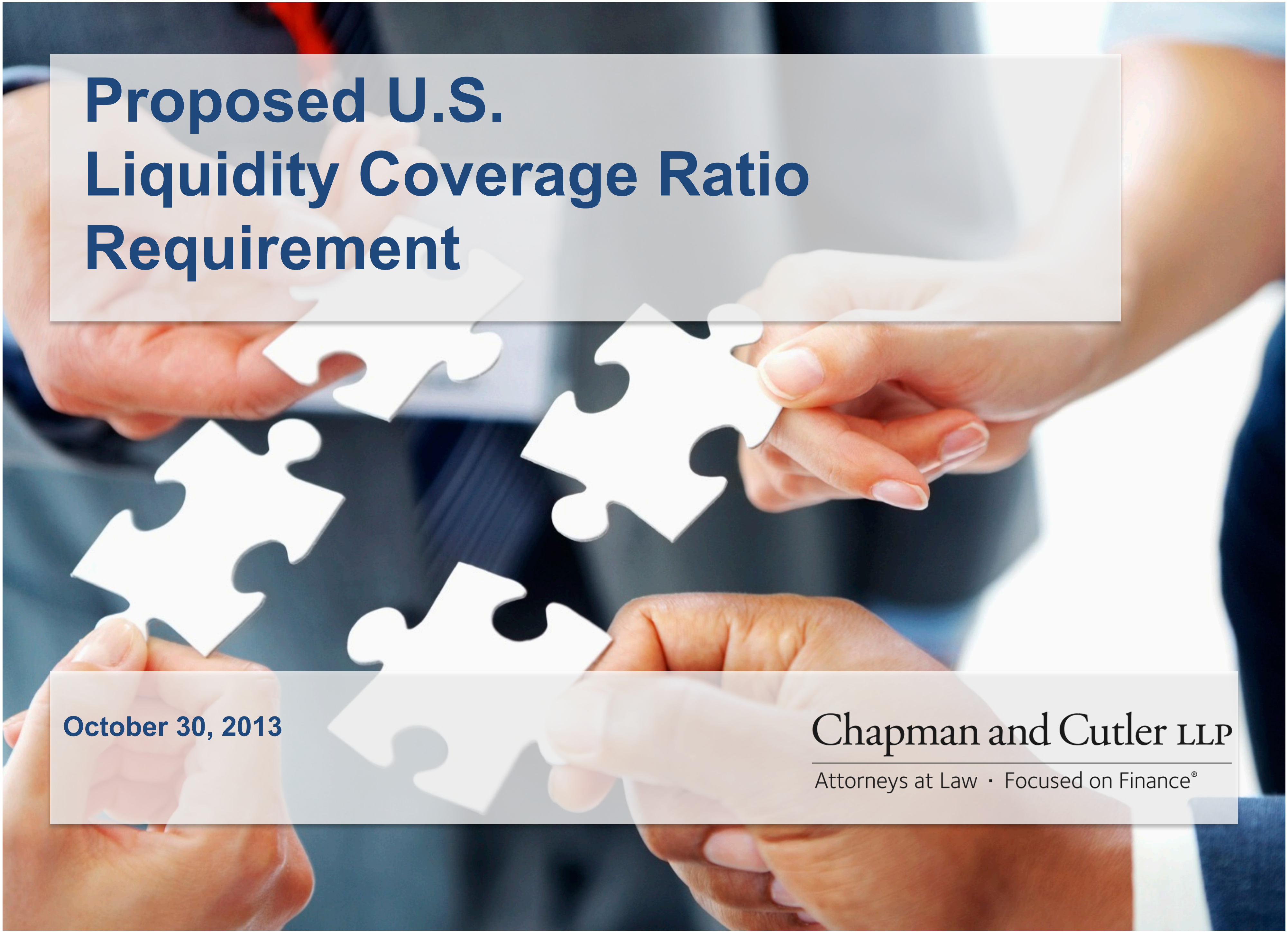
Proposed U.S. Liquidity Coverage Ratio Requirement



