

Monday, April 30, 2012

By electronic delivery; [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov)

Ms. Jennifer J. Johnson  
Secretary  
Board of Governors of the Federal Reserve System 20th Street and Constitution  
Avenue, NW  
Washington, D.C. 20551

Re: *Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies*; **Docket No. 1438 and RIN 7100-AD-86**

Dear Ms. Johnson;

The ABA Securities Association<sup>1</sup> (ABASA) is pleased to submit comments on the Notice of Proposed Rulemaking<sup>2</sup> (Proposal) published by the Board of Governors of the Federal Reserve System (Board) to implement the enhanced prudential standards and early remediation requirements of Sections 165 and 166 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).<sup>3</sup> We thank the Board for the opportunity to comment on the Proposal.

ABASA respectfully submits this comment letter to express its concern that the single counterparty credit limit (SCCL) provisions in the Proposal<sup>4</sup> have been proposed without due regard to harmonization with international approaches to counterparty credit limits. ABASA fully supports the comments and recommendations made regarding the SCCL provisions in the joint comment letter submitted April 27, 2012, by The Clearing House Association L.L.C., the American Bankers Association, the Financial Services Forum, The Financial Services Roundtable, and the Securities Industry and Financial Markets Association (Joint Trades Comment).<sup>5</sup>

ABASA supports robust enterprise-wide measurement and regulation of risk exposures and notes that its members today measure and monitor credit exposures for regulatory capital and credit risk exposures using systems developed

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<sup>1</sup> ABASA is a separately chartered affiliate of the ABA that represents those holding company members of the ABA that are actively engaged in capital markets, investment banking, and broker-dealer activities.

<sup>2</sup> Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies, 77 Fed. Reg. 594 (2012) (Proposed Jan. 5, 2012).

<sup>3</sup> Pub. L. No. 111-203, 124 Stat. 1376 (2010) codified at 12 U.S.C. 5301.

<sup>4</sup> Enhanced Prudential Standards, 77 Fed. Reg. at 649. *Subpart D - Single Counter Party Credit Limits*.

<sup>5</sup> Letter to Jennifer Johnson, Executive Secretary, Governors of the Federal Reserve Board (April 27, 2012) in response to Federal Reserve *notice of proposed rulemaking on Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies*. 77 Fed. Reg. 594 (2012).

collaboratively with their prudential regulators. The SCCL proposal, however, significantly departs from those existing systems and measures, as well as from similar regimes in other countries. As proposed, the SCCL provisions would have a significant impact on global markets, adding to the complexity facing market participants, regulators, and supervisors,<sup>6</sup> and limiting the capacity of U.S.-based financial institutions to meet the needs of their customers in a diverse global market.<sup>7</sup>

It is our understanding from the Proposal that the Basel Committee on Banking Supervision (BCBS) has established a working group to examine challenges posed by weaknesses and inconsistencies in the large exposure limit regimes across jurisdictions. The Proposal provides that “[i]f an international agreement on large exposure limits for banking firms is reached, the Board may amend [the Proposal], as necessary, to achieve consistency with the international approach.”<sup>8</sup> We appreciate that the Board is receptive to the findings of the BCBS working group but encourage the Board to await the results of the broader BCBS analysis on the SCCL before imposing a final SCCL measure on organizations operating in the United States.

There are material differences between what is proposed in the SCCL provisions of the Proposal and how exposure risk is calculated and limited in non-U.S. jurisdictions. The U.S. approach imposes substantially stricter constraints and calls for substantially different—and far less risk sensitive—calculation methodologies. The lack of SCCL harmonization will create substantial disparity between financial institutions subject to the restrictive U.S. regime and those that are not—largely because the proposed SCCL measure will dramatically overstate the risk exposures of financial institutions subject to it. Instead, the Board should propose an SCCL measure based on empirical analyses of both counterparty and systemic risk and informed by approaches taken in other jurisdictions.<sup>9</sup>

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<sup>6</sup> See, e.g., Joint comment letter submitted April 19, 2012 by International Banking Federation (of which the American Bankers Association is a founding member), Global Financial Markets Association, International Swaps and Derivatives Association (ISDA), and The Financial Services Roundtable to Timothy F. Geithner, Secretary, U.S. Treasury, and Michel Barnier, E.U. Commissioner for Internal Markets and Services, in anticipation of the 2012 G20 Financial Ministers Meeting in Washington, DC. *“Without a ‘course correction,’ U.S. and EU regulatory reform efforts have the potential to create a patchwork quilt of reforms which can only increase complexity to market participants, regulators, and supervisors, and limit the capacity of capital markets to meet clients’ needs. In addition, the ambiguity and legal uncertainty created by extraterritorial legislation has the potential to actually foster systemic risk by making it more difficult for regulators to monitor and capture activity in financial markets.”*

<sup>7</sup> Potentially, the SCCL proposal would also negatively affect non-U.S. financial institutions by restricting the ability of financial institutions subject to the SCCL proposal to transact with major non-U.S. counterparties. As a result, non-U.S. financial institutions will have less access to liquidity because the absolute capacity of financial institutions subject to the SCCL proposal to provide global liquidity will be artificially restricted.

