June 28, 2019

VIA ELECTRONIC SUBMISSION

Financial Stability Board
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Re: Financial Stability Board Evaluation of "Too-Big-to-Fail" Reforms

Ladies and Gentlemen:

The Financial Services Forum (the "Forum")[1] appreciates the opportunity to submit this letter to the Financial Stability Board (the "FSB") on its evaluation of the effects of too-big-to-fail ("TBTF") reforms.[2] The FSB's evaluation will assess whether TBTF reforms adopted since the global financial crisis are achieving their intended objectives of reducing systemic and moral hazard risks associated with systemically important banks ("SIBs"). This evaluation is applicable to all of our member institutions, the U.S. global systemically important bank holding companies ("U.S. GSIBs"), which are key stakeholders with information and experience on the efficacy and effects of TBTF reforms in the United States. Below, we describe how post-crisis regulatory reforms and actions taken by our member institutions have addressed TBTF and highlight areas where reforms could be streamlined to promote

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1 The Financial Services Forum is an economic policy and advocacy organization whose members are the chief executive officers of the eight largest and most diversified financial institutions headquartered in the United States. Forum member institutions are a leading source of lending and investment in the United States and serve millions of consumers, businesses, investors, and communities throughout the country. The Forum promotes policies that support savings and investment, deep and liquid capital markets, a competitive global marketplace, and a sound financial system.

2 Press Release, FSB, FSB Launches Evaluation of Too-Big-To-Fail Reforms and Invites Feedback from Stakeholders (May 23, 2019), https://www.fsb.org/wp-content/uploads/R230519.pdf.

efficiency and economic growth without undermining the core policy objectives that motivated these reforms.

Executive Summary

The Forum believes that TBTF reforms in the United States that have been implemented since the global financial crisis have achieved the intended objectives of substantially reducing systemic and moral hazard risks. This conclusion is shared by numerous policymakers across the political spectrum.[3]

These objectives were initially established at the Pittsburgh Summit in 2009, where G-20 leaders asked the FSB to develop resolution tools and other measures to help mitigate the disruption of financial institution failures and reduce moral hazard.[4] We support the goals set out in the G-20 Leaders Statement from the Pittsburgh Summit and the efforts that have been made by regulators and financial institutions over the past 10 years to achieve them. In fact, the U.S. regulators and the Forum's member institutions—the U.S. GSIBs—have led the way in adopting and implementing these post-crisis financial reforms to address the G-20 objectives and have served as a model for the rest of the world.

At the same time, after a period of such significant change, and given that TBTF has been addressed successfully in the United States, it is important to step back and review the framework, how various rules interact with each other, and make adjustments as needed to avoid unnecessary mis-calibration and unintended consequences. We believe there is room to improve regulatory efficiency and promote economic growth without sacrificing financial stability goals.

Further, we commend the FSB for embracing stakeholder outreach, which is a critical source of information to inform such an important effort. Market participants have devoted substantial resources to assessing both the objectives and unintended consequences of the various reforms promoted by the FSB and national authorities over the last decade. A single, brief opportunity to provide input on a draft report that will be assembled over 12 months, however, would not fully take advantage of the assistance outside perspectives can offer. We agree that stakeholder outreach is an important aspect of the evaluation and encourage the FSB to seek input iteratively

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3 *See infra* notes 11, 12, and 13.

4 G-20, Leader's Statement: The Pittsburgh Summit (Sept. 2009), https://www.treasury.gov/resource-center/international/g7-g20/Documents/pittsburgh_summit_leaders_statement_250909.pdf.

as it conducts its evaluation, allowing for multiple comment opportunities both in writing and in person through workshops and group meetings. Such a process would be consistent with the goal of FSB Chair Quarles to improve the FSB's outreach and transparency efforts,[5] and, more importantly, would allow stakeholders to fully share their perspectives and experience.

Our key observations and recommendations are as follows:

- **First, TBTF reforms in the United States have been successful in addressing systemic and moral hazard risks associated with U.S. GSIBs**. Consistent with the views of many prominent policymakers and economists, available evidence shows that both the probability and impact of a U.S. GSIB's failure have been reduced significantly. With respect to probability, improvements in the quantity and quality of bank capital and liquidity now provide a significant safeguard against financial distress. In the United States, a uniquely stringent stress testing program adds an additional buffer on top of reforms that, in many cases, already exceed internationally-agreed standards. Improvements to funding stability also have increased the resiliency of our member institutions.

  Regarding the impact of failure, our member institutions are at the forefront globally in resolution planning. Through the United States' rigorous resolution planning process, they have demonstrated the ability to be resolved in an orderly fashion under the Bankruptcy Code through a single-point-of-entry ("SPOE") strategy without taxpayer or government support and without creating contagion. To arrive at this end state, our member institutions have made significant changes to their organizational structure, reduced the complexity of their assets, entered into contractual arrangements that require their parent companies to support material subsidiaries in resolution, limited

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[5] Randal K. Quarles, Chair, FSB, Ideas of Order: Charting a Course for the FSB (Feb. 10, 2019) ("to maintain the legitimacy of our work, to increase understanding of it, and to enhance its effectiveness, we must improve our outreach and transparency—including to our membership, other global authorities, the public, and key stakeholders."), https://www.fsb.org/wp-content/uploads/Quarles-Ideas-of-order-Charting-a-course-for-the-Financial-Stability-Board.pdf; Randal K. Quarles, Chair, FSB, Letter to G-20 Leaders at 3, 4-5 (June 24, 2019) ("The FSB's extensive outreach to stakeholders… will be critical to the success of the [TBTF] evaluation... The success of the next chapter of the FSB must be written… with contributions from a wide array of stakeholders, including the knowledge of the private sector…"), https://www.fsb.org/wp-content/uploads/R250619-1.pdf.

default rights in their qualified financial contracts ("QFCs"), and complied with requirements to issue sufficient loss-absorbing debt and equity and to maintain a clean holding company, among many other changes. The orderly liquidation authority ("OLA") under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") continues to serve as a backstop to resolution under the Bankruptcy Code.

Post-crisis market reforms also have reduced substantially systemic risk and improved the functioning and stability of U.S. financial markets. Such reforms include derivative market reforms (including new central clearing, margin, and trade reporting requirements), reform of money market mutual funds, and repo market reform. Furthermore, our member institutions have reduced significantly their reliance on short-term wholesale funding.

These reforms reflect transformational structural and legal changes that came about after the G-20 Pittsburgh Summit. The effect of these reforms has been verified by major rating agencies and independent studies of the costs of credit for the U.S. GSIBs.

- **Second, the complexity and magnitude of the efforts to implement TBTF reforms naturally has led to some mis-calibration, overlap, and unintended consequences; policymakers should thoughtfully streamline the post-crisis regulatory framework to avoid such results**. As noted, TBTF reforms have achieved their objectives. However, the resulting framework has certain inefficiencies and negative unintended consequences that can be mitigated without undermining the original goals. For example, some international standards, and the U.S. requirements that implement them, are mis-calibrated and, therefore, unnecessarily raise costs and hinder growth. In addition, some measures have led to duplication of regulation, which similarly creates inefficiencies. Further, unintended consequences have arisen, such as decreased liquidity and the movement of financial intermediation outside of the regulatory perimeter. Therefore, regulators should take action to streamline and recalibrate reforms in a thoughtful way to avoid these negative domestic and cross-border effects.

- **Third, we urge the FSB to foster further international coordination to support preparation for the successful and cost-effective resolution of large, international banking organizations, avoid inefficiency in reform efforts, and help ensure a level playing field**. International coordination is critical to dealing with a global banking organization in a resolution context.

As a specific example, global coordination is necessary to avoid the damaging effects of excessive ring fencing by individual jurisdictions. Moreover, much of the legal and regulatory architecture that has been put in place will only work as intended if global regulators work collaboratively during good and bad times to ensure these changes to the financial system achieve their full potential. International coordination also is important to establish a level international playing field for SIBs with cross-border operations. Accordingly, the FSB should use this evaluation to take stock of how different jurisdictions have addressed the objective of eliminating TBTF.[6] For jurisdictions such as the United States that have achieved that objective, as we note above, the focus should now be on thoughtful recalibration of existing reforms. For jurisdictions that have further work to do in addressing TBTF, the FSB should encourage those jurisdictions to complete that work to address the TBTF issue.

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[6] *See* Jacob J. Lew, *Eight Years After the Financial Crisis: How Wall Street Reform Strengthened our Financial System and Laid the Foundation for Long-Run Growth*, 19 N.Y.U. J. LEG. & PUB. POL. 611, 618 (2016) (describing the utility of G-20 agreements and the FSB as "to promote strong financial standards, level the playing field for American companies, and avoid a race to the bottom in financial regulation.").

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I. TBTF reforms in the United States have been successful in addressing systemic and moral hazard risks associated with U.S. GSIBs.

The FSB has requested comment on the extent to which TBTF reforms for SIBs that were agreed by the G-20 after the global financial crisis are achieving their objectives of reducing systemic and moral hazard risks.[7] Although the FSB's Summary Terms of Reference mention only a few of the TBTF reforms—such as new capital buffers, total loss-absorbing capacity ("TLAC") requirements, enhanced supervision, and the establishment of effective cross-border resolution regimes and planning—the Summary Terms of Reference also recognize that G-20 member jurisdictions have enacted comprehensive changes to their financial regulatory policies that may also be relevant to its request.[8] To evaluate whether the goals of TBTF reforms have been reached, the FSB states that it will analyze if reforms have resulted in a perceived reduction in the probability and impact of failure of SIBs and also will determine whether SIBs themselves have internalized these risks as reflected in business model changes and risk profile reductions.[9]

Financial institutions are said to be TBTF when "policymakers judge that their failure would cause unacceptable disruptions to the overall financial system"[10]—*i.e.*, create systemic risk. This status can result both from an institution's size and its level of interconnectedness with the financial system as a whole. To the extent that stakeholders perceive an institution as TBTF, it presents moral hazard risk: stakeholders have a reduced incentive to monitor the institution's risk profile. This lack of market discipline may lead to excessive risk-taking, which is particularly problematic for the largest, most complex institutions considering that their failure could have cascading effects through the financial system and broader economy.

We strongly believe that TBTF reforms in the United States have achieved the intended objectives of substantially reducing systemic and moral hazard risks, and have addressed the perception of TBTF revealed by the global financial crisis over a decade ago. In fact, U.S. regulators and the Forum's member institutions have led the way in adopting post-crisis financial reforms and have served as a model

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7 FSB, Evaluation of Too-Big-To-Fail Reforms: Summary Terms of Reference at 1 (2019), https://www.fsb.org/wp-content/uploads/P230519.pdf.

8 *Id*. at 2.

9 *Id.* at 3.

10 MARC LABONTE, CONG. RESEARCH SERV., SYSTEMICALLY IMPORTANT OR "TOO BIG TO FAIL" FINANCIAL INSTITUTIONS at i (Sept. 24, 2018), https://fas.org/sgp/crs/misc/R42150.pdf.

for the rest of the world. Numerous policymakers across the political spectrum have reached the same conclusion. For instance, Federal Reserve Board ("FRB") Chairman Jerome Powell has stated that he does not believe any U.S. banking organizations are TBTF.[11] In addition, former FSB Chair Mark Carney similarly has stated that "[e]nding too big to fail…has largely been achieved."[12] Other prominent policymakers and economists concur that the reforms put in place following the financial crisis have significantly boosted the resilience of the U.S. financial system.[13]

The United States, through legislative and administrative actions, reacted quickly and comprehensively to address the regulatory shortcomings revealed by the

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[11] *See Hearing on the Nomination of Jerome H. Powell, to be Chairman of the Board of Governors of the Federal Reserve: Before the Sen. Comm. on Banking, Hous., and Urban Affairs*, 115th Cong. (2017) (Testimony of Jerome H. Powell) ("Generally speaking I think the financial system is quite strong." Asked if there are any U.S. banks that are still too big to fail in America, he responded, "I would say no to that."), https://archive.org/details/CSPAN3_20171201_171600_Federal_Reserve_Chair_Confirmation_Hearing.

[12] *See* Mark Carney, former Chair, FSB, What a Difference a Decade Makes (April 20, 2017).

[13] Randal K. Quarles, Chair, FSB, Ideas of Order: Charting a Course for the FSB (Feb. 10, 2019) ("The body of post-crisis regulation… was a tour de force of orchestration, and it has unquestionably made the financial system safer and more resilient."); Lael Brainard, Governor, FRB, Assessing Financial Stability Over the Cycle (Dec. 7, 2018) ("The regulated financial sector is also more resilient, owing to far-reaching reforms… Large banks have increased both the size and quality of their capital buffers… Financial reform has reduced funding risks associated with banks and money market funds. Large banks subject to liquidity regulation rely less on unstable short-term wholesale funding and have thicker liquidity buffers."); Janet L. Yellen, Keynote Address at the Griswold Center for Economic Policy Studies Fall Symposium: The Tenth Anniversary of the Financial Crisis (Nov. 19, 2018) ("My assessment is that the reforms put in place significantly boosted the resilience of the U.S. financial system. The risk of runs owing to maturity transformation declined. Efforts to enhance the resolvability of systemic firms promoted market discipline and reduced the problem of too big to fail."); Interview by Ben White with Daniel Tarullo, former Governor, FRB, *Did We End Too Big to Fail? Are We Safer Now?*, POLITICO MONEY (Sep. 26, 2018) ("We are certainly a lot safer now than we were ten or twelve years ago. The largest institutions are substantially better capitalized, they have much more sustainable funding patterns"); Stefan Ingves, Chairman, Basel Committee on Banking Supervision, Keynote Speech at Basel III: Are We Done Now? (Jan. 29, 2018) ("The title of this conference is 'Basel III: Are We Done Now?'. Let me answer this question at the outset: yes, we are done… These reforms have demonstrably helped to strengthen the global banking system."); Martin J. Gruenberg, former Chairman, FDIC, The Impact of Post-Crisis Reforms on the U.S. Financial System and Economy (June 15, 2016), ("As an objective matter, the banking system is significantly more resilient today as a result of these reforms."); Jacob J. Lew, former Treasury Secretary, Remarks by U.S. Treasury Secretary Jacob J. Lew at The Brookings Institution (July 8, 2015) ("Wall Street Reform ended 'too big to fail . . .'").

crisis.[14] A decade later, reforms in the United States have reduced substantially the probability that a U.S. GSIB would fail and the systemic impact of a failure. In certain cases, U.S. regulators have adopted standards that are super equivalent to global standards, such as the GSIB capital surcharge, stress testing mandates, including the global market shock and largest counterparty default scenarios, the enhanced supplementary leverage ratio ("eSLR"), certain TLAC requirements, an enhanced liquidity coverage ratio ("LCR"), and sophisticated and detailed resolution strategies and planning, which we discuss further below. Although the Summary Terms of Reference explicitly mentions only a relatively narrow set of TBTF policies,[15] as noted above, we believe the FSB should consider and evaluate the entire range of post-crisis regulations that have addressed the issue of TBTF, several of which we discuss further below.

