U.S. Basel III Liquidity Coverage Ratio Proposal

Visual Memorandum

October 30, 2013

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Davis Polk & Wardwell LLP

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Overview of U.S. Liquidity Coverage Ratio Proposal

- The Federal Reserve, OCC and FDIC have issued a proposal to implement the Basel III liquidity coverage ratio (LCR) in the United States.
- Part of the Basel III liquidity framework, the LCR requires a banking organization to maintain a minimum amount of liquid assets to withstand a 30-day standardized supervisory liquidity stress scenario.
- The U.S. LCR proposal is more stringent than the Basel Committee's LCR framework in several significant respects.
- The U.S. LCR proposal contains two versions of the LCR:
  - A **full version** for large, internationally active banking organizations.
  - A **modified, "light" version** for other large bank holding companies and savings and loan holding companies (depository institution holding companies).
- The proposed effective date is **January 1, 2015**, subject to a two-year phase-in period.
- The comment period for the proposal ends on January 31, 2014.

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Which Organizations Are Affected?

Subject to full version of LCR	Subject to LCR "Light"	Not subject to U.S. LCR proposal

▪ **Advanced approaches banking organization:** A U.S. banking organization with ≥ $250 billion in total consolidated assets or ≥ $10 billion in on-balance sheet foreign exposure*
▪ An advanced approaches banking organization's consolidated U.S. depository institution subsidiary that has ≥ $10 billion in total consolidated assets
▪ **Nonbank SIFI:** A nonbank financial company designated as systemically important by the Financial Stability Oversight Council that is **not** substantially engaged in insurance underwriting activities
▪ A nonbank SIFI's consolidated U.S. depository institution subsidiary that has ≥ $10 billion in total consolidated assets
▪ Any other banking organization that becomes subject to the U.S. LCR framework because its primary federal banking regulator determines it is appropriate based on the banking organization's size, level of complexity, risk profile, scope of operations, U.S. or non-U.S. affiliations or risk to the financial system
	▪ Depository institution holding companies with ≥ $50 billion in total consolidated assets that are **not:**
	  ▪ Grandfathered unitary savings and loan holding companies (SLHCs) deriving ≥ 50% of total assets or total revenues from activities not financial in nature;
	  ▪ Insurance underwriting companies; or
	  ▪ Holding ≥ 25% of total assets (other than credit risk insurance assets) in insurance underwriting subsidiaries.
	▪ U.S. LCR proposal would not apply to U.S. depository institution subsidiaries of the above-mentioned depository institution holding companies
		▪ A U.S. bank holding company (BHC) or SLHC with < $50 billion in total consolidated assets
		▪ A U.S. depository institution that is **not** an advanced approaches banking organization or a ≥ $10 billion consolidated subsidiary thereof
		▪ A U.S. depository institution that is **not** a ≥ $10 billion consolidated subsidiary of a nonbank SIFI
		▪ A banking organization that does not cross the applicability threshold but has opted into the U.S. advanced approaches capital rules
		▪ A bridge financial company, a subsidiary of a bridge financial company, a new depository institution or a bridge depository institution, as those terms are used in the resolution context

* The U.S. advanced approaches capital rules contain the same applicability thresholds.

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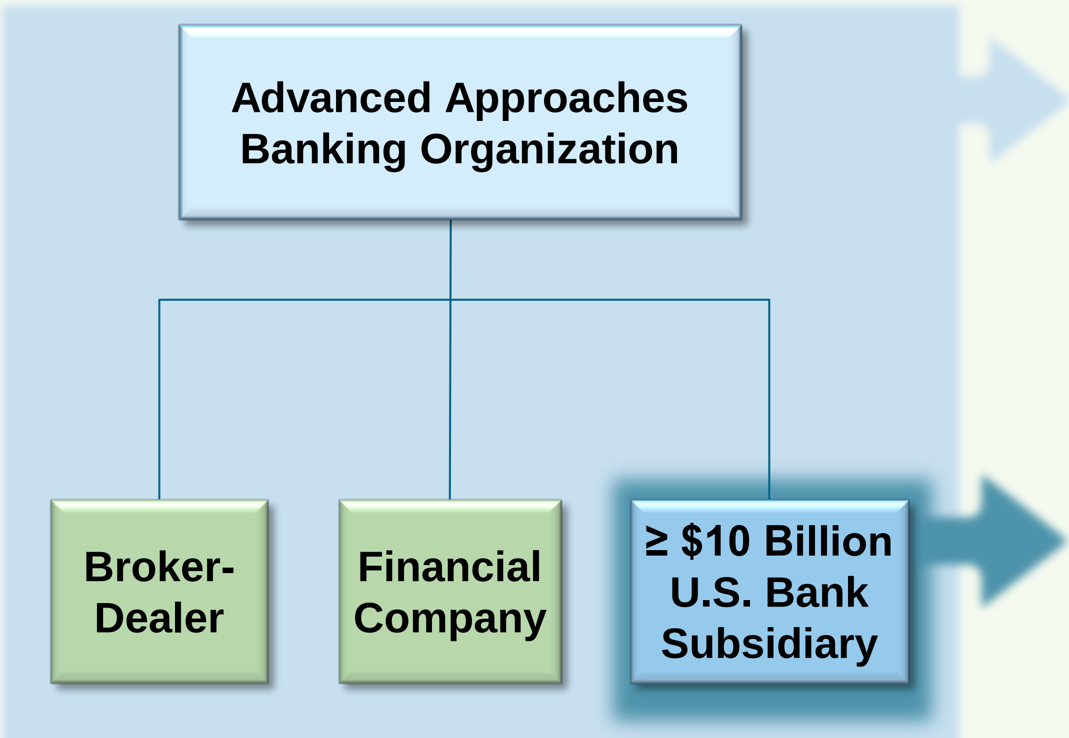
Which Organizations Are Affected?
Advanced Approaches Banking Organization

- Both an advanced approaches banking organization and its ≥ $10 billion consolidated U.S. bank subsidiary would be subject to the full version of the LCR.

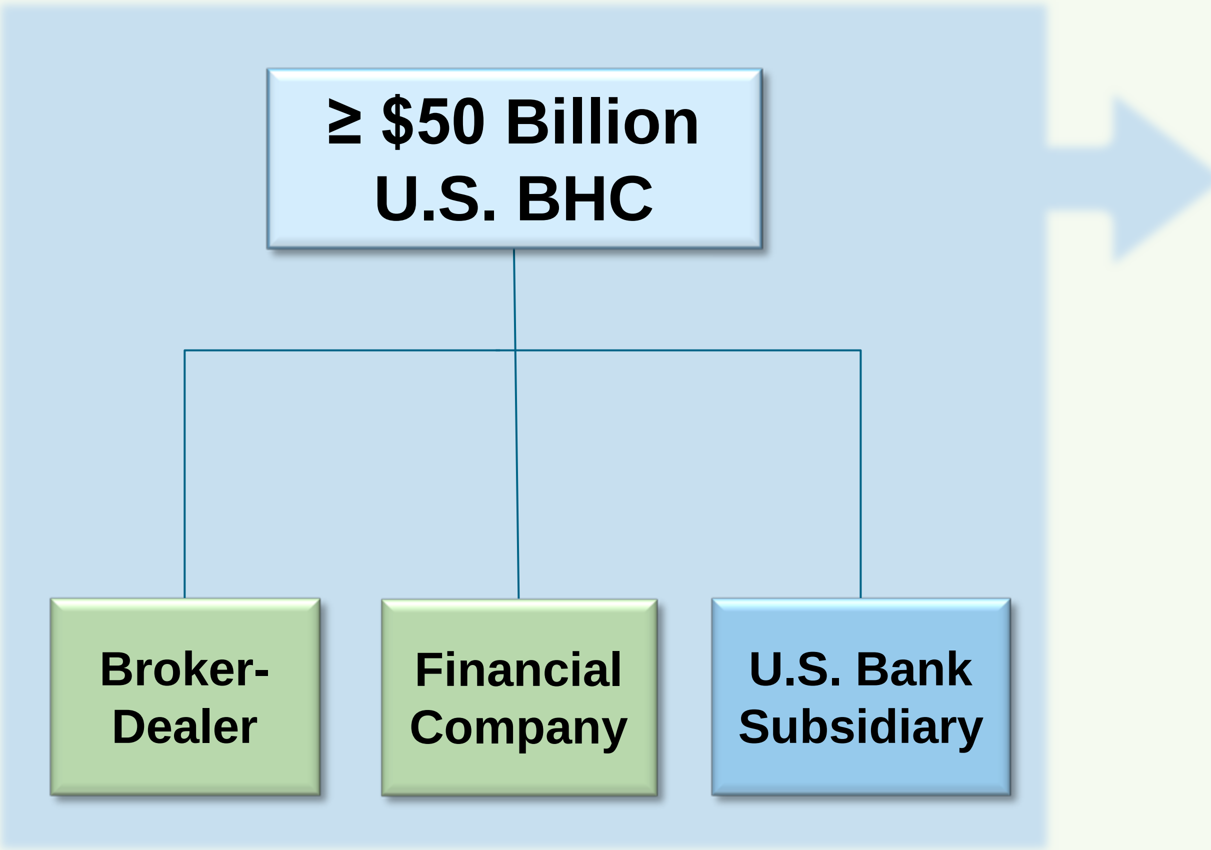


An advanced approaches banking organization would be subject to the LCR on a **consolidated basis**

Each ≥ $10 billion U.S. bank subsidiary of an advanced approaches banking organization would be subject to the LCR on a **consolidated basis**

Which Organizations Are Affected?

≥ $50 Billion U.S. BHC



A ≥ $50 billion U.S. BHC that is **not** an advanced approaches banking organization would be subject to LCR “light” on a **consolidated basis**

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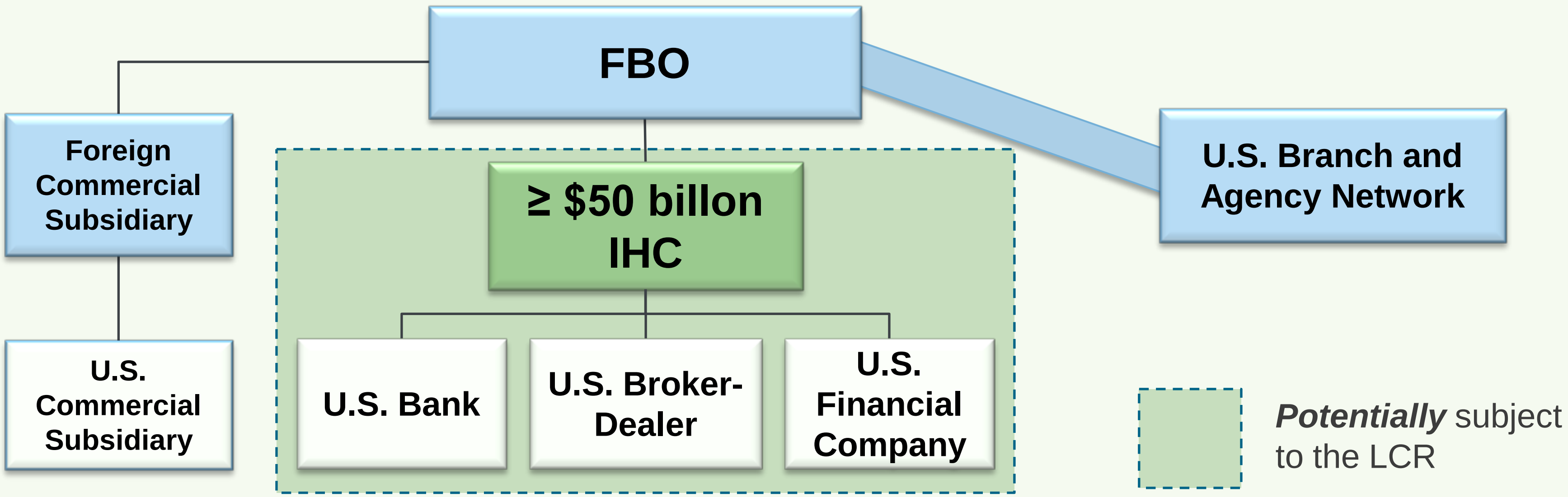
Which Organizations Are Affected?

