BNP PARIBAS

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By Electronic Mail

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Re: BNP Paribas Comment Letter on FBO Tailoring Proposals from the U.S. banking agencies.[1]

BNP Paribas appreciates the opportunity to comment on (1) the notice of proposed rulemaking issued by the Board of Governors of the Federal Reserve System (FRB) regarding proposed changes to the enhanced prudential standards (EPS) for Large Foreign Banking Organizations (FBOs), and (2) the joint notice of proposed rulemaking issued by the Office of the Comptroller of the Currency (OCC), the FRB, and the Federal Deposit Insurance Corporation (FDIC) (collectively, the Agencies) regarding proposed changes to the applicability thresholds for certain regulatory capital and liquidity requirements (collectively, the Proposals).

I. Introduction

BNP Paribas welcomes the Agencies' stated goal of providing tailored relief for FBOs from EPS in a manner that preserves a level playing field in the U.S. market. However, on balance, BNP Paribas is concerned that the Proposals, as currently calibrated, may actually increase rather than decrease regulatory burdens on FBOs – and thereby discourage FBO growth and support for U.S. jobs in the United States, hinder the ability of FBO-owned U.S. retail banks to compete with their domestic peers, and lead to greater fragmentation of the global financial system.

[1] This comment letter is submitted in response to the following rulemakings: Notices of Proposed Rulemaking, Prudential Standards for Large Foreign Banking Organizations; Revisions to Proposed Prudential Standards for Large Domestic Bank Holding Companies and Savings and Loan Holding Companies, Federal Reserve Docket No. R-1658 and RIN 7100-AF45; Joint Notice of Proposed Rulemaking, Changes to Applicability Thresholds for Regulatory Capital Requirements for Certain U.S. Subsidiaries of Foreign Banking Organizations and Application of Liquidity Requirements to Foreign banking Organizations, Certain U.S. Depository Institution Holding Companies, and Certain Depository Institution Subsidiaries, Federal Reserve Docket No. R-1628B and RIN 7100-AF21, OCC Docket No. OCC-2019-0009 and RIN 1557-AE63, FDIC RIN 3064-AE96.

This comment letter first provides a brief overview of BNP Paribas in the United States. Next, the letter aligns BNP Paribas with comments provided by various trade associations. This letter then focuses on the following three key concerns about the Proposals, and offers some recommendations for how to address them:

1) the challenges presented for FBO-owned retail banks to compete with their U.S counterparts;

2) the negative impact on direct lending and support for U.S. corporates and U.S. jobs; and

3) concerns about the potential imposition of additional liquidity requirements on U.S. branches of FBOs.

II. BNP Paribas in the United States

BNP Paribas is Europe's leading provider of banking and financial services. Incorporated in 1822, BNP Paribas has been active in the United States for more than a century and a half. As early as 1872, BNP Paribas' predecessor banks sold on European markets American railroad bonds and U.S. municipal and government bonds. In 1877, BNP Paribas opened a branch in San Francisco as part of a network of international trading centers. The commitment of BNP Paribas in the United States has only continued to grow and strengthen since that time, including with the 1979 purchase of First National Bank of San Jose – which would later become Bank of the West.

Today, the United States is central to BNP Paribas's global strategy. BNP Paribas remained committed to the U.S. franchise throughout the last financial crisis — and reaffirmed its strong commitment to the U.S. territory by embracing the creation of an intermediate holding company in 2016. As of December 31, 2018, BNP Paribas had total assets at the CUSO level of approximately $180 billion – with $120 billion in the IHC (including $90 billion in Bank of the West + $30 billion at CIB and other U.S. subsidiaries), and $60 billion in BNP Paribas branches. Over the long term, BNP Paribas sees the U.S. economy as a primary source of growth for the Group as a whole.

In terms of numbers, BNP Paribas serves 2.5 million retail customers, more than 2,000 strategic corporate and institutional clients, and generates $5.6 billion in revenue in the United States. BNP Paribas employs 14,000 people in the United States in 30 states through two core business lines –
(1) Retail Banking and Services (through BNP Paribas's wholly owned subsidiary Bank of the West), and (2) Corporate & Institutional Banking (CIB) which provides wholesale services and financing for U.S. corporates.

