By Electronic Mail

Board of Governors of the Federal Reserve System
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Washington, DC 20551

Office of the Comptroller of the Currency (OCC)
250 E Street, SW
Washington, DC 20219

Federal Deposit Insurance Corporation
550 17th Street, NW,
Washington, DC 20429

21 June 2019

SUBJECT: FBOs tailoring proposals

Dear Sirs and Madams,

On behalf of the European Banking Federation ("EBF"), the Japanese Bankers Association ("JBA") and the Canadian Bankers Association ("CBA") (jointly referred to as the "Associations"), we would like to express our gratitude for the opportunity to comment on the notices of proposed rulemaking published on April 8, 2019 by (i) the Board of Governors of the Federal Reserve System ("FRB") related to tailoring of Enhanced Prudential Standards ("EPS") for Foreign Banking Organizations ("FBOs"), and (ii) the Office of the Comptroller of the Currency ("OCC"), the FRB and the Federal Deposit Insurance Corporation (collectively referred to as the "Agencies") regarding proposed changes to the applicability thresholds for certain regulatory requirements related to capital and liquidity that were aiming to match rules for foreign banks with the risks they pose to the U.S. financial system ("FBOs tailoring proposals" or "Proposals").

We are key stakeholders in the FBOs tailoring proposals. 19 out of the 23 firms named in the Proposals are our members, of which 12 are EBF members, 4 are JBA members and 3 are CBA members. While we will provide more detailed comments on the Proposals in our individual letters, this joint letter by the EBF, JBA and CBA provides our views and concerns with respect to the Proposals from a high-level standpoint, focusing on their potential adverse impact on the global financial markets.

General comments

Overall, we welcome the Agencies' efforts to increase the efficiency of banking organizations and the resilience of the financial sector by tailoring the EPS and aligning the requirements for foreign banks with those for domestic banks.

The U.S. market has been open and fair to both domestic and foreign banks and we believe this has benefited the U.S. significantly. Foreign banks in the U.S. contribute to the diversity and depth of the financial market that characterises the U.S. as one of the largest financial markets in the world. Foreign banks also contribute to economic growth and employment in the U.S. through their role as financial intermediaries. Their global network, including the network in their home countries, plays an important role in enabling U.S. clients to expand their business overseas. The diversity and global reach brought to the U.S. financial market by FBOs is not necessarily a threat to the U.S. financial system, but rather contributes to its financial stability.

However, we are concerned that parts of the Proposals would undermine these important contributions and, ultimately lead to market fragmentation. While some of the proposed changes may indeed better align regulatory obligations with the size and complexity of the U.S. operations of FBOs, some critical requirements, especially in the context of liquidity standards, lead to fragmentation as well as create competitive disadvantages for FBOs in comparison with U.S. banks of a similar size and complexity.

In particular, we are concerned about the imposition of liquidity standards and single counterparty credit limits ("SCCL") requirements upon Intermediate Holding Companies ("IHCs") based on the Combined U.S. Operations ("CUSO") of the FBOs. We would like to point out to the fact that since the introduction of the EPS and the IHC requirements, no new IHC has been established. Imposing additional requirements on the IHCs will make their establishment even more costly and unattractive.

We are also concerned about the potential application of Liquidity Coverage Ratio requirements for branches of FBOs in the U.S. We consider that this poses a serious risk of increasing global fragmentation and duplicative regulation by ring-fencing additional liquidity buffers at the U.S. branch level. We believe this is not necessary as those branches are legally part of the home legal entity and covered by the home jurisdiction's liquidity regulations as well as OCC or state banking regulator oversight and certain EPS requirements regarding risk management, liquidity stress testing and buffer requirements.

As noted in the recent *Financial Stability Board Report on Market Fragmentation*[1], "[t]he segmentation of institutions and markets across jurisdictional lines can reduce opportunities for cross-border diversification and risk management, particularly by investors and institutions that manage their capital and liquidity on a global basis". The report also noted that "[f]ragmentation of institutions' operations across borders may prevent capital and liquidity from being channelled to those entities in need of additional resources during periods of stress".

