

U.S. Basel III Liquidity Coverage Ratio Final Rule Visual Memorandum



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Davis Polk

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Overview of U.S. Liquidity Coverage Ratio Final Rule

- The Federal Reserve, OCC and FDIC (the Agencies) have issued a final rule 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 stress scenario.
- The final rule is more stringent than the Basel Committee's LCR framework in several significant respects.
- The final rule contains two versions of the LCR:
 - A **full version** for large, internationally active banking organizations.
 - A **modified version** for other large bank holding companies and savings and loan holding companies (depository institution holding companies).
- For banking organizations that are subject to the final rule **as of September 30, 2014**, the effective date of the final rule is **January 1, 2015**, subject to a two-year phase-in period.
 - A banking organization that meets the applicability threshold for the full LCR anytime **after September 30, 2014** must comply beginning on **April 1** of the following year.
 - A banking organization that meets the applicability threshold for the modified LCR anytime **after September 30, 2014** must comply beginning on the **first day of the first quarter** after it meets the threshold.



Key Changes from LCR Proposal

Topic	Key Changes in the Final LCR Rule from the LCR Proposal
Compliance Timing	<ul style="list-style-type: none"> ▪ New transition period for compliance with the daily LCR calculation requirement, during which monthly calculation is permitted
HQLAs	<ul style="list-style-type: none"> ▪ Expansion of the pool of publicly traded common equity shares that qualify as Level 2B assets ▪ Removal of the requirement that corporate debt securities be publicly traded on a national exchange to qualify as Level 2B assets ▪ Removal of collateralized deposits (as defined) from the calculation of amounts exceeding the composition caps for the three categories of assets
Outflows and Inflows	<ul style="list-style-type: none"> ▪ In the LCR proposal, total net cash outflow was based on a “peak day” approach. In the final rule, total net cash outflow is calculated based on net outflows over a 30-day period, plus a maturity mismatch add-on that uses a peak day approach but only includes certain outflows and inflows that are likely to cause maturity mismatch ▪ Adjustment of certain outflow and inflow rates ▪ Final definition of operational deposit includes operational deposits for registered investment companies and registered investment advisers
Modified LCR	<ul style="list-style-type: none"> ▪ Net cash outflows calculated over a 30-day period, rather than the proposed 21-day period, to be consistent with the Full LCR ▪ Monthly (instead of daily) LCR calculations under the Modified LCR

Which Organizations Are Affected?

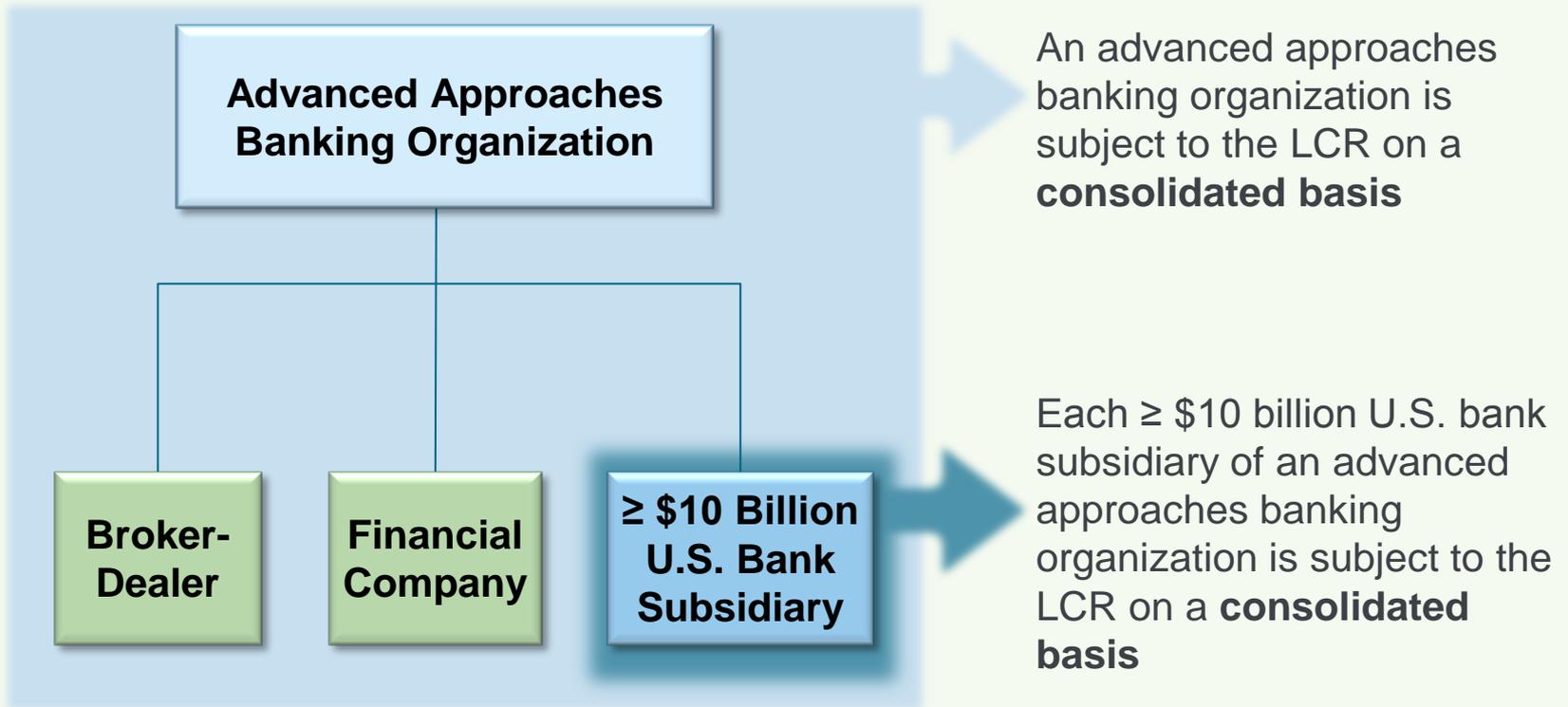
Subject to full LCR	Subject to modified LCR	<u>Not</u> subject to U.S. LCR
<ul style="list-style-type: none"> ▪ Advanced approaches banking organization: A U.S. banking organization with ≥ \$250 billion in total consolidated assets <u>or</u> ≥ \$10 billion in on-balance sheet foreign exposure* ▪ An advanced approaches banking organization's consolidated U.S. depository institution subsidiary that has ≥ \$10 billion in total consolidated assets ▪ 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 	<ul style="list-style-type: none"> ▪ U.S. bank holding companies (BHCs) and savings and loan holding companies (SLHCs) with ≥ \$50 billion in total consolidated assets that are not: <ul style="list-style-type: none"> ▪ Grandfathered unitary SLHCs deriving ≥ 50% of total assets or total revenues from activities not financial in nature; ▪ Insurance underwriting companies; <u>or</u> ▪ Holding ≥ 25% of total assets (other than credit risk insurance assets) in insurance underwriting subsidiaries. ▪ U.S. LCR does <u>not</u> apply to U.S. depository institution subsidiaries of the above-mentioned BHCs and SLHCs 	<ul style="list-style-type: none"> ▪ A U.S. 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 of the organization ▪ A banking organization that has opted into the U.S. advanced approaches capital rules ▪ A bridge financial company or its subsidiary, a new depository institution, or a bridge depository institution, as those terms are used in the resolution context ▪ A foreign banking organization (FBO) or U.S. intermediate holding company (IHC) not otherwise subject to the U.S. LCR

Nonbank SIFIs: The final rule does not apply to nonbank financial companies designated as systemically important by the Financial Stability Oversight Council or their consolidated depository institution subsidiaries. The Federal Reserve will establish any LCR requirement for such companies by separate rule or order.

Which Organizations Are Affected? *(cont.)*

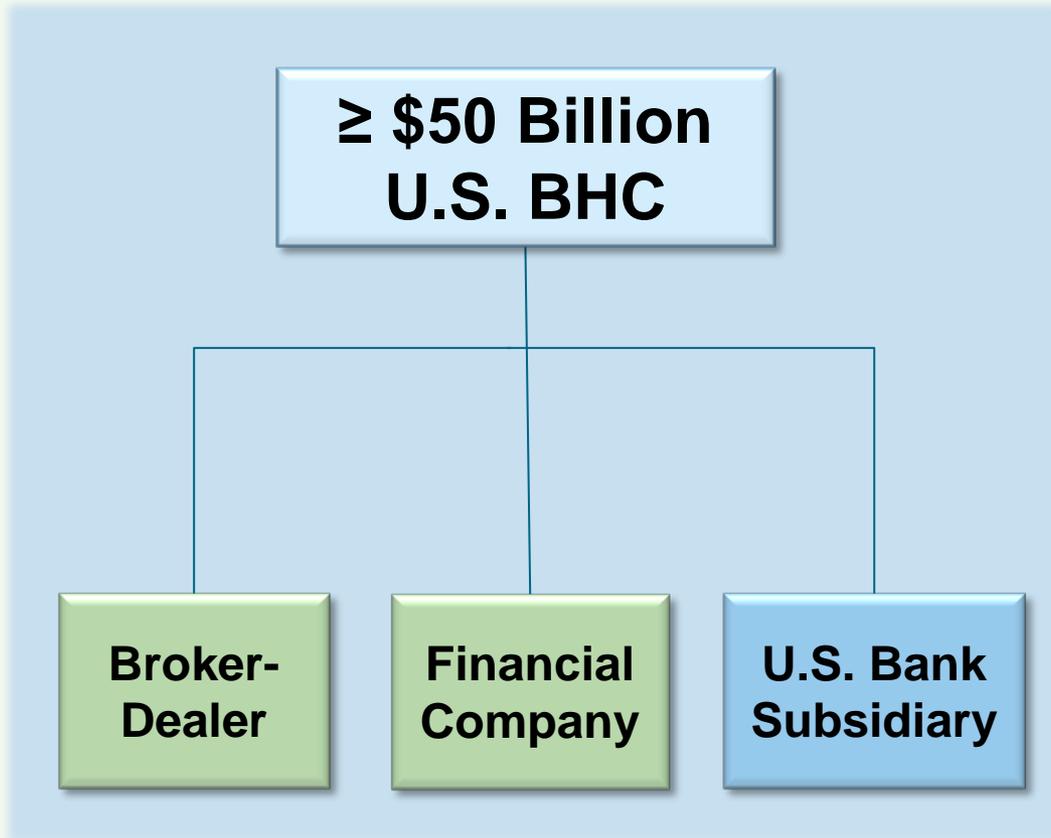
Advanced Approaches Banking Organization

