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Re: CBA[1] Comments on FBO Proposals[2] - FRB Docket No R-1628B, RIN 7100-AF21; FRB Docket No R-1658, RIN 7100-AF45; OCC Docket ID OCC 2019-0009, RIN 1557-AE63; FDIC RIN 3064-AE96

The Canadian Bankers Association (CBA) welcomes the efforts to engage with the industry and appreciates the opportunity to comment on the (1) proposal issued by the Board of Governors of the Federal Reserve System (Federal Reserve) on changes to the enhanced prudential standards (EPS) for large international banks, and (2) by the Federal Reserve, the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC) (together the Agencies) regarding proposed changes to the applicability thresholds for certain regulatory requirements and related capital and liquidity requirements for the U.S. operations of foreign banking organizations (FBOs) based on their risk profiles, (collectively, the Proposals).[3]

The CBA supports the policy objective of tailoring the U.S. regulatory regime applicable to FBOs and welcomes the Agencies' efforts to engage with stakeholders in developing a more risk-based

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[1] The Canadian Bankers Association is the voice of more than 60 domestic and foreign banks that help drive Canada's economic growth and prosperity. The CBA advocates for public policies that contribute to a sound, thriving banking system to ensure Canadians can succeed in their financial goals. www.cba.ca

[2] "Prudential Standards for Large Foreign Banking Organizations; Revisions to Proposed Prudential Standards for Large Domestic Bank Holding Companies and Savings and Loan Holding Companies", 84 Fed. Reg. 21988 (May 15, 2019) (the "EPS Proposal"); "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", 84 Fed. Reg. 24296 (May 24, 2019) (the "Capital/Liquidity Proposal").

approach to capital and liquidity requirements. However, we are concerned that the Proposals not only fail to streamline the regulatory requirements applied to Canadian banks' U.S. operations, but also increase the level of regulation based on a set of imperfect risk-based indicators and insufficiently evidenced concerns about the liquidity risk posed by the FBOs' U.S. branches and agencies to the rest of its U.S. operations.

Our concern is that if additional layers of regulation are imposed on FBOs in the U.S., an unlevel playing field will be created that will reduce competition in the U.S. market. For example, by mandating more high-quality liquid assets (HQLA) to be held, the supply of credit to the U.S. economy will be reduced, as funds deployed to liquidity buffers are no longer available to support loan origination. Not only is this inconsistent with the longstanding principle of national treatment, as well as the statutory requirement to give due regard to such principle, but it is also counterintuitive to a robust global banking system.

Use of combined U.S. operations (CUSO)-Wide Metrics

Our primary concern is with the use of CUSO-wide metrics for determining the applicability of EPS, rather than capital-related requirements, such as liquidity risk and counterparty credit risk management. Using CUSO-wide metrics would result in the application of more stringent standardized liquidity requirements on a U.S. intermediate holding company (IHC), compared to the requirements applicable to a domestic U.S. bank holding company (BHC) of comparable size and risk profile. We recommend that all EPS requirements applicable to the IHC be based on its characteristics and risk profile alone.

The Federal Reserve established the IHC requirement for FBOs with significant U.S. operations in 2014 to streamline supervision of the U.S. subsidiaries of FBOs, and to ensure that they could be regulated and supervised in a similar way to domestic BHCs. BHCs and IHCs are direct competitors – which adds to the robustness of U.S. markets and ultimately makes the system function more efficiently for clients, customers and counterparties. However, by applying regulation to the IHC based on CUSO characteristics, the Agencies are putting IHCs at a significant competitive disadvantage. We are concerned not only about the direct impact this will have on FBO's customers in the U.S., but also the potential snowball effect this could have on the global financial system.

We also recommend that the Agencies fully consider the changes introduced to the U.S. prudential regulatory regime following the financial crisis as these changes have already greatly enhanced prudential standards for IHCs commensurate with their risk profile. Additionally, Regulation QQ addresses resolution planning, leading to enhanced modelling of extreme, but plausible stress events. Both Regulation YY and QQ have resulted in a significant increase in capital and liquidity buffers and improved governance for FBOs operating in the U.S. As such, we believe these regulations already mitigate the risk posed by an FBO's U.S. operations to the U.S, financial system.

If the Agencies are concerned with the risks branch networks of FBOs pose to the U.S. system, the CBA believes that alterations to the regulatory framework for IHCs are an ineffective way to address those concerns. Moreover, as noted above, we point the Agencies to the significant increase in capital and liquidity buffers and improved governance for FBOs operating in the U.S. under Regulations YY and QQ have already effectively dealt with foreign branch risk. In particular, internal stress scenarios and benchmarking of internal assumptions to the Liquidity Coverage Ratio (LCR) required by

Regulation YY have generally ensured that FBO's branches and agencies maintain adequate liquidity buffers.

