR should permit a Covered Bank to include on a consolidated basis assets that qualify as HQLA in a subsidiary's host jurisdiction up to the amount of the subsidiary's net cash outflow.

Many Covered Banks conduct operations in multiple jurisdictions, many of which have or will have liquidity regimes that differ from the U.S. regime. To help address compliance issues and competitive considerations, we believe that, at a minimum, the Final U.S. LCR should permit a Covered Bank to include when calculating its consolidated LCR locally compliant HQLA (as subject to locally determined haircuts) held by a Covered Bank's non-U.S. subsidiaries that are subject to a LCR regime that implements the Basel LCR up to the amount of the subsidiary's net cash outflow.[120]

The definition of HQLA will differ across jurisdictions implementing the Basel LCR to reflect the assets that are highly liquid in that jurisdiction. Other jurisdictions may include, for example, committed liquidity facilities or covered bonds. First, the local definition of HQLA is most likely to reflect the highly liquid assets in the geographical markets in which the subsidiary is most active. Second, relying on the local definition of HQLA is important for competitive reasons in those jurisdictions that have a broader definition of HQLA-eligibility. This is important not only because certain outflows, such as secured funding and secured lending outflows, are determined in part based on HQLA-eligibility of the underlying collateral. Finally, this approach would also be consistent with the approach recommended by the European Banking Authority, as part of the implementation of the LCR in the EU, for HQLA in jurisdictions outside of the Euro Area.[121]

In addition, consistent with the Basel LCR,[122] we request clarification that a Covered Bank may recognize on a consolidated basis deposit insurance regimes recognized by national regulators in the jurisdictions of a Covered Bank's non-U.S. subsidiaries.

E. The sufficiency of HQLA held in the United States should be addressed as a supervisory matter.

Under Section 20(f) of the Proposed Rules, a Covered Bank is generally expected to maintain in the United States sufficient amounts and types of HQLA to meet its total net cash outflow amount in the

---

120 The same considerations would apply to non-U.S. branches of Covered Banks in jurisdictions where an LCR requirement is imposed on the branch.

121 *See* http://www.eba.europa.eu/-/eba-publishes-reports-on-liquidity.

122 Basel LCR ¶ 169.

United States. We understand the concern of the Agencies that, absent such a requirement, the liquidity requirements in non-U.S. jurisdictions may leave a Covered Bank with a shortfall of HQLA in the United States relative to net outflow in the United States. We support the approach taken by the Agencies in the Proposed Rules, which establishes the expectation that a Covered Bank will have sufficient HQLA in the United States without prescribing the actions that must be taken to meet that requirement. Because the extent and nature of each Covered Bank's non-U.S. liquidity requirements will be specific to the Covered Bank's particular circumstances and international footprint, this requirement is best addressed through the supervisory process.[123] In this way, a Covered Bank may tailor the requirement to the extent of the risk posed by competing liquidity requirements, if any, in other jurisdictions.

F. The Agencies and the SEC should consult regarding the interaction between the Proposed Rules and the SEC's proposed liquidity rule for alternative net capital broker-dealers ("ANC B-Ds") and security-based swap dealers ("SBSDs") to ensure that the interplay between the liquidity requirements do not have unintended consequences for the Covered Banks' compliance with the LCR.

The SEC published proposed rules in 2012 (the "**SEC Liquidity Proposal**") to establish regulatory liquidity standards for ANC B-Ds and SBSDs.[124] Although all ANC B-Ds are controlled by Covered Banks,[125] neither the SEC Liquidity Proposal nor the Agencies' Proposed Rules address the interaction of these two proposed liquidity regimes. In addition, although no SBSDs are currently registered with the SEC, we expect that many SBSDs will be subsidiaries of U.S. banking organizations, raising additional tensions between the two rulemakings.[126] If the Proposed Rules and the SEC Liquidity Proposal are each finalized as proposed, Covered Banks controlling ANC B-Ds or SBSDs will be subject to uncoordinated, inconsistent requirements that could weaken centralized liquidity management. We recommend that the Agencies and the SEC should coordinate their rulemakings to establish a workable regime that promotes centralized liquidity management.

Certain Covered Banks with ANC B-D subsidiaries have recommended that the SEC revise its SEC Liquidity Proposal to (i) recognize the Agencies' HQLA standards when setting liquid asset resource

---

123 As part of this process, the amount of HQLA to be held in the United States should take into account the availability of liquidity from affiliates and offices outside the United States and the ability to transfer such liquidity to a Covered Bank.

124 78 Fed. Reg. 71,818, 71,852-54 (Nov. 29, 2013). See 17 C.F.R. §§ 15c3-1(f), 18a-1(f) (proposed).

125 There are currently six ANC B-Ds, most of which are controlled by U.S. banking organizations. A foreign banking organization that controls an ANC B-D would likely be required to establish an intermediate U.S. holding company to control the ANC B-D under the Board's proposed foreign banking organization rulemaking. *See* 77 Fed. Reg. 76628 (Dec. 28, 2012).

126 Although no SBSDs have registered with the SEC yet, the registration of swap dealers with the CFTC offers rough guidance on the anticipated concentration of SBSDs among U.S. banking organizations. *See* http://www.cftc.gov/LawRegulation/DoddFrankAct/registerswapdealer.

standards at SEC-regulated subsidiaries; (ii) permit ANC B-Ds and SBSDs to use liquidity reserves on an intraday basis while meeting end-of-day liquidity minimums, similar to the Agencies' Proposed Rule § 10(a); and (iii) recognize HQLA held by an ANC B-D's or SBSD's parent company as supporting the subsidiary entity's liquidity requirements under appropriate circumstances.[127] We believe that such appropriate circumstances exist where:

- the parent banking organization is subject to the Final U.S. LCR on a consolidated basis;
- the parent banking organization has submitted a resolution plan to the Board and the FDIC;
- the resolution plan anticipates the ANC B-D or SBSD receiving liquidity support in the event of material financial distress at the parent banking organization; and
- the Board and the FDIC have not objected to the parent banking organization's resolution plan.

We request that the Agencies and the SEC consider coordinated rulemakings to put this recommendation into effect. This recommendation would align rulemakings across the agencies and promote harmonization of the liquidity and resolution regulatory regimes.

Whether or not the Agencies adopt the coordinated approach described above, we recommend modifications to the Proposed Rules to facilitate the recognition of HQLA held by ANC B-Ds or SBSDs in a Covered Bank's consolidated HQLA. In particular, we recommend that the Agencies revise Section 20(e)(3)(ii) to permit full recognition, for LCR purposes, of HQLA held by ANC B-Ds or SBSDs, without regard to the "regulatory" restrictions language in Section 20(e)(3)(ii)(B), as long as the subsidiary in question is subject to liquidity regulation by the SEC. There may be circumstances where an ANC B-D or SBSD maintains liquidity reserves well in excess of formal SEC liquidity minimums, either as a result of SEC supervisory expectations or simply because the market-making function of ANC B-Ds results in excess stocks of HQLA. Even where such liquidity reserves could be transferred within a consolidated organization in times of stress, there may be confusion around whether such reserves are technically free of "regulatory" restrictions, because in their present form the SEC's and Agencies' liquidity rulemakings are not coordinated. We believe that this modification would be consistent with the Basel LCR, which focuses on the underlying question of whether subsidiaries' assets would be "freely available" in times of stress,[128] and would promote harmonization and consistency of regulatory regimes while protecting the financial stability of specific firms and markets more generally.