- Both an advanced approaches banking organization and its \geq \$10 billion consolidated* U.S. bank subsidiary are subject to the full version of the LCR



Which Organizations Are Affected? *(cont.)*

≥ \$50 Billion U.S. BHC

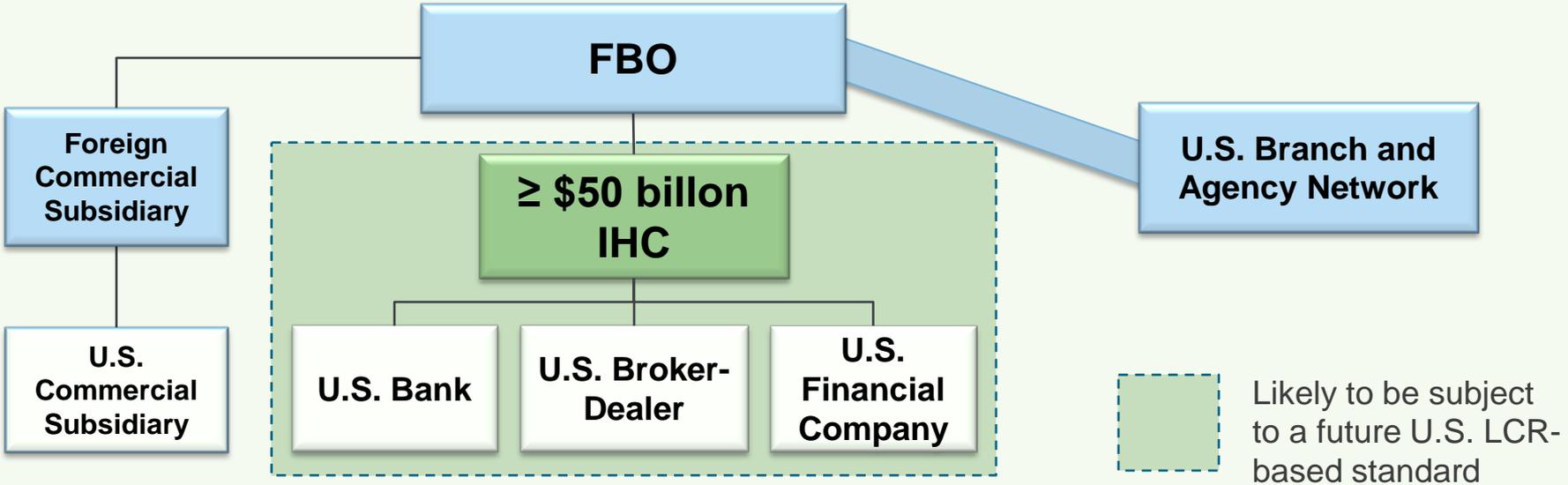


A ≥ \$50 billion U.S. BHC that is **not** an advanced approaches banking organization is subject to the modified LCR on a **consolidated basis**

Which Organizations Are Affected? *(cont.)*

Foreign Banking Organizations

- The final rule does not apply to **FBOs** or **IHCs** required to be formed under the Federal Reserve's Regulation YY that are not otherwise subject to the rule.
- The Federal Reserve stated that it anticipates a **future separate rulemaking** to implement an LCR-based standard for the U.S. operations of all or a subset of FBOs with \geq \$50 billion in **combined U.S. assets**.
 - The Federal Reserve did not indicate whether such a future standard might apply to U.S. branches and agencies of FBOs.



Summary of the LCR

- The U.S. 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 stress period.
 - **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, 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 are not commensurate with its liquidity risks.
- The U.S. LCR:
 - 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 and requiring an add-on calculation to address potential maturity mismatches between outflows and inflows.

$$\frac{\text{High-Quality Liquid Assets}}{\text{Total Net Cash Outflows}} \geq 100\%$$

Summary of the LCR: What Counts as HQLAs?

- As explained in more detail beginning on [page 20](#), the U.S. LCR 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.

* 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 are capped at 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 are capped at no more than **15%** of a banking organization's total HQLAs, generally include:
 - Certain corporate debt securities issued by non-financial companies; and
 - Certain publicly traded common equities issued by non-financial companies that are included in the Russell 1000 Index or a foreign equivalent index for shares held in foreign jurisdictions.
- Caps on Level 2 assets are meant to ensure that the majority of a banking organization's HQLAs consist of Level 1 assets.
 - The amount of Level 1 assets thus acts as a constraint on the recognition of Level 2 assets as HQLAs.

Summary of the LCR: Standardized Liquidity Stress Assumptions

- As explained in more detail beginning on [page 37](#), the types of liquidity pressures that are captured by the LCR's standardized stress assumptions, which are reflected in prescribed cash inflow and outflow rates and assumptions about counterparty and customer actions, include:
 - 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;
 - A partial loss of retail deposits and brokered deposits from retail customers; and
 - Other shocks that affect outflows linked to structured financing transactions, mortgages, central bank borrowings, and customer short positions.

U.S. LCR Final Rule Compliance Timeline

- Under the final rule, 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
Full U.S. LCR	80%	90%	100%	100%	100%
Modified U.S. LCR	—	90%	100%	100%	100%
EU CRD IV	60%	70%	80%	100%	100%
Basel Committee's LCR Framework (Jan. 2013)	60%	70%	80%	90%	100%

Basel Committee's LCR Framework vs. U.S. LCR Final Rule

Topic	Basel Committee's LCR Framework (Jan. 2013)	U.S. LCR Final Rule (Sept. 2014)
Scope of Application	<ul style="list-style-type: none"> ▪ A single version of the LCR designed for all internationally active banking organizations 	<ul style="list-style-type: none"> ▪ Two versions of the LCR: <ul style="list-style-type: none"> ▪ Full version for advanced approaches banking organizations and certain of their U.S. bank subsidiaries ▪ Modified version for large regional BHCs and SLHCs
Definition of HQLAs	<ul style="list-style-type: none"> ▪ 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 	<ul style="list-style-type: none"> ▪ HQLAs do not include: <ul style="list-style-type: none"> ▪ 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

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

Topic	Basel Committee's LCR Framework (Jan. 2013)	U.S. LCR Final Rule (Sept. 2014)
Prescribed Cash Inflow and Outflow Rates	<ul style="list-style-type: none"> ▪ 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 	<ul style="list-style-type: none"> ▪ For the full version of the LCR, total net cash outflow amount is based on outflows and inflows over a 30-day liquidity stress period, with a maturity mismatch add-on component based on difference between net cumulative peak day and net cumulative outflow amount on last day of 30-day 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 finance obligations ▪ Prescribed cash inflow and outflow rates are broadly similar to the Basel Committee's LCR framework in a number of categories
External Credit Ratings	<ul style="list-style-type: none"> ▪ Relies on external credit ratings to define certain HQLAs 	<ul style="list-style-type: none"> ▪ 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%	<ul style="list-style-type: none"> ▪ 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% 	<ul style="list-style-type: none"> ▪ A banking organization must notify its appropriate 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

When Is the LCR Calculated?

- **Full LCR:** A banking organization subject to the full LCR as of September 30, 2014 must calculate its LCR beginning **January 1, 2015** on a **daily** or **monthly** basis, depending on asset threshold.
- **Modified LCR:** A banking organization subject to the modified LCR as of September 30, 2014 must calculate its LCR beginning **January 1, 2016** on a **monthly** basis.

Frequency of LCR Calculation					
		2015		2016	
		Jan. 1 – June 30	July 1 – Dec. 31	Jan. 1 – June 30	From July 1
Full LCR	BHC or SLHC with ≥ \$700 billion in total consolidated assets or ≥ \$10 trillion in assets under custody*	Last business day of the calendar month	Each business day	Each business day	Each business day
	Any consolidated depository institution subsidiary of such a BHC or SLHC with ≥ \$10 billion in total consolidated assets*	Last business day of the calendar month	Last business day of the calendar month	Last business day of the calendar month	<i>Each business day</i>
Modified LCR	Any banking organization subject to the modified LCR	–	–	Last business day of the calendar month	Last business day of the calendar month

* Like the thresholds for the U.S. enhanced supplementary leverage ratio standards (eSLR – see Davis Polk memorandum [here](#)), these asset thresholds are designed to capture the 8 U.S. global systemically important banks (G-SIBs) and certain of their depository institution subsidiaries.

When Is the LCR Calculated? *(cont.)*

- There is a **transition period** to the daily LCR calculation for banking organizations that become subject to the full LCR anytime after September 30, 2014:
 - Monthly from April 1 to December 31 of the first year of compliance, and
 - Daily starting January 1 of the following year.
- A banking organization must calculate its LCR at the **same time on each calculation day**.
 - 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 prior written approval from its primary federal banking regulator.
- On each calculation date, a banking organization's LCR equals:

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

Modified LCR vs. Full LCR

- **30-Day Stress Period**
 - Unlike the Modified LCR 21-day stress period in the LCR proposal, the Modified LCR in the final rule uses the **same 30-day liquidity stress scenario** as the full version of LCR.
- **HQLAs**
 - Same definitions and eligibility criteria.
- **Total Net Cash Outflow Amount:** Same calculation as Full LCR but:
 - Without the peak-day maturity mismatch add-on
 - End result is multiplied by 70%

Numerator of LCR: HQLAs

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

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

- Level 1 asset amount = fair value under U.S. GAAP as of the calculation date **minus** the reserve balance requirement under section 204.5 of 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 may 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 the amount of HQLAs that exceeds the Level 2 and Level 2B asset caps as of the calculation date **without** unwinding any transactions.
- Adjusted excess HQLA amount** is 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 if eligible HQLAs are 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 2A asset amount), 0)

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

■ Adjusted Level 1 asset amount =

- fair value* of Level 1 assets that would be eligible HQLAs and would be held by a banking organization upon **unwinding** all secured funding transactions (other than collateralized deposits), 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 eligible HQLAs (HQLA Exchange Transactions), **minus**
- the amount of the reserve balance requirement under § 204.5 of the Federal Reserve's Regulation D (*i.e.*, the amount that a depository institution must maintain in an account at a Federal Reserve Bank in order to satisfy the portion of the institution's reserve requirement that is **not** met with vault cash).