In this Section, we first discuss how TBTF reforms in the United States, in the form of enhanced prudential standards and requirements to improve resolvability, as well as actions taken by our member institutions, have reduced substantially the probability that a U.S. GSIB would fail and the cost to the financial system if a U.S. GSIB were to fail. Next we discuss certain market reforms in the United States that have also had the effect of reducing systemic risk. Finally, we present evidence that the market no longer perceives the U.S. GSIBs as TBTF.

a. *Financial reforms in the United States have reduced substantially the probability that a U.S. GSIB would fail.*

Post-crisis financial reforms in the United States have subjected U.S. GSIBs to greatly enhanced prudential standards, including heightened capital requirements, liquidity requirements, and capital and liquidity stress testing. As a result of these reforms and other actions taken to improve resiliency, our member institutions today are more resilient than ever. Specifically, improvements in capital, liquidity, and funding stability have significantly increased the ability of our member institutions to withstand economic downturns and to continue to be a source of credit through the cycle.

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[14] *See* FSB, *Progress in Implementation of G-20 Financial Regulatory Reforms* at 3 (June 25, 2019) (showing that the United States has substantially implemented international standards for post-crisis financial reforms), https://www.fsb.org/wp-content/uploads/R250619-2.pdf.

[15] *See supra* note 7.

i. Capital.

Perhaps the clearest measurement of resiliency in the banking system is bank capital. By providing a constant buffer to absorb losses in the face of financial shocks, capital serves as a concrete and continuous guardrail against failure. U.S. banking organizations, especially U.S. GSIBs, are now subject to a number of new risk-based and leverage capital requirements that were developed after the financial crisis.[16] While these requirements largely reflect the U.S. implementation of Basel III,[17] in certain cases the standards that have been implemented by U.S. regulators are super equivalent to the standards developed by the Basel Committee on Banking Supervision ("Basel Committee"). For example, U.S. GSIBs are subject to more stringent leverage ratios and TLAC requirements.[18] Similarly, the U.S. GSIB surcharge includes a super equivalent "Method 2" construct.[19] These facts underscore the importance of considering the range of policies designed to deal with TBTF at the national level and therefore that a summary review of international standards is not sufficient.

The United States is also unique in the way the stress testing process is used to set minimum capital levels. During the financial crisis, the FRB turned to stress testing under the Supervisory Capital Assessment Program ("SCAP") to "determine potential losses at the largest firms if the prevailing stress severely worsened and to restore confidence in the financial sector."[20] While the original SCAP program was focused on quickly restoring capital adequacy and market confidence during a time of severe economic stress, the current Comprehensive Capital Analysis and Review ("CCAR") stress testing program has become much broader and substantive in scope. CCAR is an annual exercise under which firms are required to submit a capital plan and the FRB subsequently prescribes, on an *ex ante* basis, firms' quarter-to-quarter capital distributions. Similarly, the Dodd-

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16 *See, e.g.*, 12 CFR pt. 217.

17 Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule, 78 Fed. Reg. 62017, 62018 (Oct. 11, 2013) (implementing Basel III in the United States).

18 *See* 12 CFR pt. 252, subpt. G (implementing the TLAC Rule); 12 CFR 217.10 (implementing the eSLR for bank holding companies).

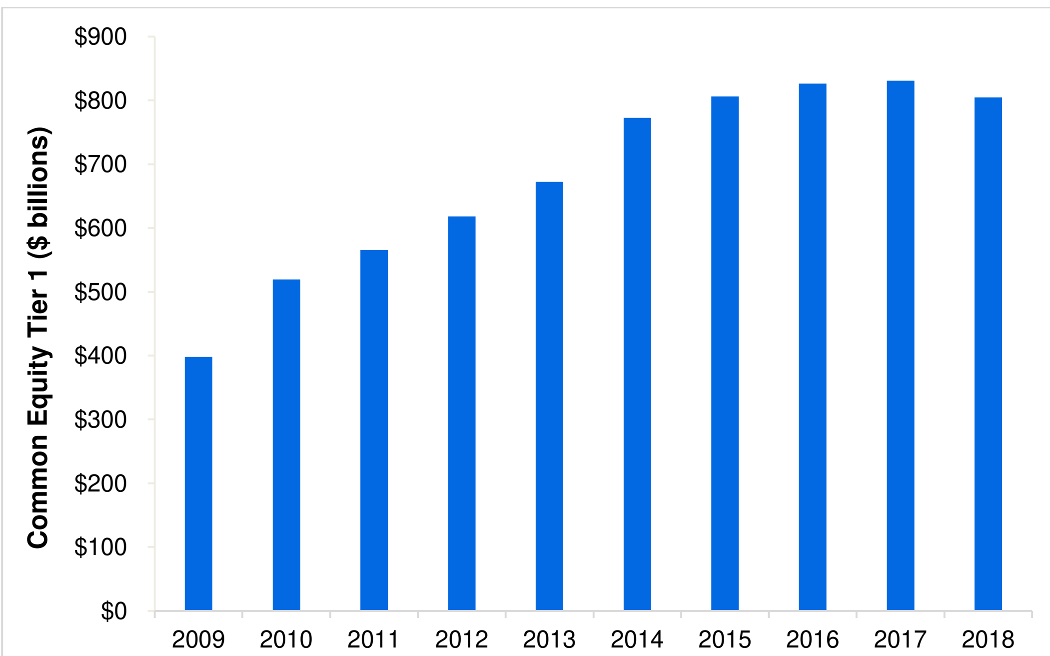
19 12 CFR pt. 217, subpt. H (implementing the GSIB surcharge).

20 Amendments to the Regulatory Capital, Capital Plan, and Stress Test Rules, 83 Fed. Reg. 18160, 18161 (April 25, 2018).

Frank Act also requires supervisory and company-run stress testing, which is incorporated into the CCAR process.[21] Moreover, the results of these analyses would have significant consequences for systemic risk under a proposal outstanding in the United States that would replace the fixed 2.5% capital conservation buffer with a "stress capital buffer" floored at 2.5% that would reflect a firm's results under CCAR.[22] In its current form, CCAR and the stress losses it projects lead to supervisory-imposed restrictions on capital distributions that are unique to the United States.

Our member institutions have increased significantly their levels of capital over the past decade. For example, they now maintain $926 billion in tier 1 capital, an increase of 42.3% since 2009. This significant improvement over the past decade is shown in Figure I.

Figure I – Forum Member Institution Common Equity Tier I Capital



Source: *Federal Reserve Y-9C*

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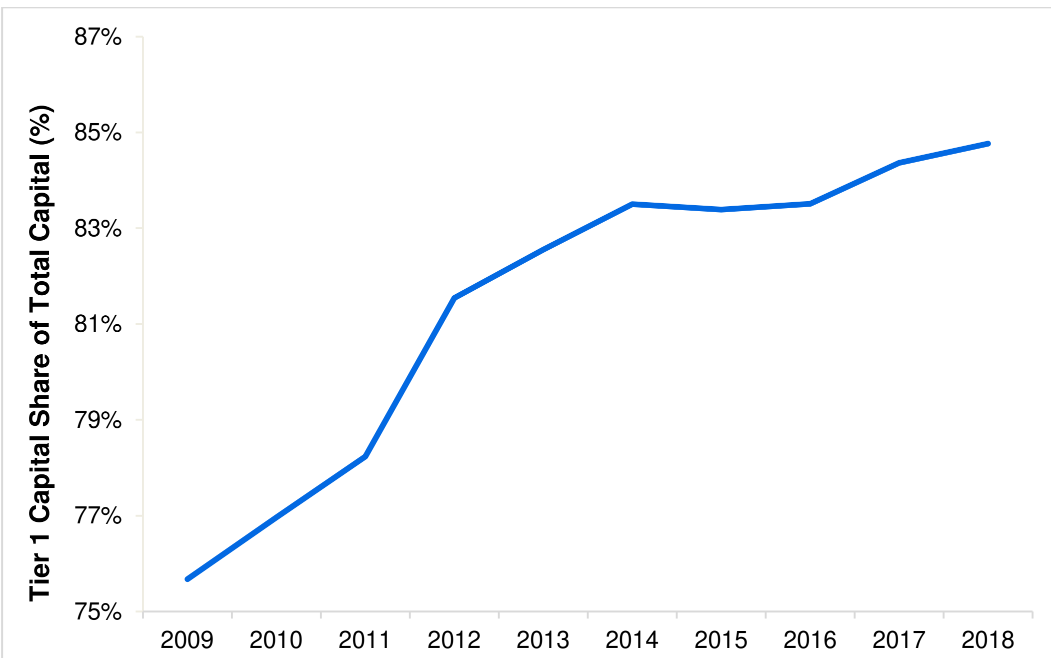
[21] 12 CFR pt. 252, subpt. F.

[22] *See* Randal K. Quarles, Vice Chairman for Supervision, FRB, Speech at the Brookings Institution, A New Chapter in Stress Testing (Nov. 9, 2018) ("For large firms, the [stress capital buffer] would replace the fixed 2.5 percent risk-based buffer with a firm-specific buffer the size of which would be based on the firm's stress test results. In this way, we are integrating the automatic restrictions on capital distributions in the current capital rule with the output of the most dynamic tool we have for assessing risk—the stress test—to create a more robust and dynamic regulatory capital regime.").

However, increases in the quantity of bank capital understate the improvements in resiliency our member institutions have achieved since the financial crisis. Importantly, they also have increased the quality of their capital. As shown in Figure II below, the fraction of total equity capital accounted for by tier 1 capital at Forum member institutions has risen steadily to 85% of total equity capital, up 10% since 2009. By dedicating a higher proportion of capital to subordinated instruments, U.S. GSIBs are now able to absorb losses of increased severity even in poor credit environments and continue to provide credit to the real economy through the cycle.

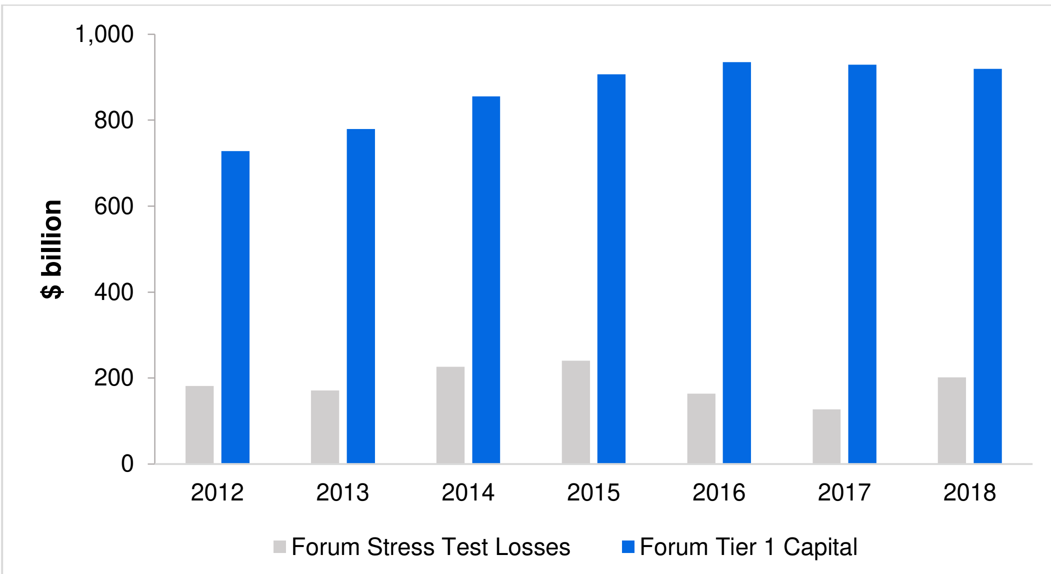
Figure II – Forum Member Institution Tier 1 Capital Percent of Total Capital



Source: *Federal Reserve Y-9C*

Further, to demonstrate the robustness of our member institutions, Figure III shows that their tier 1 capital is several times larger than the projected losses determined in their stress tests.

<u>Figure III – Forum Member Institution Stress Test Losses Compared to Tier 1 Capital</u>



Source: *Federal Reserve Y-9C; Federal Reserve DFAST results*

ii. Liquidity.

Similar to what has occurred with respect to capital, regulators responded to the financial crisis with enhanced liquidity requirements, designed to ensure the presence of resources that can be deployed quickly as needed and transformed into cash at low cost. As such, our member institutions are now required to meet certain quantitative liquidity standards (*e.g.*, the LCR) and are subject to detailed liquidity risk management standards, including liquidity stress testing, annual firm-specific and horizontal assessments of their liquidity program, as well as enhanced internal liquidity requirements (so-called Resolution Liquidity Adequacy and Positioning, or "<u>RLAP</u>," and Resolution Liquidity Execution Need, or "<u>RLEN</u>") as part of firm-specific resolution planning mandates.[23]

To meet quantitative liquidity standards, our members have greatly increased their holdings of high-quality liquid assets ("<u>HQLA</u>")—such as cash, reserves, and U.S. Treasuries—since the financial crisis. As can be seen in Figure IV, HQLA has more than doubled since 2010.