[1] FSB Report on Market Fragmentation
https://www.fsb.org/wp-content/uploads/P040619-2.pdf

To consider the effect of fragmentation, simply imagine if comparable FBO regulations were to be imposed in all host jurisdictions on all foreign banks (including American, European and Japanese banks) based on the stand-alone risk profile of their branches or subsidiaries. In such scenario, all capital and liquidity would become ring-fenced and fragmented along geographic lines, even though at the global level, their capital and liquidity are well managed and sufficiently meet prudential requirements. This resulting loss in flexibility to address stress situations will definitely damage global financial stability and significantly reduce the efficiency of global financial markets.

As stressed in the G20 Buenos Aires Summit Declaration[2], "an open and resilient financial system, grounded in agreed international standards, is crucial to support sustainable growth". We respectfully request that the FBOs tailoring proposals be modified taking a holistic view of global financial stability to create an efficient and integrated global financial market.

Specific Issues

While we will provide more detailed comments on the Proposals in our individual submissions, below we provide our high-level comments on the FBOs tailoring proposals' key issues for our member banks:

1) Risk-based indicators (RBIs)

While the Proposals nominally use the same framework of risk-based indicators for FBOs as used for domestic Bank Holding Companies ("BHCs"), the Proposals penalize FBOs for their unique structure and heavier reliance on capital markets activities in the U.S. compared to their domestic BHC counterparts. In addition, using CUSO-wide risk-based indicators to determine an IHC's categorisation for liquidity and SCCL requirements puts IHCs more often in more severely regulated categories than BHCs of the same size and risk profile. This potential punitive treatment is attributed to the new RBIs not reflecting the global structures of FBOs. As mentioned in the Proposals, FBOs have limited access to retail deposits to fund their lending to U.S. companies, and therefore must rely on short-term wholesale funding and loans from the parent.

However, this funding structure does not necessarily pose a threat to the U.S. financial system, because liquidity pools including those of U.S. branches are managed globally. In addition, the soundness of each FBO in terms of both capital and liquidity is sufficiently secured on a global basis, due to home jurisdiction regulations. RBIs that do not reflect the above characteristics would serve as additional binding constraints on organic growth of US-booked business, and would have a cliff effect, especially, since each RBI can lead to a firm being categorized as Category II or III, which come with an arsenal of additional onerous EPS requirements.

Hence, overly punitive elements from the Proposals should be eliminated and the RBIs adjusted by considering the diversity of foreign banks' business models and risk

[2] G20 Leaders' declaration Building consensus for fair and sustainable development https://www.consilium.europa.eu/media/37247/buenos_aires_leaders_declaration.pdf

profiles. In particular, we respectfully request that the following points be reconsidered:

a) Bearing in mind national treatment of FBOs, the Proposals should focus solely on the IHC and not on the CUSO when categorizing banks for EPS application. At the very least, IHC requirements should not be based on the CUSO. These adjustments allow for a better recognition of the diversity of FBOs' business models and risk profiles.
b) Inter-affiliate transactions should be excluded from all RBIs. The exemption for cross-jurisdictional activities ("CJA") should include more than just intercompany liabilities and collateralized intercompany claims (by exempting all claims from CJA calculation)
c) Assets held to satisfy regulatory requirements or liquidity risk management should not count towards any of the RBIs. For instance, clearing of derivatives for affiliates and securities borrowing / repo of U.S. Treasuries intended to create a liquidity buffer should be excluded from the off-balance sheet exposure scope. Short-term liabilities that are used to fund short-term assets (e.g. trade finance and supply chain finance) for prudent asset-liability management practices should also be excluded.
d) Transactions should be excluded from all RBI calculations where their exposures to an entity carry a 0% risk-weighting under the liquidity coverage ratio (or other existing rules), or other forms of high-quality liquid assets.
e) Transactions to meet customer demand should be excluded from all RBI calculations. For instance, saving and checking deposits should be excluded from weighted short-term wholesale funding ("wSTWF"). FBOs accept these kinds of deposits from non-U.S. clients for the purpose of providing settlement services rather than as a means of short-term funding. The wSTWF metric, in general, overstates the risk of certain types of funding and should be revised to recognize the relative stability of funding sources, consistent with other U.S. liquidity rules.