Treatment of collateralized deposits: The final rule's unwind calculation for the adjusted Level 1 asset amount does not include secured funding transactions that are collateralized deposits, such as deposits placed by states and municipalities and certain corporate trust deposits.

- Collateralized deposits are still subject to an outflow assumption.

* Fair value under the final rule means fair value as determined under U.S. GAAP.

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

- **Adjusted Level 2A asset amount = 85%** of fair value of Level 2A assets that:
 - would be eligible HQLAs, and
 - 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 of Level 2B assets that:
 - would be eligible HQLAs, and
 - 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:** A banking organization's HQLAs must be unencumbered:
 - Free of legal, regulatory, contractual or other restrictions on the banking organization's ability to monetize them; and
 - Not pledged, explicitly or implicitly, to secure or to provide credit enhancement to any transaction.
 - **Exception:** Assets may be considered unencumbered if pledged to a central bank or a U.S. GSE where:
 - Potential credit secured by the assets is not currently extended to the banking organization or its consolidated subsidiaries;* and
 - The pledged assets are not required to support access to the payment services of a central bank.

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

General Eligibility Criteria for HQLAs *(cont.)*

- **SEC Rule 15c3-3 segregated accounts:** Funds held in such accounts are considered encumbered assets.
- **Transfer of HQLAs between entities:** If legal restrictions do not allow the transfer of HQLAs between entities (e.g., between subsidiary and holding company), only HQLAs equal to **the amount of that legal entity's net outflows** should be included in the banking organization's consolidated HQLAs.
 - **Exception:** If the amount of HQLAs subject to transfer restrictions is **less** than the amount of the legal entity's net outflows, the banking organization may include **all** of the legal entity's HQLAs in its consolidated HQLAs.
- **Borrowed securities:** Borrowed securities (including those acquired through reverse repurchase agreements) that have not been rehypothecated may be considered unencumbered if:
 - the banking organization has rehypothecation rights with respect to the securities, and
 - the securities are free of legal, regulatory, contractual, or other restrictions on the ability to monetize them and have not been pledged to secure or provide credit enhancement to any transaction, with certain exceptions.

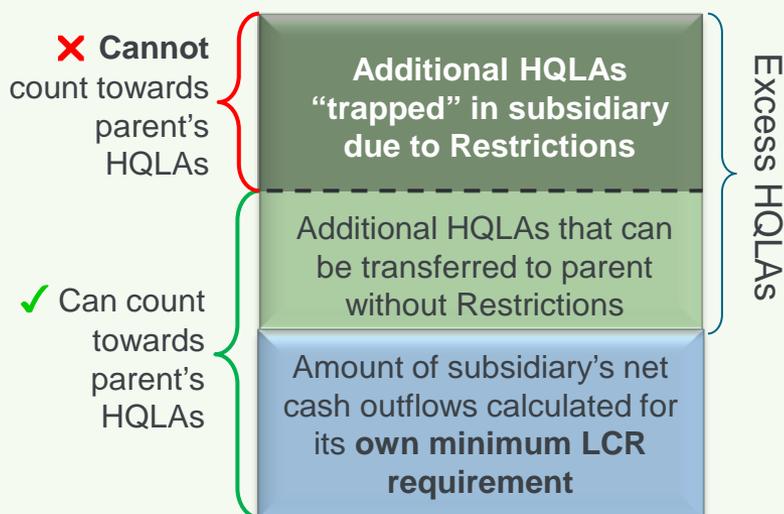
General Eligibility Criteria for HQLAs *(cont.)*

- **Client Assets:** HQLAs cannot include a client pool security held in a segregated account or an asset received from a secured funding transaction involving client pool securities held in a segregated account.
 - Client pool security is a security owned by a banking organization's customer that is not an asset of the banking organization, regardless of the banking organization's rehypothecation rights with respect to the security.
- **Certain Rehypothecated Assets:**
 - HQLAs cannot include any asset that the banking organization received with rehypothecation rights if the counterparty that provided the asset or the asset's beneficial owner has a contractual right to withdraw the asset without an obligation to pay more than *de minimis* remuneration at any time during 30 calendar days following the calculation date.
 - Exclusion extends to HQLAs resulting from transactions involving another asset received with such rehypothecation rights.
 - Generally, rehypothecated assets will be encumbered and therefore will not be includable in Eligible HQLAs, except if they are pledged to a central bank or U.S. GSE and meet the other requirements of the exception listed on [page 24](#).
- **Assets to Cover Operational Costs:** HQLAs cannot include assets specifically designated to cover operational costs such as wages or facility maintenance.

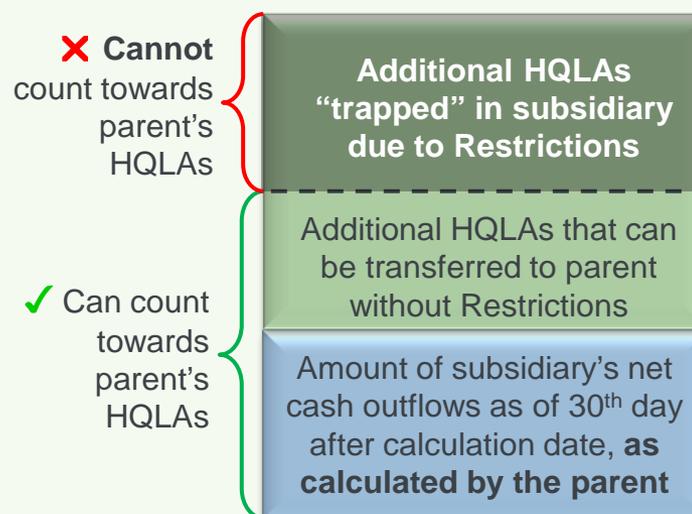
Counting HQLAs in Consolidated Subsidiaries Towards Parent Company's HQLAs

- HQLAs held by subsidiaries consolidated under U.S. GAAP are subject to limits on inclusion in the top-tier banking organization's HQLAs, depending on:
 - Whether the subsidiary is a U.S. or non-U.S. entity; and
 - Its ability 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).*
- A banking organization is required to apply only those Restrictions that are in effect as of the calculation date.

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



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

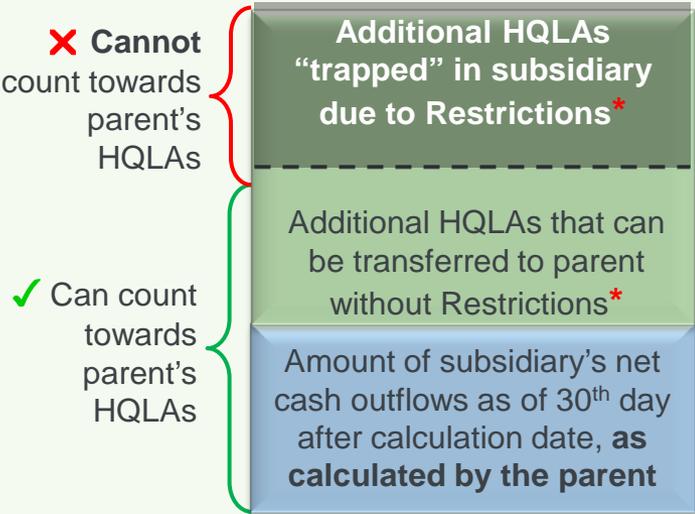


* Regulatory restrictions include Sections 23A and 23B of the Federal Reserve Act and Regulation W. Supervisory restrictions include enforcement actions, written agreements, supervisory directives or requests.

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

Non-U.S. Subsidiary

HQLAs must meet the requirements of the U.S. LCR, not those of the subsidiary's jurisdiction.



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

Maintaining HQLAs in the United States

- A banking organization is generally expected to maintain in the United States an amount and type of Eligible HQLAs that are sufficient to meet its total net cash outflows in the United States, as calculated under the final rule.
 - The Agencies will monitor this requirement through the supervisory process.
- The 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.

Operational Requirements for Eligible HQLAs

- A banking organization must meet all of the following operational requirements for HQLAs to be included in its HQLA amount (Eligible HQLAs):
- **Operational Capability to Monetize.** A banking organization must demonstrate 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 Eligible HQLA portfolio, including with respect to asset type, maturity and counterparty characteristics.
 - 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 Eligible HQLAs *(cont.)*

- Clarifications by the Agencies about the monetization standard:
 - To the extent that a banking organization monetizes assets, such as U.S. Treasury securities, on a regular, frequent basis through business-as-usual activities, it may rely on evidence of sales during the ordinary course of business and repurchase transactions of those assets to demonstrate its monetization capability.
 - However, if a banking organization monetizes certain assets sporadically or less frequently, it must monetize those types of assets through specific steps that go beyond ordinary business activities in order to meet the operational capability requirement.
 - Overnight reverse repurchase agreements (which are secured lending transactions) and the anticipated exchange of assets for cash when the transaction matures are not sufficient to meet the monetization standard.
 - Banking organizations must:
 - Show that they are not rolling over overnight reverse repurchase agreements indefinitely and hold or use the cash received from the maturing transactions for a sustained period; or
 - Periodically monetize the underlying assets through outright sale or transfer pursuant to a repurchase agreement.

Operational Requirements for Eligible HQLAs *(cont.)*

- **Control by Liquidity Management.** A banking organization must implement policies requiring control of HQLAs by the management function responsible for managing liquidity risk (e.g., Treasury).
 - 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 (no preferred method for showing segregation of assets); or
 - Demonstrating the ability to monetize HQLAs and making the proceeds available to the liquidity management function without conflicting with a business or risk management strategy of the banking organization.
 - An asset used to hedge a specific transaction cannot be included in HQLAs if the sale of the asset or its use in a repurchase transaction would conflict with another business or risk management strategy (e.g., exposes the banking organization to unhedged risk).
 - However, if an asset is used as a general macro hedge, it can still be included in the banking organization's Eligible HQLAs.
- **Termination of Specific Hedges.** The outflow amount resulting from the termination of any specific transaction hedging Eligible HQLAs must be deducted from the fair value of the applicable Eligible HQLAs.
 - This would not apply to general macro hedges.