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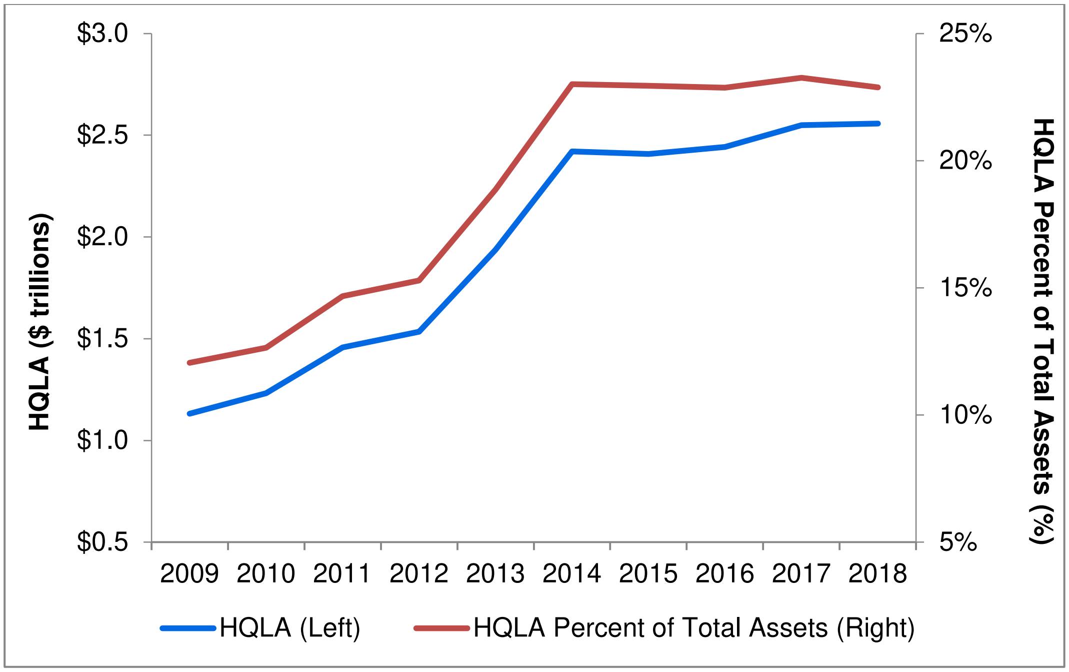
23 *See, e.g.,* 12 CFR 249.10 (LCR); 12 CFR 252.35 (liquidity stress testing). *See also* Net Stable Funding Ratio: Liquidity Risk Measurement Standards and Disclosure Requirements, 81 Fed. Reg. 35124 (June 1, 2016); Final Guidance for the 2019 and Subsequent Resolution Plan Submissions, 84 Fed. Reg. 1438 (Feb. 4, 2019).

<u>Figure IV – Forum Member Institution HQLA</u>



Source: *Federal Reserve Y-9C*

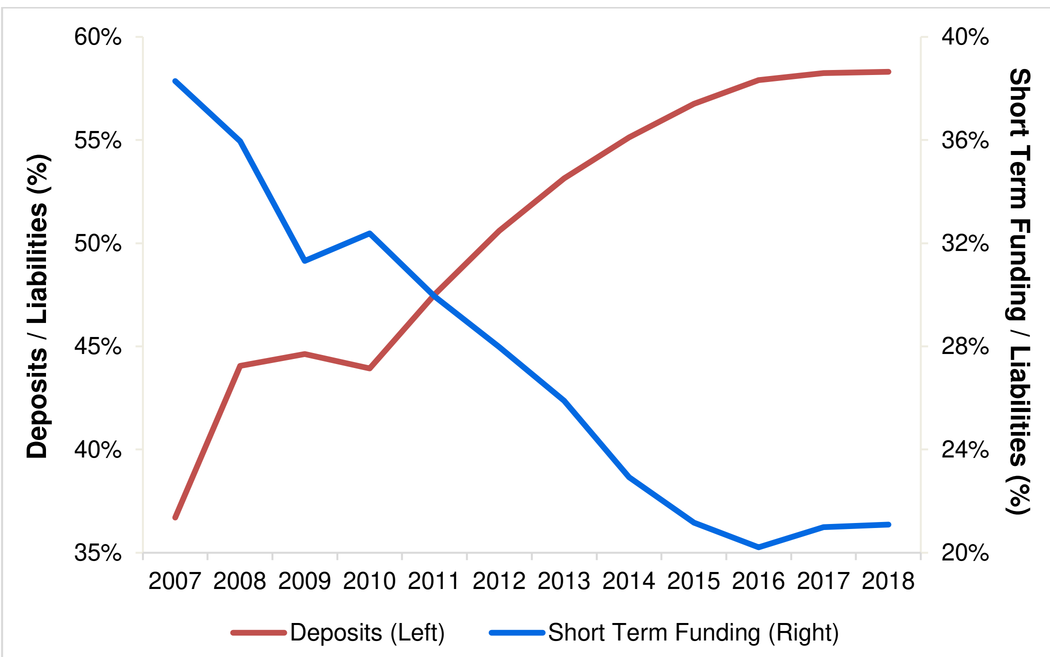
In addition, frequent assessments conducted via the FRB's Large Institution Supervisory Coordinating Committee ("<u>LISCC</u>") liquidity program evaluate the adequacy of our member institutions' liquidity positions and liquidity risk management practices. Through the liquidity program, the FRB may require firms to adjust or improve existing liquidity risk management processes, or address evolving liquidity risks to further strengthen and promote the resiliency of a firm's liquidity position.

While these improvements in liquidity undoubtedly facilitate overall resiliency, their impact on resolvability also should be considered. Specifically, a large banking organization with a higher proportion of liquid assets will be able to more effectively deal with counterparties in a manner that could forestall run-type dynamics from undermining a successful resolution. As a result, the significant increase in liquidity that has been achieved since the financial crisis should be viewed as supporting the ability to resolve a large, global banking organization.

iii. Funding stability.

In addition to holding more HQLA on their balance sheets, Forum member institutions also have made significant strides in improving the term and stability of their liabilities. Deposit funding has increased and is generally more stable than other liabilities, such as commercial paper, which are largely held by sophisticated and nimble institutional investors and do not benefit from any explicit insurance or government support. Our member institutions have improved their funding profiles since the financial crisis to decrease the probability of a run. As illustrated in Figure V, the share of their liabilities composed of short-term funding has decreased by 17%, while deposits have increased 21%. The efficacy of these efforts in reducing systemic risk has been recognized by U.S. regulators.[24]

<u>Figure V – Forum Member Institution Breakdown of Liabilities</u>



Source: *Federal Reserve Y-9C; Goldman Sachs and Morgan Stanley 10-K*

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24 *Hearing on the Semi-Annual Testimony of the FRB Supervision and Regulation of the Financial System: Before the H. Comm. on Fin. Services*, 115th Cong., 58 (2018) (Statement of Randal K. Quarles) ("Overall, the U.S. commercial banking system has strengthened considerably over the past decade… the eight U.S. [GSIBs] have developed significantly more stable funding positions as their reliance on short-term debt—including repurchase agreement, or repo, financing—has decreased by more than half since 2007 and now is equal to less than 15 percent of their total assets. The GSIBs now also hold approximately $2.4 trillion in high-quality liquid assets, representing an increase of more than 60 percent since 2011."), https://www.federalreserve.gov/newsevents/testimony/quarles20180417a.htm (hereinafter, "<u>House Testimony</u>").

iv. Large banks worldwide have made similar improvements in their resilience to financial stress.

As in the case of the United States, financial reforms also have been successful in improving the resilience of large banking organizations worldwide. Since the financial crisis, large banking organizations have become "better capitalised, less leveraged and more liquid."[25] In the words of the FSB, "the core of the global banking system is more resilient to economic or financial shocks than before the crisis."[26] First, risk-based capital ratios have shown substantial improvement over the last decade. In a recent Bank for International Settlements study, 96% of international banks sampled had a common equity tier 1 ("CET1") capital ratio over 10%.[27]

Second, global banks have made significant improvements in their liquidity and funding stability since the crisis. They have increased their holdings of HQLA such that the weighted average LCR for group 1 banks is 135.1%.[28] Further, they are better able to withstand prolonged periods of funding stress, as the weighted average net stable funding ratio for group 1 banks is 116%.[29] These improvements demonstrate a significant buffer against stress in the global financial system and an increase in overall resilience similar to that accomplished in the United States.

Finally, market-based indicators also support the "enhanced regulatory risk profile" of banking organizations worldwide.[30] For instance, credit default swap premia (a measure of institutional credit risk) have declined, while market-based leverage ratios have increased, displaying a perceived decrease in global banking organization risk.[31]

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[25] FSB, *Implementation and Effects of the G-20 Financial Regulatory Reforms* at 19 (2018), https://www.fsb.org/wp-content/uploads/P281118-1.pdf.

[26] *Id*.

[27] Basel Committee on Banking Supervision, Bank for International Settlements, *Basel III Monitoring Report* at 4 (2019), https://www.bis.org/bcbs/publ/d461.pdf.

[28] *Id*. at 80.

[29] *Id*. at 87.

[30] FSB, *Implementation and Effects of the G20 Financial Regulatory Reforms* at 34 (2018), https://www.fsb.org/wp-content/uploads/P281118-1.pdf.

[31] *Id*.

b. *U.S. statutory and regulatory reforms have reduced substantially the systemic impact if a U.S. GSIB were to fail.*

Statutory and regulatory reforms implemented in the United States also have reduced substantially the systemic impact of a U.S. GSIB if it were to fail and need to be resolved. Similarly, U.S. GSIBs have demonstrated that they can be resolved in an orderly manner without exposing taxpayers to loss and while maintaining continuity of their vital economic functions. We discuss further below some of these reforms, including the requirement to develop and submit for supervisory review comprehensive resolution plans, the TLAC rule, the rule requiring contractual stays on exercise of default rights in QFCs (the "QFC stay rule"), and the backstop OLA.

i. Resolution plans.

The Dodd-Frank Act and related implementing regulations established a requirement for the U.S. GSIBs and certain other U.S. banking organizations to submit periodic detailed resolution plans that require them to prepare for a rapid and orderly resolution under the Bankruptcy Code in the event of material financial distress or failure.[32] Furthermore, the U.S. GSIBs are subject to heightened supervisory expectations for their resolution plans regarding capital and liquidity, governance, derivatives and trading activity, and relationships with financial market infrastructures, among many other requirements.[33]

As a result, our member institutions have developed sophisticated and detailed resolution plans that have been subject to multiple rounds of rigorous review and feedback from the FRB and Federal Deposit Insurance Corporation ("FDIC"). Through this iterative resolution planning process, our member institutions have developed robust SPOE resolution strategies that have been deemed by U.S. regulators to have no "deficiencies"[34] and have made significant changes to simplify their corporate structures to support resolution. These changes clearly demonstrate that U.S. GSIBs can be resolved without creating systemic risk.

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32 *See* 12 CFR pt. 243; Final Guidance for the 2019 and Subsequent Resolution Plan Submissions, 84 Fed. Reg. 1438 (Feb. 4, 2019).

33 Final Guidance for the 2019 and Subsequent Resolution Plan Submissions 84 Fed. Reg. 1438, 1440 (Feb. 4, 2019).

34 Press Release, FRB & FDIC, Agencies Announce Joint Determination for Living Wills (Dec. 19, 2017), https://www.federalreserve.gov/newsevents/pressreleases/bcreg20171219a.htm.

Our member institutions have led the way in developing successful SPOE resolution strategies that are designed to eliminate the need for a government bailout and minimize the contagion caused by a U.S. GSIB's failure, thereby addressing systemic and moral hazard risk. Under an SPOE resolution strategy, losses would be imposed on shareholders and long-term creditors of the top-tier parent holding company without the need for additional taxpayer or government support. By imposing losses on long-term creditors that are not able to run and by requiring holding companies to recapitalize and provide liquidity support to material operating subsidiaries that conduct critical operations, the SPOE strategy also helps to minimize contagion risk to the financial system.[35]

In addition to developing SPOE strategies, the U.S. GSIBs have taken several steps to increase the efficacy of those resolution strategies. For instance, our member institutions have implemented measures to (i) prevent the disruption of intercompany services shared by multiple affiliates and of critical third-party services, (ii) ensure access to financial market infrastructures, and (iii) implement internal governance mechanisms to facilitate timely senior management and board decision-making. Moreover, Forum member institutions have developed strategies to meet margin and collateral requirements that may be required to facilitate continued access to financial market infrastructures and agent banks. The U.S. GSIBs also have developed detailed contingent capital and liquidity plans and identified objects of sale to recover from even deep distress, thereby improving both resiliency and resolvability.

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[35] *See* U.S. DEP'T OF THE TREASURY, ORDERLY LIQUIDATION AUTHORITY AND BANKRUPTCY REFORM at 10-11 (Feb. 21, 2018) ("In carrying out a resolution of a financial company under Title II, the FDIC has stated that it expects to use a [SPOE] strategy in which only the U.S. top-tier parent holding company would be placed into receivership. Under the strategy, solvent subsidiaries, such as broker-dealers, insured depository institutions, and overseas subsidiaries, would continue operating as usual (and paying their obligations when due), thereby avoiding multiple competing insolvencies and minimizing further disruptions to the financial system.") (hereinafter, "OLA Treasury Report"). *See also* Financial Services Forum, Comment Letter to FRB Re: Resolution Planning Guidance for Eight Large, Complex U.S. Banking Organizations (2018) ("SPOE strategy is the most reliable and effective way to resolve a GSIB in an orderly manner."); ECONOMIC POLICY PROGRAM, BIPARTISAN POLICY CENTER, TOO BIG TO FAIL: THE PATH TO A SOLUTION at 24 (2013) ("The SPOE recapitalization strategy is one way to resolve SIFIs, including G-SIFIs, without creating contagious panic or resorting to taxpayer-funded bailouts. As a result, it is a viable solution to the too-big-to-fail problem if properly implemented."); FDIC & BANK OF ENGLAND, RESOLVING GLOBALLY ACTIVE, SYSTEMICALLY IMPORTANT, FINANCIAL INSTITUTIONS (2012) ("[Under SPOE] [s]ound subsidiaries (domestic and foreign) would be kept open and operating, thereby limiting contagion effects and cross-border complications.").

In furtherance of the SPOE strategy, our member institutions are also unique in that they have developed secured support agreements that contractually require their parent holding companies to provide support to material operating subsidiaries in resolution. A recent U.S. Treasury Report recognized this development, acknowledging that U.S. GSIBs have "taken important steps intended to ensure that the resources of the parent holding company can reliably be provided to operating entities in the event of bankruptcy."[36] In addition, U.S. GSIBs are required, pursuant to heightened resolution planning guidance, to anticipate the capital and liquidity needs of their material subsidiaries and pre-position certain amounts of capital and liquidity at those subsidiaries to cover any necessary resources prior to contractually obligated transfers under the secured support agreements.[37] Specifically, they must "model resolution capital and liquidity needs for each material entity"—so-called RCEN and RLEN—and "hold and pre-position sufficient resources to meet those needs"—so-called RCAP and RLAP.[38]

In addition, "firms have significantly reduced the number of their subsidiaries and taken steps to better align legal entity structures with distinct business lines."[39] This restructuring would assist greatly a distressed parent holding company in supporting its subsidiaries by reducing the number and complexity of transactions necessary for a successful SPOE resolution. One clear indication of this trend is

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[36] OLA Treasury Report at 15. *See also* Bank of America Corp., Resolution Plan Submission: Public Executive Summary at 22-23 (2017) (describing contractually obligated transfers under secured support agreements); BNY Mellon, Resolution Plan: Public Section at 20-23 (2017) (same); Citigroup, Resolution Plan: Public Section at 4-5 (2017) (same); The Goldman Sachs Group, Inc., Resolution Plan: Public Section at 28-29 (2017) (same); JPMorgan Chase & Co., Resolution Plan Public Filing at 23 (2017) (same); Morgan Stanley, Resolution Plan: Public Section at 14-16 (2017) (same); State Street, Resolution Plan: Public Section at 15-16 (2017) (same); Wells Fargo, Resolution Plan: Public Section at 14-18 (2017) (same).

