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Goldman Sachs

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-AE0431

January 31 2014

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

Ladies and Gentlemen:

The Goldman Sachs Group, Inc. (Goldman Sachs) is pleased to have the opportunity to provide comments on this consultative document issued in October 2013 by the Agencies[1].

In light of the 2008 financial crisis, there is a clear need for timely, globally coordinated regulatory reform to address weaknesses in the financial system; and we would like to express our appreciation of the efforts by the Agencies to develop these proposals. We share what we believe is the broad policy objective of ensuring that new standards in liquidity risk management promote greater systemic stability and economic efficiency.

Goldman Sachs regards prudent and conservative liquidity risk management as integral to the successful operation of our businesses. It has been our policy to manage and hold sufficient liquidity in both normal and stressed environments. As our 2012 10-K states, "Liquidity is of critical importance to financial institutions. Most of the recent failures of financial institutions have occurred in large part due to insufficient liquidity. Accordingly, the firm has in place a comprehensive and conservative set of liquidity and funding policies to address both firm-specific and broader industry or market liquidity events. Our principal objective is to be able to fund the firm and to enable our core businesses to continue to serve clients and generate revenues, even under adverse circumstances."

[1] *The Office of the Comptroller of the Currency "OCC", the Board of Governors of the Federal Reserve System "Board" and the Federal Deposit Insurance Corporation "FDIC"*

Global regulatory guidance has historically focused on capital. We believe that measures should also be in place to ensure that financial institutions hold adequate liquidity. As noted in our April 2010 response letter to the Basel Committee on Banking Supervision, we welcome the introduction of a liquidity-focused framework with global scope. The philosophy behind the proposed Liquidity Coverage Ratio (LCR) is broadly in line with Goldman Sachs' liquidity risk management framework and our policy of maintaining a material pool of excess liquidity.

While we are generally supportive of the LCR, we do have thoughts about specific calibrations of risk factors and request additional clarification on certain aspects of the Agencies' proposals. Therefore, we have participated in the preparation of the comment letter written by the industry trade associations[2]; and we support the comments and recommendations in that letter. We are submitting this letter to reinforce certain of the themes in the industry letter and to highlight specific areas of focus for Goldman Sachs.

The remainder of this letter sets forth our thoughts regarding certain of the criteria and calibration of the risk factors proposed by the Agencies. We have also noted a number of areas of the proposed rules that we find to be unclear as they are currently drafted and where additional clarification from the Agencies would be beneficial.

Our objective in highlighting these concerns is to ensure that the results, and the process of transitioning to the new standards, are consistent with the objectives of greater systemic stability and economic efficiency.

High Quality Liquid Assets (HQLA)

1) Definition of HQLA eligible assets

Equities

Under the proposed rule for U.S. institutions, only publicly traded common stock included in the Standard & Poor's 500 Index (S&P 500) is considered a level 2B asset. While we agree with the concept of using recognized indices to define the constituents of the HQLA, for equities we recommend that the Agencies evaluate other indices for inclusion in line with the following four key monetization criteria which we believe to be important when defining liquidity characteristics for HQLA:

— Price transparency
— Market size
— Trading volume
— Price volatility

The criteria that index publishers use to select assets for inclusion in indices is often similar to the four key monetization criteria noted above; and we recommend the Agencies, working alongside the global regulators, broaden their definition of eligible U.S. and international equities to include a greater number of indices.

Exchange Traded Funds (ETFs) based on the indices that are included in HQLA should also be included, as the ETFs add incremental liquidity on top of the liquidity seen in the market for the underlying equities.

Having the Agencies and global regulators use a common definition of eligible equities ensures that the LCR will be implemented globally and consistently across jurisdictions.

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[2] *The joint letter submitted by 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 and the Structured Finance Industry Group*

Corporate Debt

Section 32(c) of the proposal states that "publicly traded corporate debt securities would be considered level 2B liquid assets under the proposed rule." Under the proposed rule the definition of publicly traded "would be consistent with the definition used in the Agencies' regulatory capital rules and would identify securities traded on registered exchanges with liquid two way markets."

Clarification is requested on whether the publicly traded requirement is applicable to the issuer of the debt as opposed to the debt itself, as the market structure in the U.S. does not lend itself to such a requirement in all markets, *i.e.*, the vast majority of U.S. corporate debt securities are not listed on a national securities exchange whereas the vast majority of non-U.S. indices are listed on a national securities exchange.