G. The Final U.S. LCR should provide the Agencies with the flexibility to include additional high-quality assets at future dates as HQLA.

---

[127] SIFMA and representatives of various ANC B-Ds met with the SEC on January 10, 2014 to discuss this recommendation. Materials describing this recommendation in greater detail are available at: http://www.sec.gov/comments/s7-08-12/s70812-55.pdf.

[128] Basel LCR ¶¶ 36-37.

Section 2 of the Proposed Rules contains a reservation of authority that enables the Agencies to modify a Covered Bank's liquidity requirements or take measures to improve the Bank's liquidity risk profile from time to time. However, Section 2 does not provide the Agencies with the flexibility to include additional assets as HQLA in the future. We urge the Agencies to provide in the Final U.S. LCR that other assets specified from time to time by the Agencies as HQLA may be included. The U.S. financial markets are dynamic, necessitating a mechanism to recognize as HQLA under the Final U.S. LCR assets meeting the requirements of HQLA that evolve over time.

We believe it is important that the Final U.S. LCR include a mechanism for expanding the scope of HQLA that is more streamlined than a formal rulemaking proceeding under the Administrative Procedures Act. U.S. and international banks are making substantial efforts to identify and analyze metrics that demonstrate the liquidity of securities and other assets and facilities in time of stress. If these endeavors result in agreement upon metrics that the Agencies and other bank regulators as well as the industry believe are appropriate indicators of liquidity for stress testing and buffer purposes, it will be important to create a mechanism for expanding the definition of highly liquid assets to accommodate them for all Covered Banks in an expeditious manner.

V. Operational and Other Issues

A. We request that the Agencies harmonize the LCR's calculation frequency with the Federal Reserve's complex liquidity monitoring reports and at the least defer implementation of the Proposed Rules' daily calculation requirements as part of an Agency and bank effort to prioritize the allocation of information technology resources among competing initiatives.

Section 10 of the Proposed Rules requires each Covered Bank (including each Modified Covered Bank) to calculate its LCR on each business day. And Section 40, in a parallel provision, requires each Covered Bank to notify the relevant Agency on any business day when its LCR is calculated to be less than the minimum. We urge the Agencies to modify these provisions in the Final U.S. LCR, at least for the time being and perhaps permanently, and instead provide for monthly calculations combined with monitoring and supervisory oversight. It would be imprudent from a supervisory perspective to adopt a standard that, due to its sheer complexity and lack of adequate time to properly prepare, risks providing regulators (and investors if the Basel Committee's contemplated liquidity disclosure standards are implemented) with potentially flawed data. Given that the LCR for Covered Banks is not yet finalized, it simply is not possible for Covered Banks to meet a January 2015 deadline for daily calculations with the requisite level of confidence in their accuracy. This time frame is especially imprudent if Covered Banks are required to disclose their LCRs; information that is publicly disclosed must have the highest possible level of accuracy.

Capturing and analyzing the data to perform the LCR calculation on a daily basis will require banks to implement data retrieval systems and mechanics to capture the necessary data. Much of the data necessary for the LCR calculation is, or will be, captured and refreshed on a daily basis, at least by the largest and most complex banking organizations; some, however, may not be updated daily where significant "upstream" systems development (i.e., upstream from the system performing the

calculation) is required and management determines that circumstances warrant a less-frequent update. For example, retail deposit balances in many firms, due to the relatively large and stable nature of such balances, may be updated less frequently. In addition, some outflows and inflows require the combination of data from various systems. For example, the calculation of deposit outflows would need to take into account the deposit balances and depositor type, the insured amount of such balances and, for certain smaller businesses, the amount of funding received from such businesses, in order to determine whether they would be classified as retail deposits or wholesale deposits. In addition, calculation of derivative payables under Section 32(c) and derivative payables under Section 33(b) requires firms to combine information on derivative cashflows with data in collateral and contract management systems. The detail and granularity of data required to apply the Proposed Rules mean time will be required to build sustainable reporting systems that can accurately capture and calculate these numbers in a controlled manner on a daily basis.

Moreover, the operational challenges and costs associated with developing, implementing and testing the systems necessary to calculate the LCR (or Modified LCR) on a daily basis will be greater for the many Covered Banks that are not currently subject to the Federal Reserve's "4G" reporting framework.

We urge the Agencies to move cautiously in their consideration of daily calculations. [129] The issue in the short term is the prioritization of regulatory initiatives requiring IT enhancements. The demands placed on Covered Banks' IT resources have been increasing exponentially in recent years, and if the Final U.S. LCR becomes effective on January 1, 2015 as contemplated by the U.S. Proposal, Covered Banks would need to begin work immediately on the IT upgrades and enhancements necessary to implement the Final U.S. LCR prior to the finalization of the Proposed Rules and clarification of the intent of various provisions identified herein and other ambiguities that will emerge during the course of implementation. In the near term, very substantial IT resources are required to accommodate the Agencies' recently adopted new capital rules implementing the Basel III framework (among other changes) for U.S. banks (and applicable to advanced approaches banks, which encompasses the Covered Banks, for a first reporting period ending on March 31, 2014), changes to stress testing data gathering and related requirements (both for capital planning purposes under the CCAR rules[130] and the stress testing rules implementing Section 165 of Dodd-Frank and known as the "**DFAST**" rules), [131] data gathering necessary to prepare Dodd-Frank required resolution plans, data gathering required as part of the development of compliance plans for the final Volcker Rule recently adopted by the Agencies together with the SEC and CFTC, anticipated rules to implement other sections of Dodd-Frank (e.g., the

---

[129] Our concerns with daily calculations apply equally to the aspects of the Basel Committee's recently released document entitled Liquidity Coverage Ratio Disclosure Standards (Jan. 2014) that assume daily calculations—specifically, paragraph 13 of that document, which contemplates that disclosed data "must be presented as simple averages of daily observations."

[130] Section 252.8 of Regulation Y, 12 C.F.R. Part 225.8.

[131] Regulation YY, 12 C.F.R. Part 252.

single counterparty credit limit rules), and incremental reporting required under the Federal Reserve's "5G" proposal.

In the longer term, we have serious reservations as to whether liquidity risk supervision and management cannot prudently and sufficiently be addressed through a liquidity monitoring approach on a less formal and burdensome basis than daily calculations, even for the larger and more complex Covered Banks. And for other organizations with less complex liquidity profiles, a daily calculation as a general matter is neither necessary nor appropriate. The Federal Reserve has already recognized this fact in its proposed liquidity monitoring reporting framework. Under this framework, G-SIBs would report liquidity information on a daily basis (the FR 2052a), while other organizations would report on a monthly basis (the FR 2052b).[132]

We urge the Agencies to engage in a dialogue with the banking industry to prioritize the application of IT resources to these various initiatives and, in that connection, take steps to relieve the strain on IT resources and associated operational risk, including by adjusting the implementation dates for components of some of these initiatives. In that regard, we urge the Agencies to provide for monthly calculations, at least initially and subject to further discussion with the industry and consideration of relevant issues. Implementation of this request requires changes in both Sections 10 and 40 of the Proposed Rules. It may also be appropriate for the Agencies to reconsider the need for a daily calculation requirement versus requiring that Covered Banks have the capability to calculate their LCRs at any time. To the extent the Agencies are concerned that a monthly reporting requirement conforming to the Basel LCR raises a concern that delay in recognizing and remediating shortfalls is a material risk, we urge the Agencies to work with each Covered Bank as a supervisory matter to address those concerns pending potential implementation of daily calculations at a later date.