[37] *See* Final Guidance for the 2019 and Subsequent Resolution Plan Submissions, 84 Fed. Reg. 1438 (Feb. 4, 2019).

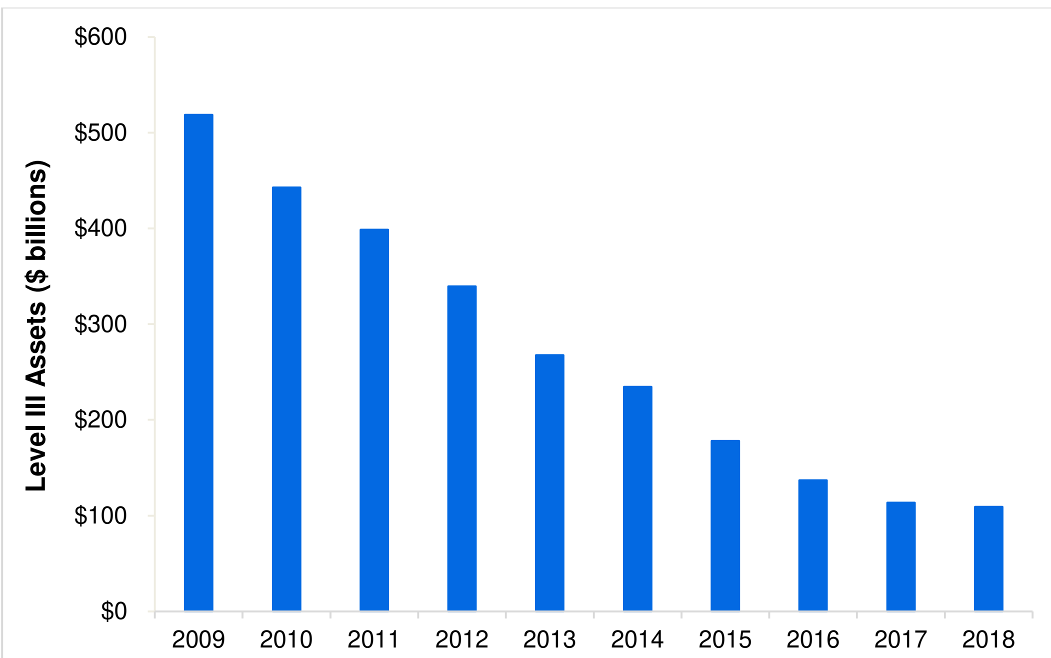
[38] *Id*. at 1442. Industry organizations have argued that these standards are unnecessarily prescriptive and duplicative of the LCR and liquidity stress testing requirements. *See, e.g.,* SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION, REBALANCING THE FINANCIAL REGULATORY LANDSCAPE at 75-76 (May 1, 2017), https://www.sifma.org/wp-content/uploads/2017/05/SIFMA-EO-White-Paper.pdf.

[39] OLA Treasury Report at 13-14.

that Forum member institutions have reduced their number of unique subsidiaries by 40% since 2009.[40]

Further, as compared to pre-crisis levels, a smaller proportion of Forum member institutions' balance sheets are devoted to complicated financial products such as Level 3 assets and trading book assets. This change reduces the difficulty of resolution and therefore mitigates the TBTF problem because resolving a financial institution with less complex assets would be less costly and simpler than resolving one with more complex assets that may be harder to value, liquidate, or hedge during a period of financial stress. Our member institutions' progress in these respects is illustrated by Figures VI and VII below.

Figure VI – Forum Member Institution Level 3 Assets



Source: *Federal Reserve Y-9C*

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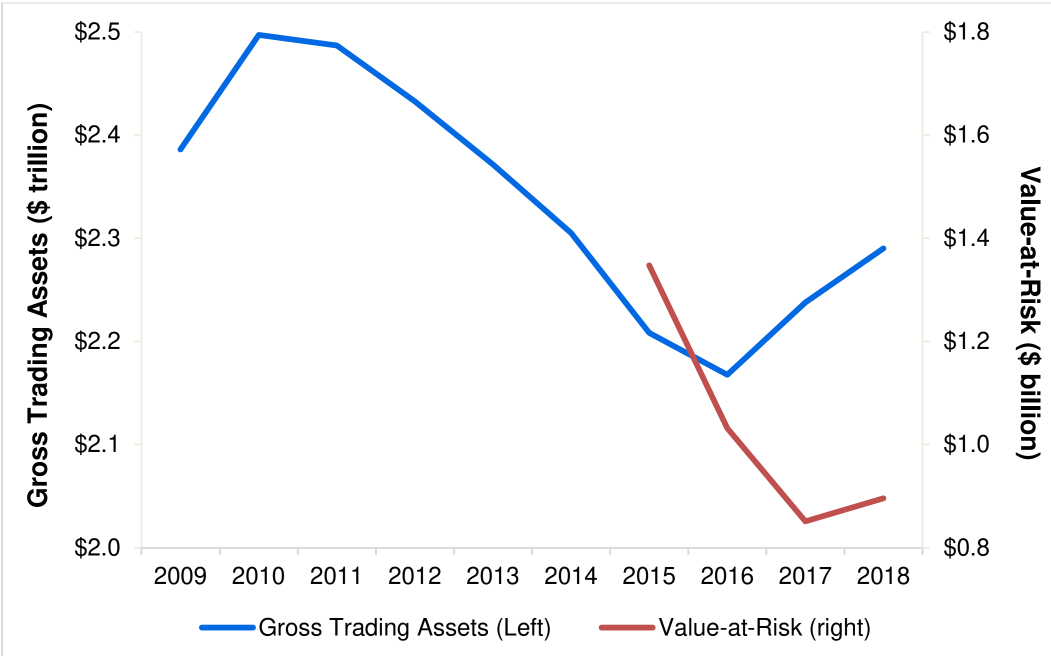
[40] Federal Financial Institutions Examination Council, National Information Center.

Figure VII – Forum Member Institution Trading Data



Source: *Federal Reserve Y-9C & FFIEC 102*

Regulators have recognized the viability of the SPOE resolution strategy and resolvability of the U.S. GSIBs. In 2013 the FDIC chose to focus on developing the SPOE strategy for resolving systemically important financial institutions under the OLA.[41] In developing this framework, the FDIC said the SPOE strategy would "provide stability to financial markets by allowing vital linkages among the critical operating subsidiaries of the firm to remain intact and preserving the continuity of services between the firm and financial markets that are necessary for the uninterrupted operation of the payments and clearing systems, among other functions."[42] Further, in their most recent review, the FRB and the FDIC have not identified deficiencies in the U.S. GSIBs' resolution plans that would make them not credible.[43]

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41 Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy, 78 Fed. Reg. 76614 (Dec. 18, 2013).

42 *Id*. at 76615.

43 Press Release, FRB & FDIC, Agencies Announce Joint Determination for Living Wills (Dec. 19, 2017), https://www.federalreserve.gov/newsevents/pressreleases/bcreg20171219a.htm.

ii. Regulatory changes to promote resolvability and address interconnectedness.

In addition to improving resolvability through resolution planning, our members are subject to regulations that require them to take other steps to facilitate an effective SPOE resolution. Such regulations include the TLAC rule, QFC stay rule, QFC recordkeeping requirements, and the single counterparty credit limit ("SCCL") rule.

U.S. GSIBs are subject to a TLAC rule, which went into effect on January 1, 2019, that requires them to hold a minimum amount of going and gone-concern capital and long-term debt ("LTD"), and to maintain a clean top-tier holding company designed to facilitate an SPOE resolution.[44] In adopting the final rule, the FRB noted that "the objective of the TLAC and LTD requirements in the final rule is to reduce the financial stability impact of a failure by requiring companies to have sufficient TLAC on both a going concern and gone-concern basis."[45] In addition, the TLAC rule avoids the need for taxpayer or government support because if a U.S. GSIB were to suffer losses, "the losses would be passed on first to shareholders of the parent company and, if the losses exceed the parent company's equity, to the holders of the parent company's debt."[46] Accordingly, the FRB recognizes that "the TLAC and LTD requirements would increase market discipline for [U.S. GSIBs] by making them bear the costs of issuing a minimum amount of LTD instruments that are capable of absorbing losses in a manner that would enhance the resiliency and resolvability of the organization."[47]

Further, the TLAC rule's clean holding company requirements facilitate the SPOE strategy by prohibiting or limiting the ability of the parent holding company to enter into certain financial arrangements that could impede the firm's orderly resolution. Under the TLAC rule, a U.S. GSIB's top-tier holding company is prohibited from issuing short-term debt, entering into QFCs with third parties, and entering into certain other arrangements that could undermine resolvability. The rule also caps the amount of other long-term third-party liabilities that are *pari*

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[44] Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations, 82 Fed. Reg. 8266 (Jan. 24, 2017).

[45] *Id.* at 8267.

[46] *Id.*

[47] *Id.*

passu or junior to TLAC debt. The FRB emphasized that "[t]hese prohibitions and limitations will enhance resiliency by reducing complexity and reliance on short-term funding and are intended to support the orderly resolution of a covered BHC."[48] In many instances, our member institutions made significant changes to their parent company liabilities and other arrangements to comply with the TLAC rule's super equivalent clean holding company requirements.

As of January 2019, Forum member institutions were required to have $620 billion in long-term debt that would provide an additional source of loss-absorbing capacity to facilitate an orderly resolution under the SPOE strategy. As the U.S. Treasury noted in a recent report, "U.S. bank holding companies have greatly enhanced their loss-absorbing capacity in recent years."[49] Further, the FRB has recognized that the TLAC rule "would improve the resolvability of a [U.S. GSIB] under either the U.S. Bankruptcy Code or Title II of the Dodd-Frank Act and improve their resiliency."[50] Our member institutions' progress in improving loss-absorbing capacity over the past decade is presented in Figure VIII.

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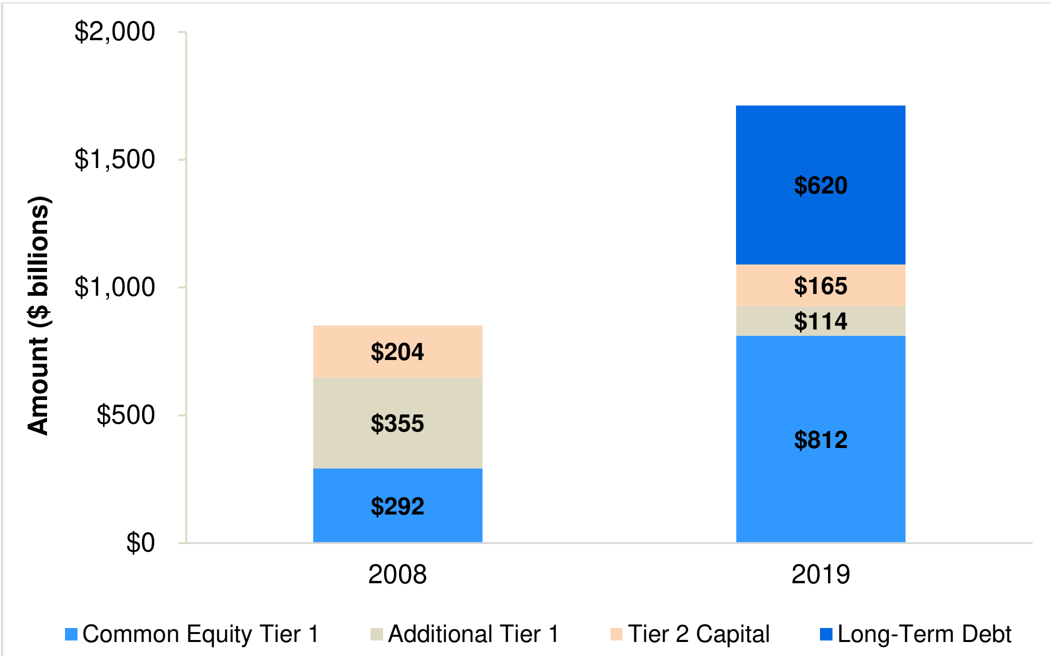
48 *Id*. at 8272.

49 OLA Treasury Report 16.

50 Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations, 82 Fed. Reg. 8266, 8268 (Jan. 24, 2017).

Figure VIII – Forum Member Institution Loss Absorbency Stack



Source: *Federal Reserve Y-9C*

In addition, our member institutions are now subject to the QFC stay rule, which substantially mitigates the ability of cross-default rights and transfer restrictions in QFCs to undermine GSIB resolution in the United States.[51] In this way, the QFC stay rule "complements the Board's final rulemaking on [TLAC] and the ongoing work of the Board and the [FDIC] on resolution planning" by "focus[ing] on improving the orderly resolution of a GSIB by limiting disruptions to a failed GSIB through its financial contracts with other companies."[52] Specifically, U.S. GSIBs are now required to ensure that default rights and restrictions on transfer in their non-cleared QFCs are limited to the same extent as they would be under Title II of the Dodd-Frank Act and the Federal Deposit Insurance Act. The QFC stay rule further facilitates an SPOE resolution by requiring U.S. GSIBs to restrict the exercise of certain types of defaults and transfer restrictions that would be triggered when an affiliate enters resolution proceedings. Further, the International Swaps and Derivatives Association ("ISDA") has developed a protocol that facilitates compliance with the QFC stay rules on an industry-wide

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51 82 Fed. Reg. 42882 (Sept. 12, 2017) (FRB rule); 82 Fed. Reg. 50228 (Oct. 30, 2017) (FDIC rule); 82 Fed. Reg. 56630 (Nov. 29, 2017) (Office of the Comptroller of the Currency rule).

52 82 Fed. Reg. at 42883.

basis.[53] As a result, the United States has made significant progress to avoid the negative consequences associated with QFC termination rights otherwise available in resolution.