Foreign Banking Organizations – *Not Addressed*

- The Federal Reserve has **not** stated how the U.S. LCR proposal would interact with its December 2012 proposal to implement Dodd-Frank enhanced prudential standards for ≥ $50 billion foreign banking organizations (FBO proposal).
  - The OCC stated that the U.S. LCR proposal would **not** apply to federal branches and agencies of foreign banks because their assets are substantially below the $250 billion asset threshold.
- In its December 2012 FBO proposal, the Federal Reserve indicated that it may apply the LCR to:
  - The U.S. operations, including U.S. branches and agencies, of *all* or a *subset* of FBOs with ≥ $50 billion in **combined U.S. assets.**



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Related Resources: Davis Polk's memorandum on the Federal Reserve's FBO proposal is available here

Summary of the LCR

- The LCR requires a banking organization's stock of unencumbered high-quality liquid assets (HQLAs) to be at least 100% of its total net cash outflows over a 30-day standardized supervisory liquidity stress scenario.
  - **Reservation of Authority:** A banking organization's primary federal banking regulator may require it to hold an amount of HQLAs greater than the minimum required by the U.S. LCR proposal, or to take any other measure to improve its liquidity risk profile, if the regulator determines that the banking organization's liquidity requirements as calculated under the U.S. LCR proposal are not commensurate with its liquidity risks.
- The U.S. LCR proposal:
  - Defines which instruments constitute HQLAs;
  - Prescribes standardized cash inflow and outflow rates that a banking organization must use to calculate its total net cash outflows over the 30-day stress period; and
  - Prescribes the methodology for calculating total net cash outflows, including capping cash inflows at 75% of cash outflows.

$$\frac{\textbf{High-quality Liquid Assets (HQLAs)}}{\textbf{Total } \textbf{\textit{Net}} \textbf{ Cash Outflows}} \geq 100\%$$

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Summary of the LCR: What Counts as HQLAs?

- As discussed in greater detail beginning on **page 18**, the U.S. LCR proposal divides HQLAs into Level 1 assets and Level 2 assets.
  - **Level 1 assets**, which are not subject to haircuts or quantitative caps, generally include:
    - Excess reserves held at a Federal Reserve Bank;
    - Withdrawable reserves held at a foreign central bank;
    - Securities issued or guaranteed by the U.S. Treasury;
    - Securities issued or guaranteed by a U.S. government agency whose obligations are explicitly guaranteed by the full faith and credit of the U.S. government; and
    - Certain securities that are claims on or guaranteed by a sovereign entity, a central bank and other international entities that are assigned a 0% risk weight under the U.S. Basel III standardized approach capital rules.*
      - This category generally includes all OECD sovereign debt *unless* it has defaulted or was restructured in the previous 5 years.

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* Davis Polk's interactive U.S. Basel III standardized approach risk weights tool is available here.

Summary of the LCR: What Counts as HQLAs? *(cont.)*

- **Level 2 assets**, which are further divided into Level 2A and Level 2B assets, are subject to prescribed haircuts and can account for no more than 40% of a banking organization's total HQLAs.
  - **Level 2A assets**, which are subject to a 15% haircut, generally include:
    - Claims on or guaranteed by a U.S. government sponsored enterprise (GSE) such as Fannie Mae and Freddie Mac; and
    - Claims on or guaranteed by a sovereign entity or a multilateral development bank (MDB) that is assigned a 20% risk weight under the U.S. Basel III standardized approach capital rules.
  - **Level 2B assets**, which are subject to a 50% haircut and can account for no more than 15% of a banking organization's total HQLAs, generally include:
    - Certain publicly-traded corporate debt securities issued by non-financial companies; and
    - Certain publicly-traded equities issued by non-financial companies that are included in the Standard & Poor's 500 Index or an equivalent index.

Summary of the LCR: Standardized Liquidity Stress Scenario

- As discussed in greater detail beginning on page 34, the types of liquidity pressures that are captured by the LCR's **standardized supervisory liquidity stress scenario**—through **prescribed** cash inflow and outflow rates and assumptions about counterparty and customer actions—include:
  - A partial loss of retail deposits and brokered deposits for retail customers;
  - A partial loss of unsecured wholesale funding capacity;
  - A partial loss of secured, short-term financing with certain collateral and counterparties;
  - Losses from derivative positions and the collateral supporting those positions;
  - Unscheduled draws on committed credit and liquidity facilities that a banking organization has provided to its clients;
  - The potential need for a banking organization to buy back debt or to honor non-contractual obligations in order to mitigate reputational and other risks; and
  - Other shocks which affect outflows linked to structured financing transactions, mortgages, central bank borrowings and customer short positions.

U.S. LCR Proposal Compliance Timeline

- Under the U.S. LCR proposal, banking organizations must maintain a minimum LCR of 100% by **January 1, 2017**.
- This is two years ahead of the Basel Committee's compliance timeline and one year ahead of the EU's CRD IV compliance timeline.

	Jan. 1, **2015**	Jan. 1, **2016**	Jan. 1, **2017**	Jan. 1, **2018**	Jan. 1, **2019**
U.S. LCR Proposal	80%	90%	**100%**	100%	100%
EU CRD IV	60%	70%	80%	**100%**	100%
Basel Committee's LCR Framework (Jan. 2013)	60%	70%	80%	90%	**100%**

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Basel Committee's LCR Framework vs. U.S. LCR Proposal

Topic	**Basel Committee's LCR Framework** (Jan. 2013)	**U.S. LCR Proposal** (Oct. 2013)
Scope of Application	▪ A single version of the LCR designed for all internationally active banking organizations	▪ Two versions of the LCR ▪ Full version for advanced approaches banking organizations, nonbank SIFIs and certain of their U.S. bank subsidiaries ▪ "Light" version for large regional BHCs and SLHCs

Definition of HQLAs	▪ Includes securities issued or guaranteed by certain public sector entities (PSEs) in Level 1 and Level 2A assets
	▪ Includes certain AA- or higher corporate debt securities and covered bonds in Level 2A assets subject to a 15% haircut
	▪ Includes certain residential mortgage-backed securities (RMBS) in Level 2B assets subject to a 25% haircut
	▪ Includes certain A+ to BBB- corporate debt securities in Level 2B assets subject to a 50% haircut
		▪ HQLAs do **not** include:
		    ▪ Securities issued or guaranteed by PSEs (*e.g.*, state, local authority or other governmental subdivision below the sovereign level) such as municipal securities
		    ▪ Covered bonds and other securities issued by financial institutions
		    ▪ RMBS
		▪ Corporate debt securities are not included in Level 2A assets
		▪ Certain corporate debt securities may qualify as Level 2B assets subject to a 50% haircut

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Related Resources: Davis Polk's memorandum on the Basel Committee's LCR framework is available **here**

Basel Committee's LCR Framework vs. U.S. LCR Proposal *(cont.)*

Topic	**Basel Committee's LCR Framework** (Jan. 2013)	**U.S. LCR Proposal** (Oct. 2013)
Prescribed Cash Inflow and Outflow Rates	▪ Prescriptive, quantitative cash inflow and outflow rates that all banking organizations must use to calculate their total net cash outflow amount over a 30-day liquidity stress period ▪ Total net cash outflow amount is based on the total cumulative amount at the end of the 30-day liquidity stress period	▪ For the full version of the LCR, total net cash outflow amount is based on the **largest** net cumulative cash outflow day within a 30-day liquidity stress period ▪ Cash inflow and outflow categories use definitions and parameters that are different from the Basel Committee's LCR framework – *e.g.*, special treatment for brokered deposits; no special treatment for trade credit ▪ Prescribed cash inflow and outflow rates are broadly similar to the Basel Committee's LCR framework in a number of categories
External Credit Ratings	▪ Relies on external credit ratings to define certain HQLAs	▪ Dodd-Frank prohibits references to external credit ratings in federal regulations ▪ Definition of HQLAs does not include references to external credit ratings
LCR Falling Below 100%	▪ A banking organization may dip into its stock of HQLAs such that its LCR falls below 100% during periods of idiosyncratic or systemic stress ▪ A banking organization should notify its regulator immediately if its LCR has fallen, or is expected to fall, below 100%	▪ A banking organization must notify its primary federal banking regulator on any business day when its LCR is < 100% ▪ If its LCR is < 100% for three consecutive business days, the banking organization must submit a liquidity compliance plan

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Related Resources: Davis Polk's memorandum on the Basel Committee's LCR framework is available here

When Is the LCR Calculated?

- A banking organization must calculate its LCR at the **same time on each business day** (calculation date).
  - A banking organization must select a calculation time by written notice to its primary federal banking regulator.
  - The elected calculation time may not be changed without written approval from its primary federal banking regulator.
- On each calculation date, a banking organization's LCR equals:

$$\frac{\textbf{HQLA amount as of the calculation date}}{\textbf{Total net cash outflow amount as of the calculation date}}$$

- The eligibility criteria for HQLAs and the method for calculating the HQLA amount are discussed beginning on **page 18**.
- The method for calculating the total net cash outflow amount and the prescribed cash inflow and outflow rates are discussed beginning on **page 34**.

LCR "Light" vs. Full Version of LCR

- **21 Days Instead of 30 Days:** LCR "light" uses a 21-day rather than a 30-day liquidity stress scenario.
- **HQLAs**
  - Same definitions and eligibility criteria for HQLAs.
  - Must incorporate into calculation of HQLAs a 21-calendar day period instead of a 30-day period.
- **Total Net Cash Outflow Amount**
  - Must use 70% (21 days / 30 days = 70%) of each cash outflow and inflow rate for cash outflows and inflows **without a contractual maturity date**.
  - Cash outflows and inflows with a contractual maturity date must be calculated on the basis of the maturity occurring within 21 calendar days instead of 30 calendar days from a calculation date.
  - Under LCR "light," total net cash outflow amount for any given calculation date is not based on the largest net cumulative cash outflow day.
    - Instead, total net cash outflow amount is based on the difference between the banking organization's cash outflows and inflows at the end of the 21-calendar day liquidity stress period.
    - Cash inflows still capped at 75% of cash outflows.

Numerator of LCR: HQLAs

The amount of a banking organization's HQLAs is calculated using the following formula:

$$\textbf{HQLA Amount} = \textbf{Level 1 asset amount} + \textbf{Level 2A asset amount} + \textbf{Level 2B asset amount} - \textbf{the } \underline{\textbf{greater}} \textbf{ of } \left\{ \begin{array}{c} \textbf{\textit{unadjusted} excess HQLA amount} \\ \textit{and} \\ \textbf{\textit{adjusted} excess HQLA amount} \end{array} \right\}$$

- Level 1 asset amount = fair value under U.S. GAAP as of the calculation date **minus** required reserves under the Federal Reserve's Regulation D.
- Level 2A asset amount = **85%** of fair value under U.S. GAAP as of the calculation date (to give effect to the 15% haircut).
- Level 2B asset amount = **50%** of fair value under U.S. GAAP as of the calculation date (to give effect to the 50% haircut).

A banking organization would include qualifying assets in each HQLA category as of a calculation date, irrespective of an asset's residual maturity.

- This portion of the formula gives effect to the **15% cap** on the amount of Level 2B assets and the **40% cap** on the total amount of Level 2 assets that can count towards a banking organization's HQLAs.
- **Unadjusted excess HQLA amount** is essentially the amount of HQLAs that exceeds the Level 2 and Level 2B asset caps on the first day of a calculation period **without** unwinding any transactions.
- **Adjusted excess HQLA amount** is essentially the amount of HQLAs that exceeds the Level 2 and Level 2B asset caps at the end of a 30-day stress period after **unwinding** all secured funding transactions, secured lending transactions, asset exchanges and collateralized derivatives transactions that mature within a 30-day stress period where HQLA is exchanged.
- The calculation of the adjusted excess HQLA amount is designed to prevent a banking organization from configuring its HQLA portfolio by engaging in transactions that create the appearance of a significant amount of Level 1 assets at the beginning of a 30-day stress period but that would unwind by the end of the period (*e.g.*, borrowing a Level 1 asset secured by a Level 2 asset overnight).

