

Office of the Comptroller of the Currency
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Washington, D.C. 20219
Attention: Legislative and Regulatory Activities
Division
Docket ID OCC-2014-0029
RIN 1557-AD97

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-1537
RIN 7100-AE 51

Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
Attention: Robert E. Feldman, Executive
Secretary
RIN 3064-AE 44

August 5, 2016

Re: “Net Stable Funding Ratio: Liquidity Risk Measurement Standards and Disclosure Requirements”

Ladies and Gentlemen:

The Goldman Sachs Group, Inc. (Goldman Sachs) is pleased to have the opportunity to provide comments to the joint notice of proposed rulemaking on the Net Stable Funding Ratio (“NSFR”) issued in April 2016 by the Office of the Comptroller of the Currency (the “OCC”), the Board of Governors of the Federal Reserve System (the “Board”), and the Federal Deposit Insurance Corporation (the “FDIC,” together with the OCC and the Board, the “Agencies”).¹

Goldman Sachs regards prudent and conservative liquidity risk management as integral to the successful operation of our businesses. Our liquidity risk management policies are designed to ensure we have sufficient financing, even when funding markets experience persistent stress. We seek to maintain a long-dated and diversified funding profile, taking into consideration the characteristics and liquidity profile of our assets. We therefore support the philosophy behind the

¹ 81 Fed. Reg. 35124 (June 1, 2016).

proposed NSFR, which is designed to require banks to maintain a sufficiently stable and long-term funding profile.

We believe, however, that there are a number of areas in which the proposed NSFR could be strengthened and improved. We also note a number of areas in the proposal where additional clarification from the Agencies would be beneficial.

We have participated in the preparation of the comment letter written by the industry trade associations,² and we support many of the comments and recommendations in that letter. We are submitting this letter to reinforce certain themes within the industry letter and to highlight specific areas of focus for Goldman Sachs. 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.

I. Treatment of Derivatives

a) Recognition of the funding value of securities collateral variation margin

Under the proposed NSFR, a bank can reduce its derivative asset value by accounting for variation margin that meets the conditions of the Agencies' Supplementary Leverage Ratio Rule ("SLR"). As a result, cash variation margin that meets the SLR conditions can reduce a bank's derivatives asset value, and the proposal effectively recognizes the funding value of cash variation margin and assigns it a Required Stable Funding ("RSF") factor of 0%. In contrast, securities variation margin received in connection with derivative contracts cannot reduce a bank's derivatives asset value. Thus, the proposed provision's treatment effectively assigns a 100% RSF factor to securities variation margin, ignoring *any* funding value. The result is that the proposal assigns no funding value to even highly liquid government securities, including U.S. Treasuries, which are classified as Level 1 High Quality Liquid Assets ("HQLA") in the Liquidity Coverage Ratio ("LCR") final rule. We believe the proposed NSFR's treatment should be amended for the following reasons:

- **Ignores real funding value of securities variation margin.** The proposed NSFR does not recognize that rehypothecatable securities variation margin received from derivative counterparties are a source of funding. A firm can generate funding using rehypothecatable securities through a variety of means including through sale, repo, pledge, or any other manner of delivery. The proposal improperly assigns no funding value to rehypothecatable securities collateral that a bank can use to generate funding.
- **Inconsistency within the NSFR framework.** The treatment of securities variation margin is inconsistent with the treatment of on-balance-sheet securities elsewhere in the proposed NSFR. For example, a U.S. Treasury security is assigned a 5% RSF factor if held unencumbered on a firm's balance sheet, while a U.S. Treasury security received as variation margin would receive a 100% RSF factor. The result is that a bank's funding requirement for a derivative receivable may vary significantly

² The joint letter was submitted by The Clearing House Association L.L.C., the Securities Industry and Financial Markets Association, The Financial Services Roundtable, American Bankers Association, Institute of International Bankers, and the CRE Finance Council.