Bank of the West is headquartered in San Francisco, California. It operates a network of retail, wealth, commercial, and business banking offices in 23 states. Approximately two-thirds of BNP Paribas employees in the United States work at Bank of the West. BNP Paribas, through Bank of the West, provides key support to the "main street" economy as the third largest U.S. agricultural lender, a major Small Business Administration lender, and a leading lender in recreational vehicles and the marine sector.

The BNP Paribas CIB business serves many of America's largest corporations and financial institutions. Through the bank's integrated model with a presence in 72 countries, BNP Paribas bankers based in the United States help U.S. corporates secure financing and manage risk not only in the United States but throughout the globe. In addition, BNP Paribas helps many of its non-U.S. clients raise capital or invest in the United States, supporting the strength, diversity, and liquidity of the U.S. financial system and the broader U.S. economy.

Given its contribution but limited U.S. systemic footprint, BNP Paribas should be provided regulatory relief for its IHC comparable to its domestic peers. However, as described below, the Proposals are actually expected to subject BNP Paribas to more stringent regulatory requirements that will negatively impact the competitive position of Bank of the West, and the ability of BNP Paribas to support U.S. clients and invest in the U.S. economy.

III. Alignment with comment letters submitted by other trade associations

BNP Paribas broadly aligns itself with the recommendations and comment letters submitted by the following trade associations: the Institute of International Bankers (IIB), the Bank Policy Institute (BPI), the European Banking Federation (EBF), the Institute of International Finance (IIF), the Securities Industry and Financial Markets Association (SIFMA), the American Bankers Association (ABA), and the Committee on Capital Markets Regulation (CCMR). In particular, among other recommendations made in the trade association letters referenced above, BNP Paribas aligns itself with the broad framework of recommendations for the Agencies to revise the Proposals so that:

- Intermediate Holding Company (IHC) requirements are based on the scope of the IHC, not the scope of a FBO's consolidated U.S. operations (CUSO);

- The Proposals' Risk-Based Indicators (RBIs) better reflect FBO structures and are changed to be more risk sensitive by exempting from the RBI calculations:

    - all inter-affiliate transactions from all RBI computations, not just for cross-jurisdictional activity (CJA); and

    - assets held to satisfy regulatory requirements and transactions deemed to carry no external exposure.

BNP Paribas also aligns itself with the trade association comments regarding opposition to the possible imposition of standardized liquidity requirements on U.S. branches.

IV. The Proposals will create an unlevel playing field for FBOs, and especially for FBO-owned retail banks such as Bank of the West

While the October 31, 2018 U.S. bank holding company (BHC) tailoring proposal (U.S. BHC Proposal) and the Proposals for FBOs appear to use the same general framework, they would result in very different treatment for similarly sized banks. This disparity in national treatment is particularly acute for FBOs with U.S. regional retail banks like BNP Paribas.

1. Inequitable treatment of FBOs

BNP Paribas welcomes the U.S. Agencies' stated intention to account for the structural differences between BHCs and FBOs in order to create a level-playing field. However, as discussed extensively in the trade association comment letters listed above in Part III, the Proposals would actually increase regulatory requirements on FBOs (including those in Category III and IV), while the U.S. BHC Proposal would provide some relief to BHCs falling under Categories III and IV – thereby modifying the existing competitive landscape in the United States.

- **Use of the CUSO Scope**

This disparity of outcomes is primarily due to the way the Proposals use CUSO indicators – rather than IHC indicators – to determine IHC requirements (e.g., the liquidity coverage ratio (LCR) and the single counterparty credit limits (SCCL)). Indeed, heightened regulatory requirements for IHCs imply significant costs, especially with liquidity rules.

Additionally, while the categorization for U.S. BHCs and FBOs looks similar, the scope on which thresholds are set disadvantage FBOs. For instance, the Proposals created a new $50 billion weighted short-term wholesale funding (wSTWF) threshold at the CUSO level which would make Category IV FBOs subject to the reduced monthly LCR and net stable funding ratio (NSFR) requirements. Even though the Proposals would extend these changes to U.S. BHCs, currently none of the U.S. BHCs would actually end-up being subject to these – and other – stricter liquidity requirements as a result of the new $50 billion wSTWF threshold.

