

## MEMORANDUM

**TO:** Public File - Notice of Public Rulemaking: Net Stable Funding Ratio: Liquidity Risk Measurement Standards and Disclosure Requirements (RIN 3064-AE44) (“NSFR NPR”)

**FROM:** Sue Dawley, Senior Attorney, Legal Division

**DATE:** September 1, 2016

**SUBJECT:** Meeting with Representatives from Securities Industry and Financial Markets Association (“SIFMA”)

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On February 11, 2015, FDIC staff, together with staff of the Board of Governors of the Federal Reserve System and the Office of the Comptroller of the Currency, met with representatives of SIFMA.

Representatives from SIFMA presented their concerns and views related to a future Net Stable Funding Ratio rulemaking action, including the impact on interdependent assets and liabilities, and presented the attached information.

The NSFR NPR was issued in the Federal Register of 81 FR 35124 (June 1, 2016).

The FDIC representatives at this meeting were:

- Kyle Hadley, Section Chief for Examination Support, Capital Markets/RMS
- Eric Schatten, Policy Analyst, Capital Markets/RMS
- Greg Feder, Counsel, Legal Division
- Sue Dawley, Senior Attorney, Legal Division

SIFMA’s representatives in attendance at the meeting were:

- Carter McDowell, SIFMA
- Keith Huebsch, Bank of America
- Manda J. D'Agata, Goldman Sachs
- Penny Novick, Morgan Stanley
- Andrew Nash, Morgan Stanley
- Gonzalo Martin, Citigroup
- Daniel J Willett, Citigroup
- Michael Pervical, JPMorgan Chase

\_\_. [10]. **Interdependent assets and liabilities.**

(a) RSF and ASF factors for Interdependent Transactions.

(1) For purposes of the calculation required by [\_\_. \_\_],<sup>1</sup> a [BANK] may assign an RSF of zero percent to any Interdependent Asset that meets the requirements of paragraphs (b) and (e) of this section.

(2) Where a [BANK] assigns an RSF of zero percent to an Interdependent Asset, the [BANK] must apply an ASF of zero percent to a corresponding Interdependent Liability that meets the requirements of paragraphs (c) and (e) of this section.

(3) If the principal amount of an asset exceeds the principal amount of the corresponding liability in an Interdependent Transaction, the amount of the Interdependent Asset is equal to the principal amount of the Interdependent Liability. Any asset amount in excess of the principal amount of the Interdependent Liability would receive an RSF in accordance with [\_\_. \_\_].<sup>2</sup>

(b) Interdependent Assets. An Interdependent Asset is an asset of the [BANK] which the [BANK] acquires or holds in an Interdependent Transaction.

(c) Interdependent Liabilities. An Interdependent Liability is a liability of the [BANK] arising in an Interdependent Transaction.

(d) Interdependent Transactions.

(1) Interdependent Transactions include the following transactions:

(i) *Derivatives market risk hedges.* A transaction, or series of transactions, in which:

(A) the [BANK] executes a derivative transaction with a counterparty;<sup>3</sup>

(B) the counterparty referred to in clause (A) provides the [BANK] with assets which the [BANK] has the practical, legal and operational ability to use to fund securities acquired or held by the [BANK] to manage market risk on the derivative transaction;

(C) the [BANK] acquires or holds securities to manage market risk on the derivative transaction;<sup>4</sup> and

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<sup>1</sup> [Note: The bracketed placeholder here is intended to cross-reference the general RSF factors.]

<sup>2</sup> [Note: The bracketed placeholder here is intended to cross-reference the general RSF factors.]

<sup>3</sup> Derivative transaction means a financial contract whose value is derived from the values of one or more underlying assets, reference rates, or indices of asset values or reference rates. Derivative contracts include interest rate derivative contracts, exchange rate derivative contracts, equity derivative contracts, commodity derivative contracts, credit derivative contracts, forward contracts, and any other instrument that poses similar counterparty credit risks. Derivative contracts also include unsettled securities, commodities, and foreign currency exchange transactions with a contractual settlement or delivery lag that is longer than the lesser of the market standard for the particular instrument or five business days. A derivative does not include any identified banking product, as that term is defined in section 402(b) of the Legal Certainty for Bank Products Act of 2000 (7 U.S.C. 27(b)), that is subject to section 403(a) of that Act (7 U.S.C. 27a(a)).

<sup>4</sup> Where a [BANK]'s asset is a security, the bank's asset counterparty is the issuer of the security.

(D) the [BANK]'s contractual arrangements with the counterparty referred to in clause (A) provide the [BANK] with the practical, legal and operational ability to establish the final price or value of the derivative transaction based on the sale price or market price of the securities acquired or held by the [BANK] to manage market risk on the derivative transaction.

(ii) *Client short facilitation.* A transaction, or series of transactions, in which:

- (A) the [BANK] executes a transaction with a counterparty to borrow a security in return for cash collateral provided by the [BANK];
- (B) the [BANK] delivers the borrowed security to, or for the account of, a different counterparty to effectuate a short sale transaction; and
- (C) the [BANK] receives or will receive cash proceeds from the counterparty referred to in clause (B) in connection with the short sale transaction.