Operational Requirements for Eligible HQLAs *(cont.)*

- **Policies and Procedures.** A banking organization must implement and maintain policies and procedures that determine the composition of its Eligible HQLAs on each applicable calculation date by:
 - Identifying its Eligible HQLAs by legal entity, geographical location, currency, account, or other relevant identifying factors as of the calculation date;
 - Determining that Eligible HQLAs meet the operational requirements; and
 - Ensuring appropriate diversification of its Eligible HQLAs by asset type, counterparty, issuer, currency, borrowing capacity, or other factors associated with the liquidity risk of the assets.

- **Documented Methodology.** A banking organization must have a documented methodology that results in a consistent treatment for determining that its Eligible HQLAs meet the operational requirements.

HQLAs: Key Definitions

Regulated financial company includes:

- A BHC or SLHC
- A company included in the organization chart of a BHC or SLHC on Form FR Y-6, as listed in the hierarchy report produced by the National Information Center website, **provided** that the top-tier BHC or SLHC is subject to the U.S. LCR
 - The Federal Reserve anticipates revising the reporting requirements used for this purpose in the near future.
- 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
- Any company not domiciled in the U.S. that is similar in structure to, and supervised and regulated in a manner similar to, entities listed above, *e.g.*, an FBO, foreign insurance company, foreign broker-dealer or foreign financial market utility

Regulated financial company does **not** include:

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

HQLAs: Key Definitions *(cont.)*

Collateralized deposit:

- A deposit of a public sector entity held at the bank that is secured under applicable law by a lien on assets owned by the bank and that gives the depositor, as holder of the lien, priority over the assets in the event the bank enters into receivership, bankruptcy, insolvency, liquidation, resolution, or similar proceeding; or
- A deposit of a fiduciary account held at the bank for which the bank is a fiduciary and sets aside assets owned by the bank as security under applicable banking regulations and that gives the depositor priority over the assets in the event bank enters into receivership, bankruptcy, insolvency, liquidation, resolution, or similar proceeding.

Financial sector entity: an investment adviser, investment company, pension fund, non-regulated fund, regulated financial company, or identified company.

Identified company: 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.

Investment company: a person or company registered with the SEC under the Investment Company Act of 1940 or foreign equivalents of such persons or companies.

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

HQLAs: Key Definitions *(cont.)*

Non-regulated fund: 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), other than a small business investment company.

- Consolidated subsidiaries of non-regulated funds are not included in the definition.
- The treatment of a foreign hedge fund or private equity fund whose investment adviser is not required to file Form PF is unclear.

Pension fund: 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.

HQLAs: Level 1 Assets

Level 1 Assets (No limit on proportion of HQLAs)	Haircut
<p>Balances held at a Federal Reserve Bank other than:</p> <ul style="list-style-type: none"> ▪ Reserve balance requirement under Regulation D (portion of reserve requirement not met with vault cash). As a result, only excess reserves held at a Federal Reserve Bank may be included in Level 1 assets. Vault cash, whether held in branches or ATMs, is excluded from Level 1 assets. ▪ Balances that a depository institution maintains on behalf of another institution; 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%
<p>Foreign withdrawable reserves (balances held by or on behalf of the banking organization at a foreign central bank that are <u>not</u> subject to restrictions on the banking organization's ability to use the reserves).</p>	
<p>A security issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, the U.S. Treasury.</p>	
<p>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.</p>	

HQLAs: Level 1 Assets

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, 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.	0%

Liquid and readily marketable means that a security is traded (through outright sales or repurchase transactions) 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.

A banking organization should be able to demonstrate its **security-by-security analysis** (which may include time-series analyses about the specific security or comparative analysis of similar securities from the same issuer) that HQLAs meet the liquid and readily marketable standard.

HQLAs: Level 1 Assets *(cont.)*

Level 1 Assets (No limit on proportion of HQLAs)	Haircut
<p>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, European Community, or an MDB, that is:</p> <ul style="list-style-type: none"> ▪ Assigned a 0% risk weight under the U.S. Basel III standardized approach capital rules as of the calculation date; <ul style="list-style-type: none"> ▪ 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 or guaranteed 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 financial sector entity or its consolidated subsidiary. 	<p>0%</p>
<p>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, if:</p> <ul style="list-style-type: none"> ▪ The sovereign entity issues the security in its own currency; ▪ The security is liquid and readily marketable; and ▪ 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 final rule. 	

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

^{*} A banking organization could demonstrate a historical record that meets this criterion by reference to historical market prices during times of stress, such as the 2007-2009 financial crisis.

HQLAs: Level 2A Assets

Level 2 Assets (Capped at 40% of total HQLAs)	Haircut
Level 2A Assets	
<p>A security issued by, or guaranteed as to the timely payment of principal and interest by, a U.S. GSE (<i>i.e.</i>, Fannie Mae, Freddie Mac, Federal Home Loan Banks (FHLB), and the Farm Credit System) that is:</p> <ul style="list-style-type: none"> ▪ 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. 	15%
<p>A security issued by, or guaranteed as to the timely payment of principal and interest by, a sovereign entity or MDB that is:</p> <ul style="list-style-type: none"> ▪ 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 or guaranteed by an entity whose obligations have a proven record as a reliable source of liquidity in repurchase or sales markets during stressed market conditions, as demonstrated by: <ul style="list-style-type: none"> ▪ 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% during a 30 calendar-day period of significant stress; and ▪ Not an obligation of a financial sector entity or its consolidated subsidiary. 	

* 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)	
<p>A corporate debt security that is:</p> <ul style="list-style-type: none"> ▪ Liquid and readily marketable; ▪ Investment grade under the OCC’s non-credit ratings based standard as of the calculation date; ▪ Issued or guaranteed by an entity whose obligations have a proven record as a reliable source of liquidity in repurchase or sales markets during stressed market conditions, as demonstrated by: <ul style="list-style-type: none"> ▪ The market price of the corporate debt security or equivalent securities of the issuer declining by $\leq 20\%$ 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 corporate debt security or equivalent securities of the issuer increasing by $\leq 20\%$ during a 30 calendar-day period of significant stress; and ▪ Not an obligation of a financial sector entity or its consolidated subsidiary. 	<p>50%</p>

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

Level 2 Assets (Capped at 40% of total HQLAs)	Haircut
Level 2B Assets (Capped at 15% of total HQLAs)	
<p>A publicly traded common equity share that is:</p> <ul style="list-style-type: none"> ▪ Liquid and readily marketable; ▪ Included in: <ul style="list-style-type: none"> ▪ The Russell 1000 Index; <u>or</u> ▪ 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; ▪ Issued in (1) U.S. dollars <u>or</u> (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; <ul style="list-style-type: none"> ▪ <i>Example:</i> A banking organization may hold a stock issued in Japanese yen as a level 2B asset only if the banking organization operates in Japan and the stock is available to support the organization's yen-denominated net cash outflows in Japan. <p style="text-align: right;"><i>Criteria continue on next page →</i></p>	<p>50%</p>

Publicly traded means, with respect to an equity security, that the equity 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.

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

Level 2 Assets (Capped at 40% of total HQLAs)	Haircut
Level 2B Assets (Capped at 15% of total HQLAs)	
<p><i>(Cont.)</i></p> <ul style="list-style-type: none"> ▪ 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, as demonstrated by: <ul style="list-style-type: none"> ▪ The market price of the security or equivalent securities of the issuer declining by $\leq 40\%$ 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 $\leq 40\%$, during a 30-calendar day period of significant stress; ▪ Not issued by a financial sector entity or by its consolidated subsidiary; ▪ 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 in which the publicly traded common equity share is held, as calculated by the banking organization under the U.S. LCR final rule. 	<p>50%</p>

Exchange-traded funds (ETFs) are excluded from Level 2B assets.

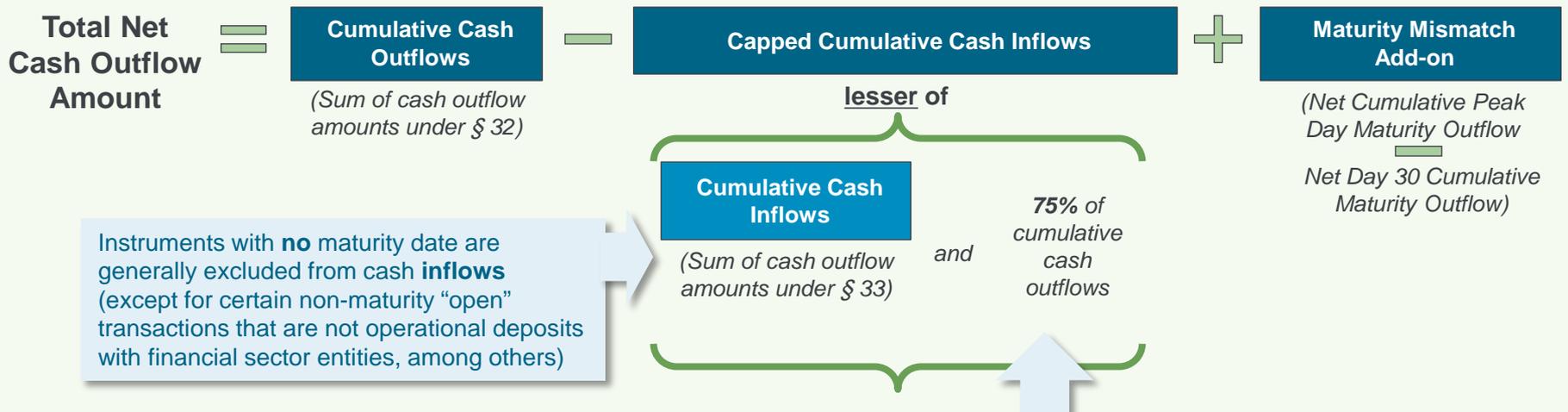
Excluded Assets

- Certain assets are excluded from counting as HQLAs, including:
 - Vault cash
 - Gold bullion
 - State and municipal securities
 - However, the staff memo to the Federal Reserve Board included a recommendation for the Board to develop a proposal for public comment to include highly liquid municipal securities as HQLAs.
 - Central bank restricted committed facility capacity
 - However, the Agencies stated they may propose at a future date to include such capacity as HQLAs.
 - The Basel Committee announced on January 12, 2014, an amendment to the Basel III Revised Liquidity Framework that included allowing capacity from restricted committed liquidity facilities of central banks as HQLAs.
 - Asset-backed securities
 - Covered bonds
 - Private-label mortgage-backed securities
 - Mortgage loans
 - Investment company shares (e.g., shares of mutual funds and money market funds)
 - ETFs
 - Collateral pledged to FHLBs that are not otherwise HQLAs
 - FHLB letters of credit
 - FHLB collateralized advance availability

Denominator of LCR: Total Net Cash Outflow Amount

Total Net Cash Outflow Amount on a calculation date represents:

- the amount of liquidity that a banking organization should expect to flow out of the consolidated organization over a 30-day stress period following the calculation date,
- minus** certain *inflows* that offset the outflows (capped at 75% of outflows),
- plus** an add-on to account for maturity mismatches from early inflows and late outflows,
- using standardized quantitative assumptions about the effects of the stress on outflow and inflow rates for different instrument and transaction types,
- while making the **most conservative assumptions** for determining maturity or transaction dates.