Finally, the Proposals do not take into account the risk reducing nature of the internal Total Loss Absorbing Capacity (TLAC) requirement imposed on IHCs owned by a foreign G-SIB, which do not apply to U.S. BHCs of a similar size. Internal TLAC is a buffer that provides significant resources and strength to these IHCs on top of home country capital requirements, but no acknowledgment of these resources is offered in the Proposals.

Recommendation – The IHC threshold – and not the CUSO threshold – should be used to determine IHC requirements

The IHC of an FBO should be subject to EPS comparable to those for U.S. BHCs of the same size and complexity as the IHC. To reduce this inequitable treatment of FBOs, the FRB should apply IHC requirements based on IHC thresholds (e.g., liquidity requirements, reporting requirements, SCCL) – instead of using the CUSO scope as is currently proposed. Relying on the CUSO scope to determine IHC liquidity and other requirements would create a complex and inappropriate framework in which IHC regulatory requirements would be misaligned with the IHC's activities, organizational structure, business model, and risk profile. The IHC would be forced to bear more regulation than its own attributes and resources would otherwise dictate, thereby distorting incentives for FBOs.

- **RBI calculations**

FBO inter-affiliate transactions artificially inflate not only the CJA threshold (for which the U.S. agencies have provided for a partial exemption), but all RBI computations, including wSTWF, off balance sheet activity exposure (OBS), and nonbank assets. These inter-affiliate transactions do not represent direct external exposure to the broader U.S. financial system and are routine internal conduit structures of international banks. Excluding these inter-affiliate transactions from all RBIs would help level the playing field with U.S. BHCs and avoid the placement of IHCs in different tailoring categories from their domestic competitors of similar size and complexity.

Recommendation – RBIs should be adjusted to avoid unfairly penalizing FBOs and FBO-owned retail banks

Inter-affiliate transactions should be broadly exempted from all RBIs (not just CJA) – including all inter-affiliate transactions, and not just intercompany liabilities and collateralized intercompany claims.

But at the very least, all transactions between an FBO's U.S. branches and the FBO's head office and other branches should be excluded from the RBIs calculations – since they are legally the same entity.
In addition, any IHC or CUSO secured funding from affiliates should be weighted based on haircuts in Section 32(j) of the LCR rule so that, for example, funding from affiliates secured by level 1 high-quality liquid assets has a zero weighting.

2. Negative impact on FBO-owned retail banks

Even though the requirements mentioned above would impact the full scope of U.S. activities for a FBO, the Proposals would have a particular negative effect on retail banks consolidated under an IHC. While BNP Paribas supports the IHC construct and recognizes that the FRB supervisory structure requires the placement of many FBO-owned retail banks under an IHC structure compared with similarly sized U.S. BHCs, the Proposals further exacerbate competitive disadvantages between FBO-owned retail banks and their U.S. peers – in some cases applying insured depository institution (IDI)-level requirements based on CUSO size.

Specifically, the Proposals could have a direct impact on the global level-playing field because they would subject FBO-owned retail banks to higher liquidity requirements than comparable U.S. peer banks. This is particularly problematic because the Proposals apply standards at the IDI level – such as LCR or the NSFR – that are applied in the United States only to internationally active banks. In addition to applying to certain IHCs, the LCR and NSFR would also apply at the level of any IDI subsidiary with at least $10 billion in assets that is a consolidated subsidiary of a Category II or Category III FBO.

Therefore, the categorization of BNP Paribas' CUSO could affect the application of LCR and NSFR requirements to Bank of the West, whereas Bank of the West's domestic peers would not be subject to such requirements. This unlevel playing field would likely have a direct negative impact on FBO-owned retail banks, which might not be able to accept certain deposits or engage in certain financial activities on the same terms as their U.S. competitors.

Lastly, the Agencies' dual reporting of IHC-level and CUSO-level metrics imposes burdens on FBOs that are not applicable to U.S. BHCs and that are not necessary in relation to an appropriately tailored EPS framework.