October 30, 2013

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Introduction

- On October 24, 2013, the Board of Governors of the Federal Reserve Board (the **Board**) released a Notice of Proposed Rulemaking (**NPR**) that proposes regulations introducing a liquidity coverage ratio (**LCR**) requirement that will test a bank's ability to withstand "liquidity stress periods" (the **Proposed Rule**). On October 30, 2013, the Federal Deposit Insurance Corporation (**FDIC**) and the Office of the Comptroller of the Currency (**OCC**) also released the NPR. We refer to the Board, the FDIC and the OCC, collectively, as the **Agencies**.
- Currently, U.S. bank regulators evaluate a bank's methods for measuring, monitoring and managing liquidity risk on a case-by-case basis in conjunction with their supervisory process. The Proposed Rule sets forth a quantitative liquidity standard designed to establish a more formal and rigorous supervisory and regulatory framework for addressing short-term liquidity risks.
- Comments to this proposal are due by **January 31, 2014**.

Relationship to Final Basel LCR

- The Basel Committee on Banking Supervision (**BCBS**) initially published international liquidity standards in December 2010 as part of the Basel III reform package and revised the LCR in January 2013 (the **Final Basel LCR**).
- For covered companies (as defined on Slide 8), the Proposed Rule implements the LCR requirement in a manner mostly consistent with the Final Basel LCR, with some modifications to reflect the characteristics and risks of specific aspects of the U.S. market and U.S. regulatory framework. However, the Proposed Rule is more stringent than the Final Basel LCR in several important areas.
- For modified LCR companies (also as defined on Slide 8), a separate rule proposal by the Board incorporates a modified version of the LCR.
- A summary of the key differences between the Proposed Rule and the Final Basel LCR is included on Slides 4-7.

Key Differences from Final Basel LCR

Shorter Compliance Period	• Under the Proposed Rule, covered companies will be required to fully comply with the LCR test by 1/1/17, with 80% compliance required by 1/1/15 and 90% compliance required by 1/1/16.
Test Against Peak Net Outflow Day	• The Proposed Rule requires covered companies (but not modified LCR companies) to hold HQLA against their largest net cumulative cash outflow day within a 30-day liquidity stress period. • The Proposed Rule requires covered companies to assume that **outflows occur on the *earliest* possible date** and that **inflows occur on the *latest* possible date** during the 30-day test period. This difference from the Final Basel LCR may lead to much higher net outflow calculations and greater HQLA requirements for covered companies.

Key Differences from Final Basel LCR *(Continued)*

More Stringent Definition of High Quality Liquid Assets

- Level 2A Liquid Assets excludes municipal general obligation securities and high investment grade corporate debt.
- RMBS does not qualify as HQLA under the Proposed Rule. The Final Basel LCR includes RMBS as a Level 2B Liquid Asset with a 25% haircut.
- Perhaps inadvertently, cash and coins have been omitted from Level 1 Liquid Assets to the extent not included in required reserves.

21-Day Liquidity Stress Scenario for Modified LCR Companies

- A separate rule proposal by the Board applies a modified LCR requirement to depository institution holding companies with total consolidated assets of $50 billion or more that are not internationally active.
- The proposed Modified LCR Rule uses a 21-day rather than a 30-day liquidity stress scenario and does not require calculation of total net cash outflows based on a peak cumulative outflow day.

Key Differences from Final Basel LCR *(Continued)*

Collateral Posting Requirement

- The Proposed Rule requires that 100% of additional collateral that a covered company might be required to post as a result of any change in its financial condition must be included as outflow amounts. By contrast, under the Final Basel LCR, a covered company would only be required to include such amounts as would result from a three notch downgrade of a credit rating.