Unadjusted and Adjusted Excess HQLA Amounts

- **Unadjusted excess HQLA amount = Level 2 cap excess amount + Level 2B cap excess amount**
  - **Level 2 cap excess amount** = Max (Level 2A asset amount + Level 2B asset amount – 0.6667 x Level 1 asset amount, 0)
  - **Level 2B cap excess amount** = Max (Level 2B asset amount – Level 2 cap excess amount – 0.1765 x (Level 1 asset amount + Level 2 asset amount), 0)
- **Adjusted excess HQLA amount = adjusted Level 2 cap excess amount + adjusted Level 2B cap excess amount**
  - **Adjusted Level 2 cap excess amount** = Max (adjusted Level 2A asset amount + adjusted Level 2B asset amount – 0.6667 x adjusted Level 1 asset amount, 0)
  - **Adjusted Level 2B cap excess amount** = Max (adjusted Level 2B asset amount – adjusted Level 2 cap excess amount – 0.1765 x (adjusted Level 1 asset amount + adjusted Level 2 asset amount), 0)

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0.6667 (40/60) is the ratio of allowable Level 2 assets to Level 1 assets. 0.1765 (15/85) is the ratio of allowable Level 2B assets to the sum of Level 1 assets and Level 2A assets.

Unadjusted and Adjusted Excess HQLA Amounts *(cont.)*

- **Adjusted Level 1 asset amount** = fair value under U.S. GAAP of Level 1 assets that would be held by a banking organization upon **unwinding** all secured funding transactions, secured lending transactions, asset exchanges or collateralized derivative transactions that **(1)** mature within 30 calendar days of the calculation date and **(2)** result in the banking organization and the counterparty exchanging HQLAs (HQLA Exchange Transactions).
- **Adjusted Level 2A asset amount** = **85%** of fair value under U.S. GAAP of Level 2A assets that would be held by a banking organization upon **unwinding** all HQLA Exchange Transactions that mature within 30 calendar days of the calculation date.
- **Adjusted Level 2B asset amount** = **50%** of fair value under U.S. GAAP of Level 2B assets that would be held by a banking organization upon **unwinding** all HQLA Exchange Transactions that mature within 30 calendar days of the calculation date.

General Eligibility Criteria for HQLAs

- **Unencumbered:** Only unencumbered assets may be included in a banking organization's HQLAs. Unencumbered means an asset is:
  - Free of legal, regulatory, contractual or other restrictions on the banking organization's ability to monetize the asset; and
  - Not pledged, explicitly or implicitly, to secure or to provide credit enhancement to any transaction.
    - **Exception:** An asset may be pledged to a central bank or a U.S. GSE if potential credit secured by the asset is not currently extended to the banking organization or its consolidated subsidiaries.*
- **Client Assets:** An HQLA <u>cannot</u> be a client pool security held in a segregated account or cash received from a secured funding transaction involving client pool securities that were held in a segregated account.
  - Client pool security is a security owned by a banking organization's customer and is not an asset of the banking organization, regardless of the banking organization's hypothecation rights to the security.
- **Operational Assets:** An HQLA <u>cannot</u> be specifically designated to cover operational costs such as wages or facility maintenance.
- **Certain Rehypothecated Assets:** A banking organization must <u>not</u> include in its HQLAs any asset that it received under a rehypothecation right if the beneficial owner has a contractual right to withdraw the asset without remuneration at any time during 30 calendar days following the calculation date.
  - Exclusion extends to HQLA-eligible assets generated from another asset received under such a rehypothecation right.

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* This exception is intended to permit collateral covered by a blanket lien from a U.S. GSE to be included in HQLAs.

Counting HQLAs in Consolidated Subsidiaries Towards Parent Company's HQLAs

- There are restrictions on the amount of HQLAs held by subsidiaries consolidated under U.S. GAAP that can count towards the parent banking organization's HQLAs.
- The specific restrictions depend on whether the subsidiary consolidated under U.S. GAAP is:
  - A U.S. or non-U.S. entity; and
  - Able to transfer excess HQLAs (including proceeds from their monetization) to its top-tier parent company during times of stress without statutory, regulatory, contractual or supervisory restrictions (Restrictions)*

U.S. subsidiary subject to U.S. LCR proposal

✗ **Cannot** count towards parent's HQLAs

Additional HQLAs "trapped" in subsidiary due to Restrictions

Additional HQLAs that can be transferred to parent without Restrictions

Excess HQLAs

✓ Can count towards parent's HQLAs

Amount of subsidiary's net cash outflows calculated for its **own minimum LCR requirement**

U.S. subsidiary not subject to U.S. LCR proposal

✗ **Cannot** count towards parent's HQLAs

Additional HQLAs "trapped" in subsidiary due to Restrictions

Additional HQLAs that can be transferred to parent without Restrictions

✓ Can count towards parent's HQLAs

Amount of subsidiary's net cash outflows as of 30th day after calculation date, **as calculated by the parent**

* Regulatory restrictions include Sections 23A and 23B of the Federal Reserve Act and Regulation W. Supervisory restrictions include enforcement actions, written agreements, supervisory directives or requests.

Counting HQLAs in Consolidated Subsidiaries Towards Parent Company's HQLAs *(cont.)*

Non-U.S. consolidated subsidiary

✗ **Cannot** count towards parent's HQLAs

Additional HQLAs "trapped" in subsidiary due to Restrictions*

✓ Can count towards parent's HQLAs

Additional HQLAs that can be transferred to parent without Restrictions*

Amount of subsidiary's net cash outflows as of 30th day after calculation date, **as calculated by the parent**

Maintaining HQLAs in the United States

- A banking organization is generally expected to maintain in the United States an amount and type of HQLAs that are sufficient to meet its total net cash outflows in the United States, as calculated under the U.S. LCR proposal.
- U.S. banking agencies stated that they do not believe it is appropriate for a banking organization to hold a disproportionate amount of HQLAs outside the United States because unforeseen impediments may prevent timely repatriation of liquidity during a crisis.

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* Restrictions include any non-U.S. LCR requirements that are more stringent than the U.S. LCR proposal, counterparty exposure limits and other statutory, regulatory or supervisory limitations.

Operational Requirements for HQLAs

- A banking organization must have the operational capability to monetize* its HQLAs by:
  - Implementing and maintaining appropriate procedures and systems to monetize any HQLA at any time in accordance with relevant standard settlement periods and procedures; and
  - Periodically monetizing a sample of HQLAs that reasonably reflects the composition of its HQLA portfolio, including with respect to asset type, maturity and counterparty characteristics.
- A banking organization must implement policies that require all HQLAs to be under the control of the management function charged with managing liquidity risk (*e.g.*, Treasury function).
  - The liquidity management function must evidence its control over HQLAs by either:
    - Segregating HQLAs from other assets with the sole intent to use HQLAs as a source of liquidity; or
    - Demonstrating the ability to monetize HQLAs and making proceeds available to the liquidity management function without conflicting with a business or risk management strategy of the banking organization.
      - *E.g.*, an asset used to hedge a specific transaction cannot be included in HQLAs if its sale would conflict with another business or risk management strategy.
      - However, if the asset is used as a general macro hedge, it can still be included in the banking organization's HQLAs.

* In this context, monetization means the receipt of funds from the outright sale of an asset or from the transfer of an asset pursuant to a repurchase agreement.

Operational Requirements for HQLAs *(cont.)*

- A banking organization must include in its total net cash outflows the amount of cash outflows that would result from the termination of any specific transaction hedging an asset in its HQLA portfolio.
  - This requirement would not apply to general macro hedges such as interest rate derivatives, but is intended to cover specific hedges that would become risk exposures if the asset being hedged were sold.
- A banking organization must implement and maintain policies and procedures that determine the composition of its HQLA portfolio on a daily basis by:
  - Identifying where its HQLAs are held by legal entity, geographical location, currency, custodial or bank account or other relevant identifying factor as of the calculation date;
  - Determining that assets included in its HQLA portfolio continue to qualify as HQLAs;
  - Ensuring appropriate diversification of its HQLA portfolio by asset type, counterparty, issuer, currency, borrowing capacity or other factors associated with the liquidity risk of the assets; and
  - Ensuring that the amount and type of HQLAs held in foreign jurisdictions are appropriate with respect to the banking organization's net cash outflows in foreign jurisdictions.
- U.S. banking agencies noted that an asset's HQLA status would not depend on whether the banking organization classifies it as available-for-sale or held-to-maturity.

HQLAs: Key Definitions

Regulated financial company includes:

- A BHC, SLHC, or nonbank SIFI;
- A company included in the organization chart of a depository institution holding company on Form FR Y-6, as listed in the hierarchy report produced by the National Information Center web site, **provided** that the top-tier depository institution holding company is subject to the U.S. LCR framework;
- A depository institution, foreign bank, credit union, industrial loan company, industrial bank or other similar institution described in Section 2 of the Bank Holding Company Act, national bank, state member bank or state non-member bank that is not a depository institution;
- An insurance company;
- A securities holding company, SEC-registered broker-dealer, futures commission merchant, swap dealer or security-based swap dealer;
- A designated financial market utility under Title VIII of the Dodd-Frank Act; and
- Any company not domiciled in the U.S. that is supervised and regulated in a manner similar to entities listed above, *e.g.*, an FBO, foreign insurance company, foreign broker-dealer or foreign designated financial market utility.

Regulated financial company does **not** include:

- U.S. GSEs;
- Central banks, Bank for International Settlements, International Monetary Fund and MDBs;
- Small business investment companies; or
- Community Development Financial Institutions.

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HQLAs: Key Definitions *(cont.)*

Investment company means a company registered with the SEC under the Investment Company Act of 1940 or foreign equivalents of such a company.

Investment adviser means a company registered with the SEC as an investment adviser under the Investment Advisers Act of 1940 or foreign equivalents of such a company.

Non-regulated fund means any hedge fund or private equity fund whose investment adviser is required to file SEC Form PF (Reporting Form for Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors) and any consolidated subsidiary of such a fund, other than a small business investment company.

Pension fund means an employee benefit plan as defined in paragraphs (3) and (32) of Section 3 of the Employee Retirement Income and Security Act of 1974 (ERISA), a "governmental plan" as defined in 29 U.S.C. 1002(32) that complies with the tax deferral qualification requirements provided in the Internal Revenue Code, or any similar employee benefit plan established under the laws of a foreign jurisdiction.

Identified company means any company that a banking organization's primary federal banking regulator has determined should be treated the same as a regulated financial company, investment company, non-regulated fund, pension fund or investment adviser, based on activities similar in scope, nature or operations to those entities.

Multilateral development bank (MDB) means the International Bank for Reconstruction and Development, the Multilateral Investment Guarantee Agency, the International Finance Corporation, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the European Investment Fund, the Nordic Investment Bank, the Caribbean Development Bank, the Islamic Development Bank, the Council of Europe Development Bank, and any other entity that provides financing for national or regional development in which the U.S. government is a shareholder or contributing member or which the banking organization's primary federal banking regulator determines poses comparable credit risk.

HQLAs: Level 1 Assets

Required reserves under the Federal Reserve's Regulation D are deducted for purposes of calculating the Level 1 asset amount. As a result, only **excess reserves** held at a Federal Reserve Bank are taken into account for purposes of the LCR. This aspect of the U.S. LCR proposal recognizes that Regulation D already requires depository institutions to maintain reserves against certain types of deposits in the form of vault cash or a balance in a Federal Reserve Bank account.

Level 1 Assets (No limit on proportion of HQLAs)	**Haircut**
Balances held at a Federal Reserve Bank **other than:** ▪ Balances that a depository institution maintains on behalf of another institution, such as balances it maintains on behalf of a respondent or on behalf of an excess balance account participant; and ▪ Term deposits held on terms and conditions that: **(1)** do not explicitly permit withdrawal upon demand prior to the expiration of the term and **(2)** do not permit them to be pledged as collateral for term or automatically-renewing overnight advances from a Federal Reserve Bank.*	**0%**
Balances held by or on behalf of the banking organization at a **foreign central bank** that are not subject to restrictions on the banking organization's ability to use the reserves.	
A security issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, the U.S. Treasury.	
A security issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, any **other** U.S. government agency whose obligations are fully and explicitly guaranteed by the full faith and credit of the U.S. government, provided that the security is liquid and readily-marketable.	