Total expected cash inflows cannot exceed 75% of cumulative cash outflows. This cap effectively sets a floor on a banking organization’s HQLAs at 25% of its total expected cash outflows.

Outflow and Inflow Table of Contents

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Maturity Mismatch: Basel Committee’s, LCR Proposal’s, and Final Rule’s Approaches

- Maturity mismatches occur when a banking organization has substantial contractual inflows late in a 30-day stress period and substantial outflows early in the same period.
- To account for maturity mismatches, instead of using the Basel Committee’s approach, the U.S. LCR proposal based total net cash outflow on the *peak* day within a 30-day stress period, when the difference between cumulative outflows and inflows, through that day, would be greatest.
- In response to numerous comments on this aspect of the LCR proposal, the final rule replaces the peak day approach for total net cash outflows with a “maturity mismatch add-on.”

Basel Committee’s LCR Framework	LCR Proposal	U.S. LCR Final Rule
<p>Calculates total net cash outflows based on the total cumulative amount at the end of the 30-day liquidity stress period.</p> <p>Is susceptible to maturity mismatches.</p>	<p>Peak day approach: total net cash outflow based on the largest net cumulative cash outflow day within a 30-day liquidity stress period.</p> <p>The concept of addressing potential maturity mismatches by focusing on the largest daily cumulative net cash outflow also appeared in the Federal Reserve’s enhanced liquidity management standards for large FBOs.</p>	<p>Similar to the Basel Committee’s approach, but with a maturity mismatch add-on to account for maturity mismatches between inflows and outflows.</p>

Formula for Calculating Maturity Mismatch Add-on

Maturity Mismatch Add-on

Net Cumulative Peak Day Maturity Outflow

(Largest daily difference in cumulative outflows and inflows with set maturity dates in the 30 calendar days following the calculation date)

Net Day 30 Cumulative Maturity Outflow

(Net cumulative outflow amount for outflows and inflows with set maturity dates on the 30th calendar day following the calculation date)

No cap on inflows
(compared to 75% cap on inflows for the non-add-on portion of total net cash outflow calculation)

Net Cumulative Maturity Outflow (for a particular day)
must be 0 or greater

Sum of certain outflow amounts calculated under § 32, maturing on or before the particular day

Sum of certain inflow amounts calculated under § 33, maturing on or before the particular day

Non-Maturity: Instruments or transactions with no maturity are excluded (except for certain “open maturity” unsecured wholesale, secured funding, and asset exchange transactions, for which maturity is determined under § 31(a)(4)). See [page 53](#).

Included Outflows and Inflows. The Maturity Mismatch Add-On includes only the following types of outflows and inflows:

Outflow Amounts Included: § 32:

- (g): Brokered deposit outflow amount for retail customers or counterparties ([page 68](#))
- (h)(1), (2), (5): Unsecured wholesale funding outflow amounts, except for escrow amounts and unsecured wholesale funding that is an operational deposit ([page 70](#))
- (j) Secured funding and asset exchange outflow amount ([page 77-81](#))
- (k) Foreign central bank borrowing outflow amount ([page 83](#))
- (l) Certain other non-operational contractual outflow amounts not otherwise described ([page 83](#))

Inflow Amounts Included: § 33:

- (c) Retail cash inflow amount ([page 55](#))
- (d) Unsecured wholesale cash inflow amount ([page 70](#))
- (e) Securities cash inflow amount ([page 83](#))
- (f) Secured lending and asset exchange cash inflow amount ([page 79-82](#))

Maturity Mismatch Add-On Example

	Outflows Likely To Cause Maturity Mismatch <i>(outflows under §§ 32(g), (h)(1), h(2), (h)(5), (j), (k), and (l) and that have a maturity date under § 31(a)(4))</i>	Cumulative Outflows Likely To Cause Maturity Mismatch	Inflows Likely To Cause Maturity Mismatch <i>(inflows under §§ 33(c), (d), (e) and (f) and that have a maturity date under section 31)</i>	Cumulative Inflows Likely To Cause Maturity Mismatch	Net Cumulative Maturity Outflows <i>(floored at 0)</i>
Day 24	40	390	9	339	51
Day 25	20	410	10	349	61
Day 26	10	420	125	474	0
Day 27	15	435	20	494	0
Day 28	20	455	15	509	0
Day 29	0	455	0	509	0
Day 30	10	465	8	517	0

Net Cumulative Peak Day Maturity Outflow: This is the largest net maturity outflow calculated for each of the 30 calendar days after the calculation date.

Net Day 30 Cumulative Maturity Outflow: Net cumulative maturity outflow on day 30.

Maturity Mismatch Add-on = Net Cumulative Peak Day Maturity Outflow (floored at 0) – Net Day 30 Cumulative Maturity Outflow (floored at 0)

= 61 – 0 = **61**

Determining Maturity of Instruments and Transactions

- In calculating outflows and inflows, a banking organization must make the **most conservative assumptions** for determining the maturity or transaction date for an instrument or transaction.
- In calculating outflows (inflows), a banking organization must assume the **earliest possible (latest possible)** maturity or transaction date, taking into account any option that could accelerate (extend) the maturity or transaction date as follows:

		Option to reduce maturity	Option to extend maturity
Outflows	Option held by investor or funds provider	Assume exercise of option at earliest possible date	Assume no exercise of option
	Option held by banking organization	Assume exercise of option at earliest possible date, <u>except</u> if either of the following is true, in which case the maturity is the original maturity date at issuance: A. Original maturity of the obligation is > 1 year and the option does not go into effect for a period of 180 days following the issuance of the instrument (<i>i.e.</i> , longer-term callable bonds); OR B. The counterparty is a sovereign entity, a U.S. GSE, or a PSE	
Inflows	Option held by borrower or banking organization	Assume no exercise of option	Assume exercise of option to extend maturity to latest possible date

- If an option is subject to a contractually defined notice period, a banking organization must determine:
 - For outflows: the earliest possible contractual maturity date **regardless of notice period**.
 - For inflows: the latest possible contractual maturity date assuming the borrower **uses entire notice period**.

Determining Maturity of Instruments and Transactions

(cont.)

■ Notice Periods

- Commenters requested recognition of contractual 30-day and longer notice periods in determining maturity or exclusion from outflow amounts
- The Agencies clarified that notice periods **are disregarded** because reputational considerations may drive a banking organization to waive them. These concerns exist “for **all types of counterparties**, including **wholesale and not just retail**, and regardless of whether there are contractual provisions favoring the [banking organization].”

■ Time deposits and other funding contracts

- Whether a time deposit or other funding contract is considered to have an “option” to withdraw before maturity (triggering the conservative assumption that the option is exercised) depends on the circumstances under which a withdrawal or acceleration can be made before maturity:

Circumstances Allowing Withdrawal or Acceleration	Maturity
Remote contingencies (i.e., death, incompetence, material adverse conditions)	At applicable maturity date
Notice or forfeiture of Interest	Earliest possible maturity date in accordance with provisions for non-maturity transactions (see page 53)

Determining Maturity of Instruments and Transactions

(cont.)

■ Matched Secured Lending and Asset Exchange Transactions

- For certain secured lending transactions or asset exchange transactions (those subject to §§ 33(f)(1)(iii) through (vii) or §§ 33(f)(2)(ii) through (x)) with contractual maturity of ≤ 30 days that generate an inflow in the form of collateral (**inflow-generating asset exchange**), and
- the banking organization uses the received collateral in a secured funding transaction or asset exchange with contractual maturity of ≤ 30 days that results in outflow in form of collateral (**outflow-generating asset exchange**), then
- the maturity date is the maturity date of **whichever these two transactions is later**.
- This treatment is meant to prevent the recognition of an earlier inflow of collateral where the collateral needed to cover the transaction does not become available until a later-maturing secured lending transaction or asset exchange

■ Segregated Broker-Dealer Inflow Amounts (Resulting from release of assets under statutory or regulatory requirements for the protection of customer trading assets, such as SEC Rule 15c3-3 – §33(g))

- The maturity is the date of the next scheduled calculation, in accordance with the banking organization's normal frequency of recalculating such requirements.

If Broker-Dealer Calculates Release of Segregated Account Balances:	Timing of Inflow
Daily	First calendar day after the calculation date
Weekly	Next scheduled calculation date

Determining Maturity of Instruments and Transactions

Non-Maturity Transactions

	Type of Non-Maturity Transaction	Maturity (except with respect to calculation of Maturity Mismatch Add-on)	Maturity for Purposes of Calculating Maturity Mismatch Add-on
Outflows	“Open” Maturity Outflows: Transactions that have no maturity, are not operational deposits, and are subject to any of the following provisions of § 32: <ul style="list-style-type: none"> (h)(2): unsecured wholesale funding provided by financial sector entities or their consolidated subsidiaries (h)(5): wholesale funding outflows not described in (h)(1)-(4) (j): secured funding and asset exchange transactions 	First calendar day after the calculation date	
	Foreign central bank borrowing outflows that have no maturity and are not operational deposits	First calendar day after the calculation date	Not included in calculation
	Any other cash outflow transaction that has no maturity date and is subject to § 32	Within 30 calendar days of the calculation date	
Inflows	“Open” Maturity Inflows: Transactions that have no maturity, are not operational deposits, and are subject to any of the following provisions of § 33: <ul style="list-style-type: none"> (d) unsecured wholesale cash inflow (f) secured lending and asset exchange transactions 	First calendar day after the calculation date	
	Any cash inflow transaction not described above that has no maturity date	Not included in calculation	

Prescribed *Outflow and Inflow* Rates

Outflow and inflow amounts are calculated by multiplying the applicable outflow / inflow rate by balance of each type of obligation or funding.