Adjustment for Greater of Adjusted vs. Unadjusted Excess HQLA Amount

- In calculating the HQLA Amount, the Proposed Rule requires that the sum of Level 1, Level 2A and Level 2B Liquid Assets be adjusted by the ***greater*** of (a) **Unadjusted Excess HQLA Amount** (the amount of HQLA that exceeds the Level 2 caps on the 1st day of the calculation period) and (b) **Adjusted Excess HQLA Amount** (the amount of HQLA that exceeds the Level 2 caps at the end of a 30-day stress period, after assuming the unwinding certain transactions). The final Basel LCR only deducts adjusted excess HQLA from Level 1, Level 2 and Level 3 Liquid Assets in calculating the HQLA Amount.

Key Differences from Final Basel LCR *(Continued)*

Treatment of Borrowings from Federal Reserve Banks

- The Proposed Rule treats borrowings from Federal Reserve Banks the same as other secured borrowings. As a result only Federal Reserve Bank borrowings secured by HQLA have an outflow assumption of less than 100%. By contrast, the Final Basel LCR provided a 0% outflow assumption for all secured borrowings from central banks.

Companies Subject to the Proposed Rule

Covered Companies Subject to Unmodified LCR

- Banking organizations with $250 billion or more in total assets
- Banking organizations with $10 billion or more in on-balance sheet foreign exposures
- Nonbanks that are designated as systemically important by the Financial Stability Oversight Council (covered nonbank companies)
- Consolidated subsidiary depository institutions of these institutions with $10 billion or more in consolidated total assets

Modified LCR Companies Subject to Modified LCR Rule

- The modified version of the LCR would apply to depository institution holding companies with total consolidated assets of $50 billion or more that are not internationally active.

Companies *Not* Subject to the Proposed Rule

- Institutions that have opted in to advanced approaches risk-based capital rules (except that such institutions that are bank holding companies may be subject to the Modified LCR Rule)
- Bridge depository institutions, bridge financial companies or subsidiaries of bridge financial companies that are subject to FDIC receivership or conservatorship
- New depository institutions

Compliance Requirements

LCR Compliance Timing and Percentages

Compliance Date	1/1/2015	1/1/2016	1/1/2017
Required LCR	80%	90%	100%

Computation of LCR

LCR Formula

- The Proposed Rule provides that a covered company would calculate its LCR by dividing the amount (minus applicable haircuts) of its high quality liquid assets (**HQLA**) by total net cash outflows, which would equal the **highest daily amount** of cumulative net cash outflows within the 30 days following a calculation date (**30-day stress period**).

Calculation Date

- The Proposed Rule would require a covered company to calculate its LCR on **each business day** as of a set time selected by the covered company prior to the effective date of the final rule and communicated in writing to its primary federal supervisor.

Computation of LCR *(Continued)*

Liquid assets held for operational liquidity needs that are unencumbered and otherwise unrestricted

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Greater of:
(i) unadjusted excess HQLA amount; and
(ii) adjusted excess HQLA amount

High Quality Liquid Assets

≥ 100%

Outflows from:
•Deposits (retail and wholesale)
•Other unsecured funding (retail and wholesale)
•Sponsored structured transactions
•Derivatives
•Commitments
•Collateral outflows
•Debt security outflows
•Secured funding and asset exchange outflows
•Other outflows
(At assumed outflow rates)

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Inflows (capped at 75% of Outflows) from:
•Net derivatives
•Retail and unsecured wholesale cash inflows
•Securities and securities lending cash inflows
•Secured lending and asset exchange inflows
(At assumed inflow rates)

Total Net Cash Outflows

Determined based on **highest daily amount** of cumulative net cash outflows within 30-day stress period

The Numerator: High Quality Liquid Assets

- The Proposed Rule's criteria and limitations surrounding HQLA are meant to ensure that a covered company's **HQLA amount only includes assets with a high potential to generate liquidity** through a sale or secured borrowing during a stress scenario.
- A covered company would include assets in each HQLA category as of a calculation date, irrespective of the asset's residual maturity (*i.e.*, no difference between long-term and short-term securities).
- For purposes of calculating a covered company's HQLA amount, the value of Level 1, Level 2A and Level 2B Liquid Assets would be equal to the **fair value** of the assets as determined under U.S. GAAP, multiplied by the appropriate haircut factor.