depending on the type of collateral received and collateral management strategy used, even when the portfolio liquidity risk is nearly identical. For example, in the following three scenarios, the same derivative portfolio with nearly identical liquidity risk profiles would have very different RSF requirements depending on collateral received and strategy utilized:

	Scenario 1	Scenario 2	Scenario 3
Derivative NPV	▪ \$1.0bn	▪ \$1.0bn	▪ \$1.0bn
Collateral ³	▪ \$1.0bn USD cash	▪ \$1.0bn UST	▪ \$1.0bn UST
Use of Collateral Received	▪ Invest in \$1.0bn UST	▪ Hold UST collateral	▪ Repo UST for cash with a high quality corporate counterparty with maturity <1 year
Implied Net RSF Factor	▪ 5%	▪ 100%	▪ 50%
Balance Sheet Treatment	<ul style="list-style-type: none"> ▪ Derivative Receivable on B/S: \$0bn ▪ UST Firm Inventory on B/S: \$1.0bn 	<ul style="list-style-type: none"> ▪ Derivative Receivable on B/S: \$1.0bn ▪ Unencumbered USTs off B/S: \$1.0bn 	<ul style="list-style-type: none"> ▪ Derivative Receivable on B/S: \$1.0bn ▪ Cash on B/S: \$1.0bn ▪ Repurchase agreement on B/S: \$1.0bn

- **Inconsistent with the Liquidity Coverage Ratio (LCR).** The proposed NSFR treatment is inconsistent with the treatment of high-quality securities collateral in the LCR. The LCR assigns a 0% haircut to unencumbered Level 1 HQLA, implying that a bank could convert the securities into cash at full value in a 30-day severe stress environment. In addition, the LCR assumes no outflows for secured financing transactions collateralized by Level 1 HQLA maturing within the 30-day stress period. In not recognizing the funding value of Level 1 HQLA collateral, the proposed NSFR applies a more punitive treatment to U.S. Treasury securities than the short-term, stress LCR metric.
- **Increased interconnectivity.** The proposed NSFR will incentivize increased interconnectivity among market participants and unnecessarily gross up balance sheets. Many counterparties rely on the ability to use securities collateral as variation margin for derivatives transactions. Additionally, it is prudent collateral risk management practice for banks to convert cash collateral received into securities collateral to minimize counterparty credit risk arising from cash balances placed at agent banks. Thus, under the proposed NSFR, counterparties with securities collateral would have to execute additional secured financing transactions to convert their securities to eligible cash collateral to post. Banks would then have to execute additional transactions (e.g., reverse repo) to convert the received cash variation margin into securities for collateral management purposes. The proposed NSFR therefore leads to these additional transactions, which would unnecessarily increase interconnectivity and gross up balance sheets.

³ Examples ignore collateral haircuts.

In summary, we urge the Agencies to recognize the funding value of Level 1 securities variation margin in the NSFR. Specifically, the proposed NSFR should be amended to allow Level 1 securities variation margin received to reduce a bank's derivative asset value with appropriate haircuts in line with those of unencumbered assets held on the balance sheet, when a bank has the contractual and operational ability to rehypothecate the collateral.

b) Calculation of gross derivative liabilities

Clarification is needed on how a firm's gross derivative payable should account for settlement payments. Proposed section 107(a)(5)(ii) states that the gross derivative liability value of a derivative transaction should be calculated "as if no variation margin had been exchanged and no settlement payments had been made based on changes in the value of the derivative transaction."⁴ We urge the Agencies to appropriately clarify the treatment of settlements in this section.

c) Funding value of initial margin

The proposed NSFR assigns an 85% RSF factor to initial margin posted for derivative transactions while assigning a 0% available stable funding ("ASF") factor to initial margin received. Initial margin received provides legitimate funding value to a bank to the extent the bank has the contractual and operational ability to rehypothecate the collateral. This initial margin is contractually linked to the derivative transaction and is available for use by a bank for the duration of the derivative contract; therefore, it should be allowed to offset initial margin posted. At a minimum, initial margin received from counterparties should receive a 50% ASF value and should be permitted to offset the 85% RSF factor on initial margin posted by a covered company, where the firm has the ability to rehypothecate the collateral.