B. We request that the Agencies extend the proposed 21-day stress period under the Modified LCR, based on 70% of the proposed outflow rates, to reflect the calendar-month cycle of the activities of Modified Covered Banks.

We appreciate the Agencies' recognition that the liquidity risk profile of Modified Covered Banks may differ from that of other Covered Banks. However, the proposal to comply with the LCR on a 21-day basis poses significant operational problems, and may result in extremely volatile LCRs for Modified Covered Banks.

As a general matter, customer activity is rooted in a calendar-month cycle, leading Covered Banks also to manage maturities and refinancing on a calendar month basis. For example, banking organizations can accurately estimate the time of the month when large volumes of customer payments will be received and can time debt maturities based on that monthly time frame. The 21-day forward-looking stress period required under the Modified LCR would consistently omit key recurring payment activity that occurs on the calendar-month cycle and force Modified Covered Banks to manage cash flows for the purpose of mitigating volatility in their ratio.

---

[132] Proposed Agency Information Collection Activities: Comment Request, 78 Fed. Reg. 57,634 (Sept. 19, 2013).

Accordingly, we respectfully ask the Agencies to extend the proposed 21-day stress period under the Modified LCR to instead encompass the calendar-month cycle. Under this approach the Modified LCR would be calculated using the Federal Reserve's proposed outflow assumptions (based on 70% of the proposed outflow rates under the full LCR) over the course of a calendar-month projection period. Modifying the projection period in this way would better align the Modified LCR with established internal liquidity management and financial reporting cycles.

C. A company should not be considered a "regulated financial company" solely because it must be included in the organizational chart on a Covered Bank's Form FR Y-6.

The second prong of the definition of "regulated financial company" in Section 3 of the Proposed Rules would include any company that must be included in the organizational chart on a Covered Bank's Form FR Y-6, as reflected on the National Information Center ("**NIC**") website. [133] Due to the breadth of investments that must be reported on the FR Y-6, this prong of the definition is overly broad and operationally burdensome without providing meaningful benefit and should be eliminated from the definition of "regulated financial company."

Form FR Y-6 is the annual report required by the Federal Reserve, the purpose of which is to provide data to supervisory staff to monitor the activities of holding companies and to ensure that their activities are conducted in a safe and sound manner. Accordingly, the FR Y-6 is an expansive form that is meant to capture a substantial range of activities and investments of depository institution holding companies. For example, the FR Y-6 requires a depository institution holding company to include on the FR Y-6 organizational chart a company in which it has an investment of between 5% and 25% of a class of the target company's voting securities. It must also include merchant banking investments that are reportable on the Federal Reserve Form FR Y-10.

The scope of the FR Y-6 means that companies will be treated as regulated financial companies even where a Covered Bank's investment may be significantly below the threshold at which it would be consolidated. A company in which a Covered Bank has a minority and possibly noncontrolling interest would not necessarily have, as suggested in the Preamble,[134] "links" with the Covered Bank that would be "sufficiently significant" to warrant treatment of such company as a regulated financial company. Furthermore, a company that is a merchant banking investment engages predominately in commercial activities—such as a company in the hospitality industry or a manufacturing company—and the Covered Bank is prohibited from engaging in their routine management. Nonetheless, it would be treated as a regulated financial company under the Proposed Rules. The organizational hierarchy chart provided on the NIC website categorizes many entities as "domestic entity other" so it would not provide a simple means to distinguish between a merchant banking investment and financial companies. In addition, this information is not incorporated into a Covered Bank's internal systems—and there is not a

---

133 National Information Center, http://www.ffiec.gov/nicpubweb/nicweb/nichome.aspx.

134 Preamble at 71825.

straightforward process for incorporating such information on an ongoing basis to reflect updates to the NIC website.

The Preamble explains in the context of the HQLA definition that the identification of "regulated financial companies" and other financial sector entities is meant to identify those companies that are likely to present "wrong way risk."[135] However, a merchant banking investment, as a nonfinancial enterprise, should not present any such risk. In the context of addressing wrong way risk, the Proposed Rules use the term "regulated financial company" together with a list of other financial sector entities (investment company, non-regulated fund, pension fund, investment adviser, and identified company).[136] These two definitions taken together already are broad enough to capture most entities, and certainly the most significant entities, that may pose wrong way risk. To the extent another class of financial sector entities is identified, the Agencies have the flexibility to add companies as "identified companies."

D. Certain trusts and other personal fiduciary accounts should be treated as individuals for purposes of the definition of "retail customer or counterparty."

Section 3 of the Proposed Rules defines a "retail customer or counterparty" as an individual or business customers that meet specific criteria. The term "retail customer or counterparty" is used to establish outflow rates, with outflow rates assigned to obligations to retail customers generally lower than those assigned to wholesale customers. We believe that personal and charitable trusts should be considered as another type of "retail customer or counterparty" when they are formed primarily for wealth management and similar personal, family or charitable purposes by retail customers because, in the experience of Covered Banks, these trusts generally behave similarly to retail customers or counterparties. In particular, we believe that deposits from such trusts generally are as stable as deposits from individuals. In addition, there are certain estates, uniform transfers to minors act accounts, and guardianships formed by retail customers ("**other personal fiduciary accounts**") that also exhibit characteristics of retail customers and counterparties and should be eligible for treatment as retail customers or counterparties.

We request recognition in the Final U.S. LCR that personal and charitable trusts and other personal fiduciary accounts may be considered retail customers or counterparties. We propose to work with the Agencies to develop a definition of "personal and charitable trust" and "other personal fiduciary accounts" that could be used either in the Final U.S. LCR or, in light of the unique characteristics of each Covered Bank's trust and fiduciary business, could be used in the supervisory process to evaluate the appropriateness of the inclusion of such customers by a Covered Bank as retail.

---

[135] Preamble at 71824.

[136] The only other context in which the term "regulated financial company" is used in the Proposed Rules is in the definition of "brokered sweep deposits" in Section 3. We do not anticipate that entities other than those enumerated in the paragraphs of the definition of "regulated financial company" other than paragraph (2) would be engaged in brokered sweep deposits with a Covered Bank.

Furthermore, certain non-profit entities, such as churches, foundations, and other charitable organizations also tend to have behavioral characteristics that resemble retail customers or counterparties. We similarly propose to work with the Agencies to develop a definition for such entities that is consistent with the "retail customer or counterparty" definition that includes criteria similar to those for business customers that are included within the definition.

VI. Clarifications

To ensure the appropriate scope of the LCR and consistent application of the LCR requirement across Covered Banks, we request clarification of certain aspects of the Proposed Rules' HQLA provisions in the Agencies' Final U.S. LCR or accompanying Preamble.

A. The Final U.S. LCR should clarify that Section 32(f)(2) applies only to derivative transactions.

We believe that the requirement to account in a Covered Bank's outflow amount for potential valuation changes in certain assets posted as collateral under Section 32(f)(2) of the Proposed Rules applies only to derivative transactions and not to other transactions, such as secured funding transactions. Imposing such a requirement on transactions other than derivative transactions would be unnecessary and duplicative. The concern that a Covered Bank may be required to post additional collateral if the fair value of the collateral declines is already addressed through the roll-over assumptions and haircuts that underlie the outflow rates for such transactions. This approach would be generally consistent with paragraph 119 of the Basel LCR, which, although it allows for application of this requirement to other types of transactions, focuses exclusively on derivatives transactions. As currently drafted, neither Section 32(f)(2) of the Proposed Rules nor the explanation in the Preamble limits the application of the outflow to derivative transactions as intended by the Basel LCR.