Liquid and readily-marketable means that a security is traded in an active secondary market with:

- More than two committed market makers;
- A large number of non-market maker participants on both the buying and selling sides of transactions;
- Timely and observable market prices; and
- A high trading volume.

* The U.S. LCR proposal noted that none of the term deposits offered by the Federal Reserve Banks to date would qualify as Level 1 assets.

HQLAs: Level 1 Assets *(cont.)*

Level 1 Assets (No limit on proportion of HQLAs)	**Haircut**
A security issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, a sovereign entity, the Bank for International Settlements, the International Monetary Fund, the European Central Bank and European Community or an MDB, that is: ▪ Assigned a 0% risk weight under the U.S. Basel III standardized approach capital rules as of the calculation date; ▪ This category generally includes all OECD sovereign debt unless it has defaulted or was restructured in the previous 5 years. ▪ Liquid and readily-marketable; ▪ 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;* and ▪ Not an obligation of a regulated financial company, investment company, non-regulated fund, pension fund, investment adviser, or identified company, or a consolidated subsidiary of any of the foregoing.	**0%**
A security issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, a sovereign entity that is <u>not</u> assigned a 0% risk weight under the U.S. Basel III standardized approach capital rules, where: ▪ The sovereign entity issues the security in its own currency; ▪ The security is liquid and readily-marketable; ▪ The banking organization holds the security in order to meet its net cash outflows in the jurisdiction of the sovereign entity, as calculated under the U.S. LCR proposal.	

Sovereign entity means a central government or an agency, department, ministry or central bank of a central government.

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* A banking organization could demonstrate a historical record that meets this criterion through reference to historical market prices during times of general liquidity stress, such as the period of financial market stress between 2007 and 2008.

HQLAs: Level 2A Assets

<table>
<tr><th>Level 2 Assets (Capped at 40% of total HQLAs)</th><th>Haircut</th></tr>
<tr><td colspan="2">Level 2A Assets</td></tr>
<tr><td>A security issued by, or guaranteed as to the timely payment of principal and interest by a U.S. GSE (i.e., Fannie Mae, Freddie Mac, Federal Home Loan Banks and the Farm Credit System) that is:
▪ Liquid and readily-marketable;
▪ Investment grade under the OCC's non-credit ratings based standard as of the calculation date;* and
▪ Senior to preferred stock.</td><td rowspan="2">15%</td></tr>
<tr><td>A security that is issued by, or guaranteed as to the timely payment of principal and interest by, a sovereign entity or MDB that is:
▪ Liquid and readily-marketable;
▪ Not included in Level 1 assets;
▪ Assigned no higher than a 20% risk weight under the U.S. Basel III standardized approach capital rules as of the 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 market price of the security or equivalent securities of the issuer declining by ≤ 10% during a 30 calendar-day period of significant stress; <u>or</u>
    ▪ The market haircut demanded by counterparties to secured lending and secured funding transactions that are collateralized by the security or equivalent securities of the issuer increasing by ≤ 10 percentage points during a 30 calendar-day period of significant stress; and
▪ Not an obligation of a regulated financial company, investment company, non-regulated fund, pension fund, investment adviser or identified company, or a consolidated subsidiary of any of the foregoing.</td></tr>
</table>

* Under the OCC's standard, investment grade means the issuer of a security has an adequate capacity to meet financial commitments under the security for the projected life of the asset or exposure. An issuer has an adequate capacity to meet financial commitments if the risk of default by the obligor is low and the full and timely repayment of principal and interest is expected. *See* 12 C.F.R §1.2(d) (Definition of "Investment Grade" as amended by *Alternatives to the Use of External Credit Ratings in the Regulations of the OCC*, 77 Fed. Reg. 35,253 (June 13, 2012), available here).

HQLAs: Level 2B Assets

Level 2 Assets (Capped at 40% of total HQLAs)	**Haircut**
Level 2B Assets (Capped at 15% of total HQLAs)	

A publicly traded corporate debt security that is:
▪ Liquid and readily-marketable;
▪ Investment grade under the OCC's non-credit ratings based standard as of the 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 market price of the publicly traded corporate debt security or equivalent securities of the issuer declining by ≤ 20% during a 30 calendar-day period of significant stress; <u>or</u>
    ▪ The market haircut demanded by counterparties to secured lending and secured funding transactions that are collateralized by the publicly traded corporate debt security or equivalent securities of the issuer increasing by ≤ 20 percentage points during a 30 calendar-day period of significant stress; and
▪ Not an obligation of a regulated financial company, investment company, non-regulated fund, pension fund, investment adviser or identified company, or a consolidated subsidiary of any of the foregoing.
	50%

Publicly traded means, with respect to a security, that the security is traded on:

- Any exchange registered with the SEC as a national securities exchange; **or**
- Any non-U.S.-based securities exchange that **(1)** is registered with, or approved by, a national securities regulatory authority; and **(2)** provides a liquid, two-way market for the security in question.

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HQLAs: Level 2B Assets *(cont.)*

Level 2 Assets (Capped at 40% of total HQLAs)	Haircut
Level 2B Assets (Capped at 15% of total HQLAs)	

A publicly traded common equity share that is:
▪ Liquid and readily-marketable;
▪ Included in:
    ▪ The Standard & Poor's 500 Index;
    ▪ An index that a banking organization's supervisor in a foreign jurisdiction recognizes for purposes of including equity shares in Level 2B assets under applicable regulatory policy, if the share is held in that foreign jurisdiction; or
    ▪ Any other index for which the banking organization can demonstrate to the satisfaction of its primary federal banking regulator that the equities represented in the index are as liquid and readily-marketable as equities included in the Standard & Poor's 500 Index;
▪ Issued in **(1)** U.S. dollars or **(2)** the currency of a jurisdiction where the banking organization operates and the banking organization holds the common equity share in order to cover its net cash outflows in that jurisdiction;
Criteria continue on next page →
	50%

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HQLAs: Level 2B Assets *(cont.)*

Level 2 Assets (Capped at 40% of total HQLAs)	**Haircut**
Level 2B Assets (Capped at 15% of total HQLAs)	

(Cont.)
▪ Issued by an entity whose publicly traded common equity shares have a proven record as a reliable source of liquidity in repurchase or sales markets during stressed market conditions, demonstrated by:
    ▪ The market price of the security or equivalent securities of the issuer declining by ≤ 40% during a 30 calendar-day period of significant stress; <u>or</u>
    ▪ The market haircut demanded by counterparties to securities borrowing and lending transactions that are collateralized by the publicly traded common equity shares or equivalent securities of the issuer increasing by ≤ 40 percentage points, during a 30-calendar day period of significant stress;
▪ Not issued by a regulated financial company, investment company, non-regulated fund, pension fund, investment adviser or identified company, or by a consolidated subsidiary of any of the foregoing;
▪ If held by a depository institution, is not acquired in satisfaction of a debt previously contracted (DPC); and
▪ If held by a consolidated subsidiary of a depository institution, the depository institution can include the publicly traded common equity share in its Level 2B assets <u>only</u> if the share is held to cover net cash outflows of the depository institution's consolidated subsidiary, as calculated by the banking organization under the U.S. LCR framework.
	50%

Denominator of LCR: Total Net Cash Outflow Amount

- **Largest Net Cumulative Cash Outflow Day:** Under the U.S. LCR proposal, a banking organization's total net cash outflow amount is based on the largest net cumulative cash outflow day within a 30-day liquidity stress period.
  - In contrast, the Basel Committee's LCR framework calculates total net cash outflows based on the total cumulative amount at the end of the 30-day liquidity stress period.
  - According to the U.S. banking agencies, the more stringent approach in the U.S. LCR proposal addresses potential maturity mismatches between cash outflows and inflows.
  - Maturity mismatches can occur when a banking organization has substantial contractual inflows late in a 30-day stress period and substantial outflows early in the same period.
    - The concept of addressing potential maturity mismatches by focusing on the largest daily cumulative net cash outflow also appeared in the Federal Reserve's December 2012 FBO proposal.

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Formula for Calculating Total Net Cash Outflow Amount

On any given calculation date, a banking organization's total net cash outflow amount is the **largest difference** between cumulative cash outflows and cumulative cash inflows, as calculated for **each of the next 30 calendar days** after the calculation date.

Difference between **cumulative cash outflows** and **cumulative cash inflows**

=

Sum of cash outflow amounts calculated under § 32(a) through § 32(g)(2) of the U.S. LCR Proposal

+

Sum of cash outflow amounts calculated under § 32(g)(3) through § 32(*l*) for instruments or transactions that have **no contractual maturity date**

+

Sum of cash outflow amounts calculated under § 32(g)(3) through § 32(*l*) for instruments or transactions that have a contractual maturity date **up to and including that calendar day**

−

the lesser of

{ the sum of cash inflow amounts under § 33(b) through § 33(f) where the instrument or transaction has a contractual maturity date **up to and including that calendar day**

and

75% of cumulative cash outflows }

This amount represents cumulative cash inflows. Instruments with **no** maturity date are excluded from cash **inflows**.

This amount must be calculated for **each** of the next 30 calendar days after the calculation date. The **largest** amount becomes the denominator of the LCR for that calculation date.

The sum of these three items represents cumulative cash outflows.

Total expected cash inflows cannot exceed 75% of total expected cash outflows.

This cap effectively sets a floor on a banking organization's HQLAs at 25% of its total expected cash outflows.

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Identifying the Largest Net Cumulative Cash Outflow Day

The U.S. LCR proposal distinguishes between **(1)** instruments or transactions that have **no** contractual maturity date and **(2)** instruments or transactions that have a contractual maturity date. Cash outflows for **(1)** are assumed to be the same for each of the next 30 calendar days after the calculation date. Cash outflows for **(2)** depend on the specific maturity or transaction date of each instrument or transaction.

Instruments with **no** maturity date are excluded from a banking organization's cash **inflows**.

	Non-maturity cash outflows (constant)	**Cumulative contractual cash outflows with maturity date up to and including the calendar day**	**Total cumulative cash outflows**	**Cumulative contractual cash inflows with maturity date up to and including the calendar day**	**Maximum inflows permitted** (due to 75% inflow cap)	**Net cumulative cash outflow**
Day 15	200	265	465	195	349	270
Day 16	200	280	480	200	360	280
Day 17	200	285	485	205	364	280
Day 18	200	295	495	210	371	**285**
Day 19	200	310	510	230	383	280
Day 20	200	310	510	230	383	280
Day 21	200	310	510	230	383	280
Day 22	200	330	530	275	398	255

This is the largest net cash outflow amount calculated for each of the 30 calendar days after the calculation date. The denominator of the banking organization's LCR for that calculation date is therefore 285.

Determining Maturity of Instruments and Transactions

- In calculating its cash outflows and inflows, a banking organization must make the **most conservative assumptions** for determining the maturity or transaction date for an instrument or transaction. This means assuming:
  - The earliest possible date for cash outflows; and
  - The latest possible date for cash inflows.
- **Cash Outflows:** In calculating cash outflows, a banking organization must assume the **earliest possible** maturity or transaction date, taking into account any option that could accelerate the maturity or transaction date as follows:
  - If an investor or funds provider has an option to reduce maturity, must assume the option is exercised at the earliest possible date;
  - If a banking organization has an option to extend maturity of an obligation it issued, must assume the option is **not** exercised; and
  - If an option is subject to a contractually defined notice period, must determine the earliest possible contractual maturity date **regardless** of notice period.
- **Cash Inflows:** In calculating cash outflows, a banking organization must assume the **latest possible** maturity or transaction date, taking into account any option that could extend the maturity or transaction date as follows:
  - If a borrower has an option to extend maturity, must assume the option is exercised to extend maturity to the latest possible date;
  - If a banking organization has an option to accelerate maturity of an instrument or transaction, must assume the option is **not** exercised; and
  - If an option is subject to a contractually defined notice period, must determine the latest possible contractual maturity date assuming the borrower uses entire notice period.

