BAFT-IFSA

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:

BAFT-IFSA is an international financial services trade association whose membership includes a broad range of financial institutions throughout the global community. As a worldwide forum for analysis, discussion, and advocacy in international financial services, BAFT-IFSA member banks provide leadership to build consensus in preserving the safe and efficient conduct of the financial system.

BAFT-IFSA appreciates the opportunity to comment on the notice of proposed rulemaking by the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System ("Federal Reserve") and the Federal Deposit Insurance Corporation ("FDIC" and, collectively, the "Agencies"), entitled *Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring* (the "US Proposal" or "Proposed Rule").[1] The Proposed Rule implements published liquidity standards by the Basel Committee on Banking Supervision ("Basel Committee" or "the Committee") for a global liquidity coverage ratio ("Basel LCR").[2] The US Proposal would implement the liquidity coverage ratio ("LCR") for banking organizations that are 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.

BAFT-IFSA supports the goals of the Basel Committee and the Agencies in promoting a more resilient banking sector and agrees that a strong banking system is the basis for sustainable economic growth. An integral part of this important effort has been the establishment of a basis for a quantitative liquidity regime and, in this regard, the LCR is an important tool for proper liquidity risk management. A crucial element of this reform, however, is the implementation of a globally consistent LCR. As such, BAFT-IFSA is concerned that material and significant differences from the Basel LCR reflected in the US Proposal could have a detrimental impact on banks with cross-border operations. Additionally, BAFT-IFSA believes that the Agencies should work through the implementation process, and through continued multilateral discussions at the Basel Committee, to correct and clarify issues in the LCR (and its interaction with other

[1] 78 Fed. Reg. 71818 (Nov. 29, 2013)

[2] Basel Committee on Banking Supervision, *Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools,* January 2013

1120 Connecticut Avenue NW, Washington, DC 20036 Telephone (202) 663-7575 Fax (202) 663-5538
www.BAFT-IFSA.com - Info@BAFT-IFSA.com

regulatory initiatives) that could have unintended consequences for the provision of real economy financing products.

Introduction and Overview:

As BAFT-IFSA represents the transaction banking segment of financial institutions globally, including the trade finance and cash management business lines, we are particularly concerned about the impact new regulatory initiatives could have on the availability and affordability of these products to the end-user consumer. Regulatory proposals which adversely impact transaction banking operations should be evaluated and adjusted.

The G-20 has promulgated a coordinated approach to financial regulation in order to strengthen the operations of the global financial system. Deviation from the standards adopted by the international community can contribute to a decrease in cross-border financial flows. This will in turn create inefficiency and risk in the financial system and also drive up costs to the end-user, further reducing the ability of banks to support international transactions crucial to companies around the world. These considerations support close adherence to the Basel LCR by the Agencies in keeping with the fundamental rationale for, and benefits of, internationally harmonized liquidity requirements.

In this letter we outline the key areas of concern regarding deviation from the international standard and discuss areas where the US Proposal would benefit from clarification or amendment. We generally are not revisiting aspects of the Proposed Rule agreed to in the Basel LCR, notwithstanding concerns with some of those aspects addressed in prior communications to the Basel Committee and other regulatory bodies. We do, however, raise concerns in some areas where we believe further discussion and clarification at the Basel Committee level would greatly benefit the overall efficacy of the LCR regime in order to avoid unintended consequences across all jurisdictions of the Committee.

Key Issues and Recommendations:

1. Address International Deviation Concerns

A number of material and significant differences are present in the US Proposal which will have a substantial impact on Covered Banks' calculations of their LCRs as compared to calculations under the Basel LCR. We believe these differences are neither necessary nor justified due to the unique circumstances of the Covered Banks. BAFT-IFSA recognizes that in implementing the LCR for individual jurisdictions, national regulators may need to make some adjustments to the Basel LCR standard. However, we strongly believe that the Agencies and other national regulators should diverge from the Basel LCR only where unique circumstances in the relevant jurisdiction warrant such differences and, at the same time, the correction of unintended consequences emanating from the global standard should be harmonized across jurisdictions.