B. We request the Agencies confirm that no outflow is assigned to trade finance contingent funding liabilities.

Paragraph 76 of the Basel LCR authorizes national regulators to apply a run-off rate of up to 5% to contingent financing liabilities related to trade finance instruments. Since the U.S. Proposal is silent as to the treatment of such liabilities, we understand the U.S. Proposal is not assigning an outflow rate to these contingent funding liabilities. This treatment makes sense because outflows under these contingent funding liabilities generally would not be triggered by stress at the bank. In order to avoid any uncertainty, we request the Agencies to clarify, either in the Final U.S. LCR or its accompanying Preamble, that there is no outflow associated with contingent financing liabilities related to trade finance instruments.

C. Loans that are conducted on an open maturity basis and contractually due on demand should be included as inflows.

We request clarification regarding the treatment of loans conducted on an open maturity basis[137] but that are contractually due on demand. We are concerned that cash inflows arising from these types of demand loans could potentially be excluded by Section 33(a)(6) of the Proposed Rules because the loans do not have an *explicit* contractual maturity date. These loans, which include stock lending and similar secured funding arrangements, are important and reliable sources of liquidity for a Covered Bank during a 30-day liquidity stress period because they are payable upon the Covered Bank's demand, and their exclusion could have a significant impact on the Covered Bank's liquidity position under the LCR. Accordingly, we request confirmation that loans contractually due on demand are *not* considered contracts with no maturity date for purposes of the LCR. We believe the types of contracts with no maturity date that Section 33(a)(6) meant to capture include, for example, trade receivables, and *not* contracts that are payable on demand.

D. The Final U.S. LCR should fix an inconsistency between the outflow rate for certain secured lending transactions and the definition of "secured lending transaction."

Section 33(f)(iv) of the Proposed Rules provides that a Covered Bank's secured lending cash inflow amount includes "100 percent of all contractual payments due to the [BANK] pursuant to secured lending transactions, to the extent that the payments are secured by assets that are not HQLA, provided that the [BANK] is not using the collateral to cover any of its short positions." This provision appears to contradict the definition of "secured lending transaction" in Section 3, which includes only transactions that are secured by assets that are included in the Covered Bank's HQLA amount. The definition further provides that, if the assets are not included in the Covered Bank's HQLA amount but are still held by the Covered Bank, then the transaction is an unsecured wholesale funding transaction. The Final U.S. LCR should amend the definition of "secured lending transaction" to address this inconsistency.

E. We request confirmation that only transactions that are conducted by or for the benefit of the liquidity management function are included when Covered Banks calculate the adjusted excess HQLA amount.

Under Section 21 of the Proposed Rules, a Covered Bank would be required to calculate both its unadjusted excess HQLA amount and the adjusted excess HQLA amount. The adjusted excess HQLA amount is calculated after giving effect to secured funding transactions where the Covered Bank and the counterparty exchange HQLA. Because Section 21 does not explicitly limit the adjusted calculation to transactions involving HQLA that are under the control of the liquidity management function for purposes of Section 20(d)(2), the provision could be read to require a Covered Bank to apply the requirement to secured funding transactions that are undertaken outside of the liquidity management function – that is, not in accordance with Section 20(d) of the Proposed Rules. We do not believe it is the intent of the Agencies to include transactions undertaken outside of the liquidity management function within the meaning of Section 20(d)(2) because such transactions would be included only as outflows or inflows in the denominator of the LCR and would not have any impact on a Covered Bank's

[137] By "open maturity," we mean contracts with no specified maturity date but that may be terminated by either party at any time.

HQLA amount in the numerator. This is the approach under the Basel LCR, which provides that the requirement to unwind the transaction applies to exchanges of any HQLA that "meet (or would meet if held unencumbered) the operational requirements for HQLA" in the paragraphs of the Basel LCR that relate to operational requirements for HQLA (paragraphs 28-40). Furthermore, this is how Covered Banks treat these transactions in LCR monitoring exercises, consistent with the Basel III monitoring instructions, and is the basis on which Covered Banks are developing their tracking and reporting systems. We request that the Agencies expressly adopt this approach and that it be reflected in the Final U.S. LCR.

Exclusion of secured funding transactions from the adjusted excess HQLA calculation is consistent with the purpose of the calculation, which the Agencies have explained is to "prevent a covered company from being able to manipulate its HQLA portfolio by engaging in transactions such as certain repurchase or reverse repurchase transactions." Covered Banks would not intend nor would they be able to manipulate the HQLA portfolio by excluding these transactions from the adjusted excess HQLA calculation because the transactions do not involve assets that will be included in HQLA pursuant to Section 20(d). Furthermore, this approach is consistent with the Basel LCR, which provides that the requirement to unwind the transaction applies to exchanges of any HQLA that "meet (or would meet if held unencumbered) the operational requirements for HQLA" in the paragraphs of the Basel LCR that relate to operational requirements for HQLA (paragraphs 28-40). This same approach is used in other Basel III monitoring instructions for the LCR. We request that the Agencies expressly adopt this approach and that it be reflected in the Final U.S. LCR.

F. The Final U.S. LCR should clarify that non-U.S. PSEs chartered for public purposes are not included in the definition of a "regulated financial company".

Section 10 of the Proposed Rules prohibits the inclusion of obligations issued by regulated financial companies in a Covered Bank's HQLA. In the Preamble, the Agencies comment on the term regulated financial company, and the exclusion from HQLA status of obligations of regulated financial companies, stating that:

> "[a]ssets that are included in HQLA should not be issued by financial sector entities since they would then be correlated with covered companies (or wrong-way risk assets)."[138]

While the definition of "regulated financial company" under Section 3 of the Proposed Rules explicitly excludes U.S. government-sponsored enterprises, it is silent regarding the treatment of non-U.S. government-sponsored enterprises and PSEs. We believe the definition of regulated financial company should not include non-U.S. PSEs that are established or chartered by a sovereign government to service a public purpose or purposes.

First, such PSEs customarily are not engaged in a full range of banking activities, given their specified public purposes, and we do not expect the trading and risk characteristics of their debt

[138] Preamble at 71824.

securities to correlate with those of Covered Banks (or, more broadly, banks in other jurisdictions that would be subject to their home countries' versions of the LCR) and, hence, to present wrong way risk concerns.

Second, paragraph (7) of the definition of regulated financial company brings within the scope of the definition

> "[a]ny company not domiciled in the United States . . . that is supervised and regulated in a manner similar to entities described in paragraphs (1) through (6) of this definition (e.g., a foreign banking organization)."

The use of the phrase "supervised in a manner similar to" the entities described in the earlier paragraphs of the definition, which include traditional banks and their holding companies, is a broad concept that could be subject to a variety of interpretations. Virtually any non-U.S. PSE that has financial functions (whether inside or outside of the United States) is subject to some regulation. It would be imprudent for a sovereign government to do otherwise.

We believe that PSEs outside of the United States that are established for a public purpose or purposes do not create wrong-way risk of the type addressed by the Agencies in the Preamble and should not be treated as regulated financial companies for purposes of the Final U.S. LCR. Securities of such entities that satisfy the other requirements for all HQLA in Section 20 of the Proposed Rules should be recognized as HQLA. Moreover, given the narrow scope of HQLA under the LCR in all jurisdictions (including the United States), it is important that the Agencies not unnecessarily exclude categories and obligations from HQLA status.