2) Liquidity requirements for branches

Instead of enhanced liquidity requirements for branches, greater deference to home country regulation and cooperation should be considered. Additional liquidity requirements should not be imposed on the U.S. branches provided that their respective home country regulations are comparable with the Basel III liquidity requirements.

U.S. branches of foreign banks are not individually–capitalised, stand-alone legal entities, but rather form a part of a larger global network. We do not agree with the view that the stand-alone branch-based liquidity structure poses a threat to the U.S. financial system. Liquidity, including that of U.S. branches, is managed globally and maintained in a sound manner under global capital and liquidity requirements. Placing additional liquidity requirements on the U.S. branches of FBOs will result in further fragmentation of the branch network's regulatory requirements. This will impede the global financial system by creating frictions in their global and USD-based activities.

Consequently, we believe that imposing a U.S.-specific liquidity requirement on U.S. branches of FBOs, above and beyond those already in place today under State laws, by the OCC and FRB liquidity stress-testing and buffer requirements, would add limited value from a financial stability standpoint, while breaching an important principle, which is that branches (unlike subsidiaries) are under the supervision of the home country. We urge the U.S. authorities to address any legitimate concerns about USD liquidity through reliance on and cooperation with the home regulator, rather than by increasing fragmentation and ring-fencing. We consider additional branch liquidity requirements unwarranted and believe they only serve to accelerate the recent, unfortunate trend towards the ring-fencing of global banking markets, both in the U.S. and abroad. Further retaliatory measures by other jurisdictions must be avoided.

3) Transition Period and Reporting

Adequate transition periods should be provided, taking into account additional burdens imposed on the FBOs.

The FRB should not lose sight of the fact that the RBIs, and associated FR Y-15 reporting, create new burdens for a number of FBOs with $100B or more of CUSO assets, some of which are not even close to the RBI triggers and should be allowed to instead report simple, streamlined data.

Moreover, all FBOs would be reporting these indicators with respect to their CUSO/branches for the first time, thus should be given sufficient time to build the necessary reporting infrastructure. In the interim, in order to achieve the desired visibility into risk classification, banks should be allowed some time to produce *pro forma* figures.

Under the current Proposals, if an FBO becomes subject to a different Category and related standards, then the new standards would be effective on the first day of the second quarter following the date on which the FBO met the criteria for the new Category. We believe this transition period is too short, taking into account the deadline[3] for submission of the FR Y-15.

As such we suggest that the Agencies set adequate transition periods, which should be longer than two years. This includes transition periods upon initial implementation as well as upon subsequent change of an FBO's Category to a higher bucket for the first time. We believe this is warranted because the FBO would need to change their IT systems and operating procedures in response to the new Category and accompanying more stringent standards

For these reasons, we propose that rules for FBOs be tailored consistently with the reforms made since the financial crisis of 2008 and the G20 initiative for addressing market fragmentation. We believe that instead of resorting to unilateral actions, supervisors from home and host jurisdictions of internationally active banks should deepen their cooperation through bilateral and multilateral fora.

[3] The FR Y-15's submission date is 50 calendar days after the March 31, June 30, and September 30 as-of dates and 65 calendar days after the December 31 as-of date. https://www.federalreserve.gov/apps/reportforms/reportdetail.aspx?sOoYJ+5BzDaRHakir9P9vg==

Yours faithfully,

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