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June 21, 2019

Via Electronic Mail

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, NW
Washington, D.C. 20551

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street, SW, Suite 3E-218
Washington, D.C. 20219

Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20249

Re:
Proposed 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 (Docket ID OCC-2019-0009, RIN 1557-AE63; FRB Docket No. R-1628B, RIN 7100-AF21; FDIC RIN 3064-AE96); Prudential Standards for Large Foreign Banking Organizations; Revisions to Proposed Prudential Standards for Large Domestic Bank Holding Companies and Savings and Loan Holding Companies (FRB Docket No. R-1658, RIN 7100-AF45)

Ladies and Gentleman:

UBS appreciates the opportunity to comment on the proposal issued by the Board of Governors of the Federal Reserve System regarding proposed changes to the enhanced prudential standards for large FBOs¹ and the proposal issued jointly with the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency on the applicability of various thresholds for certain regulatory capital requirements and the application of liquidity requirements to foreign banking organizations ("FBOs") that have "significant" U.S. operations². Our submission of one comment letter on both proposals is driven by the interrelated nature of the proposals and the basis of the applied tailoring framework. UBS has also participated in the preparation of comment letters submitted by The Bank Policy Institute, Securities Industry and Financial Markets Association and the Institute of International Bankers, among others, and broadly supports their comments and recommendations.

We broadly support the underlying objective of the proposals to implement principles of the Economic Growth, Regulatory Relief, and Consumer Protection Act ("EGRRCPA") and tailor the application of enhanced prudential standards to FBOs under Section 165 of the Dodd-Frank Act, as well as the capital and liquidity requirements for the U.S. operations of FBOs. However, we believe that further reconsideration of certain aspects of the proposals

¹ 84 Fed. Reg. No. 84 Page 21988 (May 15, 2019) (the "Federal Reserve proposal").

² 84 Fed. Reg. No. 101 Page 24296 (May 24, 2019) (the "Interagency proposal").

is warranted to ensure that the tailoring of regulatory requirements is appropriately aligned with the actual risks that individual institutions pose to the financial stability of the United States and align re-calibration efforts with the noted reform objectives of simplicity, transparency and effectiveness. In particular, we believe that the following elements warrant further reconsideration in the Agencies' finalization of the proposals:

- The reliance upon a measure of total nonbank assets as a Risk-based Indicator (RBI) that should be risk-sensitive and based on sound design, theory and analytical support and takes into account that nonbank activities are already subject to prudential regulatory requirements imposed by the Federal Reserve and other regulators; and
- The applicability of daily LCR requirements for Category III firms and their subsidiaries greater than \$10B in assets in addition to the question of applying standardized liquidity requirements to the branches of FBOs.

In addition, we would request that the Agencies consider certain technical amendments to the denominator calculation and regulatory reporting requirements related to the Supplementary Leverage Ratio (SLR) for firms that are not subject to the Advanced Capital Adequacy framework, but would become subject to the SLR if finalized as proposed.

Reliance on Nonbank Asset levels as a Risk-based Indicator

Within the Federal Reserve proposal, the following assertions are made:

- "The level of a banking organization's investment in nonbank subsidiaries provides a measure of the organization's business and operational complexity" and
- "Through its U.S. intermediate holding company, a foreign banking organization can maintain significant investments in nonbank subsidiaries, and therefore may present structural, funding, and resolution concerns analogous to those presented by domestic banking organizations" and
- "Nonbank activities also may involve a broader range of risks than those associated with banking activities, and can increase interconnectedness with other financial market participants, requiring sophisticated risk management and governance, including capital planning, stress testing, and liquidity risk management³."

While the opening statement may be true that the level of a banking organization's investment in nonbank subsidiaries provides a "measure," there is no clear statistical analysis that supports a link to either business or operational complexity thus raising questions on the efficiency or transparency of the chosen measure. The measure also provides no indication of risk sensitivity of the underlying business activities (e.g., risk weighting or exclusion of certain exposures) that is incorporated to some degree within the other RBIs. This particularly important as broker-dealer subsidiaries are major holders of high quality and liquid assets like Treasuries and agency securities and, given the lack of risk sensitivity of this metric, they actually could be penalized for holding these assets. The Federal Reserve also implies that nonbank activities are not subject to capital requirements or direct supervision.⁴ However, nonbank entities and activities are subject to multiple layers of supervision and regulatory requirements, including the Federal Reserve's supervision and regulation of the intermediate holding company (IHC) of an FBO.