<sup>8</sup> Enhanced Prudential Standards, 77 Fed. Reg. at 613.

<sup>9</sup> While we understand the Federal Reserve has an interest in ensuring U.S. institutions are appropriately supervised, given the international activities of the systemically significant institutions, it

We note that, if the Board accommodates the recommendations made with respect to the SCCL provisions of the Proposal in the Joint Trades Comment, the goal of harmonization with international approaches would largely be met, consistent with the statutory mandate of Dodd-Frank.<sup>10</sup> Set forth below are specific instances where the SCCL provisions of the Proposal depart from the approach of other countries, even those that are undertaking some similar reforms following the recent financial crisis.

- **10% limit on major counterparties.** We are not aware of any other major international financial jurisdiction that imposes such a restrictive limit. The United Kingdom (UK)<sup>11</sup> and European Union (EU)<sup>12</sup> have less stringent large exposure regimes and none is lower than 25% of capital. Moreover, the EU permits a soft limit for trading book counterparties of the subject institution.<sup>13</sup>
- **Use of the current exposure method (CEM).** CEM overstates risk by multiples compared to more risk-sensitive model-based methods. The UK<sup>14</sup> and EU<sup>15</sup> regimes permit use of model-based methods.
- **Substitution for guarantees and credit default swap protection purchased.** The Proposal mandates for purposes of the SCCL that exposure must be shifted to guarantors and credit protection providers, using notional amounts. The Proposal is inconsistent with comparable international regimes. Under the UK and EU rules, substitution for guarantees/protection providers is optional,<sup>16</sup> although it must be applied consistently.
- **Treatment of Central Counter Parties.** The Proposal currently includes central counterparties (CCPs) as counterparties. The UK<sup>17</sup> and EU<sup>18</sup> large exposure regimes exclude CCPs (subject to certain exceptions).

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is logical that the Federal Reserve also consider accepted global practices in refining the risk regime for U.S. institutions.

<sup>10</sup> Similarly, adopting the SCCL recommendations of the Joint Trades Comment would be consistent with the statutory direction to the Board to give “due regard to the principle of national treatment and equality of competitive opportunity.” 12 U.S.C. 5365(b)(2)(A).

<sup>11</sup> *Prudential Sourcebook for Banks, Building Societies and Investment Firms (BIPRU)*. Financial Services Authority (April 2012) 10.10A2.

<sup>12</sup> EUR. COM. DOC. (COM 2011) 452 def, art. 384, *Large Exposures Limit*. The European Commission’s CRR/CRD IV proposals, informally referred to as the Capital Requirements Regulation (CRR), and the Capital Requirements Directive (CRD), set out prudential requirements which are expected to be applicable as of 1 January 2013.

<sup>13</sup> EUR. COM. DOC. (COM 2011) 452 def at art 384(4).

<sup>14</sup> BIPRU at 10.2.6 & 7.

<sup>15</sup> EUR. COM. DOC. (COM 2011) 452 def, art 397, *Criteria for Credit Granting*.

<sup>16</sup> *Id.* at art. 390

<sup>17</sup> BIPRU 13.8.7, 8; BIPRU at 10.2.3A.

<sup>18</sup> EUR. COM. DOC. (COM 2011) 452 def, art 389 (1)(i).

- **Treatment of non-U.S. sovereigns.** For purposes of the SCCL, while all sovereigns, including the United States are considered counterparties, only the United States and its agencies are exempt from the Proposal's limits on credit exposure.<sup>19</sup> The EU<sup>20</sup> and UK<sup>21</sup> large exposure regimes allow exemptions for sovereigns that receive 0% risk weights under the Basel capital rules.

Given the significant impact that the SCCL provisions would have on covered companies, the lack of harmonization with international approaches threatens to create an uneven playing field between those banking organizations that operate in the United States and those that do not. The SCCL provisions must be informed by established approaches in other jurisdictions in which U.S. banking organizations (U.S. based and non-U.S. based) operate. The G20 Summit in November 2008, recognizing the global character of Group members' financial markets, called for strengthening international standards where necessary, a principle that ABASA's members support, but emphasized that this should be done in the context of "intensified international cooperation among regulators and . . . consistent implementation" in order to avoid significant regulatory divergence among major financial centers, regulatory burden, and the resultant regulatory arbitrage.<sup>22</sup>

We urge the Board to adopt the recommendations made with respect to the SCCL provisions of the Proposal in the Joint Trades Comment and consider the findings of the BCBS working group prior to implementing final SCCL regulations.

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If you have any questions or need further information, please contact me at 202-663-5325 or [ccalaby@aba.com](mailto:ccalaby@aba.com).

Sincerely,



Cecelia Calaby  
Executive Director and General Counsel  
ABA Securities Association

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<sup>19</sup> Enhanced Prudential Standards, 77 Fed. Reg. at 654, § 252.97(a)(1).

<sup>20</sup> EUR. COM. DOC. (COM 2011) 452 def at art. 389 (1)(a).

<sup>21</sup> BIPRU at 10.6.3.

<sup>22</sup> Declaration of the Summit on Financial Markets and the World Economy, Paragraph 8 (November 15, 2008).