Recommendation – IDI requirements should not be based on a CUSO threshold

The Proposals would require a depository institution that has assets of $10 billion or more and is a subsidiary of a Category II or III FBO to meet the same standardized LCR and NSFR requirement as its IHC parent. The application of the LCR and NSFR to these subsidiaries of IHCs would result in ring-fencing assets at the bank subsidiary level, thereby driving up costs and creating a competitive disadvantage for FBO-owned retail banks when compared with their U.S. competitors. In no event should an IDI subsidiary of an IHC be subject to a requirement that would not otherwise apply to the IDI but for the CUSO's categorization. Therefore, an IDI should only be subject to the LCR and NSFR if the IHC is Category II or III and the IDI has over $10 billion in assets, to ensure national treatment of IDIs regardless of whether they are subsidiaries of FBOs.

Recommendation – The most stringent liquidity reporting requirements should only apply to firms complying with full LCR requirement

The full LCR requirement and T+2 reporting for FR 2052a should be aligned. Therefore, firms complying with reduced LCR should only have to report on a T+10 basis.

V. The Proposals should be made more risk-sensitive to avoid the unintended impact on direct lending and support for U.S. corporates and U.S. Jobs

BNP Paribas welcomed the positive comments about FBO support for the U.S. economy in the 2017 U.S. Treasury reports pursuant to Executive Order 13772 on the "core principles of the financial system." In addition, BNP also welcomed the objectives of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) to reduce regulatory burdens on regional banks to further U.S. economic growth. However, as applied, the Proposals would provide disincentives for FBOs to continue supporting key financing for U.S. companies and to manage global activities from their U.S. platforms. The implicit effort to increase regulations on FBOs with large U.S. branch structures and the blunt application of the RBI thresholds will have negative impacts that will reduce critical support for the U.S. economy in a manner that likely was not intended by Congress when it passed the EGRRCPA.

- **Financing for U.S. corporates**

BNP Paribas, like many FBOs, uses its U.S. platform as one of the key conduits for direct lending, letters of credit, loan commitments, and other credit facilities for U.S. corporates. Much of the branch and IHC exposure captured under the OBS RBI are the result of this support for U.S. businesses. Similarly, inter-affiliate unsecured funding is heavily weighted under wSTWF irrespective of the collateralization or external source of funds, and such financing is critical to FBO support for U.S. corporates. Should decisions be made by FBOs to manage growth to fall below certain RBIs such as the OBS, the real economic hit is likely to be felt directly by U.S. "main street" businesses and decrease the diversity of financing in the U.S. market.

Recommendation – RBI calculations should not penalize transactions used to support U.S. corporates and the U.S. economy

Loan commitments, letters of credit, and guarantee facilities that are used to finance U.S. corporates and support the U.S. economy should be weighted in proportion with the risk-weight they actually carry. Accordingly, the Proposals should include the following adjustments:

- Apply risk-weight factors on top of the conversion factor under the OBS calculation to capture counterparty-specific risk; and

- Collateralized OBS transactions should permit netting across collateral, subject to appropriate haircuts, and any OBS transaction that cannot be drawn unless collateralized should be treated as collateralized transactions, permitting netting against the required collateral amount.

- **Promoting safety and soundness**

BNP Paribas also relies on its U.S. broker-dealer (under its IHC) to provide centralized derivatives clearing services in the United States for its global affiliates. These activities with related parties and affiliates advance regulatory objectives to promote safety and soundness of the U.S. markets. Including these exposures in RBI calculations like OBS would penalize this activity and could lead FBOs to shift clearing services from their U.S. affiliates to unaffiliated brokers owned by U.S. GSIBs – thereby increasing U.S. market concentration, weakening the diversity of the U.S. financial system, and likely driving up costs for end-users in the United States.

Recommendation – RBI calculations should not penalize transactions used to satisfy or promote regulatory requirements

The Agencies should revise the OBS RBI to exclude potential future exposure (PFEs) associated with derivatives clearing for affiliates, so long as the affiliates comply with ongoing margin requirements. This adjustment promotes the objectives of not only the Dodd-Frank Wall Street Reform and Consumer Protection Act, but the broader post-crisis derivatives reforms adopted globally. Penalizing such exposures may provide a competitive disadvantage to FBOs and further concentrate risks by shifting activities to large U.S. banks.

