November 1, 2019

Via Electronic Mail

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Re: Supplemental Comments on the Final Tailoring Rules

Ladies and Gentlemen:

The Bank Policy Institute, the Institute of International Bankers, the Securities Industry and Financial Markets Association, and the American Bankers Association (collectively, the "*Associations*")[1] are writing to provide additional comments and requests for clarification with respect to the final tailoring rules issued by the Board of Governors of the Federal Reserve System (with respect to the final rule tailoring the application of enhanced prudential standards)[2] and by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency (with respect to the interagency final rule tailoring the application of capital and

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1 Please refer to Annex 1 for descriptions of the Associations.

2 Board of Governors of the Federal Reserve System, Prudential Standards for Large Bank Holding Companies, Savings and Loan Holding Companies, Foreign Banking Organizations, 84 Fed. Reg. 59032 (Nov. 1, 2019) (hereafter, the "*EPS final rule*"), *available at* https://www.federalregister.gov/documents/2019/11/01/2019-23662/prudential-standards-for-large-bank-holding-companies-savings-and-loan-holding-companies-and-foreign.

standardized liquidity requirements).[3] In this letter we provide a number of recommendations that would allow the agencies to better achieve the objectives of the final rules, including the use of the adopted risk-based indicators for the initial categorizations of all banking organizations, as well as greater efficiency, simplicity and clarity in regulation.

I. In order to have initial categorizations for all banking organizations reflect the risk-based indicators that the agencies adopted, U.S. IHCs should be permitted to calculate their initial cross-jurisdictional activity indicator using the FR Y-15 filing as of June 30, 2020.

Under the final rules, the risk-based indicator for cross-jurisdictional activity is a key threshold. A firm with average cross-jurisdictional activity of $75 billion or more will be categorized as a Category II firm under the final rules and, therefore, subject to the most stringent standards applicable to firms that are not U.S. GSIBs. Category II standards generally include capital and standardized liquidity requirements based on the Basel Committee's standards, as well as more stringent enhanced prudential standards.

The supplemental information in the version of the final rules published in the Federal Register instruct the U.S. intermediate holding companies ("*IHCs*") of foreign banking organizations ("*FBOs*") to determine their initial categorization using four quarters of data from the current FR Y-15 reporting form. Specifically, the supplemental information to the EPS final rule states that "U.S. [IHCs] should determine the category of standards that apply to them on the effective date of this final rule, using data from the FR Y-15 and FR Y-9LP reports as-of the quarter end dates for the previous four quarters."[4] The supplemental information to the EPS final rule also notes that "[FBOs] will not be required to comply with the amended Schedule L of the FR Y-15 with respect to their U.S. [IHCs] until as-of June 30, 2020. Until that time, U.S. [IHCs] should determine their category under the tailoring framework consistent with the cross-jurisdictional activity schedule on the FR Y-15 that previously applied to U.S. [IHCs] provided that, when a [FBO] reports on the amended Schedule L with respect to its U.S. [IHC], the U.S. [IHC]'s measure of cross-jurisdictional activity will be based on the amount reported on the amended Schedule L and will not be averaged with amounts of cross-jurisdictional activity previously reported by the U.S. [IHC]."[5] The current FR Y-15 reporting form that will be used by U.S. IHCs for purposes of initial categorization does not, however, reflect the cross-jurisdictional indicator adopted in the final tailoring rules, which adjusts the "measurement of cross-jurisdictional activity for [FBOs] to exclude inter-affiliate liabilities and certain collateralized inter-affiliate claims."[6] The agencies made this adjustment "[i]n recognition of the structural differences between foreign and domestic banking

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[3] Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Changes to Applicability Thresholds for Regulatory Capital Requirements, 84 Fed. Reg. 59230 (Nov. 1, 2019) (hereafter, the "*interagency final rule*"), *available at* https://www.federalregister.gov/documents/2019/11/01/2019-23800/changes-to-applicability-thresholds-for-regulatory-capital-and-liquidity-requirements.

[4] EPS final rule, at 59067.

[5] EPS final rule, at 59067.

[6] Interagency final rule, at 59237; EPS final rule, at 59039.

organizations,"[7] as well as the fact that certain inter-affiliate liabilities (*i.e.*, internal TLAC-eligible debt) are required by regulation.