Prescribed Cash *Outflow* Rates

Cash outflow amounts are calculated by multiplying the applicable outflow rate to each type of cash outflow.

LCR "Light": Cash outflows with a contractual maturity date must be calculated on the basis of the maturity occurring within **21** calendar days instead of 30 calendar days from a calculation date.

Type of Cash Outflow	Outflow Rate	LCR "Light"
Unsecured retail funding *(regardless of maturity)* § 32(a)		
Stable retail deposits	**3%**	2.1%
All other retail deposits, including **(1)** deposits not fully insured by the FDIC or **(2)** deposits insured by foreign deposit insurance.	**10%**	7%
All funding from a retail customer or counterparty that is not a retail deposit or a brokered deposit provided by a retail customer or counterparty	**100%**	70%

Deposit is as defined in the Federal Deposit Insurance Act or an equivalent liability of the banking organization in a foreign country.

Retail deposit means a demand or term deposit that is placed with the banking organization by a retail customer or counterparty, *other than* a brokered deposit.

Retail customer or counterparty means a customer or counterparty that is:

- An individual (*i.e.*, a natural person but not a sole proprietorship); or
- A business customer, only if and to the extent that **(1)** the banking organization manages its transactions with the business customer, including deposits, unsecured funding, and credit facility and liquidity facility transactions, in the same way it manages its transactions with individuals; **(2)** transactions with the business customer have liquidity risk characteristics that are similar to comparable transactions with individuals; and **(3)** the total aggregate funding raised from the business customer is < $1.5 million.

Stable retail deposits means a retail deposit that is fully covered by **FDIC deposit insurance*** and **(1)** is held by the depositor in a transactional account or **(2)** the depositor that holds the account has another established relationship with the banking organization such as another deposit account, a loan, bill payment services or any similar service or product provided to the depositor that the banking organization demonstrates to the satisfaction of its primary federal banking regulator would make deposit withdrawal highly unlikely during a liquidity stress event.

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* The U.S. LCR proposal does not recognize other deposit insurance schemes such as those in foreign jurisdictions for stable retail deposits. Foreign insured retail deposits may be included in other retail deposits.

Prescribed Cash *Outflow* Rates *(cont.)*

Type of Cash Outflow
Structured transaction outflow amount § 32(b)
If a banking organization is a sponsor of a structured transaction, without regard to whether the issuing entity is consolidated on the banking organization's balance sheet under U.S. GAAP, the structured transaction outflow amount for each structured transaction as of the calculation date is the **greater of**: ▪ **100%** of the amount of all debt obligations of the issuing entity that mature ≤ 30 calendar days from such calculation date and all commitments made by the issuing entity to purchase assets within ≤ 30 calendar days from such calculation date; and ▪ The maximum contractual amount of funding the banking organization **may be required to provide** to the issuing entity ≤ 30 calendar days from such calculation date through a liquidity facility, a return or repurchase of assets from the issuing entity or other funding agreement.

Structured transaction means a secured transaction in which repayment of obligations and other exposures to the transaction is largely derived, directly or indirectly, from the cash flow generated by the pool of assets that secures the obligations and other exposures to the transaction.

Prescribed Cash *Outflow* Rates *(cont.)*

Type of Cash Outflow
Net derivative cash outflow amount § 32(c)
The net derivative cash outflow amount as of the calculation date is the sum of the **net derivative cash outflow** (if > 0) for **each counterparty**.*   **Net derivative cash outflow** for a given counterparty is: ▪ The sum of the payments and collateral that the banking organization will make or deliver to the counterparty ≤ 30 calendar days from the calculation date under derivative transactions;   ▪ **Less**, if the derivative transactions are subject to a qualifying master netting agreement, the sum of the payments and collateral that the banking organization will receive from the counterparty ≤ 30 calendar days from the calculation date under derivative transactions.

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 transactions include interest rate derivative contracts, exchange rate derivative contracts, equity derivative contracts, commodity derivative contracts, credit derivative contracts, and any other instrument that poses similar counterparty credit risks. Derivative transactions 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 transaction does not include any identified banking product.

Qualifying master netting agreement has the same meaning as in the U.S. Basel III final rule. In order to recognize an agreement as a qualifying master netting agreement for purposes of the U.S. LCR proposal, a banking organization must comply with specified legal review standards.

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* Net derivative cash outflow should be calculated in accordance with existing valuation methodologies and expected contractual derivatives cash flows.

Prescribed Cash *Outflow* Rates *(cont.)*

Type of Cash Outflow	Outflow Rate	LCR "Light"
Mortgage commitment outflow amount § 32(d)		
Amount of funds the banking organization has contractually committed for its own origination of retail mortgages that can be drawn upon ≤ 30 calendar days from the calculation date.	**10%**	7%
Commitment outflow amount § 32(e) – **Key Definitions**		

Committed means, with respect to a credit facility or liquidity facility, that under the terms of the legally binding agreement governing the facility, **(1)** the banking organization may not refuse to extend credit or funding under the facility or **(2)** the banking organization may refuse to extend credit under the facility (to the extent permitted under applicable law) only upon the satisfaction or occurrence of one or more specified conditions not including change in financial condition of the borrower, customary notice or administrative conditions.

Credit facility means a legally binding agreement to extend funds if requested at a future date, including a general working capital facility such as a revolving credit facility for general corporate or working capital purposes. Credit facilities do not include facilities extended expressly for the purpose of refinancing the debt of a counterparty that is otherwise unable to meet its obligations in the ordinary course of business (including through its usual sources of funding or other anticipated sources of funding). If a facility has features of **both** credit and liquidity facilities, it must be classified as a liquidity facility.

Liquidity facility means 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. A liquidity facility includes an agreement to provide liquidity support to asset-backed commercial paper by lending to, or purchasing assets from, any structure, program or conduit in the event that funds are required to repay maturing asset-backed commercial paper. Liquidity facilities **exclude** facilities that are established solely for the purpose of general working capital, such as revolving credit facilities for general corporate or working capital purposes.

Prescribed Cash *Outflow* Rates *(cont.)*

Type of Cash Outflow	Outflow Rate	LCR "Light"
Commitment outflow amount § 32(e) ***(cont.)***		
Undrawn amount of committed credit and liquidity facilities extended by a banking organization that is a depository institution to an affiliated depository institution that is subject to U.S. LCR framework	**0%**	N/A
Undrawn amount of committed credit and liquidity facilities extended by the banking organization to **retail** customers or counterparties*	**5%**	3.5%
Undrawn amount of committed **credit facilities** extended by the banking organization to a **wholesale** customer or counterparty that is not a regulated financial company, investment company, non-regulated fund, pension fund, investment adviser or identified company, or to a consolidated subsidiary of any of the foregoing.	**10%**	7%
Undrawn amount of committed **liquidity facilities** extended by the banking organization to a **wholesale** customer or counterparty that is not a regulated financial company, investment company, non-regulated fund, pension fund, investment adviser or identified company, or to a consolidated subsidiary of any of the foregoing.	**30%**	21%
Undrawn amount of committed credit and liquidity facilities extended by the banking organization to **depository institutions**, depository institution holding companies and foreign banks.	**50%**	35%
Undrawn amount of committed **credit facilities** extended by the banking organization to a regulated **financial** company, investment company, non-regulated fund, pension fund, investment adviser, or identified company, or to a consolidated subsidiary of any of the foregoing.	**40%**	28%

Retail mortgage means a mortgage that is primarily secured by a first or subsequent lien on one-to-four family residential property.

Wholesale customer or counterparty means a customer or counterparty that is not a retail customer or counterparty.

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* Undrawn **retail credit card** lines are not included in cash outflows because they are unconditionally cancelable and therefore do not meet the definition of a committed facility.

Prescribed Cash *Outflow* Rates *(cont.)*

Type of Cash Outflow	Outflow Rate	LCR "Light"
Commitment outflow amount § 32(e) ***(cont.)***		
Undrawn amount of committed **liquidity facilities** extended by the banking organization to a regulated **financial** company, investment company, non-regulated fund, pension fund, investment adviser, or identified company, or to a consolidated subsidiary of any of the foregoing.	**100%**	70%
Undrawn amount of all committed credit and liquidity facilities extended to **special purpose entities** (SPEs), excluding liquidity facilities extended to SPEs consolidated with the banking organization.*	**100%**	70%
Undrawn amount of **all other** committed credit or liquidity facilities extended by the banking organization.	**100%**	70%

Special purpose entity means a company organized for a specific purpose, the activities of which are significantly limited to those appropriate to accomplish a specific purpose, and the structure of which is intended to isolate the credit risk of the SPE.

Determining the Undrawn Amount

- **Committed Credit Facility:** Undrawn amount = entire amount that could be drawn upon within 30 calendar days of the calculation date ***less*** the amount of Level 1 assets and 85% of Level 2A assets securing the facility.
- **Committed Liquidity Facility:** Undrawn amount = entire amount that could be drawn upon within 30 calendar days of the calculation date ***less*****:**
    - The amount of Level 1 assets and 85% of Level 2A assets securing the portion of the facility that could be drawn upon within 30 calendar days of the calculation date; and
    - That portion of the facility that supports obligations of the banking organization's customer that do not mature ≤ 30 calendar days from such calculation date.
- Level 1 and 2A assets used to reduce the undrawn amount should not be included in a banking organization's HQLAs.

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* Transactions between a banking organization and its consolidated subsidiary or between two consolidated subsidiaries of the banking organization are not taken into account in cash flow calculations.

Prescribed Cash *Outflow* Rates *(cont.)*

Type of Cash Outflow	Outflow Rate
Collateral outflow amount § 32(f)	
Changes in financial condition: Additional amount of collateral the banking organization could be contractually required to post or to fund under the terms of any transaction as a result of a change in the banking organization's financial condition.*	**100%**
Potential valuation changes: Fair value under U.S. GAAP of any collateral posted to a counterparty by the banking organization that is not a Level 1 asset.	**20%**
Excess collateral: Fair value under U.S. GAAP of collateral that: ▪ the banking organization may be required by contract to return to a counterparty because the collateral posted to the banking organization exceeds the current collateral requirement of the counterparty under the governing contract; ▪ is not segregated from the banking organization's other assets; and ▪ is not already excluded from the banking organization's HQLAs under § 20(e)(5) (exclusion for certain rehypothecated assets).	**100%**
Contractually required collateral: Fair value under U.S. GAAP of collateral that the banking organization is contractually required to post to a counterparty and, as of the calculation date, the banking organization has not yet posted.	**100%**

* If multiple methods of meeting the requirement for additional collateral are available (*e.g.*, providing more collateral of the same type or replacing existing collateral with higher quality collateral), a banking organization may use the lower calculated outflow amount in its calculation.

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Prescribed Cash *Outflow* Rates *(cont.)*

Type of Cash Outflow
Collateral outflow amount – Collateral substitution § 32(f)(5)
This outflow category assumes that, in a stress scenario, a banking organization's counterparty would post the lowest quality collateral permissible under the governing contract. The outflow rate depends on the type of collateral posted by the counterparty and type of collateral with which it could be substituted under the contract without the banking organization's consent.

		Fair value of collateral posted by a counterparty that the banking organization includes in its:		
		Level 1 assets	**Level 2A assets**	**Level 2B assets**
The counterparty may replace, without the banking organization's consent, the posted collateral with:	**Level 1 assets**	Outflow rate: **0%**	Outflow rate: **0%**	Outflow rate: **0%**
	Level 2A assets	Outflow rate: **15%**	Outflow rate: **0%**	Outflow rate: **0%**
	Level 2B assets	Outflow rate: **50%**	Outflow rate: **35%**	Outflow rate: **0%**
	Non-HQLAs	Outflow rate: **100%**	Outflow rate: **85%**	Outflow rate: **50%**

Collateral outflow amount – Derivative collateral change § 32(f)(6)
The absolute value of the largest 30-consecutive calendar day cumulative net mark-to-market collateral outflow or inflow resulting from derivative transactions realized during the preceding 24 months.