We respectfully request that the Agencies, when they adopt the Final U.S. LCR, address this issue through two approaches. The first approach would be to further explain, in the Preamble to the Final U.S. LCR, how paragraph (7)'s "supervised and regulated in a manner similar" standard should be construed. Were the Agencies to go that route, they could do so by specifying that non-U.S. PSEs that are owned by sovereign and other governmental authorities and mandated to serve a public purpose are not intended to be captured by paragraph (7), notwithstanding that they may be subject to some degree of supervision and regulation in their respective home countries.

The second approach would be to address the issue in the Final U.S. LCR itself, not merely as a matter of clarification, but by adding a new clause to paragraph (8) to the definition of regulated financial company expressly excluding an appropriate class of non-U.S. PSEs. The Agencies could implement that approach by adding an exclusion for "*non-U.S. public sector entities*" and including a definition for that term reading as follows:

> "*Non-U.S. public sector entity* means an entity established or chartered by a sovereign government outside of the United States to serve a public purpose or purposes specified in the charter (whether a statute or otherwise) for such entity."

The standard suggested in the definition – a non-U.S. government sponsored entity established or chartered by a sovereign government outside of the United States to serve a public purpose or purposes—is consistent with the Proposed Rules' definition of "*U.S. government-sponsored* enterprise".

G. We request the Agencies confirm that a Covered Bank may demonstrate its operational capability to monetize HQLA through its business-as-usual activities.

The operational criteria for HQLA require that a Covered Bank have the operational capability to monetize the HQLA. To demonstrate this operational capability, Section 20(d)(1)(ii) of the Proposed Rules would require a Covered Bank to monetize periodically a sample of HQLA. We believe that Covered Banks should be able to demonstrate sufficient operational capability to monetize assets through their business-as-usual activities, together with their policies and procedures, and request confirmation in the Final U.S. LCR that this would suffice to meet this requirement. Allowing Covered Banks to demonstrate their operational capabilities in this way rather than requiring the monetization of an asset solely for demonstration purposes should avoid a situation where a Covered Bank would have to recognize a loss on its profit and loss for financial reporting purposes ("**P&L**") statement for a sale that does not have a business purpose.

The Preamble explains that the purpose of the requirement to monetize a sample of HQLA on a periodic basis is to ensure that a Covered Bank has access to the market and effective processes for monetization. The requirement also serves to demonstrate a Covered Bank has the assets available and avoid negative signaling during a period of actual stress.[139] Many Covered Banks are active participants in the markets for HQLA, including the repo markets. As such, they engage on a daily basis in transactions that demonstrate their ability to monetize assets. These ordinary course transactions show that Covered Banks have the systems and agreements with counterparties in place to access the markets. A Covered Bank's business-as-usual activities should be sufficient to address the concerns such as access to markets and effective process, as well as demonstrating that the Covered Bank has available assets. Furthermore, given the volume of activity of many Covered Banks, the signaling concern cited in the Preamble should not be an issue. And, even if the actual stress scenario resulted in a significant increase in the volume of trading activity by a Covered Bank that already is active in these markets, it is unlikely that the monetization of a sampling of assets on a periodic basis above and beyond business-as-usual activity would be sufficient to disguise the spike in activity in any event. Given the potential downside from a P&L statement perspective of requiring monetization of assets solely for the purpose of meeting the requirement of Section 20(d)(1)(ii), we believe the sensible approach is to the extent possible to rely on the Covered Bank's business-as-usual activity, together with policies and procedures that may address unique circumstances, to fulfill this requirement.

H. We request confirmation that an asset may be monetized other than by sale and still be considered available to the liquidity management function.

---

[139] Preamble at 71829.

The U.S. Proposal outlines the operational requirements for HQLA, which include a requirement that all HQLA be under the control of the liquidity management function. Section 20(d)(2) of the Proposed Rules states that satisfaction of the centralized liquidity management requirement may be evidenced by "[d]emonstrating the ability to monetize the assets and making the proceeds available to the liquidity management function without conflicting with a business risk or management strategy of the [BANK]." This text does not limit the means of monetizing an asset to its sale and, therefore, on its face would appear to allow monetization by other means including a repurchase agreement. In contrast, the Preamble provides as an example that liquid assets held as a hedge against a specific transaction may not be counted as HQLA because the *sale* of the liquid asset would disrupt the risk management strategy.[140] However, the sale of the liquid asset is not the only method of monetization, which the Agencies also recognize in the Preamble.[141] A bank can monetize an asset pursuant to a repurchase agreement. We request the Agencies clarify the language so that it is consistent throughout the Preamble that a Covered Bank can meet the operational requirements through channels of monetization other than a sale, including repurchase agreements.

I. The scope of the definition of "special purpose entity" should be clarified to ensure that it does not include entities, operating companies formed to hold specific real estate assets and other companies that do not raise the concerns the definition is meant to address.

Section 3 of the Proposed Rules defines a "special purpose entity" as a company organized for a specific purpose that has limited activities that are appropriate to accomplish a specific purpose and is structured to isolate the credit risk of the SPE. Under Section 32(e)(1)(vi) of the Proposed Rules, the outflow rate of the undrawn amount of all committed credit and liquidity facilities extended to SPEs is 100%. The Preamble provides that the 100% outflow amount is appropriate because SPEs are sensitive to emergency cash backstop needs in short-term stress environments, such as during the recent financial crisis.[142] Although we recognize that some SPEs raise unique liquidity concerns, we are concerned that the breadth of the definition could inadvertently sweep in a wider range of entities, such as operating companies formed to hold or develop specific real estate assets or SPEs used to facilitate financing arrangements.[143] To help avoid this uncertainty, it would be useful to have specific examples in the Final U.S. LCR of entities that are meant to be included in the definition, and those that are outside of the scope of the definition.

---

140 Preamble at 71829.

141 Preamble at 71829. ("Several of these requirements relate to the monetization of an asset, by which the agencies mean the receipt of funds from the outright sale of an asset or from the transfer of an asset pursuant to a repurchase agreement.")

142 Preamble at 71838.

143 SPEs may be used in financing arrangements. For example the Export-Import Bank of the United States ("**Ex-Im**") frequently uses SPEs in its aviation financing arrangements. In the case of such Ex-Im financing, guarantees are provided by Ex-Im and the financing recipient, and, therefore we do not believe that these SPEs should be considered as structured to isolate the credit risk of the SPE.

Individual limited liability companies are often formed to hold or develop specific real estate assets, such as an apartment building, hotel, or office complex. These entities are operating companies but, because of their limited specific purpose, could unintentionally be captured by the definition in the Proposed Rules, which does not exclude operating companies. Although we do not believe that operating companies were intended to be captured by the definition, we nonetheless would appreciate clarity in the Final U.S. LCR.

VII. Responses to Certain Questions in the Preamble

We have indicated below in this Part VII where in this letter we have responded to certain of the questions posed by the Agencies.

Question 1: What operational or other issues arise from requiring the calculation of the liquidity coverage ratio as of a set time selected by a covered company prior to the effective date of the rule? What significant operational costs, such as technological improvements, or other operational difficulties, if any, may arise from the requirement to calculate the liquidity coverage ratio on a daily basis? What alternatives to daily calculation should the agencies consider and why?

See the discussion in Part V.A.

Question 3: What, if any, other characteristics should be considered by the agencies in analyzing the liquidity of an asset?

See, generally, Part IV.

Question 4: What, if any, modifications should the agencies consider to the definition of "regulated financial company"? What, if any, entities should be added to, or removed from, the definition and why? What operational difficulties may be involved in identifying a "regulated financial company," including companies a depository institution holding company must report on the FR Y-6 organizational chart (or in identifying consolidated subsidiaries)? How should those operational difficulties be addressed? What alternatives for identifying companies reported on the FR Y-6 should be considered, and what difficulties may be associated with using the organizational hierarchy chart produced by the NIC Web site?