We appreciate the addition by the agencies of the guidance in the supplemental information specifying that the measure of cross-jurisdictional activity reported on the amended Schedule L as-of June 30, 2020 will not be averaged with amounts previously reported by a U.S. IHC for that indicator. There remains, however, a fundamental disconnect between the risk-based indicators adopted in the final rules and the way in which initial categorization will be determined. This disconnect is not merely a theoretical issue. Calculating cross-jurisdictional activity in accordance with the current FR Y-15 reporting form, notwithstanding the guidance that the measure reported as of June 30, 2020 will not be averaged with amounts previously reported, will result in certain U.S. IHCs being categorized in Category II even though, under the actual risk-based indicators adopted in the final rules, they should not be.

We do not believe this outcome was intended by the agencies. As a threshold matter, no policy or supervisory objective would be served by basing initial categorizations on a measure of cross-jurisdictional activity that is inconsistent with the actual measure adopted in the final rules. Moreover, in the "visuals" released by the Federal Reserve in connection with its adoption of the final rules, the Federal Reserve projected, based on estimated data and the risk-based indicators actually adopted in the final rules, that no U.S. IHC would be categorized into Category II upon initial effectiveness and for at least two quarters in 2020.[8]

The initial inappropriate categorization of U.S. IHCs would have significant negative consequences for the affected firms, most notably with respect to new or different regulatory regimes requiring significant implementation expenses that would not otherwise be necessary were all firms categorized under the final rules in the correct and appropriate category as an initial matter. These implementation expenses result from the application of an inappropriate category and the need to comply with those new or different regulatory regimes; these expenses are not linked to the length of time that a U.S. IHC is inappropriately categorized. The significant negative consequences of inappropriate categorizations include:

- Treatment as advanced approaches firms, resulting in:

  - Being subject to the proposed mandatory use of the standardized approach to counterparty credit risk ("*SA-CCR*"), which would require substantial investments and implementation expenses for firms that, if correctly categorized into Category III or IV, would not be required,

  - Being subject to the proposed regulatory capital treatment of advanced approaches firms' investments in certain unsecured debt instruments of U.S. GSIBs, foreign GSIBs and the U.S. IHCs of foreign GSIBs (including debt that qualifies as TLAC), which would, as proposed, significantly constrain the ability of "advanced approaches" U.S. IHCs to

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7 Interagency final rule, at 59237; EPS final rule, at 59039.

8 *See* List of Foreign Firms by Projected Category, *available at* https://www.federalreserve.gov/aboutthefed/boardmeetings/files/tailoring-rule-visual-20191010.pdf.

make markets in TLAC-eligible debt, be impracticable to implement and impose undue compliance burdens,

- Ineligibility for the election to opt-out of the inclusion of accumulated other comprehensive income ("*AOCI*") in capital, which could introduce substantial volatility into regulatory capital levels, and

- Ineligibility for application of the capital simplification rules.

➢ Depending on the firm's weighted short-term wholesale funding ("*wSTWF*"), potential application of more stringent liquidity requirements, which would include the full liquidity coverage ratio and, according to the Federal Reserve's visuals released in connection with its adoption of the final rules, the proposed full NSFR when finalized,[9] and

➢ Annual company-run stress testing rather than biennial company-run stress testing (if correctly categorized as Category III) or no company-run stress testing (if correctly categorized in Category IV).

To address this issue, we recommend that the Federal Reserve direct potentially affected U.S. IHCs of FBOs to apply for an extension of time for calculating the cross-jurisdictional activity indicator for purposes of their initial categorization until the amended FR Y-15 reporting form is available—that is, to instruct the firms to apply for an extension that, once granted, would allow them to begin calculating the cross-jurisdictional activity indicator for their U.S. IHCs for the period ending June 30, 2020 to reflect the risk-based indicators actually adopted in the final rules in their initial categorization.

This extension would avoid the inappropriate categorization of U.S. IHCs as Category II firms based on a measure of cross-jurisdictional activity that is inconsistent with the risk-based indicator in the final rules. This extension would not, however, affect the initial categorization of the U.S. IHCs upon effectiveness of the final rules on the basis of their size, nonbank assets, off-balance sheet exposures or wSTWF. Accordingly, this extension would result in the initial categorization of U.S. IHCs upon effectiveness of the final rules in a manner consistent with the final tailoring rules and the Federal Reserve's projections.

In addition, our recommended approach of combining an extension for initial calculation of cross-jurisdictional activity would also allow the Federal Reserve to address another disconnect between the final rules and the cross-jurisdictional indicator as reported on Schedule L of the FR Y-15 reporting form. The instructions for Line Item 2(a) of Schedule L of the FR Y-15 direct FBOs to report liabilities to the reporting group's own foreign offices and refer to the Treasury International Capital (TIC) BL-1 Report's definition of foreign office.[10] This definition of foreign office includes "any direct foreign parent, any non-U.S. branch or agency, and any foreign-resident office indirectly owned through a U.S.