The Numerator:
Calculation of HQLA Amount

[Level 1 Liquid Asset Amount + Level 2A Liquid Asset Amount (after applying 15% haircut) + Level 2B Liquid Asset Amount (after applying 50% haircut)] −

Greater of:

(a) Unadjusted Excess HQLA Amount; and

(b) Adjusted Excess HQLA Amount

The Numerator:
Types of HQLAs

Type of Liquid Asset	Description	Haircut	Cap
Level 1	Highest quality and most liquid assets	N/A	N/A
Level 2A	Relative price stability with significant liquidity	15%	When combined with Level 2B Liquid Assets, can't exceed 40% of total HQLA
Level 2B	More price volatility and less liquidity	50%	Can't exceed 15% of total HQLA

The Numerator:
Level 1 Liquid Assets

- Withdrawable Federal Reserve Bank balances
- Foreign withdrawable reserves
- Securities issued or unconditionally guaranteed as to the timely payment of principal and interest by the U.S. Department of the Treasury
- Liquid and readily-marketable securities issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, any other U.S. government agency (provided that its obligations are fully and explicitly guaranteed by the full faith and credit of the United States government)
- Foreign sovereign and multilateral organizations with a 0% risk weighting under the Basel standardized approach

The Numerator:
Level 2A Liquid Assets

- **GSE Securities:** A security issued by, or guaranteed as to the timely payment of principal and interest by, a U.S. government-sponsored enterprise (GSE) that is (1) investment grade consistent with the OCC's investment regulation as of the calculation date and (2) senior to preferred stock.
- **Securities Issued By, or Guaranteed By, Sovereign Entity or Multilateral Development Banks that have a 20% Risk Weighting under the Basel Standardized Approach**

The Numerator:
Level 2B Liquid Assets

Publicly Traded Corporate Debt Security that, among other things**:**

- Meets the definition of "investment grade" under the OCC's investment regulation as of a calculation date
- Issued by an entity whose obligations have a proven record as a reliable source of liquidity in repurchase or sales markets during stressed market conditions, demonstrated by the fact that, during a 30-day period of significant stress, the security (or equivalent securities of the issuer):
  - Market price declined by no more than 20%
  - Market haircut demanded by counterparties to secured lending and secured funding transactions increased by no more than 20%
- Not an obligation of a regulated financial company, investment company, non-regulated fund, pension fund, investment advisor, identified company *(i.e.,* any company the relevant Agency determines should be treated the same as the foregoing) or any consolidated subsidiary of the foregoing

The Numerator:
Level 2B Liquid Assets *(Continued)*

Publicly Traded Common Equity Share that, among other things:

- Included in the S&P 500, an equally liquid U.S. index or an index recognized for Level 2A assets in a non-U.S. jurisdiction
- Issued in U.S. dollars (or the currency of a jurisdiction where the covered company operates and the stock offsets its net cash outflows in that jurisdiction)
- Issued by an entity whose common stock has a proven record as a reliable source of liquidity in the repurchase or sales markets during stressed market conditions, demonstrated by the fact that, during a 30-day period of significant stress, the security (or equivalent securities of the issuer):
  - Market price declined by no more than 40%
  - Market haircut demanded by counterparties to secured lending and secured funding transactions increased by no more than 40%
- Not issued by a regulated financial company, investment company, non-regulated fund, pension fund, investment advisor, identified company company *(i.e.,* any company the relevant Agency determines should be treated the same as the foregoing) or any consolidated subsidiary of the foregoing