2) **Operational requirements of HQLA**

Section 20(d) of the proposal states that "a covered company would be required to implement policies that require all HQLA to be under the control of the management function that is charged with managing liquidity risk. To do so, a covered company would be required either to segregate assets from other assets, with the sole intent to use them as a source of liquidity or to demonstrate its ability to monetize the assets and have the resulting funds available to the risk management function, without conflicting with a business or risk management strategy. Thus, if an HQLA were being used to hedge a specific transaction, such as holding an asset to hedge a call option that the covered company had written, it could not be included in the HQLA amount because its sale would conflict with another business or risk management strategy. However, if HQLA were being used as a general macro hedge, such as interest rate risk of the covered company's portfolio, it could still be included in the HQLA amount."

Even if an asset is a hedge or co-mingled with trading positions, firms are able to generate cash from that asset without selling it, and therefore are able to retain the desired trading or hedge relationship. Whether an asset is a trading position, a hedge to a trading position, or sourced via another means, once that asset is moved into a central clearance account and determined to be unencumbered and operationally and legally rehypothecatable or saleable, the Treasurer can generate liquidity through repo, pledging to clearinghouses, pledging as collateral for a secured line of credit or through regular open market operations with central banks. When the asset is used to generate funding through any of these means, the firm still retains the economic exposure and therefore the business position is unaffected. We believe that the monetization ability should be defined as ability to repo and/or sell the position.

The most important factors for maintaining the integrity of the liquidity pool are ensuring that the Treasurer has control of positions, location detail (including asset location, access to the repo markets and counterparties, and operational readiness) and, importantly, the ability to monetize the assets in an appropriate period of time (through liquidation, by sale, or by entering into repurchase agreements, or from maturities of reverse repurchase agreements). Covered companies should have appropriate policies and procedures in place that establish proper authority of the Treasurer or the management function charged with the liquidity risk management function to monetize. We request the Agencies clarify the language to state that the control of the Treasurer and the ability to monetize through sale and/or repo are the important requirements of the liquidity pool.

3) **Cash placements at agent banks**
Per the proposed rule, only cash held at central banks qualifies as HQLA, while cash balances held in operational deposits at other regulated financial companies cannot be included as inflows as they "may not be reliable sources of liquidity during a stressed scenario." Clarification is requested on whether cash held at agent banks for other than operational purposes, *e.g.*, demand deposits, can count towards a covered company's HQLA or inflow, which we believe it should.

Prime Brokerage

1) **Homogenous treatment of internalization in the customer flow**
In the proposal, long and short pairs in the non-HQLA asset class receive different run-off factors based on the type of pair. For example, firm longs paired with customer shorts attract a 100% risk factor while customer longs paired with customer shorts attract a 50% risk factor. Similarly, customer longs or firm longs paired with a stock loan attract a 100% risk factor. The type of long-short pairing in isolation does not correlate to the run-off risk of a customer short. If customer shorts are closed out, they will be closed out irrespective of the long that is covering them. The proposed treatment encourages arbitrary LCR optimizations of long-short pairs that do not necessarily change the true risk of internalization.

The funding risk created by internalization is more accurately assessed by measuring customer and CUSIP concentrations, rather than looking at the asset class or the type of long-short pair. More concentrated the ownership of the long and/or short increases the risk of internalization providing stable funding. Capturing concentrated risks, and extrapolating to the rest of the portfolio, will better depict the impact of run-off risk and incentivizes prudent diversification when using internalization as a source of funding and we believe would be beneficial to incorporate into the rules instead of shocking the aggregate pool of shorts across the entire customer base.

2) **Less than 30 day assets funded with term liabilities**
Paragraph 146 of the finalized Basel III LCR guidance makes it clear that no inflow benefit for <30 day margin loans/reverse repos would be allowed if funded by term liabilities (e.g. repos >30 days), "as a covered company should assume that such reverse repo or securities borrowing arrangements will be rolled-over and will not give rise to any cash inflows (0%), reflecting its need to continue to cover the short position or to repurchase the relevant securities." Clarification is requested regarding whether the U.S. proposal intended to diverge from the Basel guidance. The lack of clarification could result in inconsistent interpretation across various institutions.

Additionally we urge the Agencies to permit inflows on <30 day margin loans that are funded with term liabilities (e.g. repo > 30 days), as the close-out of the margin loan in a term repo creates capacity for other inventory (*e.g.*, firm inventory) that may otherwise go unencumbered (if they were being funded with repos that are assumed to roll off in the LCR).