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9 *See* Requirements for Domestic and Foreign Banking Organizations, *available at* https://www.federalreserve.gov/aboutthefed/boardmeetings/files/tailoring-rule-visual-20191010.pdf.

10 The revised instructions adopted in connection with the final rules are available at https://www.federalreserve.gov/reportforms/formsreview/FR_Y-15%20Instruction%20Revisions%20Tailoring%20Final%2010-10.pdf.

subsidiary depository or non-depository financial institution" and excludes "offices of the reporter's parent's non-banking or banking subsidiaries as own foreign offices."[11] Accordingly, referring to the TIC BL-1 Report's definition of "foreign office" would not capture all inter-affiliate liabilities of a U.S. IHC or an FBO's combined U.S. operations. The final rules clearly intended to exclude *all* inter-affiliate liabilities from the cross-jurisdictional indicator for FBOs, as neither the interagency nor EPS final rules specify any exception to these exclusions in the supplemental information or the actual rules text. Our recommended approach would allow the Federal Reserve to revise the instructions in a manner consistent with the final rules, with the revision applicable for purposes of initial categorizations on the basis of a U.S. IHC's cross-jurisdictional activity.[12]

If our recommended extension is not implemented, the Federal Reserve should clarify that a U.S. IHC that is initially categorized in Category II as a result of its cross-jurisdictional activity would cease to be categorized as Category II on that basis if it reports cross-jurisdictional activity of less than $75 billion as of June 30, 2020. This clarification is necessary because the supplemental information for the EPS final rule about not averaging cross-jurisdictional activity reported for June 30, 2020 with amounts previously reported does not expressly address re-categorization into the appropriate category based on the measure reported as of June 30, 2020. Under the final rules, a change in category from Category II to another category would require that the U.S. IHC's cross-jurisdictional activity be below $75 billion for each of the four most recent calendar quarters—here, the test is based on the indicator for the four more recent calendar quarters, not the average over the four most recent calendar quarters.[13] Accordingly, consistent with the guidance about the absence of averaging cross-jurisdictional activity as of June 30, 2020 with previously reported amounts, the Federal Reserve should confirm that the measure of cross-jurisdictional activity reported by a U.S. IHC as of June 30, 2020 will be viewed in isolation from information reported on the current FR Y-15 prior to June 30, 2020. Put differently, if our recommended extension for initial calculation of cross-jurisdictional activity is not implemented, the Federal Reserve should clarify that a U.S. IHC that is inappropriately categorized upon effectiveness on the basis of its previously reported cross-jurisdictional activity would be re-categorized based on the FR Y-15 report as of June 30, 2020, without reference to amounts reported for the cross-jurisdictional activity indicator in prior FR Y-15 reports. We understand this outcome to be the implication and intent of the clarification regarding the cross-jurisdictional activity indicator provided in the supplemental information published in the Federal Register notice, as noted above. Absent such clarification, under the final rules, if a U.S. IHC is inappropriately categorized as a Category II firm upon effectiveness, there would be uncertainty as to whether it would remain a Category II firm until it has

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11 Instructions for the Treasury International Capital (TIC) Form B Reports, *Reports by Financial Institutions of Liabilities to, and Claims on, Foreign Residents by U.S. Residents*, at 25.

12 The FR Y-15 reporting form is currently under review and out for comment pursuant to the Paperwork Reduction Act, 84 Fed. Reg. 47509 (Sept. 10, 2019). BPI is planning to separately submit comments on these proposed revisions to the FR Y-15.

13 *See* rule text for 12 C.F.R. §§ 238.10(b)(2)(i)(B); 252.5(c)(2)(i)(B). 12 C.F.R. § 252.5(c)(2)(i)(B) states that after meeting the criteria to be categorized as a Category II banking organization, a firm "continues to be a Category II banking organization until the banking organization has … less than $75 billion in cross-jurisdictional activity ***for each of*** the four most recent calendar quarters …"; EPS final rule, at 59099 (emphasis added).

reported cross-jurisdictional activity of less than $75 billion for four consecutive quarters, beginning with the report as of June 30, 2020 and ending with the report as of March 31, 2021.

II. The agencies should revise the calculation instructions for the wSTWF indicator to provide that the wSTWF measure reported on the most recent FR Y-15 report (itself a four-quarter average) will be used for purposes of initial and subsequent categorizations.