Type of Outflow or Inflow		Outflow	Inflow
Outflows	Retail funding (regardless of maturity – i.e., whether matures ≤ 30 days or > 30 days – or whether transaction is secured*) § 32(a)		
	(1) Stable retail deposits	3%	
	(2) All other retail deposits, including (i) deposits partially insured by the FDIC or (ii) deposits insured by foreign deposit insurance.	10%	
	All deposits placed at the bank by a third party on behalf of a retail customer or counterparty that are not brokered deposits, where the retail customer or counterparty owns the account and where:		
	▪ (3) the entire amount is covered by deposit insurance	20%	} Changed from 100% in LCR proposal
	▪ (4) less than the entire amount is covered by deposit insurance	40%	
	(5) All funding from a retail customer or counterparty that is <u>not</u>	40%	
(i) a retail deposit			
(ii) a brokered deposit provided by a retail customer or counterparty, or			
(iii) a debt instrument issued by the banking organization that is owned by a retail customer or counterparty			
Inflows	Retail cash inflow amount § 33(c)		
	Payments contractually payable to the banking organization from retail customers or counterparties.		50%

Pension fund deposits, if beneficiary can direct investments, are included in retail deposits placed by third parties.

Prescribed *Outflow and Inflow Rates* (cont.)

Type of Outflow or Inflow		
<i>Retail funding</i> (regardless of maturity – i.e., whether matures ≤ 30 days or > 30 days – or whether transaction is secured) § 32(a)	& <i>Retail cash inflow amount</i> § 33(c)	– Key Definitions

Deposit:

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

Retail deposit: 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: a customer or counterparty that is any of the following:

- An individual (i.e., a natural person but not a sole proprietorship).
- A business customer, only if and to the extent that **(i)** 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; **(ii)** transactions with the business customer have liquidity risk characteristics that are similar to comparable transactions with individuals; and **(iii)** the total aggregate funding raised from the business customer is < \$1.5 million.
- A living or testamentary trust that **(i)** is solely for the benefit of natural persons; **(ii)** does not have a corporate trustee; and **(iii)** terminates within 21 years and 10 months after the death of grantors or beneficiaries of the trust living on the effect date of the trust or within 25 years, if applicable under state law.

Stable retail deposits: a retail deposit that is fully covered by **FDIC deposit insurance*** and **(i)** is held by the depositor in a transactional account or **(ii)** 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.

* The U.S. LCR final rule 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 *Outflow and Inflow Rates* (cont.)

Type of Outflow or Inflow

Structured transaction outflow amount § 32(b)

If a banking organization is a sponsor* of a structured transaction, where the issuing entity is not consolidated on the banking organization's balance sheet under U.S. GAAP, the structured transaction outflow amount for each such 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: 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.

* The Agencies declined to define “**sponsor**” in the final rule because they believe the term to be generally understood within the marketplace. “Generally, the agencies consider covered companies to be sponsors when they have **significant control or influence over the structuring, organization, or operation of a structured transaction.**”

Prescribed *Outflow and Inflow Rates* (cont.)

Type of Outflow or Inflow

Net derivative cash outflow (inflow) amount § 32(c), 33(b) – Key Definitions

Derivative transaction: 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, forward 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: 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 Final Rule, a banking organization must comply with specified legal review standards.

Prescribed *Outflow and Inflow Rates* (cont.)

Treatment for same-day settling FX derivative transactions added by the final rule, bringing U.S. LCR in line with Basel Committee's LCR Framework.

Type of Outflow or Inflow

Net derivative cash outflow (inflow) amount §§ 32(c), 33(b)

The net derivative cash outflow (inflow) amount as of the calculation date is 100% of the sum of **the net derivative cash outflow (inflow) for each counterparty**,* which does not include forward sales of mortgage loans or derivatives that are mortgage commitments under § 32(d) (33(a)(2))

Net derivative cash outflow (inflow) for a given counterparty



(1) Net derivative cash outflow (inflow) for derivative transactions subject to a **qualifying master netting agreement**



(2) Net derivative cash outflow (inflow) **for foreign currency exchange derivative transactions** (regardless of whether subject to a qualifying master netting agreement) that result in the full exchange of contractual cash principal payments in different currencies within the same business day.

Net derivative cash outflow (inflow) for a set of derivative transactions, for a given counterparty



Gross Outflow (for a set of transactions)

The amount, if > 0, of contractual payments and collateral that the banking organization will **make or deliver to (receive from)** the counterparty ≤ 30 calendar days from the calculation date under derivative transactions.

Gross Inflow (for a set of transactions)

Contractual payments and collateral that the banking organization will **receive from (make or deliver to)** the counterparty ≤ 30 calendar days from the calculation date under derivative transactions.

Treatment of derivative transactions **not subject to qualifying master netting agreements** and that are **not same-day settling FX derivative transactions** – see [next page](#) →

Prescribed *Outflow and Inflow Rates* (cont.)

Type of Outflow or Inflow

Net derivative cash outflow (inflow) amount § 32(c), 33(b)

- The Agencies clarified that, under the LCR proposal, if derivative transactions are **not subject to a qualifying master netting agreement**, derivative cash outflows (inflows) for these transactions would be included in the net derivative cash outflow (inflow) amount, **without any netting** and subject to the LCR proposal's cap on total inflows. Aside from adding special treatment for certain same-day settling FX transactions not subject to qualifying master netting agreements, neither the final rule text nor preamble indicated a change to this treatment.
- **Net derivative cash outflow (inflow) for a given counterparty** should *also* include the following term:

With respect to any derivative transactions with a counterparty that:

- **are not subject to qualifying master netting agreements and**
- **are not foreign currency exchange derivative transactions that result in the full exchange of contractual cash principal payments in different currencies within the same business day,**

the amount (if > 0) of contractual payments and collateral that the banking organization will **make or deliver to (receive from)** the counterparty ≤ 30 calendar days from the calculation date under such transactions.

Prescribed *Outflow and Inflow Rates* (cont.)

Type of Outflow or Inflow		Outflow	Inflow
Outflows	<i>Mortgage commitment outflow amount</i> § 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%	
	<ul style="list-style-type: none"> The Agencies clarified that the outflow amount is based upon the amount contractually committed for the banking organization's own originations for retail mortgages that can be drawn upon 30 calendar days or less from the calculation date, and not the entire unfunded amount of commitments that cannot be drawn within 30 calendar days. The Agencies also clarified that mortgage commitment outflows may not be netted against such inflows as those related to Variable Interest Entity (VIE) liabilities (estimated cash inflows from linked assets in securitization trust), the forward sale of projected to-be-announced mortgage inflows, and GSE standby facilities. 		
Inflows	<i>Excluded mortgage cash inflows</i> § 33(a)(2)		
	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%

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

Prescribed *Outflow and Inflow Rates* (cont.)

Type of Outflow or Inflow

Commitment outflow amount § 32(e), **Excluded credit or liquidity facility inflows** § 33(a)(3) – Key Definitions

Committed: with respect to a credit facility or liquidity facility, under the terms of the legally binding written 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: 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.

- A credit facility does **not** include a legally binding written agreement to extend funds at a future date to a counterparty that is made for the purpose of refinancing the debt of the counterparty when it is unable to obtain a primary or anticipated source of funding.

Liquidity facility: a legally binding written agreement to extend funds at a future date to a counterparty that is made 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.
- If a facility has features of **both** credit and liquidity facilities, it must be classified as a liquidity facility.

Letter of Credit – the final rule clarifies that a letter of credit may be a credit facility or liquidity facility if it meets the relevant definition. Thus, banking organizations will need to review their letters of credit to determine whether they are commitments under the LCR.

* The Agencies clarified the definition of liquidity facility in the final rule by eliminating the requirement that the liquidity facility be made “expressly” for the purpose of refinancing debt. The definition in the final rule is intended to include commitments that are used to refinance debt, regardless of whether there is an express contractual clause.

Prescribed *Outflow and Inflow Rates* (cont.)

Type of Outflow or Inflow		Outflow
Outflows	Commitment outflow amount § 32(e)(1)	
	(i) 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	0%
	(ii) Undrawn amount of committed credit and liquidity facilities extended by the banking organization to retail customers or counterparties	5%
	(iii) Undrawn amount of committed credit facilities extended by the banking organization to a wholesale customer or counterparty that is <u>not</u> a financial sector entity or its consolidated subsidiary, including an SPE (except SPEs covered by (viii) below) that is a consolidated subsidiary of such customer or counterparty	10%
	(iv) Undrawn amount of committed liquidity facilities extended by the banking organization to a wholesale customer or counterparty that is <u>not</u> a financial sector entity or its consolidated subsidiary, including an SPE (except SPEs covered by (viii) below) that is a consolidated subsidiary of such customer or counterparty	30%
	(v) Undrawn amount of committed credit and liquidity facilities extended by the banking organization to depository institutions, depository institution holding companies and foreign banks (excluding (i) above).	50%
(vi) Undrawn amount of committed credit facilities extended by the banking organization to a financial sector entity or its consolidated subsidiary, including an SPE (except SPEs covered by (vii) below) that is a consolidated subsidiary of a financial sector entity (excluding (i) and (v) above)	40%	

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

Prescribed *Outflow and Inflow Rates* (cont.)

Type of Outflow or Inflow		Outflow	Inflow
Outflows	Commitment outflow amount § 32(e)(1) (cont.)		
	(vii) Undrawn amount of committed liquidity facilities extended to a financial sector entity or its consolidated subsidiary, including an SPE (except SPEs covered by (viii) below) that is a consolidated subsidiary of a financial sector entity, excluding (i) and (v) above and liquidity facilities included in § 32(b)(2) for structured transactions.	100%	
	(viii) Undrawn amount of all committed credit and liquidity facilities extended to an SPE* that issues or has issued CP or securities (other than equity securities issued to a company of which the SPE is a consolidated subsidiary) to finance its purchases or operations, and excluding liquidity facilities included in § 32(b)(2) for structured transactions.	100%	
	(ix): Undrawn amount of all other committed credit or liquidity facilities extended by the banking organization.	100%	
Inflows	Excluded credit or liquidity facility inflows § 33(a)(3)		
	The amount of any credit or liquidity facilities extended to the banking organization		0%

Special purpose entity, or SPE: 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.