II. Treatment of Brokered Deposits

In determining the appropriate ASF factor for deposit liabilities, we believe that certain contractual features with respect to brokered deposits should be considered stabilizing factors when evaluating liquidity risk. More stable funding value should be assigned where there are contractual terms, such as restrictions on early redemptions and prioritization in a brokered deposit sweep waterfall structure, that provide protection from outflows of deposit balances in a stressed scenario. Specifically, we believe the Agencies should consider the following two calibrations.

a) Fully-insured, non-affiliate brokered sweep deposits

Contractual priority in deposit waterfall structure. The proposed NSFR assigns a 90% ASF factor to fully-insured, affiliate brokered sweep deposits and only a 50% ASF factor to non-affiliate brokered sweep deposits, regardless of insurance coverage. The Agencies note that the divergence in treatment is based on the view that "[w]ithin the waterfall structure, affiliates of

⁴ 81 Fed. Reg. 35169.

the deposit broker tend to be the first to receive deposits and the last from which deposits are withdrawn.”⁵

We agree with the Agencies’ view that priority within a deposit waterfall structure reflects more stable funding; therefore, we urge the Agencies to apply the same rationale to banks that have preferential, priority treatment in their contracts with non-affiliated broker dealers. In many cases, broker dealers provide contractual preferential treatment to non-affiliate banks. For example, a depository institution placed near the top of a broker dealer sweep program’s priority list would realize outflows only after a substantial amount of the deposit balances have been withdrawn.

The proposed NSFR should be updated to apply a 90% ASF factor to brokered sweep deposits that are fully insured, regardless of affiliate status, where 1) a depository institution has contractual prioritization over other participating depository institutions such that no deposit outflows from its program balance allocation would occur unless 50% of the overall program balances are withdrawn (reflecting structural priority), and 2) the contractual agreement has a remaining term greater than 1 year. Banks whose programs or contractual agreements with unaffiliated deposit brokers do not meet the above specified criteria should continue to receive a 50% ASF factor for their brokered sweep deposit balances.

b) Brokered retail term deposits

Contractual restrictions on early redemption. The proposed NSFR assigns a 90% ASF factor to retail deposits with a remaining maturity of greater than 1 year due to the risk that a bank might grant an early redemption request for franchise or reputational reasons, even if not contractually required.

The proposed NSFR should be revised to recognize that certain term deposits with contractual restrictions on redemption would not be susceptible to early redemption risk. For example, if a bank is not contractually required to maintain a secondary market for term deposits or early redemptions are permitted only upon certain specified events (e.g., death or determination of mental incapacity of depositor), then there is little risk that the deposit will be redeemed prior to its contractual maturity date. If a bank can demonstrate to the satisfaction of prudential supervisors that they do not allow clients to redeem term deposits prior to maturity, even during historical periods of stress, and the balances are fully insured, the full 100% funding value of the deposit should be recognized.

III. Other considerations

a) Disclosure

Under the proposed disclosure requirements, covered companies are required to disclose their NSFR on a spot basis at quarter-end. We believe that disclosure of a bank’s average NSFR over the quarter would give market participants and regulators a more appropriate view of a firm’s funding position over time, as spot metrics may vary across business dates. Disclosure of a

⁵ 81 Fed. Reg. 35137.

quarterly average would also be more consistent with other public liquidity disclosures, namely, the Agencies' proposed LCR disclosure requirements, which require covered companies to publicly disclose a quarterly average LCR.

b) Consolidation limitations

Section 108 of the proposed rule allows a consolidated company to include in its ASF amount excess ASF from subsidiaries only to the extent a subsidiary can "transfer assets to the top-tier [BANK], taking into account statutory, regulatory, contractual, or supervisory restrictions."⁶ In calculating a subsidiary's excess ASF amount, the proposal's preamble⁷ states that excess ASF should not include intercompany transactions between consolidated subsidiaries that are netted on the consolidated firm's GAAP balance sheet. The proposed NSFR should be updated to clarify that under the rules of consolidation, capital held at the consolidated subsidiary level must be included in the consolidated subsidiary's ASF, given that the consolidated subsidiary may be subject to its own standalone capital requirements and dividend restrictions and cannot freely transfer such funding to the top-tier holding company.