Clarification

3) **Treatment of inflows from segregated balances related to regulatory requirements**
The treatment of inflows related to the release of balances held in segregated accounts in accordance with regulatory requirements (*e.g.,* SEC rule 15c3-3) is not explicitly addressed in the proposed rules. This was addressed in paragraph 155 of the Basel III LCR rules, which allows banks to recognize them as 100% inflows, stating that "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." It is our understanding that it was not the intent of the Agencies to exclude this from the proposal and we request that language allowing inflows from segregated balances in accordance with regulatory requirements be explicitly included so as to conform with the Basel III LCR guidance.

4) **Client portfolio unwind**
Section 32(j) of the proposal "recognizes that clients will not be able to close all short positions without also reducing leverage", suggesting symmetrical treatment of a customer's short outflow with the inflows of its margin loans. However, the proposal applies an outflow factor to all customer shorts and does not allow inflows on > 30 day margin loans. This implies that > 30 day margin loan customers would close out all of their shorts and become, in effect, a long-only levered hedge fund.

This conflicts with the recognition in the proposal that margin loan terms constrain a client's ability to make such a portfolio shift. Clarification is requested regarding whether firms should (1) recognize that term margin loan deleverage within 30 days, to align with the outflow assumption of those customers' shorts or (2) apply the same tenor assumptions to shorts as applied to these customers' margin loans.

Deposits

1) **Definition of natural person - revocable versus irrevocable trusts and personal investment vehicles**
Section 32(a) of the proposal states that "retail customers and counterparties would include individuals and certain small businesses" and that individual means "a natural person, and does not include a sole proprietorship." In the case of trusts, which are currently treated as financials, we recommend that a distinction be made between revocable and irrevocable trusts, as revocable trusts share many of the same characteristics as an individual. In a revocable trust, the grantor retains control of the assets and has the option to terminate the trust at any point in the future. We view this type of trust as under the control of an individual, and it should therefore receive outflow factors commensurate with retail deposits (3-10%). Any assets placed in an irrevocable trust belong to the trust and thus the grantor gives up control of the assets to the trustee and it should therefore receive the stated outflow factor of 100%.

We also propose that the definition of a natural person include personal investment vehicles that are controlled by an individual person or family. These entities are commonly used by individuals and families for estate planning, tax planning or liability management reasons. Financial institutions providing investment advisory, brokerage, and banking services to individuals interact with these entities as alter egos for an individual on the same basis that they interact with the individuals themselves.

2) **Buyback risk on term brokered certificate of deposits (CDs)**
Under the proposed rule, brokered deposits with a maturity of greater than 30 days attract a 10% outflow factor. We urge the Agencies to make a distinction between those brokered deposits where a client can break the term of the maturity with payment of a penalty vs. those brokered deposits where either (i) there is no contractual withdrawal right or (ii) the withdrawal rights are limited to death or incapacity. We urge the Agencies to exclude the latter from attracting a 10% outflow factor based on these contractual limitations on withdrawals and because this is no different than term unsecured funding.

3) **Outflow factor on brokered sweep deposits**
Brokered sweep deposits share the same characteristics as stable retail deposits as defined in the proposal, since they are issued to retail clients and the balances are 100% FDIC insured. While we agree that an outflow factor >3% (retail stable deposits) should apply given the intermediary that exists between the bank receiving the deposits and the broker-dealer sweeping the deposits, we do not believe the structure warrants an incremental outflow factor of 22%. We therefore recommend a 10% outflow factor commensurate with the risk factor applied to "Other Retail Deposits."

Clarification

4) **Outflow factor on uninsured brokered sweep deposits**
Section 32(g) makes a clear distinction between (1) fully insured brokered sweep deposits "that do originate with a consolidated subsidiary or a company that is a consolidated subsidiary of the same top tiered company", *i.e.,* affiliated deposits and (2) fully insured deposits "that do not originate with a consolidated subsidiary or a company that is a consolidated subsidiary of the same top tiered company", *i.e.,* non-affiliated deposits.

However in the case of uninsured deposits the section only makes reference to non-affiliated deposits that are assigned a 40% outflow rate. Clarification is requested as to the outflow rate applicable to uninsured brokered sweep deposits "that do originate with a consolidated subsidiary or a company that is a consolidated subsidiary of the same top tiered company", *i.e.,* affiliated deposits.

Derivatives

Clarification

1) **Liquidity outflows related to potential valuation changes**
Section 32(f) of the proposal applies an outflow of "20% of the fair value of any collateral posted to a counterpart by the bank that is not a level 1 liquid asset" to cover potential mark-to-market losses in times of stress. However the scope of application is not addressed in the Agencies' proposal. It is our understanding that this outflow rate applies only to collateralized derivative

transactions and not to secured funding and other transactions. It would be duplicative to assign this outflow rate to secured funding transactions which already attract separate risk factors as outlined in section 32(j) of the proposal. We request that the Agencies explicitly mention collateralized derivatives in this section.