Practical reasons illustrate the importance of this to the global provision of banking services. The need for consistency and credibility in decisions made collectively by the Basel Committee is critical, as the proper and efficient functioning of markets requires regulatory certainty and competitive parity across jurisdictions. Additionally, many Covered Banks on a consolidated basis have international footprints that include significant subsidiaries in non-US jurisdictions where national regulators are adopting their own version of the Basel LCR. There are considerable operational challenges when applying different standards at the level of subsidiaries whose LCR calculations are part of the consolidated parent covered company.

In addition to specific concerns for transaction banking outlined further in this section, international deviation should be corrected in several explicit areas to avoid perverse consequences. First, BAFT-IFSA believes that the US Proposal's requirement to maintain more High Quality Liquid Assets (HQLA) than mandated by the Basel LCR detracts from the goal of competitive equality across jurisdictions. Requiring banks in different jurisdictions that have matching 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. To avoid potential market distortions and negative effects on the liquidity of certain assets, the Agencies should adhere to the Basel LCR standards regarding HQLA.[3]

Second, we believe the US Proposal's treatment of operational deposits narrows the Basel LCR's approach in important respects and fails to fully and adequately recognize the scope of operational deposits. We strongly believe the Agencies should more closely follow the Basel Committee's approach, while taking into account certain clarification issues necessary to ensure all operational activities are treated in an appropriate manner as they concern run-off calculations.[4] In particular, as operating deposit balances differ by company and by industry, any sort of measure that relies on across-the-board standard calculations will be ineffective and will lead to inefficiencies that will impede the servicing of companies reliant on financial products to support and grow their businesses.

Clarification regarding the treatment of correspondent banking operational deposits is discussed in detail in Part 2 of this section of our letter. More broadly, however, BAFT-IFSA believes the agencies should also consider and adjust specific deviations from the Basel LCR standard as they relate to operational requirements in the US Proposal concerning written agreements (section 4(b)(1)); volatility (section 4(b)(2)); primary purpose (section 4(b)(4)); and prime brokerage (section 4(b)(7)).

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."[5]

While we believe this criteria to be generally correct we also believe that achieving this objective does not require the introduction of standards that materially and significantly deviate from the Basel LCR. In implementation of the LCR standard, there should be an appropriate "operational vs. non-operational" evaluation of the classification of financial services activities. Investment advisors, commercial wire activity and check clearing services are examples of areas where a careful review of whether the underlying activities conform to the defined scope of operational deposits generated by clearing, custody and cash management activities under the Basel LCR would be beneficial and would help ensure the proper outflow calculation is applied. This will avoid preemptively capturing broad swaths of deposit activities arising from operational services and applying run-off rates that are unnecessarily punitive and that could harm the availability and affordability of important operational financing to the end-user consumer.

Third, we believe that the Agencies' unilateral proposal to calculate the LCR on what we refer to herein as a "peak day" basis as opposed to the Basel LCR basis of cumulative net cash outflows over the 30 day period poses a variety of implementation challenges and would require Covered Banks to maintain substantially more HQLA than banks whose national regulators follow the Basel LCR approach.[6] Accordingly, we encourage the Agencies not to move forward with the Proposed Rule's peak day approach at this time and to conform to the Basel LCR. If regulators were to consider a peak day

[3] Basel LCR Section 4

[4] The relevant provisions in the Proposed Rule are the definitions of "operational deposit" and "operational services" in Section 2, the operational requirements in Section 4(b), and the outflow rates in Sections 32(h)(3) and 32(h)(4)

[5] Proposed Rule Preamble at 71841

[6] Basel LCR Para 69 and Proposed Rule Section 30

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approach, it should be carefully evaluated for application and impact as an international standard through the Basel Committee process.

Fourth, we believe 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 study that analyzes the HQLA of Covered Banks under the Agencies' final rule shows that an accelerated timeframe is warranted based on the status of Covered Banks' compliance.[7]

2. Address Concerns for the Treatment of Correspondent Banking Services

As noted, BAFT-IFSA believes there are material concerns with the treatment of operational deposits under the US Proposal. We specifically request clarification as to how the proposal impacts the provision of correspondent banking services. Section 4(b)(8)'s implementation of the Basel LCR's potential exclusion of operational deposits arising out of correspondent banking [8] could cast an excessively broad net and warrants interpretation in the final US rulemaking, along with further discussion and clarification by the full Basel Committee.