In its 2016 proposal of the Capital Plan Rule⁵, the Federal Reserve indicated that it considered a nonbank asset threshold to be a proxy for complexity. As the Federal Reserve was determining the appropriate level of the threshold, it indicated that "the threshold of \$125 billion in nonbank assets would exclude companies that engage in equities trading, prime brokerage, and investment banking activities, and therefore have risk profiles that are more similar to those of the most complex U.S. financial firms than to the risk profiles of the smaller, less complex bank holding companies⁶." In the final rule⁷, the Federal Reserve noted that the distress or failure of firms with significant nonbank assets has coincided with or increased the effects of significant disruptions to the stability of the U.S. financial system. To support this conclusion, it provided the examples of Wachovia and Long Term

³ 84 Fed. Reg. No. 94 page 21997 (May 15, 2019)

⁴ 84 Fed. Reg. No. 94 page 21997 (May 15, 2019)

⁵ 81 Fed. Reg. No. 190 page 67239 (September 30, 2016)

⁶ 81 Fed. Reg. No. 190 page 67243 (September 30, 2016)

⁷ 82 Fed. Reg. No. 22 page 9313 (February 3, 2017)

Capital Management and their respective nonbank asset levels. These appear to be inappropriate examples, as the Federal Reserve acknowledged that Wachovia's issues were the result of accelerated withdrawals from their accounts of its bank depositors and reduced liquidity support from wholesale funds providers⁸. Meanwhile, Long Terms Capital Management was a highly leveraged hedge fund reliant upon investor funding and substantive credit lines from counterparties. Neither of these examples bears much resemblance to the activities of covered FBO IHCs and their respective risk profiles and financial (capital/liquidity) resources, as well as, those of their parent companies.

Given the noted challenges of the current metric and its lack of conceptual soundness, we believe that the elimination of this arbitrary indicator would be appropriate.

In lieu of eliminating this metric, we urge the Agencies to consider other solutions to better and improve the risk sensitivity of this proposed RBI. These include the following:

- Employing a risk-weighted measure for nonbank assets based on current RWA standards for regulatory capital. Such a solution would be more effective and transparent than the proposed method in that it draws a degree of risk-sensitivity for higher risk balance sheet exposures and assimilates the weighting applied within the other RBIs. The Federal Reserve could accomplish this objective by collecting additional data within its FR Y-9LP regulatory report;
- Another way to address the lack of risk-sensitivity in the proposed measure would be to apply a limited set of permissible deductions for assets that are already deducted from regulatory capital (for example, deferred tax assets and goodwill) and low risk assets that qualify as HQLA under existing LCR rules or liquid buffer assets under Regulation YY that exhibit low market and credit risk. While the Federal Reserve previously raised concerns about low risk assets may be used in connection with complex activities (including prime brokerage and other trading activities), the employment of a STWF indicator designed to address liquidity risks should mitigate such concerns and make the measure of these assets in the nonbank asset indicator superfluous. To ensure the transparency of the re-calibrated nonbank asset indicator, the considered deductions should be based on existing data already captured across regulatory reports and subject to already standardized definitions and incremental reporting requirements.

Standardized liquidity requirements imposed on certain IHCs and branches/agencies

The Agencies indicate that the "proposed framework would apply standardized liquidity requirements with respect to the U.S. operations of foreign banking organizations according to the proposed risk-based categories." This would expand the application of standardized liquidity like the LCR, which were targeted at large, internationally active banking organizations that were defined by their levels of assets or on-balance sheet foreign exposures. Whatever its merits, the amended approach in the Interagency proposal still relies on metrics that have limited applicability to a firm's liquidity risk profile. For example, a non-Advanced firm, or one with less than \$250 billion assets, could be subject to daily LCR requirements by virtue of its categorization (Category 3 in the proposals) even if it is below the \$75 billion threshold of the Weighted ST Wholesale Finance indicator exposure or if its liquidity risk profile doesn't warrant such treatment. This required daily compliance requirement in the Interagency proposal is further challenged by the fact that the same firm would be permitted to file its liquidity risk exposure reports on a monthly basis (FR 2052a). Given these disconnects, we believe that the Agencies should reconsider the qualifying requirements for the daily LCR measure, even the reduced requirements, to one where the firm's liquidity risk profile (e.g. its weighted STWF) is the primary driver of its standardized liquidity requirements. Further, corresponding changes made to the measures applicable to the IHC should be extended to its subsidiary depository institution and align requirements to the current LCR's Modified framework.