The Numerator: Operational Requirements of HQLA

Operational capability to monetize HQLA

- Implement and maintain appropriate procedures and systems to monetize the asset at any time in accordance with relevant standard settlement periods and procedures
- Periodically monetize a sample of HQLA that reasonably reflects the composition of the covered company's total HQLA portfolio

Control of HQLA by management function charged with managing liquidity risk

Account for termination of any specific transaction hedging HQLA

Policies and procedures for daily assessment of HQLA

- Identify HQLA by legal entity, geographical location, currency, custodial or bank account, and other relevant identifying factors
- Determine that the assets continue to qualify as HQLA
- Ensure that the HQLA are appropriately diversified
- Evaluate whether HQLA held in foreign jurisdictions is appropriate with respect to net cash outflows in foreign jurisdictions

The Numerator:
Additional Liquidity Requirements for HQLA

Unencumbered

- Free of legal, regulatory, contractual or other restrictions on ability to monetize
- Not pledged, explicitly or implicitly, to secure or provide credit enhancement to any transaction (except that asset could be pledged to a central bank or a U.S. GSE to secure potential borrowings if credit secured by the asset has not been extended to the covered company or its consolidated subsidiaries)

Not a client pool security- or cash received from a repurchase agreement on a client pool security - held in a segregated account

Not an asset received under a rehypothecation right where the beneficial owner has a contractual right to withdraw the asset without remuneration at any time during a 30-day stress period

Not an asset specifically designated to cover operational costs (such as wages or facility maintenance)

The Numerator: Adjustments for Excess HQLA Amount

The Agencies believe that the proposed Level 2 caps and haircuts should be applied to a covered company's HQLA both before and after certain transactions are unwound, such as transactions where HQLA will be exchanged for HQLA within the next 30 days, in order to ensure that the HQLA portfolio is appropriately diversified.

The Numerator:
Adjustments for Excess HQLA Amount *(Continued)*

Unadjusted Excess HQLA Amount	▪ The amount of HQLA that exceeds the Level 2 caps on the first day of a calculation period
Adjusted Excess HQLA Amount	▪ The amount of HQLA that exceeds the Level 2 caps at the end of a 30-day stress period after unwinding certain transactions ▪ To determine adjusted excess HQLA amount, a covered company must assume the unwinding of all secured funding transactions, secured lending transactions, asset exchanges and collateralized derivates transactions that mature within a 30-day stress period where HQLA is exchanged for other HQLA in the next 30 days.

The Denominator: Total Net Cash Outflow

- The Proposed Rule would require a covered company to **calculate its total stressed net cash outflow amount for each of the 30 days following the calculation date**, thereby establishing the dollar value that must be offset by the HQLA amount.
- The total net cash outflow amount would be the highest dollar amount of net cumulative cash outflows calculated for any day during the 30-day stress period.
- To do this, a covered company will be required to calculate its total cumulative stressed net cash outflows occurring on each of the 30 days following the calculation date.
- The total net cash outflow amount for each day within the 30-day test period would be (a) the sum of the cumulative stressed outflow amounts *less* (b) the sum of the cumulative stressed inflow amounts through such day. Cumulative stressed inflow amounts are limited to **75%** of cumulative stressed outflow amounts.

The Denominator:
Outflow Amounts

- All outflows from contractual obligations are taken into account in determining the LCR.
- 100% of any contractual outflows that are not specifically described in the Proposed Rule are included in outflow amounts for purpose of the LCR denominator.
- Specified outflow amounts are assumed to occur during each liquidity stress period at rates between 0 and 100% as set forth in the Proposed Rule. Specified categories of outflow amounts include the following:

▪ Unsecured retail funding outflows	▪ Brokered deposit outflows
▪ Outflows from sponsored structured finance transactions	▪ Unsecured funding outflows
▪ Net derivative cash outflows	▪ Debt security outflows
▪ Mortgage commitment outflows	▪ Secured funding outflows
▪ Credit and liquidity commitment outflows	▪ Asset exchange outflows
▪ Collateral outflows	▪ Foreign central bank outflows

The Denominator: Structured Transaction Outflow Amount

The Proposed Rule's structured transaction outflow amount would capture obligations and exposures associated with structured transactions sponsored by a covered company, without regard to whether the structured transaction vehicle that is the issuing entity is consolidated on the covered company's balance sheet.