Additionally, less than 30-day wholesale unsecured funding should be excluded from the wSTWF calculation, up to the amount of cash deposited at the FRB. This would improve the risk-sensitivity of the wSTWF RBI by filtering the volatility stemming from overnight unsecured wholesale deposits when their associated liquidity risk is sterilized (e.g., through an overnight FBR deposit).

VI. Opposition to potential imposition of additional standardized liquidity requirements on U.S. branches

BNP Paribas is also concerned about the possible imposition of additional standardized liquidity requirements like the LCR on FBOs' U.S. branches and agencies. Such requirements at the branch level would be a departure from the historical treatment of branches, which are a legal part of the parent entity, and are thereby more appropriately regulated by home country supervisors.

Additional liquidity requirements at the branch level would be duplicative of existing liquidity buffers, risk greater market fragmentation, and weaken the stability of the global financial system by locking up resources that could otherwise be deployed efficiently to address a potential crisis. U.S. and global post-crisis prudential frameworks already have effective safeguards in place to address capital and liquidity concerns of both home and host regulators. Therefore, additional standardized liquidity requirements on U.S. branches would lead to "buffers on top of buffers" since U.S. branches of FBOs already are subject to home country liquidity requirements as well as U.S. supervision and regulation (e.g. internal liquidity stress testing).

Such a further step in ring-fencing would also go in the opposite direction of the work by the Financial Stability Board (FSB) on fragmentation, which aims to increase deference to home country supervisors. In the case of EU headquartered banks, such deference could be based on the holistic liquidity framework implemented through the EU single rule book (e.g., Capital Requirements Regulation 1 (CRR1) and the recently approved Capital Requirements Regulation 2 (CRR2)). In addition, and as described in more detail in the Appendix of the EBF comment letter, the EU liquidity risk management framework includes, among other standards, a minimum LCR requirement of 100%, a supervisory reporting by currency for all currencies representing more than 5% of the total balance sheet, a requirement for an internal liquidity adequacy assessment process (ILAAP), and supervisor-run liquidity stress-testing.

This holistic framework, under the Single Supervisory Mechanism (SSM) for most EU banks with a significant U.S. presence, should provide the Agencies with comfort that the U.S. dollar liquidity position of the FBO's U.S. branches, and of the EU banks as a whole, are effectively monitored and supervised.

Recommendation – Greater deference, cooperation, and data sharing with home country regulators

BNP Paribas recommends that U.S. regulators should rely on increased international cooperation and data sharing among regulators, as well as deference to existing, robust home country regulations, supervision, and liquidity requirements. Any discussion about new measures at the branch level should take place in a coordinated international manner, possibly at the FSB level, to allow global regulators to address any liquidity concerns in an efficient and effective manner.

Like the SCCL rule, the FRB should encourage the use of substituted compliance, defer to home country liquidity regulation, and rely on increased cooperation among regulators through international supervisory forums. Regulators should coordinate ways to provide the FRB with greater transparency and reporting of relevant home country LCR results, which already cover U.S. branches and agencies.

VII. Conclusion

BNP Paribas is committed to the U.S. market, its second largest capital allocation after France. But BNP Paribas can only sustain or grow its U.S. investments with a regulatory framework that preserves competition for FBO-owned retail banks, and other financial services.

BNP Paribas appreciates the challenges inherent in tailoring EPS requirements, and the Agencies' stated goal of maintaining a level playing field in the U.S. marketplace. However, the Proposals as currently drafted do not achieve these goals – and therefore BNP Paribas respectfully requests that they be revised to reflect FBO specific structures in order to permit FBOs to continue to support U.S. retail customers and U.S. companies. Moreover, to avoid further market fragmentation, BNP Paribas also urges the Agencies to avoid imposing additional liquidity requirements on U.S. branches of FBOs, and instead align with G-20 and FSB recommendations to address any concerns about branch liquidity through greater regulatory deference, supervisory communication, and information sharing.

Sincerely,

[redacted]

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