The final rules instruct subject firms to determine their initial and subsequent categorizations using risk-based indicators in their four most recent FR Y-15 and FR Y-9LP filings. However, the wSTWF measure itself, as reported on the FR Y-15, is a four-quarter average (that is, the figure reported for this line item on the FR Y-15 reporting form is an average over the previous 12 months). Under this approach, firms would be required to calculate the four-quarter average of four-quarter averages reported for this measure on the form—an outcome unique to the wSTWF indicator that does not apply with respect to the other risk-based indicators reported on the FR Y-15. Unlike the other indicators, which use four reporting periods to capture data over a one-year period, the use of wSTWF as reported for four quarters would actually capture data over a period of 1.75 years and significantly overweight data for certain quarters. As an example, using the reports cited in footnotes 131 and 133 of the supplemental information to the EPS final rule (reports as of March 31, 2019; June 30, 2019; September 30, 2019; and December 31, 2019):

- Data for the fourth quarter of 2019 would be reflected once (in the report as of December 31, 2019),
- Data for the third quarter of 2019 would be reflected twice (in the reports as of September 30, 2019 and December 31, 2019),
- Data for the second quarter of 2019 would be reflected three times (in the reports as of June 30, 2019; September 30, 2019; and December 31, 2019),
- Data for the first quarter of 2019 would be reflected four times (in the reports as of March 31, 2019; June 30, 2019; September 30, 2019; and December 31, 2019),
- Data for fourth quarter of 2018 would be reflected three times (in the reports as of March 31, 2019; June 30, 2019; and September 30, 2019),
- Data for the third quarter of 2018 would be reflected twice (in the reports as of March 31, 2019 and June 30, 2019), and
- Data for the second quarter of 2018 would be reflected once (in the report as of March 31, 2019).

Accordingly, we recommend that the agencies issue a revision to provide for the most recently reported wSTWF measure on the FR Y-15 (itself a four-quarter average) to be used for purposes of initial and subsequent categorizations, rather than an average of the wSTWF measures reported in each of the previous four quarters. Requiring firms to use a four-quarter average of four-quarter averages for the wSTWF indicator, as specified in the final rules, would yield unintended outcomes. Rather than a simple average as of four quarterly balance sheet dates, the approach under the final rules would double count figures reported in the middle bands of the four-quarter period, thus impacting the initial and subsequent categorizations and potentially significantly extending the applicability of more stringent liquidity standards once a firm's wSTWF declines below $75 billion. By allowing firms to instead use the wSTWF measure as reported on the most recent FR Y-15—the average over the prior 12-month reporting period—this risk-based indicator would be aligned with the other risk-based indicators on which a firm's categorization will be based.

III. The agencies should clarify the effective dates that will apply under each of the final rules.

The interagency and EPS final rules both state that they will become effective on December 31, 2019.[14] In the discussion of administrative law matters of the interagency final rule, the agencies state, however, that the interagency final rule "will be effective on the first day of the first calendar quarter following" December 31, 2019 but that "any banking organization subject to the final rule may elect to adopt amendments on" December 31, 2019.[15] The first date of the first calendar quarter following December 31, 2019 would be January 1, 2020—a difference of only one day. Consistent with the agencies' apparent intent to provide an appreciable period of time during which firms would have the flexibility to early adopt the provisions of the final rules or to comply as of the beginning of the next calendar quarter, the agencies' should revise these provisions to clarify that the rules will be effective as of the first day of the second calendar quarter following December 31, 2019—which would be April 1, 2020, while also permitting early adoption as of December 31, 2019. This would sync the effective dates of the final rules and provide for a clear and consistent effective date while also providing firms the option to elect to early adopt the final rules as of 60 days following publication in the Federal Register or following an additional transition period, consistent with the apparent intent of the provision outlined in the administrative law section of the interagency final rule.

IV. The Federal Reserve should provide timely additional guidance on capital planning and CCAR.

The commentary in the supplemental information to the EPS final rule regarding the Federal Reserve's plans to release a future proposal on capital planning does not answer a number of important questions for Category IV firms, including with respect to what the required annual capital plan submission will entail for Category IV firms and which FR Y-14 schedules these firms will be required to submit. The Federal Reserve should provide timely additional information regarding how the Federal Reserve plans to incorporate changes to its capital rule. Moreover, for both Category III and Category IV firms, the Federal Reserve should explain how changes applicable to non-advanced approaches firms that become effective in 2020, such as the capital simplifications rule, will be incorporated into projections for the 2020 cycle for those firms.