2) **Changes in financial condition**
Section 32(f) of the proposal assigns a risk factor of 100% to "all additional amounts that the covered company would need to post or fund as additional collateral under a contract as a result of a change in its financial condition." Paragraph 118 of the 2013 Basel III LCR guidance specifies that this change in financial condition is defined as "any downgrade up to and including a 3-notch downgrade."

Since many contractual triggers in derivative transactions and other collateralized transactions are specifically related to credit rating downgrades, clarification is requested around how a covered company should calculate this outflow amount given the absence of an explicit ratings notch downgrade. Furthermore, the proposed rule states that "If multiple methods of meeting the requirement for additional collateral are available, the banks may use the lower calculated amount in its calculation."

We encourage the Agencies to employ a standardized approach to determining the collateral flows required in the event of a change in financial condition across the covered companies to allow for equitable treatment and avoid creating inconsistencies across firms.

<u>Other</u>

1) **Cap on gross cash inflows**
Consistent with the Basel III LCR guidance, the proposed rules apply a 75% cap on total inflows to reduce reliance on inflows during period of stress. We recommend that the Agencies make the distinction between contractual and contingent inflows and apply a cap only on the contingent inflows.

Applying a cap on inflows that a covered company is contractually entitled to receive within the 30 days of the calculation date or where the inflow is directly correlated with an outflow creates an asymmetry. For example, where a stock borrow facilitates a customer short, the outflow of the customer short proceeds would be funded entirely by the cash returned from the securities lender upon closing out of the stock borrows. It would be imbalanced to assume that the securities lender would not return 25% of the cash collateral that was pledged (see illustration below).

	Balance	Run-off factor	Inflow/Outflow
Customer Short	(100)	100%	(100)
Stock Borrow	100	100%	100
Actual Net Outflow			0
LCR Net Outflow (with cap)			(25)

Examples of contractual inflows include borrows, the lockup, and reverse repos. If the 75% cap is retained for gross inflows it could be viewed as applying a 25% default or failure probability to counterparties, which is punitive.

Furthermore, requiring a covered company to prefund for the worst net cumulative outflows within the 30 day period further reduces the reliance on inflows by capturing any potential timing mismatch between outflows and inflows over the 30 day period.

2) **Equivalence of regulatory regimes and legal entity implementation**
We urge the Agencies to ensure that these standards are implemented on a consistent basis globally. A country-by-country approach to liquidity regulation will incentivize regulatory arbitrage, leading to fragmentation of the availability of global liquidity and concentrated liquidity pools. We recommend that the Agencies align their proposal with international guidance or incorporate the international rules in the relevant jurisdictions. As an example, differences in local jurisdiction guidance around HQLA eligibility could put U.S.-based covered companies at a significant disadvantage relative to other jurisdictions.

Many U.S. bank holding companies have significant subsidiaries in non-U.S. jurisdictions where national regulators are adopting their own versions of the Basel III LCR guidance. The proposal allows a covered company to include in its consolidated HQLA the amount of assets up to the net cash outflows of the non-U.S. consolidated subsidiary that are included in the covered company's net cash outflow, plus any additional amount of HQLA held by the non-U.S. consolidated subsidiary that is available for transfer to the covered company's parent entity during times of stress without statutory, regulatory, contractual or supervisory restrictions. If the Basel III LCR guidance varies by jurisdiction, it may result in increasing the amount of trapped liquidity at subsidiaries.

<u>Clarification</u>

3) **Individual advisory and brokerage services – free credits**
Section 32(h) of the proposal states that "deposit balances maintained in connection with the provision of prime brokerage services be treated the same as unsecured wholesale funding provided by a financial entity or affiliate of a covered company, and thus be assigned a 100% outflow factor." We note that free credit balances from individuals, which are distinct from prime brokerage clients, are not explicitly accounted for in the proposal. In addition, Securities Investor Protection Corporation (SIPC) insurance treatment is also not mentioned. We therefore request clarification on both of these points.

In closing, we wish to reiterate our support for the efforts of the Agencies, and to express our desire to assist the Agencies in any way that would be helpful.

Yours sincerely,

Elizabeth. E. Robinson
Global Treasurer

cc. Mr. Lance Auer, Federal Reserve Bank of New York
Mr. Terrence McCarthy, Federal Deposit Insurance Corporation