The Basel LCR recognizes deposits arising from operational accounts (OPAC), which are assigned a 25% run-off rate. To be deemed OPAC, it is understood that the account should exhibit payments and collections being executed on behalf of the client. It is also understood that OPAC treatment is to be applied across all client segments. This lower LCR outflow factor recognizes the highly stable nature of cash balances linked to operational accounts held by banks on behalf of their clients. The OPAC qualifications center on the client's utilization characteristics. The qualifying activities in the context of an operational relationship include - for Financial Institutions (FI) - "clearing, custody, or cash management activities" that meet certain criteria.[9]

Other non-OPAC deposits are assigned different run-off rates: 40% for non-operational corporate client balances and 100% for deposits arising from "correspondent banking". Under the Basel LCR, correspondent banking is defined 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 (e.g. so-called nostro and vostro accounts used to settle transactions in a currency other than the domestic currency of the respondent bank for the provision of clearing and settlement of payments)."[10]

However, the Basel LCR definition of correspondent banking has led to some confusion. In this context, the current definition does not match the practical fact that much of financial institutions' correspondent relationships *are* operational in nature. Using this narrow definition ignores the broader basket of correspondent banking activities, and may detrimentally affect the run-off rate of deposits through the erroneous, broad-brush application of a 100% LCR outflow factor. Clarification on a broader definition explicitly allowing for the inclusion of correspondent banking relationships as operational, and the allowance for a 25% outflow calculation for those operational deposits, will help support the necessary

[7] The US Proposal is an accelerated implementation timeframe. Under the US 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. In 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

[8] Basel LCR Para 99, Footnote 42

[9] IBID; Para 94

[10] IBID; Para 99, Footnote 42

provision of correspondent banking services to client banks, and thereby ensure the ability of client banks to continue to service the cash management needs of organizations that drive the real economy. [11]

As such, we encourage the Agencies, both through the rulemaking process and through discussions at the Basel Committee, to take an activity-based approach, whereby flows generated by correspondent transactions with underlying commercial operations relating to banks and their customers should be classified as operational in nature for the purpose of correspondent banking outflows, as they behave in a similar fashion to those of Corporate Operational relationship accounts. These balances should qualify for the 25% operational outflow factor as applied to both financial and non-financial customers. [12]

3. Address Concerns for the Treatment of Trade Finance and Export Finance Services

Global trade relies upon accessible financing for trade transactions. Trade financing assists customers with their import and export requirements by providing import/export financing as well as country and counterparty risk mitigation. Trade finance, as a transaction banking product, is a core banking business serving the real economy and should be carefully considered when implementing new liquidity standards.

The Basel LCR appropriately authorizes national regulators to apply a run-off rate of up to 5% to contingent financing liabilities related to trade finance instruments.[13] Because the US Proposal is silent as to the treatment of such liabilities, we understand the US 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 a stress situation at a financial institution. In order to avoid any uncertainty, we request the Agencies to clarify, either in the final rule or its accompanying Preamble, that there is a 0% outflow associated with contingent financing liabilities related to trade finance instruments.

In addition, as inflows generally match outflows for contingent trade finance obligations, BAFT-IFSA believes monies due from trade financing activities with a residual maturity of up to 30 days should be taken into account in full as inflows, as opposed to the current assumed inflow assignment of 50%.[14] This treatment would be consistent with the applied inflow rate for trade finance obligations adopted under Capital Requirements Directive IV (CRDIV/CRR) in the European Union and is an example of a correction by a Basel Committee jurisdiction of an issue that could, if left unaltered, lead to unintended consequences in the financing of international trade.[15] This correction should be adopted by the Agencies and harmonized across all jurisdictions of the Basel Committee.

BAFT-IFSA also believes the scope of the definition of Special Purpose Entity (SPE) should be clarified to ensure that it does not include entities that do not raise the concerns the definition is meant to address,

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[11] In practice, a correspondent bank account is an account held by one financial institution with another financial institution in a currency where the account holder has limited or no ability to transact. The use of a correspondent fills a settlement or capability gap and a correspondent bank account may facilitate settlement of transactions on behalf of the client bank or the client bank's customers. In both cases, the correspondent is acting as an independent intermediary in the flow and the respondent has a substantive operational dependency on the correspondent. Such correspondent clients may demand far greater OPAC services including domestic or cross-border clearing / payments and collections, foreign exchange settlements, standard settlement processes, automated collections, and standing orders. The accounts display deposit stickiness because the balances are supported by underlying commercial payments and collections.