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Prescribed Cash *Outflow* Rates *(cont.)*

Type of Cash Outflow	Outflow Rate	LCR "Light"
Retail brokered deposit outflow amount § 32(g)		
§ 32(g)(1): Brokered deposits at the banking organization provided by a retail customer or counterparty that are not described in § 32(g)(3) through § 32(g)(7), such as brokered deposits that are not reciprocal deposits or brokered sweep deposits, and which mature **≤** 30 calendar days from the calculation date.	**100%**	70%
§ 32(g)(2): Brokered deposits at the banking organization provided by a retail customer or counterparty that are not described in § 32(g)(3) through § 32(g)(7), such as brokered deposits that are not reciprocal deposits or brokered sweep deposits, and which mature **>** 30 calendar days from the calculation date.	**10%**	7%

Brokered deposit means any deposit held at the banking organization that is obtained, directly or indirectly, from or through the mediation or assistance of a deposit broker as that term is defined in Section 29 of the Federal Deposit Insurance Act, and includes a reciprocal brokered deposit and a brokered sweep deposit.

Brokered sweep deposit means a deposit held at the banking organization by a customer or counterparty through a contractual feature that automatically transfers to the banking organization from another **regulated financial company** at the close of each business day amounts identified under the agreement governing the account from which the amount is being transferred.

Reciprocal brokered deposit means a brokered deposit that a banking organization receives through a deposit placement network on a reciprocal basis, such that **(1)** for any deposit received, the banking organization (as agent for the depositors) places the same amount with other depository institutions through the network and **(2)** each member of the network sets the interest rate to be paid on the entire amount of funds it places with other network members.

Prescribed Cash *Outflow* Rates *(cont.)*

<table>
<tr><th>Type of Cash Outflow</th><th>Outflow Rate</th><th>LCR “Light”</th></tr>
<tr><td colspan="3">Retail brokered deposit outflow amount § 32(g)</td></tr>
<tr><td>§ 32(g)(3): Reciprocal brokered deposits at the banking organization provided by a retail customer or counterparty where the entire amount is fully insured by the FDIC.</td><td>10%</td><td>7%</td></tr>
<tr><td>§ 32(g)(4): Reciprocal brokered deposits at the banking organization provided by a retail customer or counterparty, where the entire amount is <u>not</u> fully insured by the FDIC.</td><td>25%</td><td>17.5%</td></tr>
<tr><td>§ 32(g)(5): Brokered sweep deposits at the banking organization provided by a retail customer or counterparty:
▪ That are deposited in accordance with a contract between the retail customer or counterparty and the banking organization, its consolidated subsidiary or a company that is a consolidated subsidiary of the banking organization’s top-tier parent company; and
▪ Where the entire amount is fully insured by the FDIC.</td><td>10%</td><td>7%</td></tr>
<tr><td>§ 32(g)(6): Brokered sweep deposits at the banking organization provided by a retail customer or counterparty:
▪ That are <u>not</u> deposited in accordance with a contract between the retail customer or counterparty and the banking organization, its consolidated subsidiary or a company that is a consolidated subsidiary of the banking organization’s top-tier parent company; and
▪ Where the entire amount is fully insured by the FDIC.</td><td>25%</td><td>17.5%</td></tr>
<tr><td>§ 32(g)(7): Brokered sweep deposits at the banking organization provided by a retail customer or counterparty where the entire amount is <u>not</u> fully insured by the FDIC.</td><td>40%</td><td>28%</td></tr>
</table>

Prescribed Cash *Outflow* Rates *(cont.)*

Type of Cash Outflow	Outflow Rate	LCR "Light"
Unsecured wholesale funding outflow amount § 32(h)		
§ 32(h)(1)(i): Unsecured wholesale funding that is <u>not</u> an operational deposit and is <u>not</u> provided by a regulated financial company, investment company, non-regulated fund, pension fund, investment adviser, identified company, sovereign entity, U.S. GSE, public sector entity, or MDB, or consolidated subsidiary of any of the foregoing, that is fully insured by the FDIC.	**20%**	14%
§ 32(h)(1)(ii): Unsecured wholesale funding that is <u>not</u> an operational deposit and is <u>not</u> provided by a regulated financial company, investment company, non-regulated fund, pension fund, investment adviser, identified company, sovereign entity, U.S. GSE, public sector entity, or MDB, or consolidated subsidiary of any of the foregoing, where: **(1)** the amount is <u>not</u> fully insured by the FDIC; <u>or</u> **(2)** the funding is a brokered deposit.	**40%**	28%
§ 32(h)(2): Unsecured wholesale funding that is <u>not</u> an operational deposit and is <u>not</u> included in § 32(h)(1), including funding provided by a consolidated subsidiary of the banking organization or a company that is a consolidated subsidiary of the banking organization's top-tier parent company.	**100%**	70%
§ 32(h)(3): **Operational deposits**,* other than escrow accounts, that are fully insured by the FDIC.	**5%**	3.5%
§ 32(h)(4): **Operational deposits** <u>not</u> included in § 32(h)(3), including all escrow accounts and operational deposits that are not fully insured by the FDIC.	**25%**	17.5%
§ 32(h)(5): All other types of unsecured wholesale funding, including deposit balances maintained in connection with the provision of prime brokerage services.	**100%**	70%

* Funds in excess of those required for the provision of operational services must be **excluded** from operational deposit balances and treated on a counterparty-by-counterparty basis as a non-operational deposit.

Prescribed Cash *Outflow* Rates *(cont.)*
Operational Deposits

- **Definition:** Operational deposit refers to unsecured wholesale funding that is required for the banking organization to provide **operational services** (as defined) as an independent third-party intermediary to the wholesale customer or counterparty providing the unsecured wholesale funding.
  - **Custody and Prime Brokerage Accounts for Funds and Advisers:** An account **cannot** qualify as an operational deposit if it is provided in connection with operational services provided to:
    - An investment company;
    - A non-regulated fund; or
    - An investment adviser.

Definitions on page 27

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Prescribed Cash *Outflow* Rates *(cont.)*
Operational Deposits

- **Operational services** refers to the following services, provided they are performed as part of cash management, clearing, or custody services:
  - Payment remittance;
  - Payroll administration and control over the disbursement of funds;
  - Transmission, reconciliation, and confirmation of payment orders;
  - Daylight overdraft;
  - Determination of intra-day and final settlement positions;
  - Settlement of securities transactions;
  - Transfer of recurring contractual payments;
  - Client subscriptions and redemptions;
  - Scheduled distribution of client funds;
  - Escrow, funds transfer, stock transfer, and agency services, including payment and settlement services, payment of fees, taxes, and other expenses; and
  - Collection and aggregation of funds.

Prescribed Cash *Outflow* Rates *(cont.)*
Operational Deposits

Recognition Requirements: In order to recognize a deposit as an operational deposit, a banking organization must comply with the following requirements:*

- The deposit must be held pursuant to a legally binding written agreement, the termination of which is subject to a minimum 30-day notice period or significant termination costs are borne by the customer providing the deposit if a majority of the deposit balance is withdrawn from the operational deposit prior to the end of a 30-day notice period;
- There must not be significant volatility in the average balance of the deposit;
- The deposit must be held in an account designated as an operational account;
- The customer must hold the deposit at the banking organization for the primary purpose of obtaining the operational services provided by the banking organization;
- The deposit account must not be designed to create an economic incentive for the customer to maintain excess funds therein through increased revenue, reduction in fees, or other offered economic incentives;
- The banking organization must demonstrate that the deposit is empirically linked to the operational services and that it has a methodology for identifying any excess amount, which must be excluded from the operational deposit amount;
- The deposit must not be provided in connection with the banking organization's provision of operational services to an investment company, non-regulated fund, or investment adviser; and
- The deposits must not be for correspondent banking arrangements pursuant to which the banking organization (as correspondent) holds deposits owned by another depository institution (as respondent) and the respondent temporarily places excess funds in an overnight deposit with the banking organization.

* The U.S. banking agencies stated that they intend to **closely monitor** classification of operational deposits by banking organizations to ensure that the deposits meet these requirements.

Prescribed Cash *Outflow* Rates *(cont.)*
Operational Deposits

- **Excess Balances:** Banking organizations are expected to develop internal policies and methodologies to ensure that amounts categorized as operational deposits are limited to only those funds needed to facilitate the customer's operational service needs.
  - Balances in excess of those required for the provision of operational services must be **excluded** from operational deposit balances and treated on a counterparty-by-counterparty basis as a non-operational deposit.
  - If a banking organization is unable to separately identify excess balances and balances needed for operational services, the entire balance must be treated as a non-operational deposit.

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Prescribed Cash *Outflow* Rates *(cont.)*

Type of Cash Outflow	Outflow Rate
Debt security outflow amount § 32(i)	
Debt securities, other than structured securities, issued by the banking organization that mature **>** 30 calendar days after the calculation date and for which the banking organization is the primary market maker.	**3%**
Structured securities issued by the banking organization that mature **>** 30 calendar days after the calculation date and for which the banking organization is the primary market maker.	**5%**
Secured funding outflow amount * § 32(j)(1)	
Funds the banking organization must pay pursuant to secured funding transactions, to the extent that the funds are secured by **Level 1** assets.	**0%**
Funds the banking organization must pay pursuant to secured funding transactions, to the extent that the funds are secured by **Level 2A** assets.	**15%**

Structured security means a security whose cash flow characteristics depend upon one or more indices or that have imbedded forwards, options, or other derivatives or a security where an investor's investment return and the issuer's payment obligations are contingent on, or highly sensitive to, changes in the value of underlying assets, indices, interest rates or cash flows.

Secured funding transaction means any funding transaction that gives rise to a cash obligation of the banking organization to a counterparty that is secured under applicable law by a lien on specifically designated assets owned by the banking organization that gives the counterparty, as holder of the lien, priority over the assets in the case of bankruptcy, insolvency, liquidation, or resolution. Secured funding transactions include repurchase transactions, loans of collateral to the banking organization's customers to effect short positions, other secured loans and borrowings from a Federal Reserve Bank.

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* Borrowings from the Federal Reserve Banks must be treated the same as other secured funding transactions because these borrowings are not automatically rolled over.

Prescribed Cash *Outflow* Rates *(cont.)*

Type of Cash Outflow	Outflow Rate
Secured funding outflow amount § 32(j)(1) ***(cont.)***	
Funds the banking organization must pay pursuant to secured funding transactions with sovereign entities, MDBs or U.S. GSEs that are assigned a risk weight of 20% under the U.S. Basel III standardized approach capital rules, to the extent that the funds are not secured by **Level 1 or Level 2A** assets.	**25%**
Funds the banking organization must pay pursuant to secured funding transactions, to the extent that the funds are secured by **Level 2B** assets.	**50%**
Funds received from secured funding transactions that are customer short positions where the customer short positions are covered by other customers' collateral and the collateral consists of **non-HQLAs**.	**50%**
All other funds the banking organization must pay pursuant to secured funding transactions, to the extent that the funds are secured by **non-HQLAs**.	**100%**

Short position means a legally binding agreement to deliver a non-cash asset to a counterparty in the future.

Prescribed Cash *Outflow* Rates *(cont.)*

Type of Cash Outflow				
Asset exchange outflow amount § 32(j)(2)				
The outflow rate depends on the type of assets being exchanged pursuant to the asset exchange between the banking organization and the counterparty.		Fair value under U.S. GAAP of these assets that the banking organization must **post** to a counterparty pursuant to an asset exchange:		
		Level 1 assets	**Level 2A assets**	**Level 2B assets**
Where the banking organization will **receive** these assets from the counterparty pursuant to the asset exchange:	**Level 1 assets**	Outflow rate: **0%**	Outflow rate: **0%**	Outflow rate: **0%**
	Level 2A assets	Outflow rate: **15%**	Outflow rate: **0%**	Outflow rate: **0%**
	Level 2B assets	Outflow rate: **50%**	Outflow rate: **35%**	Outflow rate: **0%**
	Non-HQLAs	Outflow rate: **100%**	Outflow rate: **85%**	Outflow rate: **50%**

Asset exchange means a transaction that requires the counterparties to exchange non-cash assets at a future date. Asset exchanges do not include secured funding and secured lending transactions.