* The final rule narrows the applicability of the 100% outflow rate for unconsolidated SPEs to only those types of SPEs that experienced stress during the financial crisis.

Prescribed *Outflow and Inflow Rates* (cont.)

Type of Outflow or Inflow

Commitment outflow amount § 32(e)(1) (cont.)

Determining the Undrawn Amount

Undrawn amount: entire unused amount that could be drawn upon within 30 calendar days of the calculation date under the governing agreement **less** the amount of Level 1 assets and Level 2A assets securing the facility.

- Amount of Level 1 assets = fair value of level 1 assets
- Amount of Level 2A assets = 85% of fair value of level 2A assets

Provided that:

- The assets pledged upon a draw on the facility would be Eligible HQLAs; and
- The assets have not been included in the banking organization's Eligible HQLA

- Notice periods for draws are not recognized.
- The Agencies clarified that, if a commitment's contractual terms provide for maturities > 30 days, or do not permit withdrawal but for the occurrence of a contractual milestone that cannot occur within 30 days, amounts of obligations with such maturities or subject to such milestone are **not** included in undrawn amount.
- The Agencies also declined to provide any special treatment for commitments to CCPs and financial market utilities (FMUs). The rationale is that these commitments generally require HQLAs to be posted as collateral, and the undrawn amount is reduced by Level 1 and 2A HQLAs securing such a commitment.

Prescribed *Outflow and Inflow Rates* (cont.)

Type of Outflow or Inflow	Outflow
<i>Collateral outflow amount</i> § 32(f)	
<p>(1) Changes in financial condition: Additional amount of collateral the banking organization could be contractually required to pledge or to fund under the terms of any transaction as a result of a change in the banking organization's financial condition.</p>	100%
<ul style="list-style-type: none"> ▪ The Agencies clarified that: <ul style="list-style-type: none"> ▪ All contract clauses related to posting or funding of collateral as a result of change of financial condition should be reviewed, including credit rating downgrade triggers, <u>but excluding</u> general material adverse change (MAC) clauses. ▪ All amounts of collateral that could be posted in accordance with downgrade trigger clauses in all applicable legal agreements should be included in collateral outflow amount ▪ 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 method for posting collateral that results in the lowest calculated outflow amount. 	
<p>(2) Derivative collateral potential valuation changes: Fair value of any collateral securing a derivative transaction pledged to a counterparty by the banking organization that is <u>not</u> a Level 1 asset.</p>	20%
<ul style="list-style-type: none"> ▪ The Agencies clarified that: <ul style="list-style-type: none"> ▪ Only collateral securing derivative transactions should be assessed, and not collateral supporting other transactions, such as that securing secured funding transactions under § 32(j) ▪ Consistent with other derivative netting provisions in the rule, banking organizations can apply the outflow rate to netted collateral, not the pre-netted gross amount, but only if the collateral can be netted under the same qualifying master netting agreement. 	

Prescribed *Outflow and Inflow Rates* (cont.)

Type of Outflow or Inflow	Outflow
<i>Collateral outflow amount</i> § 32(f) (cont.)	
<p>(3) Potential derivative valuation changes: The absolute value of the <u>largest</u> 30-consecutive calendar day cumulative net mark-to-market collateral outflow or inflow realized during the preceding 24 months resulting from derivative transaction valuation changes (<i>i.e.</i>, 2-year look-back on variation margin changes).</p>	100%
<ul style="list-style-type: none"> ▪ The Agencies clarified that the look-back should only include variation margin, not initial margin. 	
<p>(4) Excess collateral: Fair value of collateral that:</p> <ul style="list-style-type: none"> ▪ the banking organization could be required by contract to return to a counterparty because the collateral pledged 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 such that it cannot be rehypothecated; and ▪ is not already excluded as Eligible HQLA by the banking organization under § 22(b)(5) (exclusion for certain rehypothecated assets). 	100%
<p>(5) Contractually required collateral: Fair value of collateral that the banking organization is contractually required to pledge to a counterparty and, as of the calculation date, the banking organization has not yet pledged.</p>	100%

Prescribed *Outflow and Inflow Rates* (cont.)

Type of Outflow or Inflow

Collateral outflow amount – Collateral substitution § 32(f)(6)

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 the type of collateral with which it could be substituted under the contract without the banking organization's consent.

		Fair value of collateral pledged by a counterparty that qualifies as Eligible HQLA and as:		
		Level 1 assets	Level 2A assets	Level 2B assets
The counterparty may replace, without the banking organization's consent, the pledged 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%

- The Agencies clarified that this section applies only to collateral that a counterparty has posted to the banking organization as of the calculation date, and does not apply to collateral a banking organization has posted to a counterparty, nor to any collateral that the banking organization could repost to a counterparty, after a collateral substitution has occurred.

Prescribed *Outflow and Inflow Rates* (cont.)

Type of Outflow or Inflow				
<i>Retail brokered deposit outflow amount</i> § 32(g)				
Outflow rates for retail brokered deposits			Entire amount fully insured by the FDIC	
			Yes	No
Reciprocal brokered deposits at the banking organization provided by a retail customer or counterparty			10% § 32(g)(5)	25% § 32(g)(6)
Brokered sweep deposits at the banking organization provided by a retail customer or counterparty	deposited in accordance with a contract between the retail customer or counterparty and the banking organization, its controlled* subsidiary or a company that is a controlled subsidiary of the banking organization's top-tier parent company.	Yes	10% § 32(g)(7)	40% § 32(g)(9)
		No	25% § 32(g)(8)	

Brokered deposit: 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 defined in Section 29 of the Federal Deposit Insurance Act), and includes a reciprocal brokered deposit and a brokered sweep deposit.

Brokered sweep deposit: 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: 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.

* The final rule extended the outflow rates for retail brokered sweep deposits to subsidiaries and affiliates **controlled** for purposes of the Bank Holding Company Act of 1956, not just **consolidated** subsidiaries and affiliates.

Prescribed *Outflow and Inflow Rates* (cont.)

Type of Outflow or Inflow	Outflow
<i>Retail brokered deposit outflow amount</i> § 32(g)	
Other brokered deposits at the banking organization provided by a retail customer or counterparty (<i>i.e.</i> , those <u>not</u> described in §§ 32(g)(5) through 32(g)(9), such as: <ul style="list-style-type: none"> ▪ brokered deposits that are not reciprocal deposits or brokered sweep deposits; and ▪ non-maturity brokered deposits that are in transactional accounts, including those placed through certain third-party marketers, affinity groups and internet deposit broker entities) and which:	
(1) mature ≤ 30 calendar days from the calculation date.	100%
(2) mature > 30 calendar days from the calculation date.	10%
(3) are held in a transactional account with no contractual maturity date and are fully insured by the FDIC .	20%
(4) are held in a transactional account with no contractual maturity date and are not fully insured by the FDIC .	40%

- The Agencies clarified that:
 - All retail brokered deposits, **regardless of contractual provisions for withdrawal**, are subject to the above outflow rates.
 - The LCR final rule does not alter the treatment of pass-through FDIC insurance for deposits.
 - Brokered deposits held by a fiduciary agent on behalf of a retail customer or counterpart are subject to the applicable outflow rate for retail brokered deposits.
- Deposits held by a fiduciary on behalf of a retail customer or counterparty that are not brokered deposits are subject to the 20% and 40% outflow rates of §§ 32(a)(3) and (a)(4), as applicable. See [page 54](#).

Prescribed *Outflow and Inflow Rates* (cont.)

Type of Outflow or Inflow		Outflow	Inflow
Outflows	Unsecured wholesale funding outflow amount § 32(h)		
	(1) Unsecured wholesale funding that is <u>not</u> an operational deposit and is <u>not</u> provided by a financial sector entity or consolidated subsidiary if: <ul style="list-style-type: none"> ▪ (i) the amount is fully insured by the FDIC and the funding is not a brokered deposit. 	20%	
	<ul style="list-style-type: none"> ▪ (ii) (A) the amount is <u>not</u> fully insured by the FDIC; <u>or</u> (B) the funding is a brokered deposit. 	40%	
	(2) Unsecured wholesale funding that is <u>not</u> an operational deposit and is <u>not</u> included in § 32(h)(1) above, including (i) funding provided by a company that is a consolidated subsidiary of the same top-tier parent company of which the covered company is a consolidated subsidiary and (ii) debt instruments issued by the banking organization, including such instruments owned by retail customers or counterparties.	100%	
	(3) Operational deposits ,* other than operational deposits held in escrow accounts, that are fully insured by the FDIC.	5%	
	(4) Operational deposits <u>not</u> included in § 32(h)(3) above, including all escrow accounts and operational deposits that are <u>not</u> fully insured by the FDIC.	25%	
(5) All other types of unsecured wholesale funding, including deposit balances maintained in connection with the provision of prime brokerage services.	100%		
Inflows	Unsecured wholesale cash inflow amount § 33(d) and excluded inflows from operational deposits § 33(a)(1)		
	(1) Payments contractually payable to the banking organization from financial sector entities or their consolidated subsidiaries .		100%
	(2) Payments contractually payable to the banking organization from wholesale customers or counterparties that are <u>not</u> financial sector entities or their consolidated subsidiaries, provided that , with respect to revolving credit facilities, the amount of the existing loan is <u>not</u> included in the unsecured wholesale cash inflow amount and the remaining undrawn balance is included in the outflow amount under § 32(e)(1) above (commitment outflow amounts).		50%
	§ 33(a)(1): Amounts the banking organization holds in operational deposits at other regulated financial companies.		0%

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

Prescribed *Outflow and Inflow Rates* (cont.)

Operational Deposits

■ Definition of Operational Deposit:

- Unsecured wholesale funding or a collateralized deposit that is necessary for the banking organization to provide **operational services** (as defined on [next page](#)) as an independent third-party intermediary, agent or administrator to the wholesale customer or counterparty providing the unsecured wholesale funding or collateralized deposit.
 - Banking organization must also comply with operational requirements to recognize an operational deposit.
 - See definition of collateralized deposit on [page 35](#).
- **Prime brokerage deposits and operational services to non-regulated funds are excluded:** A deposit **cannot** qualify as an operational deposit if it is provided in connection with
 - prime brokerage services to any customer or third party, or
 - operational services to a non-regulated fund (as defined on [page 36](#)).