Further, financial companies and troubled insured depository institutions in the United States, including U.S. GSIBs, are now subject to enhanced recordkeeping requirements for their QFCs, ensuring the availability of relevant information in the event of a resolution.[54] In general, firms subject to these requirements must collect and maintain digital records on over 100 data points, including data regarding QFC positions, counterparties, legal documentation, and collateral.[55] In addition, these records must be capable of being made available for examination within 24 hours of a request by appropriate authorities or, in the case of a troubled insured depository institution, no later than 7 a.m. (Eastern Time) each day.[56] These extensive requirements would "enable the FDIC to have prompt access to detailed information about the QFC portfolios of [banking organizations] for which the FDIC is appointed receiver."[57]

Finally, the SCCL rule addresses problems of interconnectedness and contagion by limiting the extent to which large banking organizations are put at risk by the failure of one of their counterparties. By limiting credit exposure to any single counterparty, the rule reduces the risk of contagion if a U.S. GSIB were to fail.[58]

iii. The orderly liquidation authority.

Title II of the Dodd-Frank Act established the OLA, which remains in place as a backstop to resolution under the Bankruptcy Code.[59] If the OLA is invoked, it

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53 *See* ISDA, ISDA 2018 U.S. RESOLUTION STAY PROTOCOL, https://www.isda.org/protocol/isda-2018-us-resolution-stay-protocol/.

54 *See* 31 CFR pt. 148; 12 CFR pt. 371.

55 *See* 31 CFR 148.4; 31 CFR pt. 148, app. A. *See also* 12 CFR 371.4; 12 CFR pt. 371, app. B.

56 31 CFR 148.3(a)(3); 12 CFR 371.3(c).

57 82 Fed. Reg. 35584, 35584 (Jul. 31, 2017). *See also* Qualified Financial Contracts Recordkeeping Related to Orderly Liquidation Authority, 81 Fed. Reg. 75624 (Oct. 31, 2016).

58 *See* 12 CFR pt. 252, subpt. H; Single-Counterparty Credit Limits for Bank Holding Companies and Foreign Banking Organizations, 83 Fed. Reg. 38460 (Aug. 6, 2018) ("The final rule… reduce[s] the risks arising from [a large bank's] failure.").

59 *See* 12 U.S.C. § 5383 (requiring recommendation by two-thirds of each of the FRB and the FDIC Board and a determination by the Secretary of the Treasury, in consultation with the President, that, among other things, the failure of the company in bankruptcy would have serious adverse effects on U.S. financial stability).

would allow the FDIC to resolve the company using broad statutory powers akin to those it uses to resolve a failed depository institution. Title II of the Dodd-Frank Act also establishes an orderly liquidation fund ("OLF") at the U.S. Treasury to serve as a liquidity facility that the FDIC can draw upon to facilitate resolution under OLA. Taxpayers, however, would not bear the cost of funding to the failed company through the OLF because any loss to the OLF that the FDIC cannot recover would be reimbursed by assessments on the largest financial companies within five years. In addition, Title II by its terms prohibits the use of taxpayer funds to prevent the liquidation of a company under the OLA.[60] Accordingly, although there is broad agreement that U.S. GSIBs are capable of being resolved in an orderly fashion under the Bankruptcy Code, the OLA exists as a backstop resolution power that would allow the FDIC to resolve them without support from U.S. taxpayers.[61]

c. ***Other post-crisis market reforms have reduced substantially systemic risk and improved the functioning and stability of U.S. financial markets.***

In addition to the TBTF reforms described above, U.S. GSIBs have benefitted from numerous market reforms that have reduced substantially systemic risk and improved the functioning and stability of financial markets. Such reforms include derivative market reforms, reform of money market mutual funds, and repo market reform.

i. Derivatives reform.

The structure and regulation of the global derivatives market has been transformed in the past decade. Two key developments are (i) the substantial increase in central clearing of over-the-counter ("OTC") derivatives, illustrated in Figure IX[62]

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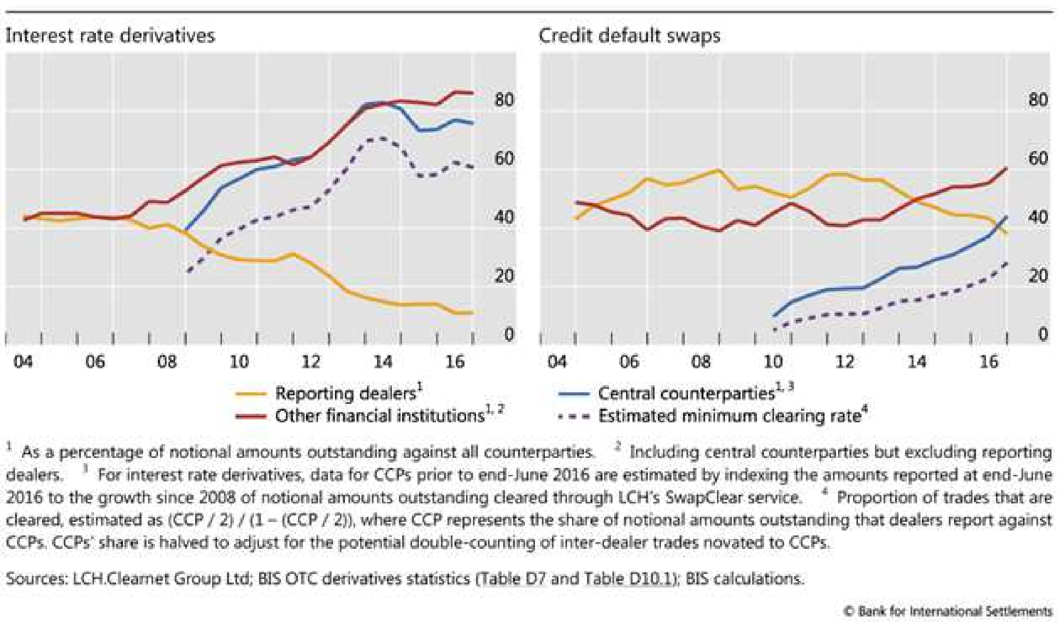
[60] 12 U.S.C. § 5394.

[61] *See also* THE CLEARING HOUSE, REPORT ON THE ORDERLY LIQUIDATION AUTHORITY, at 6, 15 (2013) ("The Simulation Exercise confirmed the views that have been expressed by banking regulators and Members of Congress that Title II OLA can be a viable mechanism for resolution of a large, complex SIFI… Title II imposed losses on equity holders and creditors.… Consequently, there will be no government bailout and no taxpayer loss under Title II."), https://www.theclearinghouse.org/research/articles/2013/01/20130117-tch-ola-simulation-resolution-report.

[62] *See, e.g.*, Philip Wooldridge, *Central Clearing Makes Further Inroads, in* BIS QUARTERLY REVIEW at 8 (June 2017) (showing that central clearing of credit and interest rate derivatives has increased substantially over the past decade, and that as of the end of 2017 55% of credit default swaps were centrally cleared and 75% of interest rate derivatives were), https://www.bis.org/publ/qtrpdf/r_qt1706.pdf.

and (ii) the mandated exchange of initial and variation margin on all OTC derivatives that are not centrally cleared. Central clearing is an important reform because clearing brings transparency and strict risk-management standards to derivative trading. Financial reforms required 85% of interest rate derivatives by notional value to be centrally cleared by 2017; as of the end of 2019's first quarter 88.9% of interest rate derivatives met this standard, along with 81% of credit derivatives.[63] This rise in central clearing has reduced measurably the systemic risk posed by derivative markets. This reduction is supported by central counterparties ("CCPs") that collect margin (initial and variation margin) and maintain well-established and agreed-upon procedures for closing out defaulted members.

Figure IX – Growth of Central Clearing (Notional Amounts Outstanding by Counterparty, in Percent)



***Source:** Wooldridge supra note 62*

[63] ISDA, ACTUAL CLEARED VOLUMES VS. MANDATED CLEARED VOLUMES: ANALYZING THE US DERIVATIVES MARKET at 3 (July 2018) (showing the 85% clearing mandate), https://www.isda.org/a/6yYEE/Actual-Cleared-Volumes-vs-Mandated-Cleared-Volumes.pdf; ISDA, SWAPSINFO FIRST QUARTER OF 2019 REVIEW at 2-3 (April 2019) (stating that, as of the end of 2019's first quarter, 88.9% of interest rate derivatives were centrally cleared and 81% of credit derivatives were, both by notional value), https://www.isda.org/a/RNUME/SwapsInfo-Q1-2019-Review.pdf.

In addition, U.S. regulators (including most recently the U.S. Securities and Exchange Commission, or "SEC"), have implemented G-20 commitments made at the Pittsburgh Summit, and through the work of the Basel Committee and International Organization of Securities Commissions, by imposing mandatory initial and variation margin requirements for swaps and security-based swaps. As such, our member institution affiliates that are swap dealers are now required to collect and post variation margin in the form of cash and/or highly-liquid securities to fully cover swap and security-based swap exposures with all financial counterparties.[64]

Further, our member institutions are subject to requirements to both collect and post segregated initial margin when transacting with other major financial institutions and will be subject to these requirements with respect to all financial counterparties with "material swaps exposure" beginning September 1, 2020.[65] These requirements are intended (and have been calibrated) pursuant to Title VII of the Dodd-Frank Act to offset greater risk to swap entities from uncleared derivatives relative to cleared derivatives.[66] They also complement mandatory capital requirements by imposing a "defaulter pay" model on the uncleared swaps space and by acting as an additional liquidity constraint on swap entities (in particular through the mandatory requirement to post initial margin into segregation).

According to the 2017 ISDA margin survey, the top 20 global derivative dealers have collected \$130 billion in initial margin to support uncleared derivatives, and CCPs clearing interest rate and credit derivatives have collected \$190 billion in initial margin on these transactions.[67] The ISDA report also indicates that both uncleared and cleared initial margin have risen by 22% over the past year.

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[64] Legal entities within our member institutions that are not swap dealers are indirectly subject to these same requirements when transacting with swap dealers.

[65] "Material swaps exposure" exists when an entity and its affiliates have an average daily aggregate notional amount of non-cleared swaps, security-based swaps, foreign exchange forwards, and foreign exchange swaps with all counterparties over a specified three month testing period greater than \$8 billion.

[66] Initial margin requirements are generally calibrated to cover a ten day margin period of risk at a one-tailed 99% confidence level. Cleared derivatives are generally required to be risk managed at a 95% confidence level over a five day margin period of risk.

[67] ISDA, MARGIN SURVEY FULL YEAR 2017 at 3 (2018), http://assets.isda.org/media/85260f13-60/6a228cda-pdf/.

In addition to these global, market-wide reforms it should be noted that the United States has taken further measures with respect to derivative markets that are intended to directly support and facilitate the resolution of a U.S. GSIB. Specifically, under the Dodd-Frank Act, U.S. GSIBs are subject to swap reporting requirements.[68] Moreover, U.S. GSIBs are required to maintain an ongoing inventory of contact information for each counterparty with which it maintains a swap transaction that can be transferred to regulators in a resolution. Both of these U.S. requirements are intended to directly support the efficient wind-down of a U.S. GSIB's derivative portfolio in a resolution event.

ii. Money market fund reform.

In the United States, the reform of money market mutual funds represents another important improvement to the overall resiliency of the financial system that supports the efficient resolution of large banking organizations. The SEC first released amendments to its rules on money market funds in 2010, which were "designed to make money market funds more resilient by reducing the interest rate, credit, and liquidity risks of their portfolios."[69] Later, in 2014, the SEC further amended its rules to "require a floating net asset value (NAV) for institutional prime money market funds, which allows the daily share prices of these funds to fluctuate along with changes in the market-based value of fund assets."[70] The rules also authorize these funds to impose liquidity fees and redemption gates during times of stress, providing tools to forestall a run, and include additional revisions to diversification, disclosure, and stress testing requirements.[71] The 2014 regulations were intended to "address money market funds' susceptibility to heavy redemptions in times of stress, improve their ability to manage and mitigate potential contagion from such redemptions, and increase the transparency of their

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68 To illustrate the newfound ubiquity of swap reporting, consider that only 15% of credit default swap trades included complete counterparty information in 2014, whereas 95% met this standard in 2018. *See* COMMODITY FUTURES TRADING COMMISSION, SWAPS REGULATION VERSION 2.0: AN ASSESSMENT OF THE CURRENT IMPLEMENTATION OF REFORM AND PROPOSALS FOR NEXT STEPS at 25 (April 26, 2018), https://www.cftc.gov/sites/default/files/2018-04/oce_chairman_swapregversion2whitepaper_042618.pdf.

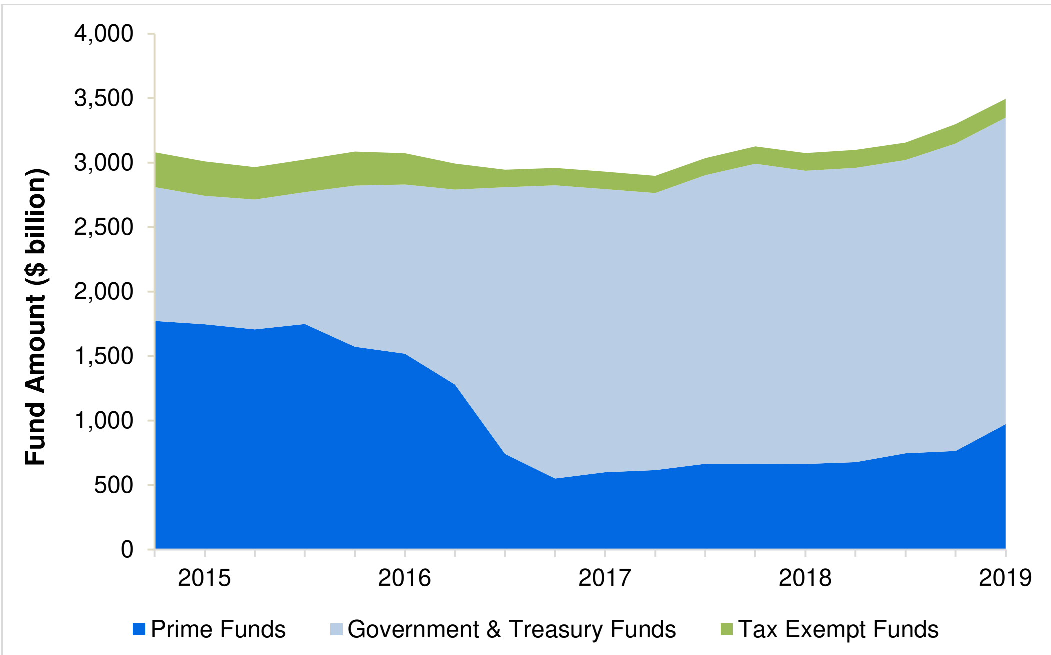
69 SEC, MONEY MARKET FUNDS (Nov. 3, 2016), https://www.sec.gov/spotlight/money-market.shtml.