(iii) *Client short facilitation in derivative form.* A transaction, or series of transactions, in which:

- (A) the [BANK] executes a transaction with a counterparty to borrow a security in return for cash collateral provided by the [BANK];
- (B) the [BANK] sells the borrowed security to a different counterparty to effectuate a short sale transaction on behalf of the [BANK];
- (C) the [BANK] receives or will receive cash proceeds from the counterparty referred to in clause (B) in connection with the short sale transaction; and
- (D) the [BANK] provides the economic gain or loss resulting from the short sale transaction to an unaffiliated counterparty through a derivative transaction.

(iv) *Firm short facilitation.* A transaction, or series of transactions, in which:

- (A) the [BANK] executes a transaction with a counterparty to borrow a security in return for cash collateral provided by the [BANK];
- (B) the [BANK] delivers the borrowed security to effectuate a short sale transaction or maintain a short sale position for itself; and
- (C) the [BANK] demonstrates that the transaction, or series of transactions, meet the applicable requirements set forth in paragraph (f).

(v) *Segregated client assets.* A transaction, or series of transactions, in which the [BANK] segregates client assets at a custodian in accordance with 17 C.F.R. § 240.15c3-3 (or comparable client asset segregation regimes established under foreign law), resulting in the [BANK] recognizing an asset for the amount of client segregated assets and a corresponding liability to the client.

(vi) *Client clearing transactions.* A transaction, or series of transactions, in which:<sup>5</sup>

- (A) the [BANK] receives assets from its client in connection with a derivative transaction that the client intends to have cleared with a central counterparty;<sup>6</sup>
- (B) the [BANK] deposits assets with a CCP or a designated custodian corresponding to the assets received from the client;
- (C) the [BANK] acts in a regulated capacity to facilitate the clearing of its client's cleared transaction with a CCP;<sup>7</sup> and
- (D) the [BANK] does not guarantee the performance of the CCP and has no payment obligation to the client in the event of a CCP default.

(vii) *Other qualifying transactions.* A transaction, or series of transactions, in which:

- (A) the [BANK] receives funding from a counterparty and, under applicable accounting standards, records such funding as liabilities; and
- (B) under applicable accounting standards, the [BANK] records assets that are effectively funded by the counterparty liabilities referred to in clause (A).

(2) In some cases, a [BANK] may execute a transaction with an affiliate, following which the affiliate executes a transaction with an unaffiliated counterparty. In these cases, for purposes of paragraph (d)(1) of this section, the [BANK] is deemed to have executed a transaction with the affiliate's counterparty.

(e) Operational requirements. In order to recognize certain assets and liabilities as Interdependent Assets and Interdependent Liabilities, respectively, a [BANK] must demonstrate that the Interdependent Transaction meets the applicable requirements set forth in this paragraph (e).

(1) Under applicable accounting standards, the assets and liabilities must be clearly identifiable from other assets and liabilities of the [BANK].

(2) Subject to paragraph (a)(3) of this section, the principal amount of the assets and liabilities must be the same.

(3) The maturity of the assets and liabilities must be the same, or the [BANK]'s contractual and operational arrangements must result in the functional equivalent of the assets and liabilities having the same effective maturity, unwind or sale date.

(4) The [BANK] must be acting in a pass-through unit capacity such that funding from the liabilities effectively funds the assets.

(5) The counterparty for the [BANK]'s asset must be different from the counterparty for the [BANK]'s liability, unless the counterparty is a state, local authority, or other government subdivision below the level of a sovereign (including U.S. states and municipalities).

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<sup>5</sup> Paragraph (d)(v) includes any derivative transaction cleared for a client by a [BANK] with a CCP in the [BANK]'s capacity as a clearing member or as a clearing member client.

<sup>6</sup> **Central counterparty (CCP)** means a counterparty (for example, a clearing house) that facilitates trades between counterparties in one or more financial markets by either guaranteeing trades or novating contracts.

<sup>7</sup> A [BANK] or [BANK] subsidiary acting as a registered futures commission merchant meets this requirement.

(6) The counterparty described in paragraphs (d)(1)(i)(A), (d)(1)(ii)(B) or (d)(1)(iii)(D) of this section must not be a depository institution holding company with total consolidated assets of \$50 billion or more, a nonbank financial company supervised by the Board, or a subsidiary of a company described in this paragraph.

(7) The [AGENCY] has not otherwise determined that classifying the transaction as an Interdependent Transaction would result in perverse incentives or unintended consequences.

(f) Additional operational requirements for firm short facilitation. In order to recognize certain assets and liabilities as Interdependent Assets and Interdependent Liabilities, respectively, the assets associated with Firm short facilitation must meet the requirements set forth in this paragraph (f) in addition to those established in paragraph (e).

(1) To satisfy the requirement under (e)(3) of the preceding paragraph, the maturity date of the transaction must be overnight (next business day) or open (meaning either party can provide notification of their intention to unwind the trade, where the settlement of such unwind will occur in a time frame not exceeding the standard settlement cycle for the underlying security).

(2) The intent of the series of transactions referenced in section (d)(1)(iv) is for the [BANK] to borrow a security for the purpose of effectuating or maintaining a short sale transaction for itself, rather than to provide financing or leverage for a client position. Generally speaking, this is evidenced by the market value of the securities received not exceeding the amount of cash provided to the counterparty.