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Prescribed Cash *Outflow* Rates *(cont.)*

<table>
<tr><th>Type of Cash Outflow</th><th>Outflow Rate</th></tr>
<tr><td colspan="2">Foreign central bank borrowing outflow amount § 32(k)</td></tr>
<tr><td colspan="2">Where the banking organization has borrowed from a foreign jurisdiction’s central bank, its foreign central bank borrowing outflow amount = amount based on the outflow rate that is assigned to borrowings from central banks in that jurisdiction’s LCR framework.

If the foreign jurisdiction has <u>not</u> specified a central bank borrowing outflow amount based on a prescribed outflow rate in its LCR framework, the foreign central bank borrowing outflow amount must be calculated under § 32(j).</td></tr>
<tr><td colspan="2">Other contractual outflow amount § 32(l)</td></tr>
<tr><td>Funding or amounts payable by the banking organization to counterparties under legally binding agreements that are not described above, e.g., salaries and any other payments owed 30 days or less from a calculation date.</td><td>100%</td></tr>
</table>

Exclusion for Intragroup Transactions. In calculating its cash outflows, a banking organization should exclude:

- Transactions between the banking organization and a consolidated subsidiary; and
- Transactions between two consolidated subsidiaries of the banking organization.

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Prescribed Cash *Inflow* Rates

Cash inflow amounts are calculated by multiplying the applicable inflow rate to each type of cash inflow.

LCR "Light": Cash inflows with a contractual maturity date must be calculated on the basis of the maturity occurring within **21** calendar days instead of 30 calendar days from a calculation date.

Type of Cash Inflow	Inflow Rate
Excluded cash inflows § 33(a)	
Amounts the banking organization holds in operational deposits at other regulated financial companies.	**0%**
Amounts the banking organization expects, or is contractually entitled to receive, ≤ 30 calendar days from the calculation date due to forward sales of mortgage loans and any derivatives that are mortgage commitments subject to § 32(d).	**0%**
The amount of any credit or liquidity facilities extended to the banking organization.	**0%**
The amount of any asset included in the banking organization's HQLAs and any amounts payable to the banking organization with respect to those assets.	**0%**
Any amounts payable to the banking organization from an obligation of a customer or counterparty that is a nonperforming asset as of the calculation date or that the banking organization has reason to expect will become a nonperforming exposure ≤ 30 calendar days from the calculation date.	**0%**
Amounts payable to the banking organization on any exposure that has **no contractual maturity date** or that matures after 30 calendar days of the calculation date.	**0%**

Nonperforming exposure means an exposure that is > 90 days past due or nonaccrual.

Since instruments with no contractual maturity date are excluded from a banking organization's cash inflows altogether, the 70% multiplier under LCR "light" for instruments and transactions that have no maturity date is not applicable.

Prescribed Cash *Inflow* Rates *(cont.)*

<table>
<tr><th>Type of Cash Inflow</th><th>Inflow Rate</th></tr>
<tr><td colspan="2">Net derivative cash inflow amount § 33(b)</td></tr>
<tr><td colspan="2">The net derivative cash inflow amount as of the calculation date is the sum of the net derivative cash inflow (if > 0) for each counterparty.
Net derivative cash inflow for a given counterparty is:
▪ The sum of the payments and collateral that the banking organization will receive from the counterparty ≤ 30 calendar days from the calculation date under derivative transactions;
▪ Less, if the derivative transactions are subject to a qualifying master netting agreement, the sum of the payments and collateral that the banking organization will make or deliver to the counterparty ≤ 30 calendar days from the calculation date under derivative transactions.</td></tr>
<tr><td colspan="2">Retail cash inflow amount § 33(c)</td></tr>
<tr><td>Payments contractually payable to the banking organization from retail customers or counterparties.</td><td>50%</td></tr>
<tr><td colspan="2">Unsecured wholesale cash inflow amount § 33(d)</td></tr>
<tr><td>Payments contractually payable to the banking organization from regulated financial companies, investment companies, non-regulated funds, pension funds, investment advisers, or identified companies, or from a consolidated subsidiary of any of the foregoing, or central banks.</td><td>100%</td></tr>
</table>

Prescribed Cash *Inflow* Rates *(cont.)*

Type of Cash Inflow	Inflow Rate
Unsecured wholesale cash inflow amount § 33(d) ***(cont.)***	
Payments contractually payable to the banking organization from **wholesale** customers or counterparties that are not regulated financial companies, investment companies, non-regulated funds, pension funds, investment advisers, or identified companies, or consolidated subsidiaries of any of the foregoing, **provided that**, with respect to revolving credit facilities, the amount of the existing loan is not included and the remaining undrawn balance is included in the outflow amount under § 32(e)(1).	**50%**
Securities cash inflow amount § 33(e)	
Contractual payments due to the banking organization on securities it owns that are **non-HQLAs**.	**100%**
Secured lending cash inflow amount § 33(f)(1)	
Contractual payments due to the banking organization pursuant to secured lending transactions, to the extent that the payments are secured by **Level 1** assets, provided that the Level 1 assets are included in the banking organization's HQLAs.	**0%**

Secured lending transaction means any lending transaction that gives rise to a cash obligation of a counterparty to the banking organization that is secured under applicable law by a lien on specifically designated assets owned by the counterparty and included in the banking organization's HQLAs that gives the banking organization, as holder of the lien, priority over the assets in the case of bankruptcy, insolvency, liquidation, or resolution. Secured lending transactions include reverse repurchase transactions and securities borrowing transactions. If the specifically designated assets are not included in the banking organization's HQLAs but are still held by the banking organization, the transaction is an unsecured wholesale funding transaction.

Prescribed Cash *Inflow* Rates *(cont.)*

Type of Cash Inflow	Inflow Rate
Secured lending cash inflow amount § 33(f)(1) ***(cont.)***	
Contractual payments due to the banking organization pursuant to secured lending transactions, to the extent that the payments are secured by **Level 2A** assets, provided that the banking organization is not using the collateral to cover any of its short positions, and provided that the Level 2A assets are included in the banking organization's HQLAs.	**15%**
Contractual payments due to the banking organization pursuant to secured lending transactions, to the extent that the payments are secured by **Level 2B** assets, provided that the banking organization is not using the collateral to cover any of its short positions, and provided that the Level 2B assets are included in the banking organization's HQLAs.	**50%**
Contractual payments due to the banking organization pursuant to secured lending transactions, to the extent that the payments are secured by **non-HQLAs**, provided that the banking organization is not using the collateral to cover any of its short positions.	**100%**
Contractual payments due to the banking organization pursuant to collateralized margin loans extended to customers, provided that the loans are <u>not</u> secured by HQLAs and the banking organization is not using the collateral to cover any of its short positions.	**50%**

Prescribed Cash *Inflow* Rates *(cont.)*

Type of Cash Inflow				
Asset exchange cash inflow amount § 33(f)(2)				
The inflow rate depends on the type of assets being exchanged pursuant to the asset exchange between the banking organization and the counterparty.		Fair value under U.S. GAAP of these assets that the banking organization will **receive** from a counterparty pursuant to the asset exchange:		
		Level 1 assets	**Level 2A assets**	**Level 2B assets**
Where the banking organization must **post** these assets to the counterparty pursuant to the asset exchange:	**Level 1 assets**	Inflow rate: **0%**	Inflow rate: **0%**	Inflow rate: **0%**
	Level 2A assets	Inflow rate: **15%**	Inflow rate: **0%**	Inflow rate: **0%**
	Level 2B assets	Inflow rate: **50%**	Inflow rate: **35%**	Inflow rate: **0%**
	Non-HQLAs	Inflow rate: **100%**	Inflow rate: **85%**	Inflow rate: **50%**

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Prescribed Cash *Inflow* Rates *(cont.)*

Type of Cash Inflow	Inflow Rate
Other cash inflow amounts § 33(g)	
Other cash inflow amounts that are not described above.	**0%**

Exclusion for Intragroup Transactions. In calculating its cash inflows, a banking organization should exclude:

- Transactions between the banking organization and a consolidated subsidiary; and
- Transactions between two consolidated subsidiaries of the banking organization.

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Falling Below 100% LCR During Periods of Stress

- A banking organization must generally maintain, on a consolidated basis, an LCR of ≥ 100% (once the LCR is fully phased-in).
  - However, the U.S. banking agencies recognize that under certain circumstances, it may be necessary for a banking organization's LCR to briefly fall below 100% to fund unanticipated liquidity needs.
- **Notification Requirement:** A banking organization must notify its primary federal banking regulator on any business day when its LCR is < 100%.
- **Liquidity Compliance Plan:** If a banking organization's LCR is < 100% for three consecutive business days, or if its primary federal banking regulator has determined that the banking organization is otherwise materially noncompliant with the LCR requirement, the banking organization must promptly provide a plan for achieving compliance with the minimum LCR requirement and other requirements in the U.S. LCR framework.

Falling Below 100% LCR During Periods of Stress *(cont.)*

- **Contents of Liquidity Compliance Plan:** A banking organization's liquidity compliance plan must include, as applicable:
  - An assessment of the banking organization's liquidity position;
  - Actions the banking organization has taken and will take to achieve full compliance with the U.S. LCR framework, including:
    - A plan for adjusting the banking organization's risk profile, risk management and funding sources in order to achieve full compliance; and
    - A plan for remediating any operational or management issues that contributed to noncompliance;
  - An estimated timeframe for achieving full compliance; and
  - A commitment to report to the primary federal banking regulator no less than weekly on progress to achieve compliance in accordance with the plan until full compliance is achieved.

Falling Below 100% LCR During Periods of Stress *(cont.)*

- **Supervisory and Enforcement Actions:** A banking organization's primary federal banking regulator may, at its discretion, take additional supervisory or enforcement actions to address noncompliance with the minimum LCR requirement.
- A supervisory or enforcement action may be appropriate based on:
  - Operational issues at the banking organization;
  - Whether the violation is a part of a pattern;
  - Whether the liquidity shortfall was temporary or caused by an unusual event; and
  - The extent of the shortfall or the noncompliance.
- A liquidity shortfall would not necessarily result in supervisory action, but, at a minimum, would result in heightened supervisory monitoring.
- As with other regulatory violations, a banking organization may be required to enter into a written agreement if it does not meet the minimum LCR requirement within an appropriate period of time.

Relationship Between U.S. LCR Proposal and Proposed Dodd-Frank *Qualitative* Liquidity Framework

- Section 165 of the Dodd-Frank Act requires the Federal Reserve to issue enhanced prudential standards, including liquidity standards, for ≥ $50 billion U.S. BHCs, ≥ $50 billion FBOs and nonbank SIFIs.
- **Domestic Proposal:** In December 2011, the Federal Reserve proposed enhanced prudential standards for ≥ $50 billion U.S. BHCs and U.S. nonbank SIFIs.
- **FBO Proposal:** In December 2012, the Federal Reserve proposed enhanced prudential standards for ≥ $50 billion FBOs and foreign nonbank SIFIs.
- **Qualitative Liquidity Framework:** The domestic proposal and the FBO proposal introduced a qualitative liquidity framework that focuses on liquidity risk management, cash flow projections, *internal* liquidity stress testing and maintaining a buffer of highly liquid assets sufficient to meet projected net cash flows under the *internal* stress tests. *See* visual on page 68.
  - The proposed **qualitative** liquidity framework represented the first stage in establishing a regulatory liquidity framework for large banking organizations.
  - The **quantitative** requirements in the U.S. LCR proposal are part of the second stage.