Risk-Based Indicators (RBIs) and Foreign Bank Business Models

The proposed RBIs do not consider the normal business operations of FBOs and in some cases penalize FBOs for transactions that pose little to no risk or are required by U.S. regulation.

We recommend that the Agencies review the RBIs and amend them to ensure the calculations do not disadvantage FBOs. This could include but is not limited to: (i) excluding all inter-affiliate transactions for the purposes of calculating all RBIs; (ii) redefining "nonbank assets" to exclude all Level 1 and Level 2A HQLA and (iii) the indexing of RBIs dollar thresholds.

We appreciate the Agencies' inclination to determine an FBO's level of regulation using the same metrics as proposed for the domestic BHCs. However, FBOs' U.S. operations are inherently different and must be measured with a more nuanced approach than is currently in the Proposals.

Weighting of affiliate-sourced deposits and risk sensitivity of the weighted short-term wholesale funding (wSTWF) Risk-Based Indicator (RBI)

The use of a liquidity risk-based measure is an important aspect of the Proposals and should be considered in the determination of a firm's liquidity requirements. As the categorization is intended to tailor the requirements to the relative risk of a given firm, the measure used to asses liquidity risk should also be risk-sensitive.

The Proposals' weightings of wSTWF set forth in Schedule G of the Federal Reserve's Form FR Y-15 are, however, too punitive as they lack granularity and use "resolution assumption haircuts" to calculate total outflows. As a result, the wSTWF RBI is not consistent with the LCR rule, imposes the resolution scenario as the binding liquidity constraint and overstates the liquidity risk posed by some types of funding, including affiliate-brokered sweep deposits. The insufficiently granular reporting lines artificially worsen the true profile of the firm's weighted short-term wholesale funding position. Appropriate adjustments are needed to the wSTWF RBI to accurately reflect the stability of these deposits and Schedule G should be revised to be consistent with the U.S. LCR final rule outflow methodologies. Such updates would more accurately reflect the risks posed by certain funding sources. For example, affiliated sweep deposits would receive a 10% weighting vs the currently proposed 25% weighting.

To ease the reporting burden on smaller firms, we suggest that only firms whose categorization is dependent upon breaching the wSTWF RBI threshold be required to complete the more granular reporting we propose.

CUSO metrics and retaining modified LCR

As mentioned above, we are concerned that using CUSO-wide metrics would result in more stringent standardized liquidity risk management requirements for an IHC than for a U.S. BHC of comparable size and risk profile. We recommend that the liquidity risk management requirements for the IHC be based on the IHC's risk profile alone. We also believe that the Agencies should retain the current modified LCR requirements rather than introducing the more stringent reduced LCR requirements. The latter also brings with it stand alone LCR requirements for any insured depository institutions (IDI) with $10 billion or more in assets owned by an IHC and subject to full or reduced LCR, whereas under the modified LCR regime such IDI would not be subject to LCR. We do not believe such IDIs should be obliged to comply with daily LCR calculation and reporting requirements as proposed, since IDIs owned by an FBO would be placed at a competitive disadvantage compared to those owned by a domestic U.S. BHC of a similar size and risk profile.

Operational Burden

The Proposals underestimate the operational burden associated with daily preparation of the Complex Institution Liquidity Monitoring Report (FR 2052a) and would impose this burden on many more FBOs (including those Category III firms that use the same system and same data to generate the FR 2052a and calculate their LCR reporting). As such, and in combination with the fact that categorization of FBOs is driven by CUSO assets and RBIs, the Proposals effectively treat IHCs differently than U.S. domestic BHCs of similar size and risk profile. Daily FR 2052a reporting is a significant burden that should apply only to the most systemically important firms. For Category III institutions, daily 2052a reporting is a severe outcome for breaching the $75 billion wSTWF threshold. For those Category III firms with less than $75 billion in wSTWF, relief granted through the tailoring of the LCR calculation (i.e., reduced vs full LCR) is not as meaningful if, operationally, the same burden is imposed on Category II and III firms. There would be virtually no difference in operational burden between Category I, II and III firms. Instead, we respectfully submit that a sliding scale for LCR burden should be introduced as follows, Category I firms daily full LCR / 2052a and T+2 for 2052a; Category II monthly full LCR / 2052a and T+10 2052a; Category III modified LCR / 2052a quarterly; Category IV – no LCR

Home Country Regulation of FBOs' U.S. Branch Networks

We believe the Proposals do not fully consider home country regulation of FBOs. While we understand that the Agencies may have concerns with the efficacy of regulation in some foreign jurisdictions, we believe it is unnecessary and unfair to impose additional obligations on all FBOs to mitigate this risk. Instead, the Agencies could rely on existing home country regulation and cooperation with home country authorities to ensure regulatory effectiveness across borders. Otherwise, we fear that such policies could disincentivize FBOs' investment and growth in the U.S.