With respect to the question of whether to apply standardized liquidity requirements to the branches and agencies of FBOs, we believe that the contemplated requirements are unnecessary and only increase the level of complexity

⁸ *The Acquisition of Wachovia Corporation by Wells Fargo & Company* Scott G. Alvarez, General Counsel, Board of Governors of the Federal Reserve System, Before the Financial Crisis Inquiry Commission, Washington, D.C. (September 1, 2010)

with no offsetting benefit. As exposures within the US branches of FBOs are already subject to standardized liquidity requirements imposed on their parent FBOs by their home-country regulators, we do not see the need for yet another layer of requirements that are already subject to liquidity risk supervision and regulation by their licensing authorities (i.e., the OCC and/or state bank supervisors). Further, under Regulation YY, branches are subject to liquidity stress testing and liquid asset buffer requirements that effectively impose the pre-positioning and trapping of liquid assets within the FBO's US branches. In addition to creating an undue, incremental burden, the requirements would likely result in additional regulatory reporting (FR 2052a "Complex Institution Liquidity Monitoring Report") by the combined branches in addition to those filed by CUSO and the IHC to fulfill existing requirements and others to be imposed by the proposals. Lastly, it is unclear what has contributed to the concern underlying this question given that Regulation YY liquidity stress testing and liquid asset buffer requirements only became effective less than 3 years ago and at that time were based on a 14 day horizon. At a minimum, any proposal should be conceptually sound and clearly targeted at actual risks.

Capital calculation requirements imposed on certain IHCs

As a result of the Proposals and the prescribed categorization framework, certain firms currently not subject to the Advanced Capital Adequacy Framework would become subject to the SLR in addition to the current leverage ratio. This would also result in increased reporting requirements relative to certain sections of the FFIEC 101 "Regulatory Capital Reporting for Institutions Subject to the Advanced Capital Adequacy Framework" For these firms

In calculating the SLR denominator according to the FFIEC 101 instructions, on-balance sheet exposures would be averaged over the reporting quarter on a daily basis, whereas, similar exposures for the Leverage Ratio are permitted to be calculated based on the average of the balances as of the close of business for each day for the calendar quarter or an average of the balances as of the close of business on each Wednesday during the calendar quarter. In the Agencies' adoption⁹ of revised methods to calculate the denominator of the SLR, the proposed method using the arithmetic mean of the total leverage exposure calculated for each day of the quarter was amended recognizing the operational burden associated for the averaging of off-balance sheet-related exposures while daily averaging was adopted for on-balance sheet exposures. With this precedence in mind and the objective of Question 31 in the Interagency proposal, we believe that the Agencies should allow for certain modifications to the calculation of the SLR denominator that would allow for the arithmetic mean of on-balance sheet-related exposures to be calculated in a manner similar to that applied in the Leverage Ratio. The off-balance sheet exposures would remain subject to the final rules adopted by the Agencies in 2014. Such a change would also need to be reflected in the forthcoming proposed amendments to the FFIEC 101 reporting instructions.

* * *

We appreciate the opportunity to provide our views and respectfully request that the Agencies consider our suggestions on the proposals. We stand ready to participate in further dialogue and/or discussions with the Federal Reserve, as necessary. We feel strongly that the final guidance issued by the Federal Reserve should be tailored to fit the US risk profiles and governance and control structures of IHCs operating in the US

Sincerely,



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Cc: UBS Americas Holding LLC Board of Directors
Michael Alix, Americas Chief Risk Officer

⁹ 79 Fed. Reg. No. 187 page 57725 (September 26, 2014)

Michael Davidson, Americas Treasurer
Jeff Samuel, Americas Head of Group Regulatory and Governance