70 Press Release, SEC, SEC Adopts Money Market Fund Reform Rules (July 23, 2014), https://www.sec.gov/news/press-release/2014-143.

71 *Id.*

risks" while still preserving the benefits of money market funds.[72] Because of these new tools and the resulting reduction in prime money market funds along with the greater presence of government-backed money market funds as illustrated in Figure X below, large-scale redemptions are much less likely to cause stress in financial markets that would make the resolution of large banking organizations more difficult and costly.

Figure X – Composition of Money Market Funds



Source: *SEC Money Market Fund Statistics*

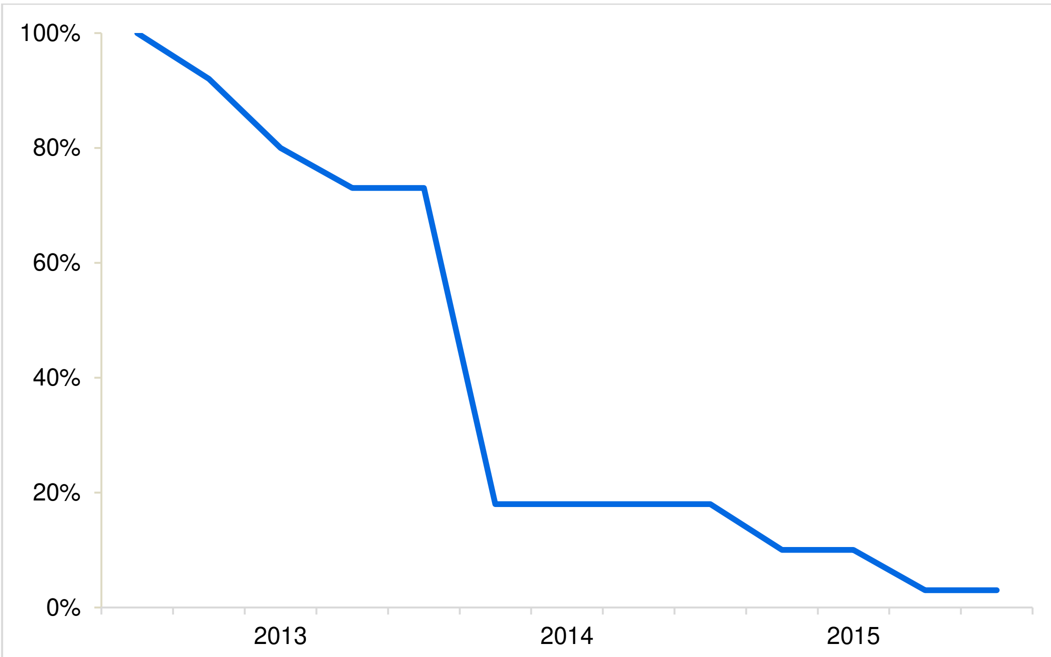
iii. Repo market reform.

Leading up to the financial crisis, repo markets were a key source of short-term funding for banking organizations. This reliance on short-term repo funding created the greater potential for run behavior that could produce or worsen a period of financial distress and could complicate the resolution of large banking organizations. Therefore, in an industry-led effort that was organized and supported by the Federal Reserve Bank of New York, banking organizations made several improvements to the tri-party repo market that have largely reduced the provision of uncollateralized, intraday credit, as shown below in Figure XI. As a

[72] Money Market Fund Reform; Amendments to Form PF, 79 Fed. Reg. 47735, 47736 (Aug. 14, 2014).

result, credit risk presented by repo markets has decreased materially, which has led to an improvement in the safety and stability of the banking system.

Figure XI – Intraday Credit Extended: U.S. Tri-Party Repo Collateral



Source: *BNY Mellon "The Future of Wholesale Funding Markets"*

d. ***Studies show that the market no longer perceives U.S. GSIBs as TBTF.***

As noted above, our member institutions have taken important steps to facilitate their resolvability and reduce financial stability and moral hazard risk. Moreover, evidence suggests that the market no longer perceives them as TBTF, further buttressing the effects of the substantial changes that have been made. For example, all three major rating agencies "have effectively removed their expectations of government support for U.S. GSIBs' holding company creditors over the past several years."[73] Further, the Government Accountability Office

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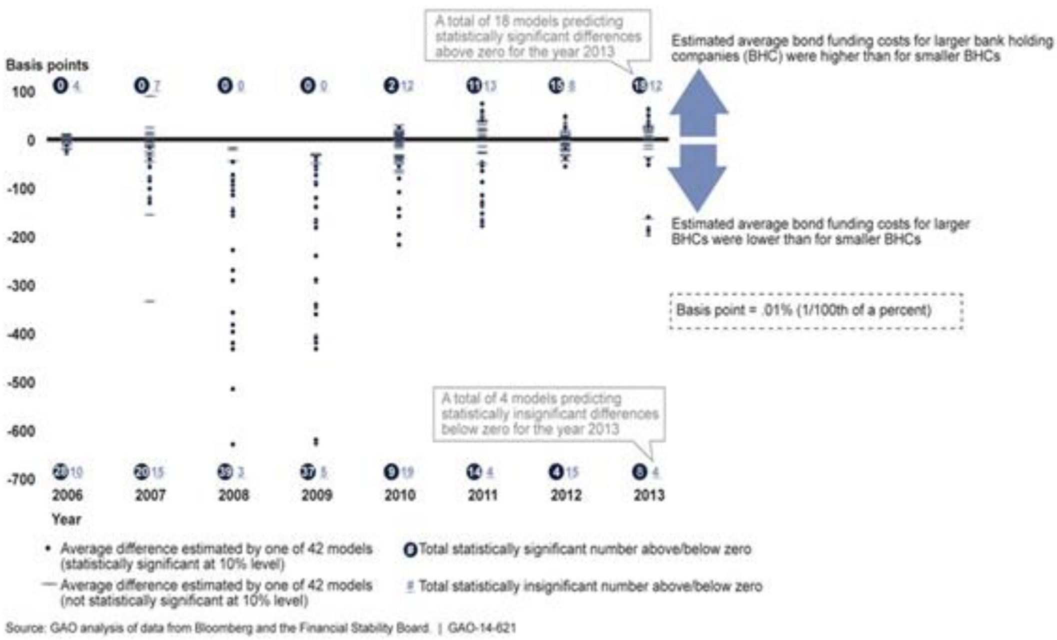
73 OLA Treasury Report at 19. *See also* Moody's Investors Service, Rating Action: Moody's Concludes Review of Eight Large US Banks (Nov. 14, 2013), https://www.moodys.com/research/Moodysconcludes-review-of-eight-large-US-banks--PR_286790; Fitch Ratings, Fitch: TLAC Supports the Upgrades of Eight U.S. GSIB Operating Companies, (May 19, 2015), https://www.fitchratings.com/site/pr/984992; S&P Global, U.S. Global Systemically Important Bank Holding Companies Downgraded Based On Uncertain Likelihood Of Government Support (Dec. 3, 2015), https://www.capitaliq.com/CIQDotNet/CreditResearch/RenderArticle.aspx?articleId=149045

conducted a study on the size of funding subsidies based on TBTF status, finding that they had "declined or reversed" since the pre-crisis era.[74] Figure XII below, reproduced from that study, shows that bond funding costs for banking organizations with $1 trillion in assets and those with $10 billion converged between 2006 and 2013.

Figure XII – Estimates from 42 Models of Average Bond Funding Cost Differences Between Bank Holding Companies with $1 Trillion and $10 Billion in Assets, 2006-2013



Source: *infra note 74 at 50*

More recent evidence is consistent with this finding. A 2018 research paper by economists at the Federal Reserve Bank of New York shows that funding costs for large banking organizations rose in response to resolution planning requirements. The researchers found that such requirements resulted in an increase in Forum member institution funding costs of roughly 0.4%, or $38 billion, per year. The authors interpret this increase in funding costs as clear evidence that TBTF

2&SctArtId=357868&from=CM&nsl_code=LIME&sourceObjectId=9438258&sourceRevId=1&fee_ind=N&exp_date=20251202-14:59:54.

[74] U.S. GOV'T ACCOUNTABILITY OFFICE, REPORT TO CONGRESSIONAL REQUESTERS: LARGE BANK HOLDING COMPANIES: EXPECTATIONS OF GOVERNMENT SUPPORT at 46 (2014), https://www.gao.gov/assets/670/665162.pdf.

subsidies have declined.[75] Figure XIII shows the study's findings regarding increases in cost of funding as a result of resolution planning requirements for each Forum member institution.

Figure XIII – Post-Living Will Increases in Funding Costs

	Annual Funding Cost Increase	
Forum Member	Basis Points (1/100 %)	$USD (millions)
Bank of America	43	9,205
Bank of New York Mellon	1	45
Citigroup	76	14,227
Goldman Sachs	51	4,747
JPMorgan Chase	27	6,104
Morgan Stanley	32	2,402
State Street	3	76
Wells Fargo	9	1,151
Total	**39**	**37,957**

** Total is the total asset-weighted average cost of funding

Source: *Federal Reserve Bank of New York "Resolving Too Big to Fail"*

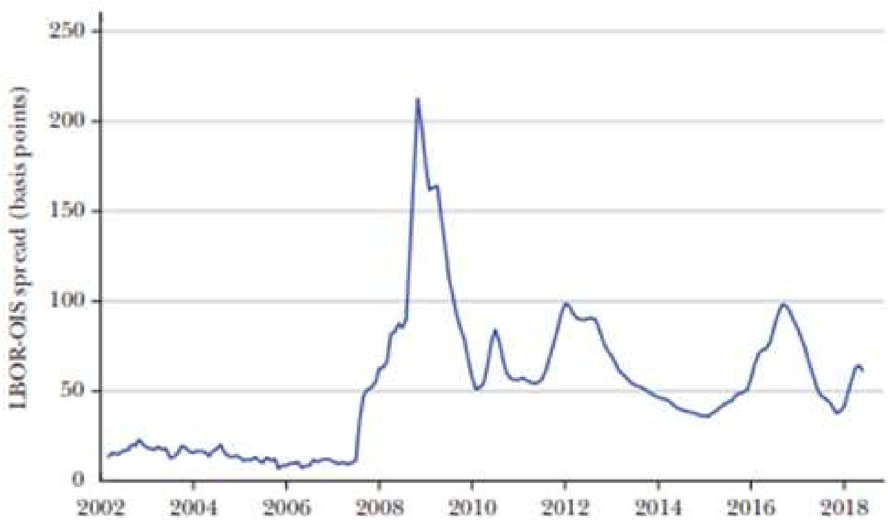
A 2019 research paper by Darrell Duffie of Stanford University draws a similar conclusion based on the funding spreads of large bank holding companies. In particular, it shows that one measure of the credit spread paid by large banking organizations has increased from a handful of basis points before the crisis to between 50 and 100 basis points in the post-crisis period.[76] Professor Duffie concludes that the increase in large banking organization funding costs clearly demonstrates that TBTF subsidies have declined: "[w]hether or not bail-in [orderly resolution] works reasonably well in practice, what matters for big banking organization borrowing costs is that creditors believe that it would be tried. It appears that they do now believe this. As shown…the cost of wholesale unsecured credit for the largest banking organizations has increased dramatically, despite the significant improvements in capital and liquidity achieved under the

75 Nicholas Cetorelli & James Traina, *Resolving "Too Big to Fail"* (Federal Reserve Bank of New York, Staff Report No. 859, 2018) (Specifically, the authors state that "[w]e interpret our findings as a reduction in 'too big to fail' subsidies."), https://www.newyorkfed.org/research/staff_reports/sr859.

76 Darrell Duffie, *Prone to Fail: The Pre-Crisis Financial System*, 33 J. Econ. Persp. 81, 98 fig.5 (2019), https://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.33.1.81.

post-crisis regulations."[77] In particular, Professor Duffie rightly observes that, in light of the significant post-crisis increases in capital and liquidity, one would naturally expect large banking organization borrowing costs to go down. The fact that they have actually gone up strongly signals that creditors of banking organizations understand and require compensation for the fact that the government is unlikely to provide support in times of stress. Figure XIV shows the changes in one measure of the cost of wholesale unsecured credit for the largest banking organizations over time, illustrating the significant and sustained increase following the financial crisis.

Figure XIV – Average One-Year Credit Spread of Large Banking Organization Borrowing US Dollars: LIBOR versus the OIS Swap Rate



Source: Author using data from Bloomberg.
Note: The figure shows the difference between the one-year US Dollar London Interbank Offered Rate (LIBOR) and the one-year overnight index swap (OIS) rate based on the Fed Funds rate.

Source: *supra note 76 at 98*

Finally, a 2019 research paper by economists at UCLA, the Federal Reserve Bank of Minneapolis, and the Stockholm School of Economics uses a quantitative macroeconomic model to measure the implicit value of government guarantees that is imputed into the market value of bank equity relative to its book value.[78]

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77 *Id*. at 100.

78 Andrew G. Atkeson et al., *Government Guarantees and the Valuation of American Banks*, *in* 33 NBER MACROECONOMICS ANNUAL 2018 (Martin Eichenbaum & Jonathan A. Parker eds., forthcoming 2019), http://www.adriendavernas.com/papers/valuationofbanks.pdf.

Using data on U.S. bank holding companies, the authors conclude that over the 2011-2017 period their model "predicts that banks currently do not derive much of their market value from government guarantees."[79] Moreover, the authors' results show that the estimated value of government guarantees over the 2011 to 2017 period is only 10% of the estimated value over the pre-crisis (1996-2007) period. Accordingly, these results provide further evidence that the size of any implicit government guarantees that may have existed in the pre-crisis era has been reduced substantially.

II. Regulators should address adverse effects without undermining core progress in addressing TBTF.

The FSB in its Summary Terms of Reference also asks about the broader effects of TBTF reforms on the financial system and markets and about any material unintended consequences of the reforms. In particular, the FSB seeks comment on any changes in the financial system's resilience and structure, the functioning of financial markets, global financial integration, or the cost and availability of financing, noting that the evaluation will assess "both domestic and cross-border effects" of TBTF reforms.[80] For the reasons discussed below, we believe now is an appropriate time for regulators to address in a thoughtful way certain adverse effects of the post-crisis reforms, which can be done without undermining the substantial progress that has been made on addressing TBTF.

a. *TBTF reforms have resulted in certain unintended consequences.*

Some TBTF reforms have had unintended consequences in the form of negative effects on the structure and resilience of the financial system and financial markets. For example, several studies have shown that the post-crisis period has seen a reduction in financial market liquidity,[81] which commentators suggest might have

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[79] *Id*. at 43.