The outflow amount for each of a covered company's sponsored structured transactions would be the greater of:	
(a)	100% of the amount of all debt obligations of the issuing entity that mature 30 days or less from the calculation date and all commitments made by the issuing entity to purchase assets within 30 days or less from the calculation date; and
(b)	the maximum contractual amount of funding the covered company may be required to provide to the issuing entity 30 days or less from such calculation date through a liquidity facility, a return or repurchase of assets from the issuing entity, or other funding agreement.

The Denominator: Commitment Outflow Amount

The Proposed Rule's commitment outflow amount would capture the undrawn portion of committed credit and liquidity facilities provided by a covered company to its customers and counterparties that can be drawn down within 30 days of the calculation date.

Term	Definition
Liquidity Facility	a legally binding agreement to extend funds at a future date to a counterparty that is made expressly for the purpose of refinancing the debt of the counterparty when it is unable to obtain a primary or anticipated source of funding (*e.g.*, liquidity support to ABCP)
Credit Facility	any other legally binding agreement to extend funds if requested at a future date (*e.g.*, revolving credit facility for general corporate or working capital purposes)
Committed	the terms governing the facility prohibit a covered company from refusing to extend credit or funding under the facility (except where certain conditions by the terms of the facility have been met)
Mixed Use Facilities	Facilities that have aspects of both credit and liquidity facilities constitute liquidity facilities for these purposes

The Denominator:
Commitment Outflow Amount - Assumed Drawdown Percentage

Commitment Type	Assumed Drawdown Percentage of Unfunded Amounts
Committed credit facilities to non-financial corporates	10%
Committed liquidity facilities to non-financial corporates	30%
Committed credit and liquidity facilities to depository institutions, depository institution holding companies and foreign banks (other than commitments to affiliated depository institutions, which are 0%)	50%
Committed credit facilities to non-bank financial institutions	40%
Committed liquidity facilities to non-bank financial institutions	100%
Committed credit and liquidity facilities to SPVs	100%

The Denominator: Commitment Outflow Amount – Determining the Undrawn Amount of the Commitment

For committed credit facilities, the undrawn amount is:

- the amount of the facility that could be drawn on within 30 days of the calculation date, *less*
- the fair value of Level 1 Liquid Assets and 85% of the fair value of Level 2A Liquid Assets that are not included in the covered company's HQLA securing the facility.

For committed liquidity facilities, the undrawn amount is:

- the entire undrawn amount of the facility that could be drawn on within 30 days of the calculation date, *less*
- the sum of:

  (i) the fair value of Level 1 Liquid Assets and 85% of the fair value of Level 2A Liquid Assets that are not included in the covered company's HQLA securing the portion of the facility that could be drawn on within 30 days of the calculation date, and

  (ii) the portion of the facility that supports obligations of the covered company's customer that do not mature 30 days or less from the calculation date.

The Denominator: Other Noteworthy Issues Regarding Outflow Amounts

- 100% of additional collateral that a covered company might be required to post as a result of a change in its financial condition must be included as outflow amounts. Under the Final Basel LCR, covered companies would only be required to include such amounts as would result from a three notch downgrade of a credit rating.
- The assumed outflow percentages for several categories of obligations are higher than the assumed outflow percentages for these same obligations in the Final Basel LCR. For example, undrawn commitment amounts under committed credit and liquidity facilities extended by covered companies to depository institutions are assigned a 50% assumed outflow rate under the Proposed Rule as opposed to a 40% assumed outflow rate under the Final Basel LCR.