See the discussion in Parts V.C and VI.F.

Question 9: How well does the proposed definition of "liquid and readily-marketable" meet the agencies' goal of identifying HQLA that could be converted into cash in order to meet a covered company's liquidity needs during times of stress? What other characteristics, if any, of a traded security

and relevant markets should the agencies consider? What other approaches for capturing this liquidity characteristic should the agencies consider? Provide detailed description of and justifications for any alternative approaches.

See the discussion in Part IV.C.

Question 10: *What, if any, alternative factors should be considered in determining the assets that qualify as level 1 liquid assets? What, if any, additional assets should qualify as level 1 liquid assets based on the characteristics for HQLA that the agencies discussed above? Provide detailed justification based on the liquidity characteristics of any such assets, including historical data and observations.*

See the discussion in Part IV.A.1.

Question 12: *What other assets, if any, should the agencies include in level 2A liquid assets? How should such assets be identified and what are the characteristics of those assets that would justify their inclusion in level 2A liquid assets?*

See the discussion in Part IV.A.3.

Question 14: *What alternative treatment, if any, should the agencies consider for obligations of U.S. GSEs and why? Provide justification and supporting data.*

See the discussion in Part IV.A.1.

Question 15: *What, if any, additional criteria should the agencies consider in determining the type of securities that should qualify as level 2B liquid assets? What alternatives to the S&P 500 should be considered in determining the liquidity of an equity security and why? In addition to an investment grade classification, what additional characteristics denote the liquidity quality of corporate debt that the agencies would be legally permitted to use in light of the Dodd-Frank Act prohibition against agencies' regulations referencing credit ratings? The agencies solicit detailed comment, with supporting data, on the advantages and disadvantages of the proposed investment grade criteria as well as recommended alternatives.*

See the discussions in Parts IV.A.2, 4 and 5 and IV.B.

Question 19: *Are the proposed operational criteria sufficiently clear to determine whether an asset could be included in the pool of HQLA? Why or why not? If not, what requirements need clarification?*

See the discussions in Parts VI.G and VI.H.

Question 22: *The agencies seek comment on all aspects of the criteria for HQLA, including issues of domestic and international competitive equity, and the adequacy of the proposed HQLA criteria in meeting the agencies' goal of requiring a covered company to maintain a buffer of liquid assets sufficient to withstand a 30-day stress period.*

See the discussion in Part II.A and, generally,Part IV.

Question 23: *What effects may the provision in section 20(f) that a covered company is generally expected to maintain HQLA in the United States sufficient to meet its total net cash outflow amount in the United States have on a company's management of HQLA? Should the agencies be concerned about the transferability of liquidity between national jurisdictions during a time of financial distress and, if so, would such a requirement be sufficient to allay these concerns? Would holding HQLA in a foreign jurisdiction in an amount beyond such jurisdiction's estimated outflow limit the operational capacity of HQLA to meet liquidity needs in the United States; conversely, would the proposed general requirement unnecessarily disrupt overall banking operations? What changes, if any, to section 20(f) should the agencies consider to ensure that a covered company has sufficient HQLA readily available to meet its outflows in the United States? Should the agencies consider quantitative limits to ensure that a covered company has sufficient HQLA readily available in the United States to meet its net outflows in the United States and support its operations during periods of stress? Why or why not?*

See the discussion in Part IV.E.

Question 26: *What, if any, modifications should the agencies consider to the treatment of HQLA held by consolidated U.S. subsidiaries and why?*

See the discussion in Part II.A.3.

Question 27: *The agencies solicit comment on the proposed method for including the HQLA held at non-U.S. consolidated subsidiaries in a covered company's HQLA. Is it appropriate to include in HQLA some amount of HQLA that is held in non-U.S. consolidated subsidiaries? If not, why not? Should the proposed rule be supplemented with quantitative restrictions on the amount of HQLA that can be held in foreign branches and subsidiaries for the liquidity coverage ratio calculation of the consolidated U.S. entity? If so, how should the rule require a correlation between the geographic locations of a covered company's HQLA and the location of the outflows the HQLA is intended to cover? What portion of HQLA held by non-U.S. consolidated subsidiaries is freely available for use in connection with a covered company's U.S. operations during times of stress? In determining the amount of HQLA held at a non-U.S. consolidated subsidiary that a covered company can include in its HQLA, should a covered*

company be required to take into account any net cash outflows arising in connection with transactions between a non-U.S. entity and another affiliate? What challenges, if any, of the proposed methodology are not addressed? Please suggest specific solutions.

See the discussion in Part IV.D.

Question 28: *Does the method the agencies are proposing for determining net cash outflows appropriately capture the potential mismatch between the timing of inflows and outflows under the 30-day stress period? Why or why not? Are there alternative methodologies for determining the net cumulative cash outflows that would more appropriately capture the maturity mismatch risk within 30 days about which the agencies are concerned? Provide specific suggestions and supporting data or other information.*

See the discussion in Part II.A.1.

Question 29: *What costs or other burdens would be incurred as a result of the proposed method for calculating net cash outflows? What modifications should the agencies consider to mitigate such costs or burdens, while establishing appropriate means to capture potential mismatches between the timing of inflows and outflows within a 30-day stress period?*

See the discussion in Part II.A.1 and, generally, Part III.

Question 30: *The agencies solicit commenters' views on the proposed treatment for maturing instruments and for determining the date of transactions. Specifically, what are commenters' views on the proposed provisions that would require covered companies to apply the most conservative treatment with the respect to inflow and outflow dates and embedded options?*

See the discussion in Part II.A.1 and Part III.E.

Question 31: *What notice requirements, if any, should a covered company be able to recognize for counterparties that have options to accelerate the maturity of transactions and instruments included as outflows? Should a distinction be drawn between wholesale and retail customers or counterparties? Provide justification and supporting information.*

See the discussion in Part III.E.

Question 33: *The agencies solicit comments on the proposed rule's treatment of deposits that are insured in foreign jurisdictions, views on the stability of foreign-entity insured deposits in a stressed environment, and how to best determine if foreign deposit insurance system is similar to FDIC insurance.*

See the discussion in Part III.M.

Question 36: *The agencies solicit comment on the outflow rate for the insured portion of those deposits that are in excess of deposit insurance limit. Specifically, should the insured portion of a deposit that exceeds $250,000 (e.g., the portion of deposit balances up to and including $250,000) receive a different outflow rate than the uninsured portion of the deposit? Why or why not? Please provide supporting data.*

See the discussion in Part III.K.

Question 37: *What, if any modifications to the structured transaction outflows should the agencies consider? In particular, what, if any, modifications to the definition of structured transaction should be considered? Please provide justifications and supporting data.*

See footnote 56 and the SIFMA/SFIG Letter.

Question 38: *What, if any, additional factors or aspects of derivatives transactions should be considered for the treatment of derivatives contracts under the proposed rule?*

See the discussion in Part III.G.

Question 42: *What, if any, additional factors should be considered in determining the treatment of unfunded commitments under the proposal? What, if any, additional distinctions between different types of unfunded commitments should the agencies consider? If necessary, how might the definitions of credit facility and liquidity facility be further clarified or distinguished? Are the various proposed treatments for unfunded commitments consistent with industry experience? Provide detailed explanations and supporting information.*

See the discussion in Part III.A.