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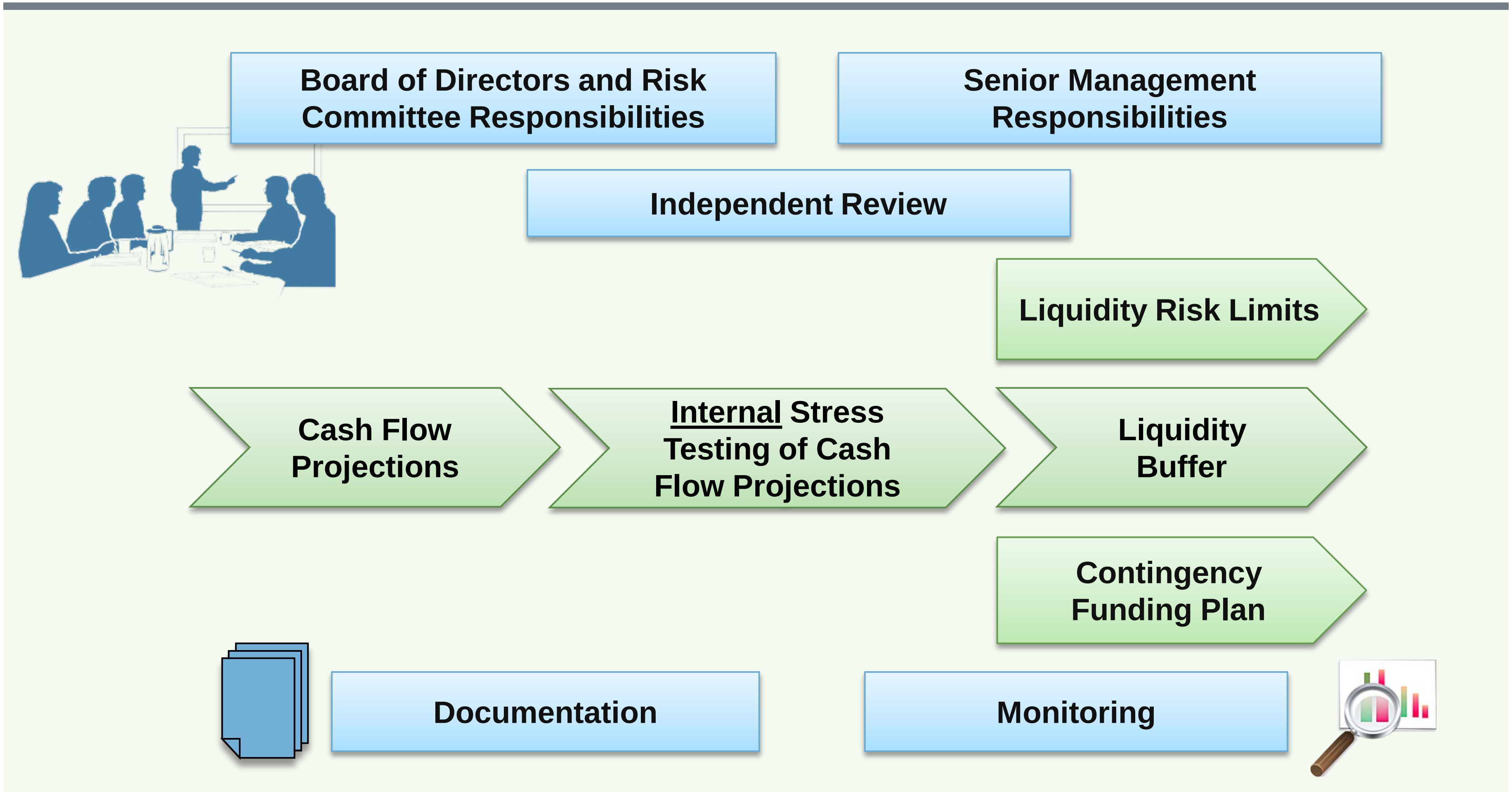
Related Resources: Davis Polk's memorandum on the domestic proposal is available here. Davis Polk's memorandum on the FBO proposal is available here.

Relationship Between U.S. LCR Proposal and Proposed Dodd-Frank *Qualitative* Liquidity Framework *(cont.)*

- According to the U.S. banking agencies, the proposed qualitative and quantitative liquidity requirements are intended to complement each other.
- The LCR is based on a **standardized supervisory** stress scenario.
- While the LCR would establish one scenario for stress testing, the U.S. banking agencies expect banking organizations to maintain robust **internal liquidity stress testing** frameworks that incorporate additional scenarios that are more tailored to their unique liquidity risk profiles.
- Banking organizations should use these additional internally developed liquidity stress scenarios in conjunction with the LCR to appropriately determine their liquidity buffers.
- The U.S. banking agencies noted that the LCR is a **minimum** requirement; banking organizations that pose greater systemic risk to the U.S. banking system or whose internal liquidity stress testing indicates a need for higher liquidity buffers may need to exceed the minimum LCR requirement to meet supervisory expectations.

Visual Overview of the Proposed Dodd-Frank *Qualitative* Liquidity Framework



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U.S. LCR Proposal vs. Proposed Dodd-Frank *Qualitative* Liquidity Framework

Topic	U.S. LCR Proposal	Proposed Dodd-Frank *Qualitative* Liquidity Framework
Assets Eligible for Liquidity Buffer	▪ HQLAs are categorized into different levels: Level 1; Level 2A; and Level 2B. ▪ Level 2A and 2B assets are subject to prescribed haircuts and quantitative caps.	▪ Highly liquid assets are <u>not</u> categorized into different levels. ▪ Only certain asset classes are automatically included in the definition of highly liquid assets: cash; securities issued or guaranteed by the U.S. government, a U.S. government agency or a U.S. GSE (*e.g.*, Fannie Mae and Freddie Mac). ▪ Banking organizations can include other assets in their liquidity buffer if the Federal Reserve is satisfied that those other assets meet certain criteria. ▪ Banking organizations must apply their own haircuts to highly liquid assets.
Cash Flow Projections	▪ Prescriptive, quantitative cash inflow and outflow rates that banking organizations must use to calculate their total net cash outflow amount under a 30-day liquidity stress period.	▪ Banking organizations must make **their own** cash flow projections and design **their own** liquidity stress scenarios that meet certain minimum requirements to stress test their cash flow projections. ▪ Does <u>not</u> prescribe cash inflow or outflow rates. ▪ Internal cash flow projections and liquidity stress scenarios must reflect the banking organization’s capital structure, risk profile, complexity, activities and size.

U.S. LCR Proposal vs. Proposed Dodd-Frank *Qualitative* Liquidity Framework *(cont.)*

Topic	U.S. LCR Proposal	Proposed Dodd-Frank *Qualitative* Liquidity Framework
Duration of Stress Period	▪ 30 days (on a continuous basis)	▪ Liquidity buffer is based on liquidity needs over a 30-day stress period, but liquidity stress tests must be conducted over a range of time horizons.
Frequency of Calculation	▪ LCR must be calculated on each business day.	▪ Stress tests that inform the liquidity buffer must be conducted at least monthly. ▪ Liquidity buffer must be maintained on a continuous basis.
Falling Below the Liquidity Buffer	▪ A banking organization must notify its primary federal banking regulator on any business day when its LCR is < 100%. ▪ If its LCR is < 100% for three consecutive business days, the banking organization must submit a liquidity compliance plan.	▪ Does <u>not</u> provide guidance on falling below the liquidity buffer. ▪ Substantial noncompliance with Dodd-Frank qualitative liquidity standards would trigger early remediation actions.

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Basel Committee's Public Disclosure Requirements for the LCR

Not Part of U.S. LCR Proposal

- U.S. banking agencies will issue a separate proposal addressing regulatory reporting and disclosure requirements for the LCR.

Basel Committee's LCR Disclosure Proposal

- In July 2013, the Basel Committee proposed public disclosure standards for the LCR.
- **Scope of Application:** The disclosure standards are intended to apply to internationally active banks on a consolidated basis.
- **Compliance Timing:** The Basel Committee expects national regulators to implement the LCR disclosure standards by January 1, 2015 so that banks in their jurisdiction may begin making disclosures in 2015.
- **Frequency of Disclosures:** Banking organizations are required to make LCR disclosures with the same frequency as the publication of their financial statements, irrespective of whether the financial statements are audited.
- **Location of Disclosures:** A banking organization's LCR disclosures must either be included in its published financial reports or, at a minimum, these financial reports must provide a direct and prominent link to LCR disclosures on the banking organization's website or in publicly available regulatory reports.

Basel Committee's LCR Disclosure Proposal: Content of Disclosures

- LCR disclosures must be made on a consolidated basis and presented in a single currency.
- Data must be presented as simple averages of daily observations over the previous quarter.
- **Common Quantitative Disclosure Template:** To promote consistency and ease of use of disclosures and to enhance market discipline, the Basel Committee's proposal would require banking organizations to disclose components of the LCR using a common disclosure template.
  - The common disclosure template contains 23 line items.
  - Both unweighted and weighted values of the LCR components must be disclosed.
    - The unweighted value of HQLAs refers to their market value.
    - The unweighted value of cash inflows and outflows refers to the outstanding balances of various types of liabilities, off-balance sheet items or contractual receivables.
    - The weighted value of HQLAs refers to the value after haircuts are applied.
    - The weighted value of cash inflows and outflows refers to the value after the prescribed inflow and outflow rates and assumptions are applied.

Basel Committee's LCR Disclosure Proposal: Content of Disclosures *(cont.)*

- **Qualitative Disclosures:** In addition to the common disclosure template, banking organizations should provide sufficient qualitative discussion of the LCR to facilitate a greater understanding of the quantitative disclosures. Where significant to the LCR, banking organizations could discuss:
  - Main drivers of LCR results and the evolution of the contribution of inputs to LCR calculations over time;
  - Intra-period changes and changes over time;
  - Composition of HQLAs;
  - Concentration of funding sources;
  - Derivatives exposures and potential collateral calls;
  - Currency mismatch in the LCR;
  - The degree of centralization of liquidity management and interaction between the group's units; and
  - Other inflows and outflows in the LCR calculation that are not captured in the common disclosure template but which the banking organization considers to be relevant for its liquidity profile.
- **Optional Additional Disclosures:** A banking organization may choose to disclose additional qualitative and quantitative information in order to facilitate understanding and awareness of its internal liquidity risk measurement and management.

What's Next in Bank Liquidity Reforms?

- **Interaction Between LCR and Central Bank Operations:** There is ongoing international study of the interaction between the Basel III LCR and central bank operations.
  - **U.S. Implementation:** U.S. banking agencies are working with the Basel Committee on these matters and may consider amending the U.S. LCR proposal if the Basel Committee proposes modifications to the Basel III LCR.
- **Net Stable Funding Ratio (NSFR):** According to the Basel Committee, the NSFR—Basel III's longer-term structural liquidity standard—is "currently under review . . . to address any unintended consequences prior to its implementation" by January 1, 2018.
  - **U.S. Implementation:** U.S. banking agencies are considering what changes to the NSFR they may recommend to the Basel Committee. They anticipate issuing a proposal to implement the NSFR in the United States ahead of its scheduled global implementation in 2018.
- **Final Version of Dodd-Frank Qualitative Liquidity Framework:** The Federal Reserve plans to finalize the Dodd-Frank enhanced prudential standards, including the Dodd-Frank qualitative liquidity framework, as set forth in the domestic proposal and FBO proposal.
- **Measures to Address Risks Related to Short-term Wholesale Funding:** The Federal Reserve is considering possible measures to address risks related to short-term wholesale funding, including additional liquidity and capital requirements.

Davis Polk Contacts

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

Luigi L. De Ghenghi	212 450 4296	luigi.deghenghi@davispolk.com
Randall D. Guynn	212 450 4239	randall.guynn@davispolk.com
Lena V. Kiely	212 450 4619	lena.kiely@davispolk.com
Cristina Victoria Regojo	202 962 7067	cristina.regojo@davispolk.com
Reena Agrawal Sahni	212 450 4801	reena.sahni@davispolk.com
Margaret E. Tahyar	212 450 4379	margaret.tahyar@davispolk.com
Andrew S. Fei	212 450 4063	andrew.fei@davispolk.com

Related Resources: Davis Polk's memoranda, visuals, interactive tools and webcasts on bank capital, liquidity and other prudential standards are available at **USBasel3.com**

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