[80] FSB, Evaluation of Too-Big-To-Fail Reforms: Summary Terms of Reference at 1, 3 (May 23, 2019), https://www.fsb.org/wp-content/uploads/P230519.pdf.

[81] *See, e.g.*, Hendrik Bessembinder et al., *Capital Commitment and Illiquidity in Corporate Bonds*, 73 J. Fin. 1615 (2018) (showing that large dealer banks are less willing to commit capital to bond inventory that would allow customers to complete trades, thereby reducing the liquidity they provide to their customers), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2752610; Mike Anderson & René M. Stulz, *Is Post-Crisis Bond Liquidity Lower?* (NBER Working Paper No. 23317) (finding that liquidity is worse post-crisis when market volatility is high), https://www.nber.org/papers/w23317; Jaewon Choi & Yesol Huh, *Customer Liquidity Provision: Implications for Corporate Bond Transaction Costs* (FRB, Finance and

been caused at least in part by post-crisis reforms such as heightened capital and liquidity requirements and the Volcker Rule.[82] TBTF reforms that constrain the market-making capacity of banking organizations[83] exacerbate the market liquidity problem, particularly during times of stress. This deterioration in market liquidity has important implications for the welfare of investors, corporations, pension funds, and other entities that use financial markets to manage risks and provide for the future. Therefore, the costs of reduced market liquidity should be quantitatively assessed in the FSB evaluation of TBTF reforms.

Another unintended consequence of TBTF reforms has been the movement of certain activity outside of the regulated banking sector. In large part, this migration appears to be the result of the increased regulation of large banks following the financial crisis. A recent research report written by the FSB shows that the nonbank sector has increased from $28 trillion to $51.6 trillion over the 2010-2017 period.[84] The same report also shows that the banking sector has

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Economics Discussion Series Working Paper 2017-116) (finding evidence of deteriorating market liquidity), https://www.federalreserve.gov/econres/feds/files/2017116pap.pdf; Paul Schultz, *Inventory Management by Corporate Bond Dealers* (unpublished manuscript) (same), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2966919.

82 *See* Jack Bao, Maureen O'Hara & Alex Zhou, *The Volcker Rule and Market-Making in Times of Stress* (FRB, Finance and Economics Discussion Series Working Paper 2016-102) (arguing that bond liquidity during periods of stress has worsened post-crisis as a result of the Volcker Rule), https://www.federalreserve.gov/econresdata/feds/2016/files/2016102pap.pdf; Lotfi Karoui et al., *The Great Liquidity Debate: Where We Stand 10 Years Later,* GOLDMAN SACHS CREDIT STRATEGY RESEARCH (June 12, 2019) (arguing that post-crisis regulatory changes have resulted in deteriorating liquidity conditions for corporate bonds). *See also supra* note 81.

83 For example, the U.S. Treasury Department and industry organizations have recently expressed concern that the proposed U.S. rule on TLAC cross-holdings may constrain market making in loss-absorbing debt instruments. *See* U.S. DEP'T OF THE TREASURY, A FINANCIAL SYSTEM THAT CREATES ECONOMIC OPPORTUNITIES: CAPITAL MARKETS at 85-88 (Oct. 2017) (arguing that the Volcker Rule and heightened capital and liquidity standards have reduced market making and liquidity in the corporate bond market); Securities Industry and Financial Markets Association, Comment Letter to Office of the Comptroller of the Currency, FDIC & FRB Re: Regulatory Capital Treatment for Investments in Certain Unsecured Debt Instruments of Global Systemically Important U.S. Bank Holding Companies, Certain Intermediate Holding Companies, and Global Systemically Important Foreign Banking Organizations (June 7, 2019); Bank Policy Institute et al., Comment Letter to Office of the Comptroller of the Currency, FRB & FDIC Re: Regulatory Capital Treatment for Investments in Certain Unsecured Debt Instruments of Global Systemically Important U.S. Bank Holding Companies, Certain Intermediate Holding Companies, and Global Systemically Important Foreign Banking Organizations (June 7, 2019).

84 FSB, *Global Monitoring Report on Non-Bank Financial Intermediation* 2018 at 44 (exhibit 4-4) (2018), https://www.fsb.org/wp-content/uploads/P040219.pdf.

declined globally from holding roughly 45% of all financial sector assets to 40% of financial sector assets over the same period.[85] In the United States, Forum member institutions have seen their share of total U.S. financial system assets decline from roughly 14% to 11%. The flow of activities outside of the regulatory perimeter is a factor the FSB should carefully consider as it evaluates TBTF reforms. Specifically, an increase in assets and activities outside the regulatory perimeter presents the potential for financial stability risks that may not be fully understood or mitigated.

In addition, TBTF reforms have had a measurable impact on the cost and availability of credit. The Basel Committee's own analysis of the cost of financial reforms clearly recognizes that increases in the cost of funding for banks increases lending rates and depresses economic growth. As such, any evaluation of TBTF reforms should consider the overall impact of such reforms on macroeconomic growth and should be rationalized with those costs in mind. The FSB should consider, for instance, recommending that the Basel Committee's assessment of long-term economic impact posed by increased capital and liquidity requirements be supplemented to include the effects of other regulatory efforts to address systemic risk, such as the resolution planning, TLAC, QFC, and various other reforms discussed above.[86] Although the Basel Committee recently updated this assessment to include some discussion of resolution planning and TLAC, it has not fully considered the impacts of all TBTF reforms, claiming that they cannot be adequately calculated until the reforms are crisis-tested.[87] We believe that this approach is suboptimal and could result in a material underestimation of the true cost of regulatory reform to the financial system and financial markets.

b. *There is opportunity to achieve efficiencies in the post-crisis framework and address adverse effects on financial markets without undermining the core progress made in addressing the problem of TBTF.*

As FSB Chair Quarles has acknowledged, after adopting such comprehensive reforms, "now is an eminently natural and expected time to step back and assess

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[85] *Id.* at 14 (exhibit 2-2).

[86] *See* Basel Committee on Banking Supervision, *An Assessment of the Long-Term Economic Impact of Stronger Capital and Liquidity Requirements* (Aug. 2010), https://www.bis.org/publ/bcbs173.pdf.

[87] *See* Basel Committee on Banking Supervision, *The Costs and Benefits of Bank Capital – A Review of the Literature* at 12 (June 2019), https://www.bis.org/bcbs/publ/wp37.htm.

those efforts" and find ways to achieve efficiency, simplicity, and transparency of regulation, including by assessing costs against benefits, using fewer tools to achieve an objective, and addressing unintended adverse consequences.[88] Former FRB Governor Tarullo similarly stated that "the novelty of many of the forms of regulations adopted by financial regulators, either in implementing the Dodd-Frank Act or under existing authorities, almost assures that some recalibration and reconsiderations will be warranted on the basis of experience."[89] We agree with these statements—now is the right time to consider ways to streamline the existing regulatory framework implemented since the financial crisis to improve efficiency and enhance the ability of our member institutions to serve as a source of strength for the U.S. and global economy. Below, we highlight in particular certain international standards that we believe could be improved.

First, we recommend that regulators consider ways to streamline regulation to address instances where several policies may be working to address the same issue, which results in duplicative and inefficient regulations with overlapping effects. As discussed below, a number of rules adopted since the financial crisis are designed to address similar risks, and many of these requirements can be streamlined without undermining the underlying policy objective. Second, some post-crisis regulations on their own are not well calibrated and achieve little policy benefit at a significant cost to the financial system. We recommend that these regulations' efficiency be improved without undermining the goal of addressing TBTF. As FRB Chairman Jerome Powell recently noted, "laws, regulations, and supervisory practices could be adjusted in a way that preserves the gains in safety and soundness but helps financial institutions devote as much of their resources as possible to supporting economic growth."[90]

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[88] Randal K. Quarles, Vice Chairman for Supervision, FRB, Speech at the Institute for International Monetary Affairs 26th International Financial Symposium, The U.S. Economy after the Global Financial Crisis (Feb. 22, 2018), https://www.federalreserve.gov/newsevents/speech/quarles20180222a.htm. *See also* Randal K. Quarles, Chair, FSB, Letter to G-20 Leaders at 3 (June 24, 2019) ("As implementation [of post-crisis reforms] progresses, we can evaluate the effects of those reforms to ensure that we are achieving the intended gains in financial stability and that the reforms are not unnecessarily burdensome.").

[89] Daniel K. Tarullo, Speech at the Woodrow Wilson School, Departing Thoughts (Apr. 4, 2017), https://www.federalreserve.gov/newsevents/speech/tarullo20170404a.htm.

[90] Jerome H. Powell, Governor, FRB, Speech at The Global Finance Forum (Apr. 20, 2017) (also expressing his support for adjustments "designed to enhance the efficiency and effectiveness of regulation without sacrificing safety and soundness or undermining

i. GSIB surcharge.

One example of duplication in the post-crisis regulatory framework is the GSIB surcharge as implemented in the United States.[91] Although ostensibly designed to implement the global standard established by the Basel Committee,[92] in fact the U.S. GSIB surcharge is super equivalent to the Basel Committee's standard. The FRB has explained that the GSIB surcharge is based on the assumption that it is necessary to "reduce the likelihood that the failure or material financial distress of [a GSIB] will again pose a threat to U.S. financial stability" and to decrease the likelihood of failure in the first instance.[93] This dual rationale of improving resiliency and resolvability of GSIBs also has been used to justify the many capital, liquidity, and loss absorbency reforms discussed above, which have resulted in duplicative regulatory requirements that address the same risks.

Moreover, the calibration of the GSIB surcharge—both the Basel Committee's version and the super equivalent U.S. version—does not reflect the enhancements to resiliency, liquidity, and resolvability that have been achieved since the surcharge was first adopted, including: enhancements to resolution planning, minimum margin and capital requirements related to non-cleared swaps and security-based swaps, TLAC requirements, QFC contractual stay and recordkeeping requirements, and enhanced supervisory practices.[94] In addition, the FRB's capital planning and stress testing programs already are designed to

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macroprudential goals"), https://www.federalreserve.gov/newsevents/speech/powell20170420a.htm.

91 For a further discussion of overlapping and duplicative requirements, *see* Financial Services Forum, Comment Letter to FRB Re: Amendments to the Regulatory Capital, Capital Plan, and Stress Test Rules (June 25, 2018), https://www.fsforum.com/wp-content/uploads/2018/06/forum_scb_comment_letter.pdf.

92 *See* Basel Committee on Banking Supervision, *Global Systemically Important Banks: Revised Assessment Methodology and the Higher Loss Absorbency Requirement* (July 2018), https://www.bis.org/bcbs/publ/d445.pdf.

93 Regulatory Capital Rules: Implementation of Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies, 80 Fed. Reg. 49082, 49092 (Aug. 14, 2015).

94 For example, Vice Chairman Quarles has stated that the GSIBs have made "substantial progress" with their living wills to improve their resolvability. House Testimony. In addition, minimum margin and capital requirements related to non-cleared swaps and security-based swaps were finalized in late 2015, 80 Fed. Reg. 74840 (Nov. 30, 2015); TLAC requirements for GSIBs were finalized on January 24, 2017, 82 Fed. Reg. 8266 (Jan. 24, 2017); and QFC stay requirements were finalized on September 12, 2017, 82 Fed. Reg. 42882 (Sept. 12, 2017).

capture risks that are particularly acute for GSIBs, *e.g.*, the global market shock and the large counterparty default scenario. It is also worth noting that the reliance of the GSIB score and surcharge on the value of the exchange rate at a single point in time creates unnecessary volatility in the score and surcharge.

Accordingly, the GSIB surcharge as currently implemented is mis-calibrated and imposes costs that outweigh the incremental benefits the surcharge provides. In the United States, the effect of this mis-calibration is even more pronounced because, as mentioned above, the U.S. GSIB surcharge is super equivalent to the Basel Committee's standard and often results in higher surcharges for U.S. GSIBs, and because, as discussed above, the U.S. GSIBs are at the forefront of reforms to reduce systemic risk. Therefore, the surcharge unnecessarily raises costs, which are ultimately passed down to businesses and households that are seeking credit to make investments that contribute to economic growth. As FSB Chair Quarles has emphasized, at this stage, these types of impediments could imperil the sustainability of economic growth.[95]

ii. Net stable funding ratio.

We believe the net stable funding ratio ("NSFR"), a quantitative liquidity standard finalized by the Basel Committee[96] and proposed to be implemented by U.S. prudential regulators,[97] is both duplicative of other liquidity requirements and mis-calibrated. Therefore, we believe there is a serious question of whether the NSFR is needed at all. In particular, the NSFR addresses many of the same risks as liquidity requirements that have already been implemented for U.S. banking organizations. Since the Basel Committee finalized its NSFR standard in 2014, the FRB has required U.S. firms to implement several liquidity regulatory mandates, such as enhanced prudential standards, that include liquidity risk management, liquidity stress testing, and buffer requirements. In combination with the LCR, these rules effectively duplicate the requirements of the NSFR.

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95 Randal K. Quarles, Vice Chairman for Supervision, FRB, Speech at 34th Annual NABE Economic Policy Conference, An Assessment of the U.S. Economy (Feb. 26, 2018) (noting that the "sustainability of the recent upturn in growth will depend importantly" on developments in factors such as capital investment), https://www.bis.org/review/r180307a.pdf.

96 Basel Committee on Banking Supervision, *Basel III: The Net Stable Funding Ratio* (Oct. 2014), https://www.bis.org/bcbs/publ/d295.pdf.

97 Net Stable Funding Ratio: Liquidity Risk Measurement Standards and Disclosure Requirements, 81 Fed. Reg. 35123 (June 1, 2016).

This overlap leads to mis-calibration in the aggregate, which in turn could introduce risks that exacerbate an economic downturn. For example, banking organizations facilitate liquidity management transactions for companies, including by financing highly liquid securities, such as U.S. Treasury and agency securities, through the secured funding market. However, the NSFR imposes a funding requirement on banking organizations, even for these highly liquid securities. Furthermore, the Basel Committee's leverage ratio framework discourages banking organizations from holding low-risk assets on their balance sheet. In a stress event, the combination of these requirements may limit a banking organization's ability to provide liquidity to the market and thus exacerbate a downturn or otherwise lead to herding behavior or "fire sales" and greater contagion risk.