  The Proposed Rule also creates categories of outflow amounts (*e.g.*, brokered deposits and mortgage commitment outflows) that were not specified in the Final Basel LCR.
- Obligations owed by a covered company to its consolidated subsidiaries or between consolidated subsidiaries are excluded from outflow amounts.

The Denominator: Total Cash Inflow Amount

The total cash inflow amount would be limited to the lesser of:

(1) the sum of cash inflow amounts; and

(2) 75% of expected cash outflows.

The total cash inflow amount would be calculated by multiplying the outstanding balances of contractual receivables and other cash inflows as of a calculation date by the inflow rates set forth in the Proposed Rule.

The Denominator: Categories *Excluded* from Inflow Amounts

Certain categories of inflows are specifically excluded from inflow amounts for purposes of calculating the denominator of the LCR under the Proposed Rule, including:

- Amounts the covered company holds in operational deposits at other regulated financial companies
- Amounts the covered company expects, or is contractually entitled to receive, 30 days or less from the calculation date due to forward sales of mortgage loans and any derivatives that are mortgage commitments
- The amount of any credit or liquidity facilities extended to the covered company
- The amount of any asset included in the covered company's HQLA amount and any amounts payable to the covered company with respect to those assets
- Any amounts payable to the covered company from an obligation of a customer or counterparty that is a nonperforming asset as of the calculation date or that the covered company has reason to expect will become a nonperforming exposure 30 days or less from the calculation date
- Amounts payable to the covered company on any exposure that has no contractual maturity date or that matures after 30 days of the calculation date

Amounts owed to a covered company by its consolidated subsidiaries or between consolidated subsidiaries are also excluded from inflow amounts.

The Denominator: Categories *Included* in Inflow Amounts

- Cash inflows not specifically described in the Proposed Rule do not constitute inflow amounts for purposes of calculating the denominator of the LCR under the Proposed Rule.
- Specific categories of inflow amounts are assigned inflow percentages between 0 and 100% and include the following:

▪ Net derivative cash inflows
▪ Cash inflows from retail customers and counterparties
▪ Cash inflows on unsecured wholesale obligations
▪ Contractual payments due on securities that are not HQLA
▪ Secured lending cash inflows
▪ Asset exchange cash inflows

Modified LCR Rule

The Board proposes to tailor the Proposed Rule's LCR requirement as applied to modified LCR companies pursuant to its authority under Section 165 of Dodd-Frank.

While the Board believes that it is important for all bank holding companies subject to Section 165 to be subject to quantitative liquidity standards, it recognizes that to the extent that these companies are not covered companies they are not likely to have as great a systemic impact.

The Modified LCR Rule is a simpler and less stringent form of the Proposed Rule's LCR.

Key Differences from Unmodified LCR:
▪ Outflow rates based on a 21-day (rather than a 30-day) stress scenario
▪ No requirement to calculate a peak maximum cumulative outflow day for total net cash outflows. LCR denominator is based on total net outflows for the relevant stress periods.
▪ 30% haircut for outflows with no contractual maturity date

Consequences of Failure to Maintain Required LCR

The Proposed Rule establishes a framework for a flexible supervisory response when a covered company's LCR falls below the required LCR level (**LCR shortfall**).

- A covered company would be required to notify its primary federal supervisor **on any business day** that it has a LCR shortfall.
- If the LCR shortfall persists for **3 consecutive business days** or if the relevant supervisor has determined that the covered company is otherwise materially noncompliant with the rule, the covered company would be required to submit to its primary federal supervisor a plan for remediation of the shortfall.

Under this flexible supervisory response framework, a LCR shortfall would not necessarily result in supervisory action but is likely to result in heightened supervisory monitoring.

The same consequences would apply to a modified LCR company that fails to maintain its required LCR level.

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