The Canadian regulatory regime is a prime example of a strong regulatory system that, like the U.S., is invested in protecting the safety of the system while encouraging economic growth and healthy competition. The Canadian regulatory regime is mature and, in most areas, harmonized with the U.S. EPS regulatory framework. Canada's prudential regulator, the Office of the Superintendent of Financial Institutions (OSFI), and the Canadian Deposit Insurance Corporation (CDIC) have a long history of close cooperation with U.S. financial regulatory authorities. The Crisis Management Group (CMG) and supervisory colleges provide another effective forum for information sharing and discussion. This ongoing cooperation coupled with OSFI's conservative approach should allow U.S. regulators to take comfort in Canadian foreign banking organizations being subject to, on a consolidated basis, standards comparable to those applied to U.S. domestic firms.

OSFI has often required Canadian banks to introduce key liquidity metrics ahead of other jurisdictions.

For example, in January 2015 Canadian banks implemented a more stringent application of Basel III LCR without the gradual phase-in from 2015 to 2019 provided by the Basel Committee on Banking Supervision (BCBS). This meant that Canadian banks were required to match the cover of 100% at that time. In addition to early LCR implementation, OSFI has also been proactive in the application of the Net Stable Funding Ratio (NSFR), with a Canadian compliance date of January 2020.

By adopting LCR and NSFR in advance of other jurisdictions, OSFI has demonstrated its commitment to having Canadian financial institutions prioritize provisioning of resources required for short-term and long-term balance sheet resiliency, thereby providing an effective framework for coordination with U.S. regulatory authorities. OSFI has also applied additional capital requirements proactively, for example announcing a Domestic Stability Buffer (DSB) of 1.75% in December 2018, with an increase to 2% in June 2019. The DSB supplements the Pillar 1 buffers for Domestic Systemically Important Banks (D-SIBs), the largest six banks, and is intended to proactively cover a range of systemic vulnerabilities.

We also note that U.S. regulators have supervisory tools to manage foreign branch risks and we believe any residual concerns about Canadian FBO operations can be effectively addressed within the existing regulatory framework. Canadian banks already maintain an adequate buffer for the structural assets of the FBO and IHC on a consolidated basis. Regulation YY requires the maintenance of a specific liquidity buffer for the branch in addition to the cash equivalency deposit (CED) required by the OCC or similar buffers required by state banking regulator. Finally, under Canadian law, the failure of a foreign (including U.S.) branch of a Canadian bank would be considered a failure of the Canadian bank itself - a Canadian insolvency regime feature which protects the solvency of Canadian banks' U.S. branches, among others. Section 369 of the Bank Act provides that in the event of bank insolvency, the payment of deposit liabilities and all other liabilities of the bank form an equal charge on the assets of the bank, with the exception of subordinated debt. In other words, there is no preference accorded to Canadian depositors or creditors.

Conclusion

We believe that the Proposals issued by the Agencies do not mitigate risks posed by FBOs to the U.S. system, but instead disadvantage FBOs based solely on their home country. Therefore, we recommend that the Agencies consider the existing home country regulation of FBOs when finalizing the Proposals, as we believe that the majority of jurisdictions – including Canada – share the Agencies' goals of preserving safety and soundness in the global financial system.

We urge the Agencies to amend the Proposals to apply regulation to IHCs based solely on an IHC's characteristics, and to review the methodologies to calculate the RBIs to ensure that FBOs are not penalized for non-risky, regular business operations. At a minimum, we recommend that the Agencies apply modified LCR instead of reduced LCR to Category III and Category IV IHCs. Furthermore, if the Agencies believe that the U.S. branch networks of FBOs present liquidity risk that is not sufficiently mitigated by home country regulations, we request that the Agencies, in consultation with international regulators, consider addressing branch liquidity requirements in a separate rule - if at all.

Canadian banks, along with their FBO peers, play a critical role in the U.S. financial system. We encourage the Agencies to finalize a rule that supports the presence of FBOs in U.S. markets while protecting the safety and soundness of the U.S. financial system.

Thank you for considering our comments. We would be pleased to answer any questions or elaborate further at your convenience.

Sincerely,

[redacted]

cc: Bernard Dupont, Senior Director, Capital Division, OSFI
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