V. Technical matters.

Technical matters relating to the final tailoring rules are addressed in <u>Annex 2</u> of this letter.

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14 Interagency final rule, at 59230; EPS final rule, at 59032.

15 Interagency final rule, at 59263.

The Associations appreciate the opportunity to provide supplemental comments on the final rules. If you have any questions, please contact David Wagner at 646.736.3958 (david.wagner@bpi.com), Briget Polichene at 646.213.1149 (bpolichene@iib.org), Carter McDowell at 202.962.7327 (cmcdowell@sifma.org), or Justin Underwood at 202.663.5273 (junderwood@aba.com).

Respectfully submitted,

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Annex 1: The Associations

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

The 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. Further information is available at www.iib.org.

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

The American Bankers Association is the voice of the nation's $16 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $12 trillion in deposits and extend more than $8 trillion in loans.

Annex 2: Technical Matters

- The interagency final rule provides that "[c]onsistent with the final framework and the proposed transitions for foreign banking organizations, under the final rule, a U.S. intermediate holding company that meets the applicability criteria for the LCR rule on the effective date of the final rule, but was not subject to an LCR requirement immediately prior to the effective date, must comply with the applicable LCR requirement *one year following the effective date of the final rule*" (which is also stated later in the actual rule text for the interagency final rule),[1] but provides in a table immediately following this statement that the "mandatory compliance date" as of the effective date of the final rule will be the "*First day of the fifth full calendar quarter following the effective date*."[2] The agencies should clarify the transition period such that there is consistency between the text and tables in the supplementary information as well as the rules text in the interagency final rule.

- FR Y-15, Schedule N – FBO Short-Term Wholesale Funding Indicator (Part II) includes line 7, Average risk-weighted assets, while the EPS final rule indicated that RWAs for the FBO CUSO would not be required.[3] Specifically, the Federal Reserve notes in the supplemental information to the EPS final rule that "[FBOs] also will not be required to calculate average risk-weighted assets for their combined U.S. operations in Column B on Schedule N, line item 7." Accordingly, the Federal Reserve should eliminate this line item.

- The revised instructions for Schedule N to the FR Y-15 reporting form on the Federal Reserve's website state that "[b]anking organizations that have reported the Complex Institution Liquidity Monitoring Report (FR 2052a) daily for the last twelve months must report the average value using daily data for the U.S. operations of the FBO. All other respondents must report the average value using monthly data (*i.e.*, provide the average of the twelve month-end balances within the last four quarters)."[4]

    - The Federal Reserve should confirm that FBOs will be expected to report the wSTWF for their combined U.S. operations ("*CUSO*") using a full-year daily average (July 1, 2019 to June 30, 2020) if they submit the FR2052a daily.

    - For FBOs currently filing the FR2052a report monthly, for the first CUSO wSTWF reporting date as of June 30, 2020, the Federal Reserve should confirm that these firms should report a 12-month average CUSO wSTWF (from July 1, 2019 to June 30, 2020), using monthly data.

- Given that the final rule eliminates the mid-cycle stress testing requirement for all bank holding companies, the Federal Reserve should clarify what firms will be required to submit in the FR Y-14A Summary and Macro Scenario schedules (Schedules A and B, respectively) as of June 30, as those schedules remain listed as semi-annual submission requirements in the draft FR Y-14A instructions.

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[1] Rule text for 12 C.F.R. § 249.50(b); Interagency final rule, at 59257 (emphasis added).

[2] Interagency final rule, at 59257 (emphasis added).

[3] EPS final rule, at 59064.

[4] The revised instructions are available at https://www.federalreserve.gov/reportforms/formsreview/FR_Y-15%20Instruction%20Revisions%20Tailoring%20Final%2010-10.pdf.

- Table II in the EPS final rule states that for U.S. IHCs and CUSO of FBOs, cross-jurisdictional activity is reported on the FR Y-15, Schedule L, Line Item 4, Columns A and B, respectively.[5] The revised form on the Federal Reserve's website provides that cross-jurisdictional activity is reported on Line Item 5 (which is consistent with the reporting for U.S. BHCs on the corresponding Line Item in Schedule E). The Federal Reserve should provide an updated version of Table II referring to Line Item 5.[6]

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5 EPS final rule, at 59062.

6 The revised form is available at https://www.federalreserve.gov/reportforms/formsreview/FR_Y-15%20Form%20Revisions%20Tailoring%20Final%2010-10.pdf.