[12] For further information, please see the BAFT-IFSA Letter to the Basel Committee on the impact of the LCR on correspondent banking services; October 4, 2013:
http://www.baft-ifsa.com/Handlers/AptifyAttachmentHandler.ashx?AttachmentID=Wrqaajg675U%3d

[13] Basel LCR; Para 138

[14] IBID; Para 154

[15] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (CRDIV/CRR): Article 425 (2)(b)

particularly as it relates to entities involved in export financing. 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.[16] Although we recognize that some SPEs raise unique liquidity concerns, we are concerned that the breadth of the definition could inadvertently include a wider range of entities.

Specifically, a significant amount of aviation financing through the Export-Import Bank of the United States ("Ex-Im" or "Ex-Im Bank") is done through special purpose vehicles and this type of financing would seem to potentially fall into the category of SPE under the proposal, particularly given the broad definition outlined in the rulemaking. An applied 100% outflow rate on this type of business would have a significant impact on committed facilities for aircraft finance under Ex-Im loans and could substantially reduce such important export financing activity. In light of the guarantees that are provided by Ex-Im Bank, and the type of financing recipient, we do not believe that these SPEs should be considered as structured to isolate the credit risk of the SPE. To help avoid uncertainty for Ex-Im related financing, it would be helpful to have specific examples in the final US LCR of entities that are meant to be included in the definition and those that are outside of the scope of the definition and, as such, Ex-Im financing should clearly be considered outside of scope.

4. Analyze and Address Adverse Interactions between the Basel III Leverage Ratio and the LCR

Both the Basel III Leverage Ratio[17] (and, as proposed in the US, the Enhanced Supplementary Leverage Ratio)[18] and the Basel LCR are important standards to promote sound capital and liquidity risk management. We respectfully request, however, for the Agencies and the Basel Committee to review and correct potential unintended consequences from overlapping requirements in the two ratios which could impact the provision of transaction banking services globally. For example, the LCR requires banks to hold HQLA in case of a liquidity stress scenario. These assets that are mostly held at Central Banks are counted into the leverage ratio exposure although they cannot actually be used for anything other than HQLA and are not a source of leverage. Additionally, when a bank takes cash deposits from its clients, the cash is either matched off against a loan (*i.e.* used as funding) or it is placed with a Central Bank. If it is placed with a Central Bank, an asset is created on the bank's balance sheet which adversely impacts the leverage ratio Exposure Measure. By providing deposit taking services to its clients and passing the cash through to a Central Bank, banks are penalized for providing "basic" banking services due to the negative impact on the leverage ratio exposure. This creates a disincentive for providing client-based services like deposit taking. By recognizing and correcting this interaction, and also reviewing further areas where the standards may work at cross-purposes with each other, the Basel III capital and liquidity regime would be enhanced without harming the effectiveness of the framework's overall purpose.[19]

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[16] Proposed Rule Preamble at 71838

[17] Basel Committee on Banking Supervision; *Revised Basel III leverage ratio framework and disclosure requirements*, June 2013

[18] Regulatory Capital Rules: *Regulatory Capital Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and Their Subsidiary Insured Depository Institutions*, 78 Fed. Reg. 51,101; August 20, 2013

[19] For further information on BAFT-IFSA's recommendations for the Basel III Leverage Ratio, please see BAFT-IFSA's Letter to the Basel Committee; September 20, 2013:
http://www.baft-ifsa.com/Handlers/AptifyAttachmentHandler.ashx?AttachmentID=hflQtS209cM%3d

For further information on BAFT-IFSA's recommendations concerning the US Enhanced Supplementary Leverage Ratio Proposal, please see BAFT-IFSA's Letter to the US Banking Agencies; October 21, 2013:
http://www.baft-ifsa.com/Handlers/AptifyAttachmentHandler.ashx?AttachmentID=Agfkb%2b5on7w%3d

Conclusion:

BAFT-IFSA appreciates the opportunity to highlight these issues of concern and clarification. We look forward to further dialogue with the Agencies, and the Basel Committee, going forward.

Very truly yours,

Tod R. Burwell

Tod R. Burwell
President and Chief Executive Officer