For these reasons, we believe that the Basel Committee should reevaluate whether the NSFR is needed to address supervisory concerns about overreliance on structural funding and reliance on short-term wholesale funding. At a minimum, the Basel Committee should provide more flexibility for the application of national discretion under the NSFR[98] in recognition of the adoption in local jurisdictions (such as the United States, as described above) of many reforms that are more stringent than the Basel Committee's post-crisis regime.

iii. TLAC rule.

Another example of mis-calibration is the TLAC rule. The FSB established international standards for internal and external TLAC and clean holding company requirements, which the United States has implemented with certain super equivalent features.[99] Our member institutions have recommended several modifications that would not diminish the objectives of the TLAC rule but would materially improve its efficiency. These include eliminating the separate LTD requirement, lowering the internal TLAC calibration that applies to the covered intermediate holding companies ("IHCs") of foreign GSIBs to avoid the similar ring fencing of U.S. GSIB operations in non-U.S. jurisdictions, and making other

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98 Currently, the Basel Committee's NSFR only explicitly contemplates national discretion with respect to certain discrete elements. *See id.* at paras. 25(a), 45.

99 *See* FSB, *Guiding Principles on the Internal Total Loss-absorbing Capacity of G-SIBs ('Internal TLAC')* (July 6, 2017), https://www.fsb.org/wp-content/uploads/P060717-1.pdf; FSB, *Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution* (Nov. 9, 2015), https://www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf.

adjustments to the calibration of TLAC requirements.[100] FSB Chair Quarles has agreed that the TLAC rule could be improved, stating that the FRB should "look closely" at the possibility of "streamlin[ing] the elements of our resolution loss absorbency regime."[101] The FSB should consider whether changes to its international standards are appropriate to address these and other concerns regarding TLAC requirements, such as permitting structured notes to qualify as TLAC and encouraging all jurisdictions to lower their internal TLAC calibration (as discussed further below).

iv. Overlapping capital standards.

A number of different capital standards overlap and address similar risks, presenting an opportunity to improve regulatory efficiencies. Specifically, since the financial crisis, the Basel Committee has introduced a number of revisions to the Basel III framework focused on capital markets activities, including: the

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100 U.S. DEP'T OF THE TREASURY, A FINANCIAL SYSTEM THAT CREATES ECONOMIC OPPORTUNITIES: BANKS AND CREDIT UNIONS 17-18 (June 2017) (recommending reevaluating the 90% internal TLAC standard); Bank Policy Institute et al., Comment Letter to FSB Re: Monitoring the Technical Implementation of the FSB TLAC Standard at 2-3 (Aug. 20, 2018) (arguing that the TLAC standard in the United States is too high and should be calibrated at the low end of the 75% to 90% range); The Clearing House et al., Comment Letter to FSB Re: Proposed Guiding Principles of Internal TLAC at 6 (Feb. 17, 2017) (same); The Clearing House et al., Comment Letter to FRB Re: the Notice of Proposed Rulemaking on External TLAC, Long-Term Debt, Clean Holding Company and Other Requirements Applicable to U.S. GSIBs, Annex 1-9 (Feb. 19, 2016) (same); The Clearing House et al., Comment Letter to Office of the Comptroller of the Currency & FRB Re: Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for U.S. Global Systemically Important Bank Holding Companies and Certain of Their Subsidiary Insured Depository Institutions; Total Loss-Absorbing Capacity Requirements for U.S. Global Systemically Important Bank Holding Companies at 13 (June 25, 2018) (arguing for recalibration of the TLAC and LTD SLR).

101 Randal K. Quarles, Vice Chairman for Supervision, FRB, Speech at the Harvard Law School Symposium on International Financial Systems, Trust Everyone – But Brand Your Cattle: Finding the Right Balance in Cross-Border Resolution at 9 (May 16, 2018), https://www.federalreserve.gov/newsevents/speech/files/quarles20180516a.pdf. *See also* Securities Industry and Financial Markets Association, Comment Letter to Office of the Comptroller of the Currency, FDIC & FRB Re: Regulatory Capital Treatment for Investments in Certain Unsecured Debt Instruments of Global Systemically Important U.S. Bank Holding Companies, Certain Intermediate Holding Companies, and Global Systemically Important Foreign Banking Organizations (June 7, 2019); Bank Policy Institute et al., Comment Letter to Office of the Comptroller of the Currency, FRB & FDIC Re: Regulatory Capital Treatment for Investments in Certain Unsecured Debt Instruments of Global Systemically Important U.S. Bank Holding Companies, Certain Intermediate Holding Companies, and Global Systemically Important Foreign Banking Organizations (June 7, 2019).

standardized approach for measuring counterparty credit risk exposures ("SA-CCR") in 2014; revisions to counterparty risk weights and the credit valuation adjustment ("CVA") risk framework, and introduction of a framework of minimum haircut floors for non-centrally cleared securities financing transactions, all pursuant to Basel III finalization in 2017;[102] and a revised market risk capital rule, commonly referred to as the "fundamental review of the trading book" or ("FRTB"), in 2016, with further revisions finalized in 2019.[103] Yet the Basel Committee has not analyzed or sought public comment on the potential cumulative impact of these standards on financial market intermediation. As one example of how the standards can overlap, a firm's derivatives activities could be simultaneously affected by the changes to the standardized counterparty risk weights, SA-CCR, the CVA framework revisions, and FRTB.

Although the Basel Committee has conducted quantitative impact studies ("QIS") on the impact of these measures on banks' overall capital levels, it has not considered the impact of these requirements on banks' financial intermediation activities, and moreover, these QIS do not consider any super equivalency that supervisors may adopt as a matter of national discretion. The FSB and the Basel Committee, as appropriate, should evaluate the cumulative impact that these regulations have on financial market activity and use that evaluation to inform how each piece of the framework may be re-calibrated.[104]

III. We urge the FSB to foster further international coordination to support preparation for the successful and cost-effective resolution of large, international banking organizations, avoid inefficiency in reform efforts, and help ensure a level playing field.

The FSB can help address the adverse effects of TBTF reforms by promoting international regulatory coordination. In particular, the current regulatory framework has enabled *ex ante* ring fencing of resources in host jurisdictions,

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102 Basel Committee on Banking Supervision, *Basel III: Finalising Post-Crisis Reforms* at 45-47 (Dec. 7, 2017).

103 Basel Committee on Banking Supervision, *Minimum Capital Requirements for Market Risk* (Jan. 14, 2019).

104 We commend the Basel Committee for beginning this effort by recalibrating the leverage ratio to serve as a backstop to risk-based capital and to align with liquidity requirements. We recommend that U.S. regulators do the same by finalizing their proposal to recalibrate the eSLR rule. *See* Financial Services Forum, Comment Letter to FRB and Office of the Comptroller of the Currency Re: Regulatory Capital Rules (June 25, 2018), https://www.fsforum.com/wp-content/uploads/2018/06/forum_eslr_comment_letter.pdf.

which creates fragmentation in the financial system and threatens the effectiveness of cross-border resolution.[105] The FSB should support the international coordination necessary to avoid this adverse result. In this regard, we commend the FSB for acknowledging this problem and beginning the process to fix it through its report on market fragmentation.[106] Similarly, we support the FSB's work to facilitate cross-border data aggregation for derivatives trades, including through the use and collection of legal entity identifiers.[107] We would be happy to engage with the FSB in its further work on these topics.

To elaborate, excessive pre-positioning of resources in host jurisdictions, due to internal TLAC requirements at the high end of the 75% to 90% range established by the FSB, is harmful to the resolution of a cross-border SIB because it reduces the amount of surplus loss-absorbing capacity held at the parent or at intermediate funding entities that can be relied upon to recapitalize material subsidiaries.[108]

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[105] *See* Katia D'Hulster & Inci Otker-Robe, *Ring-Fencing Cross-Border Banks: An Effective Supervisory Response?*, 5 J. Fin. Persp. 1, 13 (2018) ("The existence of 'trapped pools of resources' (liquidity and capital) in different jurisdictions makes the financial system, as a whole, less resilient and more fragmented. Ring fencing reduces the ability of global banking groups to mobilize resources to respond quickly to problems in particular locations. There is broad consensus that group-wide mobility of resources can help to dampen the impact of financial stability shocks and act as a stabilizer, a shock absorber or a source of systemic stability.").

[106] FSB, *Report on Market Fragmentation* at 11 (June 4, 2019) ("High levels of pre-positioning in host jurisdictions that are not commensurate with actual risks could potentially result in an insufficiency of resources that remain readily available to be deployed flexibly where needed within a group in times of stress. This problem is particularly acute if there is a lack of cooperation or trust between home and host authorities and in the absence of legally enforceable mechanisms that allow for resources held elsewhere in the group to be deployed where they are needed in stress."), https://www.fsb.org/wp-content/uploads/P040619-2.pdf.

[107] *See, e.g.,* FSB, *OTC Derivatives Market Reforms: Thirteenth Progress Report on Implementation* (Nov. 19, 2018), https://www.fsb.org/wp-content/uploads/P191118-5.pdf. *See also* Randal K. Quarles, Chair, FSB, Letter to G-20 Leaders at 4 (June 24, 2019) (recognizing the need for global adoption of legal entity identifiers).

[108] Bank Policy Institute et al., Comment Letter to FSB Re: Monitoring the Technical Implementation of the FSB TLAC Standard at 2-3 (Aug. 20, 2018) ("We believe that the imposition by GSIB host jurisdictions of internal TLAC requirements that default to the most stringent calibration contemplated by the TLAC Term Sheet increases the risk that, in an actual financial distress scenario, the formulaic distribution of internal TLAC would not match the actual distribution of losses incurred ('misallocation risk')."); The Clearing House et al., Comment Letter to FSB Re: Proposed Guiding Principles of Internal TLAC at 12 (February 17, 2017) ("This balkanization of pre-positioned assets will increase the risk that the top-tier parent will not have a sufficient amount of contributable assets to recapitalize all of its material subgroups if the distribution of internal TLAC does not match the distribution of losses in an actual financial distress scenario.").

The result is "misallocation risk," meaning the risk that there are insufficient surplus resources at the top-tier company to match the losses of material subsidiaries in an actual resolution scenario.[109] By trapping capital and liquidity in areas where it may not be needed, countries increase the chance their depositors are protected but at the expense of stability in the financial system as a whole and costs to the broader economy.[110] Super equivalent internal TLAC at the high end of the range also creates a collective action problem that commentators have extensively described[111] (*i.e.*, it increases the likelihood that other jurisdictions will likewise raise their internal TLAC requirements and otherwise encourage or require ring fencing). FSB Chair Quarles recognized this dynamic when he suggested that the FRB consider reducing its internal TLAC calibration for covered IHCs to be at the lower end of the range.[112]

We recommend that the FSB work to foster greater international coordination to avoid collective action problems that are harmful to both financial stability and economic growth, including coordination to facilitate cross-border resolutions.

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[109] *See supra* notes 105, 106, and 108; OLA Treasury Report at 22-23 (describing the problems posed by ring fencing).

[110] *See* D. Wilson Ervin, *The Risky Business of Ring Fencing* (Dec. 12, 2017) (unpublished working paper) ("In the fully ring-fenced bank…the risk of failure for each subsidiary actually ends up…4.8x higher than our baseline…[with the addition of contagion] the risk of failure could be as much as 15.1x over the baseline case."), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3085649; Greg Baer, Bank Policy Institute, *A Toxic Mix of Ring-Fencing and Tax Policy - And a Ready Antidote*, (Dec. 21, 2017) (describing inefficiencies introduced by ring fencing).

[111] Bank Policy Institute et al., Comment Letter to FSB Re: Monitoring the Technical Implementation of the FSB TLAC Standard at 9 (Aug. 20, 2018) ("If host authority A believes that other host authorities will require an excessive amount of internal TLAC, trapping any corresponding pre-positioned assets in those other host jurisdictions, host authority A will have a strong incentive to also impose internal TLAC requirements at similar excessive levels."); The Clearing House et al., Comment Letter to FSB Re: Proposed Guiding Principles of Internal TLAC at 5 (Feb. 17, 2017) (same).

[112] Randal K. Quarles, Vice Chairman for Supervision, Fed. Reserve Bd., Speech at the Harvard Law School Symposium on International Financial Systems, Trust Everyone – But Brand Your Cattle: Finding the Right Balance in Cross-Border Resolution at 9 (May 16, 2018) ("I believe we should consider whether the internal TLAC calibration for IHCs could be adjusted to reflect the practice of other regulators without adversely affecting resolvability and U.S. financial stability. The current calibration is at the top end of the scale set forth by the FSB, and willingness by the United States to reconsider its calibration may prompt other jurisdictions to do the same, which could better the prospects of successful resolution for both foreign GSIBs operating in the United States, and for U.S. GSIBs operating abroad. Alternatively, it may be possible to streamline the elements of our resolution loss absorbency regime, which include both TLAC and long-term debt requirements."), https://www.federalreserve.gov/newsevents/speech/files/quarles20180516a.pdf.

The FSB could start by strongly encouraging that the calibration of internal TLAC be at the low end of the range in the TLAC term sheet or by revisiting the standard set in that term sheet, among other TLAC standards as discussed above.

International coordination is also important to establishing a level playing field for SIBs with cross-border operations. Accordingly, the FSB should use this evaluation to take stock of how different jurisdictions have addressed the objective of eliminating TBTF. For jurisdictions such as the United States that have achieved that objective, the FSB and national authorities should focus on opportunities to streamline the existing reforms. For jurisdictions that have further work to do in addressing TBTF, the FSB should encourage those jurisdictions to complete that work. In sum, the FSB should actively support a collaborative international regulatory framework to improve efficiency and avoid a "tit-for-tat" dynamic where jurisdictions create onerous requirements that undermine the efficacy of TBTF reforms and the functioning of global financial markets.[113] Such collaboration should include support for engagement among regulatory authorities within the Crisis Management Groups that have been established for SIBs.

IV. Conclusion

The FSB should recognize the significant progress that U.S. regulators and U.S. GSIBs have made in reducing both the probability and impact of a U.S. GSIB's failure. Now that the hard work of implementing reforms to solve the TBTF problem is largely complete, we believe regulators have an opportunity to more carefully calibrate and streamline those TBTF reforms in a way that will foster growth without undermining the progress that has been made. In addition, the FSB should continue fostering international coordination to promote effective, efficient, and relatively even regulation of cross-border SIBs.

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113 Another example of a "tit-for-tat" ring fencing dynamic is the intermediate holding company requirement.

Thank you for considering these comments. Please feel free to contact the undersigned (KFromer@fsforum.com) with any questions.

Respectfully submitted,

Kevin Fromer
President and CEO
The Financial Services Forum