Specifically, a bank holding company typically raises capital at the holding company level and capitalizes its subsidiaries through equity injections. In practice, capital held at the consolidated subsidiary cannot be up-streamed freely to the top-tier holding company due to regulatory restrictions. For example, a consolidated bank subsidiary subject to the proposed NSFR with \$60 ASF (\$10 regulatory capital and \$50 of external deposits) and \$50 RSF (\$40 of external loans and \$10 of intercompany loans) would have a standalone NSFR of 120%. For purposes of the consolidated firm's NSFR, the amount of excess ASF at the consolidated bank subsidiary would be \$60 ASF (\$10 of regulatory capital and \$50 of external deposits) minus \$40 RSF (\$40 external loans, excluding the \$10 of intercompany loans), or \$20 excess ASF. The ASF included in the calculation should include regulatory capital as the consolidated bank subsidiary is required to maintain minimum regulatory capital requirements and is subject to dividend restrictions. Not including regulatory capital in the excess ASF calculation would imply that the consolidated subsidiary would be able to operate without *any* regulatory capital and have no restrictions on returning regulatory capital to the parent company. In addition, if regulatory capital were excluded from the calculation, it would directly conflict with the proposal's requirement to consider Regulation W, which is based on a subsidiary's capital stock, and its restrictions on the transferability of returning assets to the top-tier holding company.

Additionally, the proposed NSFR notes that the approach to calculating a covered company's consolidated ASF amount "would be similar to the approach taken in the LCR rule to calculate a covered company's HQLA amount."⁸ We would note that to be truly consistent with the LCR, for consolidated subsidiaries subject to the proposed NSFR, ASF available to the consolidated company should be based on the consolidated subsidiaries' standalone ASF and RSF calculations.

c) Impact on client facilitation

⁶ 81 Fed. Reg. 35169.

⁷ 81 Fed. Reg. 35155, FN 89.

⁸ 81 Fed. Reg. 35156.

The proposed NSFR does not recognize linked transactions for areas that we believe will be significantly impacted by the proposal including client clearing, client short facilitation, and equity derivatives. We believe that the proposed NSFR will result in significantly higher costs for these businesses and may conflict with regulatory reform for centralized clearing and discourage the risk management practice of holding segregated client assets. We believe that new costs would result in higher bid/offer spreads, increased management fees, a reduction in market liquidity, and would ultimately push some client facilitation activity into the shadow banking system. We urge the Agencies to consider the incremental impact of the proposed rule on specific capital markets activities.

d) Definitions of commitments

The Agencies should further clarify the definitions of “credit facility,” “liquidity facility,” and “undrawn amount.” The Agencies should provide examples of various types of lending commitments and whether they would be considered credit facilities or liquidity facilities under the rule. Specifically, the Agencies should clarify the treatment of commercial paper backstop facilities where the customer has no commercial paper currently outstanding, along with the treatment of facilities that are expected to be cancelled without funding (e.g., an unfunded bridge to a capital markets issuance).

Additionally, the preamble of the proposed NSFR states that the “undrawn amount” need not include amounts that are “contingent on the occurrence of contractual milestones or other events that cannot be reasonably expected to be reached or occur” within the time horizon.⁸ The Agencies should provide greater clarity on this determination, including the required level of support for excluding such commitments. The Agencies should also confirm the treatment of funded commitments, which result in contractually offsetting inflows (e.g., through an offsetting contractual collateral inflow from a secured funding transaction).

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.

Sincerely,



Robin Vince

Treasurer

The Goldman Sachs Group, Inc.

⁸ 81 Fed. Reg. 35143.