Question 43: *Is the proposed rule's definition of SPE appropriate, under-inclusive, or over-inclusive? Why?*

See the discussion in Part III.B and VI.I.

Question 46: *What, if any, additional factors or aspects for collateral outflow amounts should be considered under the proposal? For example, should the outflow include initial margin collateral flows in addition to variation margin collateral flows? Why or why not? Does the 24 month look back approach adequately capture mark to market valuation changes, or are there alternative treatments that would better capture this risk?*

See the discussion in Part III.G.

Question 47: *The agencies seek commenters' views on the proposed outflow rates for brokered deposits. Specifically, what are commenters' views on the range of outflow rates to brokered deposits? Where commenters disagree with the proposed treatment, please provide alternative proposals supported by sound analysis as well as the associated advantages and disadvantages for such alternative proposals.*

See the discussion in Part III.L.

Question 48: *Is it appropriate to assign a particular outflow rate to brokered sweep deposits entirely covered by deposit insurance that originate with a consolidated subsidiary of a covered company, and different outflow rates to other brokered deposits entirely covered by deposit insurance? Why or why not? What different outflow rates, if any should the agencies consider for application to all brokered sweep deposits entirely covered by deposit insurance? Provide justification and supporting information.*

See the discussion in Part III.L.

Question 49: *The agencies solicit commenters' views on the criteria for, and treatment of, operational deposits. What, if any, of the identified operational services should not be included or what other services not identified should be included? What, if any, additional conditions should be considered with regard to the definition of operational deposits? Is the proposed outflow rate consistent with industry experience, particularly during the recent financial crisis? Why or why not?*

See the discussion in Part II.A.2.

Question 50: *What are commenters' views on the proposed treatment of excess operational deposits? What operational burdens or other issues may be associated with identifying excess amounts in operational deposits? What other factors, if any, should be considered in determining whether to classify an unsecured wholesale deposit as an operational deposit?*

See the discussion in Part II.A.2.

Question 51: *Have the agencies appropriately identified prime brokerage services for the purposes of the exclusion of prime brokerage deposits from operational deposits? Should additional categories of customer be included, such as insurance companies or pension funds? What additional characteristics could identify prime brokerage deposits? Should the proposed rule include a definition of prime brokerage services or prime brokerage deposits and if so, how should those terms be defined? Is the higher outflow rate for prime brokerage deposits appropriate? Why or why not? What other treatments, if any, should the agencies consider?*

See the discussion in Part II.A.2.

Question 53: *What additional criteria could be considered in determining whether certain unsecured wholesale funding activities should receive a 3 or 5 percent outflow rate associated with primary market maker activity?*

See the discussion in Part III.D.

Question 54: *The agencies solicit commenters' views on the proposed treatment of secured funding activities. Do commenters agree with the proposed outflow rates as they relate to the collateral? Why or why not? Should municipal and other public sector entity deposits be treated as secured funding transactions? What, if any, additional secured-funding risk factors should be reflected in the rule?*

See the discussion in Part II.A.5 and III.J.

Question 60: *What, if any, additional items the agencies should explicitly exclude from inflows? What, if any excluded items should the agencies consider including in inflows? Please provide justification and supporting information.*

See the discussion in Parts III.C, III.I and III.J.2.

Question 65: *The agencies solicit commenters' views on the treatment of secured lending transaction and asset exchange inflows. What, if any, modifications should the agencies consider? Specifically, what are commenters' perspectives on when an inflow should be reflected in the ratio's denominator as opposed to the HQLA amount? Provide justification and supporting data.*

See the discussion in Part III.J.

Question 72: *What concerns, if any, do commenters have in meeting the proposed transitional arrangements?*

See the discussion in Part II.A.4.

Question 73: *Are the proposed transition periods appropriate for all covered companies? Are there any situations that may prevent a covered company from achieving compliance within the proposed transition periods? Are there alternatives to the proposed transition periods that would better achieve the agencies' goal of establishing a quantitative liquidity requirement in a timely fashion while not disrupting lending and the real economy?*

See the discussion in Part II.A.4.

Question 74: *What, if any, modifications to the modified liquidity coverage ratio should the Board consider? In particular, what, if any, modifications to incorporation of the 21-calendar day stress period should be considered? Please provide justification and supporting data.*

See the discussion in Part V.B.

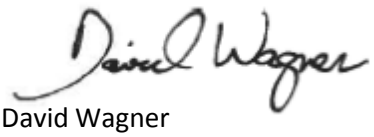
Question 76: *What operational burdens may modified LCR holding companies face in complying with the proposal? What modifications to transition periods should the Board consider for modified LCR holding companies?*

See the discussion in Part V.B.

* * *

If you have any questions or need further information, please contact David Wagner at 212-613-9883 (email: david.wagner@theclearinghouse.org).

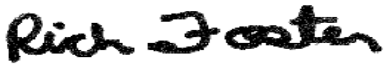
Respectfully submitted,



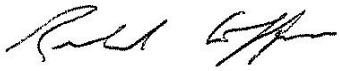
David Wagner
Executive Managing Director and Head of Finance Affairs
The Clearing House Association L.L.C

Cecelia A. Calaby
Senior Vice President
American Bankers Association

Kenneth E. Bentsen, Jr.
President & CEO
Securities Industry and Financial Markets Association



Richard Foster
Vice President & Senior Counsel for
Regulatory and Legal Affairs
Financial Services Roundtable



Richard Coffman
General Counsel
Institute of International Bankers

Som-lok Leung
Executive Director
International Association of Credit Portfolio Managers

Richard Johns
Executive Director
Structured Finance Industry Group

cc: The Honorable Thomas J. Curry
Office of the Comptroller of the Currency

Amy Friend
Office of the Comptroller of the Currency

Kerri Corn
Office of the Comptroller of the Currency

The Honorable Ben Bernanke
Board of Governors of the Federal Reserve System

The Honorable Janet Yellen
Board of Governors of the Federal Reserve System

The Honorable Daniel Tarullo
Board of Governors of the Federal Reserve System

The Honorable Sarah Bloom Raskin
Board of Governors of the Federal Reserve System

The Honorable Jeremy Stein
Board of Governors of the Federal Reserve System

The Honorable Jerome Powell
Board of Governors of the Federal Reserve System

Scott Alvarez
Board of Governors of the Federal Reserve System

Michael Gibson
Board of Governors of the Federal Reserve System

Mark Van Der Weide
Board of Governors of the Federal Reserve System

Anna Lee Hewko
Board of Governors of the Federal Reserve System

David Emmel
Board of Governors of the Federal Reserve System

The Honorable Martin J. Gruenberg
Federal Deposit Insurance Corporation

Rick Osterman
Federal Deposit Insurance Corporation

Kyle Hadley
Federal Deposit Insurance Corporation

Jason Cave
Federal Deposit Insurance Corporation

Bob Bean
Federal Deposit Insurance Corporation

The Honorable Mary Miller
Department of the Treasury

Cyrus Amir-Mokri
Department of the Treasury

Matthew Rutherford
Department of the Treasury

William C. Dudley
Federal Reserve Bank of New York

Diane K. Dobbeck
Federal Reserve Bank of New York

Sylvie Matherat
Basel Committee on Banking Supervision

Carolyn Wilkins
Basel Committee on Banking Supervision

H. Rodgin Cohen
Sullivan & Cromwell LLP

Mark Welshimer
Sullivan & Cromwell LLP

Andrew Gladin
Sullivan & Cromwell LLP

Andrea Tokheim
Sullivan & Cromwell LLP

Lauren Wansor
Sullivan & Cromwell LLP

Brett Waxman
The Clearing House

Jennifer Scott
The Clearing House

Annex A

The Clearing House. Established in 1853, The Clearing House is the oldest banking association and payments company in the United States. It is owned by the world's largest commercial banks, which collectively employ over 2 million people and hold more than half of all U.S. deposits. The Clearing House Association L.L.C. is a nonpartisan advocacy organization representing – through regulatory comment letters, amicus briefs and white papers – the interests of its owner banks on a variety of systemically important banking issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing and settlement services to its member banks and other financial institutions, clearing almost $2 trillion daily and representing nearly half of the automated clearing-house, funds transfer, and check-image payments made in the U.S. *See* The Clearing House's web page at www.theclearinghouse.org.

The American Bankers Association. The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $14 trillion banking industry and its 2 million employees. Learn more at www.aba.com.

The Securities Industry and Financial Markets Association. The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. 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, please visit www.sifma.org.

The Financial Services Roundtable. The Financial Services Roundtable represents 100 integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the Chief Executive Officer. Roundtable member companies provide fuel for America's economic engine, accounting directly for $98.4 trillion in managed assets, $1.1 trillion in revenue, and 2.4 million jobs. For more information, visit www.fsround.org.

Institute of International Bankers. The Institute of International Bankers (IIB) is the only national association devoted exclusively to representing and advancing the interests of the international banking community in the United States. Its membership is comprised of internationally headquartered banking and financial institutions from over 35 countries around the world doing business in the United States. The IIB's mission is to help resolve the many special legislative, regulatory, tax and compliance issues confronting internationally headquartered institutions that engage in banking, securities and other financial activities in the United States. Through its advocacy efforts the IIB seeks results that are consistent with the U.S. policy of national treatment and appropriately limit the extraterritorial application of U.S. laws to the global operations of its member institutions.

The International Association of Credit Portfolio Managers. The International Association of Credit Portfolio Managers (IACPM), with 89 member institutions located in 17 countries, is an industry association dedicated to the advancement of credit portfolio management. Founded in 2001, the

organization's programs of meetings, studies, research and collaboration are designed to increase awareness of the value and function of credit portfolio management among financial markets worldwide, and to discuss and resolve issues of common interest to its members.

Structured Finance Industry Group. Structured Finance Industry Group, Inc. ("SFIG") is a member-based, trade industry advocacy group focused on improving and strengthening the broader structured finance and securitization market. SFIG provides an inclusive network for securitization professionals to collaborate and, as industry leaders, drive necessary changes, be an advocate for the securitization community, share best practices and innovative ideas, and educate industry members through conferences and other programs. Members of SFIG represent all sectors of the securitization market including issuers, investors, financial intermediaries, law firms, accounting firms, technology firms, rating agencies, servicers, and trustees. Further information can be found at www.sfindustry.org.

Annex B

For the following example, we assume that the subject depository institution has: (i) $10 billion in secured demand deposit from various U.S. municipalities; (ii) posted $11 billion of Level 2A HQLA as collateral for the deposits; (iii) $8 billion on unencumbered Level 1 assets; (iv) $10 billion of unencumbered Level 2A assets; and (v) no Level 2B assets. Initially, under Section 21 of the Proposed Rules (in billions):

- Level 1 liquid asset amount: *$8*
- Level 2A liquid asset amount: *$8.5* (10 * .85)
- Level 2B liquid asset amount: *$0*

The required unwind of the $10 billion secured municipal deposit, however, increases Level 2A liquid assets by $11 billion and reduces cash by $10 billion. Thus:

- Adjusted level 1 liquid asset amount: *$-2* ($8 - $10)
- Adjusted level 2A liquid asset amount: $17.85 (($10 + $11) * .85)
- Adjusted level 2B liquid asset amount: $0
- Calculate unadjusted excess HQLA amount (Section 21(c))
    - Step 1: Calculate the Level 2 cap excess amount (Section 21(d)):
        - Level 2 cap excess amount = Max (Level 2A liquid asset amount + Level 2B liquid asset amount – 0.6667 * Level 1 liquid asset amount, 0)
            = Max ($8.5 + 0 – 0.6667*$8, 0)

            = Max ($8.5 – $5.3336, 0)

            = Max ($3.1664, 0)

            = *$3.1664*
    - Step 2: Calculate the Level 2B cap excess amount (Section 21(e))
        - Level 2B cap excess amount = Max (Level 2B liquid asset amount – Level 2 cap excess amount – 0.1765 * (Level 1 liquid asset amount + Level 2 liquid asset amount), 0)

            = Max (0 – $3.1664 – 0.1765*($8 + $8.5), 0)

            = Max ($-3.1664 – $2.9123, $0)

= Max ($-6.0787, 0)

= *$0*

- Step 3: Calculate the unadjusted excess HQLA amount (Section 21(c))
  - Unadjusted excess HQLA amount = Level 2 cap excess amount + Level 2B cap excess amount

    = $3.1664 + $0

    = *$3.1664*

- Calculate adjusted excess HQLA amount (Section 21(g))
  - Step 1: Calculate the adjusted level 2 cap excess amount (section 21(h))
    - Adjusted Level 2 cap excess amount = Max (adjusted Level 2A liquid asset amount + adjusted Level 2B liquid asset amount – 0.6667 * adjusted Level 1 liquid asset amount, 0)

      = Max ($17.85 + 0 - 0.6667 * $-2, $0)

      = Max ($17.85 – $-1.3334, $0)

      = Max ($19.1834, $0)

      = $*19.1834*
  - Step 2: Calculate the adjusted Level 2B cap excess amount (Section 21(i))
    - Adjusted Level 2B cap excess amount = Max (adjusted Level 2B liquid asset amount – adjusted Level 2 cap excess amount – 0.1765 * (adjusted Level 1 liquid asset amount + adjusted Level 2 liquid asset amount, 0)

      = Max (0 – $19.1834 – $0.1765 * ($-2 + $17.85), $0)

      = Max ($-19.1834 – $2.7975, $0)

      = Max ($-21.9809, $0)

      = *$0*
  - Step 3: Calculate the adjusted excess HQLA amount (Section 21(g))

        - Adjusted excess HQLA amount = adjusted Level 2 cap excess amount + adjusted Level 2B cap excess amount

          = $19.1834 + $ 0

          = *$19.1834*

- Determine the HQLA amount (Section 21(a))

    - HQLA = Level 1 liquid asset amount + Level 2A liquid asset amount + Level 2B liquid asset amount – Max (unadjusted excess HQLA amount, adjusted excess HQLA amount)

      = $8 + $8.5 + $0 – Max ($3.1664, $19.1834)

      = $16.5 – $19.1834

      = **$**-*2.6834*

Annex C

Country/Region	**Name of index**
Australia	All Ordinaries, AS51
Austria	Austrian Traded Index
Belgium	BEL 20
Canada	S&P/TSX Composite Index
France	CAC 40, SBF 250
Germany	DAX, HDAX, CDAX
European	Dow Jones Stoxx 50 Index, FTSE Eurotop 300
Hong Kong	Hang Seng 33, HSCEI, HSCI
Italy	MIB 30
Japan	Nikkei 225
Korea	Kospi
Netherlands	AEX, AMX
Singapore	Straits Times Index
Spain	IBEX 35
Sweden	OMX
Switzerland	SMI, SPI
UK	FTSE 100, FTSE Mid 250, FTSE All Share
U.S.	Russell 3000