Prime brokerage services: a package of services offered by the banking organization whereby

- the banking organization, among other services, executes, clears, settles, and finances transactions entered into by the customer or a third-party entity on behalf of the customer (such as an executing broker), and
- the banking organization has a right to use or rehypothecate assets provided by the customer, including in connection with the extension of margin and other similar financing of the customer, subject to applicable law, and includes operational services provided to a non-regulated fund.

Prescribed *Outflow and Inflow Rates* (cont.)

Operational Deposits

- **Definition of Operational Services:** the following services, provided they are performed as part of cash management, clearing, or custody services:
 - Payment remittance;
 - Administration of payments and cash flows related to the safekeeping of investment assets, not including the purchase or sale of assets;
 - 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 capital distributions and recurring contractual payments;
 - Customer subscriptions and redemptions;
 - Scheduled distribution of customer 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 *Outflow and Inflow Rates* (cont.)

Operational Deposits

■ Operational Deposits

- Clarifications by the Agencies regarding the definition of operational services:
 - Administration of payments and cash flows, etc., is intended to cover collateral management payment processing.
 - Services solely involving the movement of money, not the transfer of collateral
 - Does not include any activity that would constitute prime brokerage services
 - Existing categories of services cover corporate trust services that should fall within the definition of operational services.

Prescribed *Outflow and Inflow Rates* (cont.)

Operational Deposits

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

- The related operational services must be performed pursuant to a legally binding written agreement; and
 - The termination of the agreement must be subject to a minimum 30-calendar day notice period; **or**
 - As a result of termination of the agreement or transfer of services to a third-party provider, the customer providing the deposit would incur significant contractual termination costs or switching costs (switching costs including significant technology, administrative, and legal service costs incurred in connection with the transfer of the operational services to a third-party provider).
 - The Agencies clarified that switching costs would not include routine costs of moving accounts.
- The deposit must be held in an account designated as an operational account.
 - The Agencies clarified that one or more linked accounts may be designated as operational and that designation is intended to prevent intermingling of operational deposits with other deposits and facilitate identification of excess balances.
- 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 Agencies clarified that earnings credit rates (ECR), to offset expenses related to operational services, are acceptable as long as they do not incentivize excess deposits.

[\(continued on next page →\)](#)

Prescribed *Outflow and Inflow Rates* (cont.)

Operational Deposits

Operational Requirements: ([continued from previous page](#))

- The banking organization must demonstrate that the deposit is empirically linked to the operational services and that it has a methodology that takes into account the volatility of the average balance for identifying any excess amount, which must be excluded from the operational deposit amount.
 - The Agencies clarified that excess balances may be calculated on an aggregated basis (by customer, service or both), but analysis must be sufficiently granular to assess the risks of withdrawal and must be documented.
- The deposit must not be provided in connection with the banking organization's provision of **prime brokerage services** (defined on [page 71](#)).
- The deposit must not be for arrangements in 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.

Prescribed *Outflow and Inflow Rates* (cont.)

Type of Outflow or Inflow	Outflow
<i>Debt security buyback outflow amount</i> § 32(i)	
Debt securities issued by the banking organization that mature > 30 calendar days after the calculation date and for which the banking organization or a consolidated subsidiary of the banking organization is the primary market maker, and that are:	
(1) not structured securities	3%
(2) structured securities	5%

Structured security: a security

- whose cash flow characteristics depend upon one or more indices, or
- that has embedded forwards, options, or other derivatives, or
- 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.

Prescribed *Outflow and Inflow Rates* (cont.)

Type of Outflow or Inflow	Outflow
Secured funding outflow amount * § 32(j)(1) – Key Definitions	

Secured funding transaction: any funding transaction that

- Is subject to a legally binding agreement as of the calculation date and
- Gives rise to a cash obligation of the banking organization to a counterparty that is secured under applicable law by a lien on assets owned by the banking organization, which gives the counterparty, as holder of the lien, priority over the assets in the event the banking organization enters into receivership, bankruptcy, insolvency, liquidation, resolution or similar proceeding.

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.

Customer short position: a legally binding written agreement pursuant to which the customer must deliver to the banking organization a non-cash asset that the customer has already sold.

Secured funding transaction and asset exchange outflow rates under § 32(j) and secured lending transaction and asset exchange inflow rates under § 33(f) apply only to transactions with wholesale counterparties.

Prescribed *Outflow and Inflow Rates* (cont.)

Type of Outflow or Inflow		Outflow
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:	(1)(i) Level 1 assets (<i>but see (1)(iii) below</i>)	0%
	(1)(ii) Level 2A assets (<i>but see (1)(iii) below</i>)	15%
	(1)(iv) Level 2B assets	50%
(1)(iii) Transactions with sovereigns, MDBs, and U.S. GSEs subject to a 20% risk weight under the U.S. Basel III standardized approach capital rules, to the extent secured by assets other than Level 1 or Level 2A assets		25% <i>but see (2) below</i>
(1)(v) 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 assets that are not HQLAs .		50%
(1)(vi) Funds the banking organization must pay pursuant to secured funding transactions, to the extent that the funds are secured by assets that are not HQLAs , except as above		100%
(2) If the outflow rate listed above is > outflow rate under § 32(h) for a wholesale unsecured transaction (that is not an operational deposit with the same wholesale counterparty)		Unsecured wholesale transaction (that is not operational deposit) rate for that counterparty
<ul style="list-style-type: none"> ▪ Exceptions: <ul style="list-style-type: none"> (2)(i) Secured funding transactions secured by collateral received by the banking organization under a secured lending transaction asset exchange 		Applicable outflow rate above
(2)(ii) Collateralized deposits that are operational deposits		Applicable operational deposits outflow rate in § 32(h)(3) or (h)(4), if such outflow rate < applicable outflow rate above

Prescribed *Outflow and Inflow Rates* (cont.)

Type of Outflow or Inflow						
Secured lending cash inflow amount § 33(f)(1)						
		Collateral is HQLA		Collateral is not HQLA		
		Included in Eligible HQLAs	Not included in Eligible HQLAs	Secures a collateralized margin loan	Does not secure a collateralized margin loan	
Held by banking organization and available for immediate return to the counterparty	Yes (including where the asset is pledged to a central bank or U.S. GSE but does not currently secure extended credit and is not required to support central bank payment services – see page 26)	Level 1: 0% Level 2A: 15% Level 2B: 50%	100%			
	No - Where the asset securing the secured lending transaction has been rehypothecated and used to secure	any secured funding transaction or obligation, or delivered in an asset exchange, that will mature within 30 calendar days of the calculation date*	N/A†	Level 1: 0% Level 2A: 15% Level 2B: 50%	50%	100%
		(or has been delivered into) any transaction or obligation which will not mature or expire within 30 calendar days or may extend beyond 30 calendar days of the calculation date)	N/A†	0%		

Inflow rate for contractual payments due to the banking organization pursuant to secured lending transactions

* Under § 31(a)(3) of the final rule, the maturity date of the secured lending transaction cannot be earlier than the maturity date of the secured funding transaction.

† These transactions are not applicable because transactions that have been “rehypothecated and used to secure” a transaction would generally be encumbered and therefore not includable in Eligible HQLAs. See [page 26](#).

Prescribed *Outflow and Inflow Rates* (cont.)

Type of Outflow or Inflow

Secured lending cash inflow amount § 33(f)(1) (cont.)

Secured lending transaction: any lending transaction that

- Is subject to a legally binding agreement of the calculation date and
- Gives rise to a cash obligation of a counterparty to the banking organization that is secured under applicable law by a lien on assets owned by the counterparty, which gives the banking organization, as holder of the lien, priority over the assets in the event the counterparty enters into receivership, bankruptcy, insolvency, liquidation, resolution, or similar proceeding.

Secured lending transactions include reverse repurchase transactions and securities borrowing transactions.

Secured lending cash inflow rates are designed to complement secured funding transaction outflow rates:

- 50% inflow rate on margin loans secured by assets that are not HQLAs reflects assumption that not all margin loans may pay down in a stress period.
 - Balances the 50% secured funding transaction outflow rate for customer short positions covered by other customers' collateral that does not consist of HQLAs.
- 0% inflow rate for a secured lending transaction or asset exchange that matures within 30 days, where collateral is reused in a secured funding transaction that matures > 30 days, reflects assumption that secured lending transaction or asset exchange may need to be rolled over and will not produce inflow.

Prescribed *Outflow and Inflow Rates* (cont.)

Type of Outflow or Inflow						
<i>Asset exchange outflow amount</i> § 32(j)(3)						
<p>The outflow rate depends on whether the banking organization has or will have available the asset that it will be required to deliver and the type of assets being exchanged pursuant to the asset exchange between the banking organization and the counterparty.</p>		<p>Outflow amount = fair value of the following types of assets that the banking organization must post to a counterparty pursuant to an asset exchange × the following applicable outflow rates</p>				
		<p>Banking organization has rehypothecated the assets underlying the asset exchange, and the assets will not be returned within 30 days of the calculation date</p> <p style="text-align: center;"> Yes No </p>				
		Any assets	Level 1 assets	Level 2A assets	Level 2B assets	Not HQLAs
Where the banking organization will receive these assets from the counterparty pursuant to the asset exchange:	Level 1 assets	0%	0%	0%	0%	0% [†]
	Level 2A assets	15%	15%	0%	0%	0% [†]
	Level 2B assets	50%	50%	35%	0%	0% [†]
	Not HQLAs	100%	100%	85%	50%	0% [†]

Asset exchange: a transaction in which, as of the calculation date, the counterparties have previously exchanged non-cash assets, and have each agreed to return such assets to each other at a future date. Asset exchanges do not include secured funding and secured lending transactions.

[†] The Agencies noted that “[a]sset exchanges can give rise to a change in a covered company’s liquidity, such as where the [banking organization] is obligated to provide higher-quality assets in return for less liquid, lower-quality assets.” Where the banking organization must provide assets that are of the lowest type (i.e., not HQLAs), there will be no outflows.

Prescribed *Outflow and Inflow Rates* (cont.)

Type of Outflow or Inflow						
<i>Asset exchange inflow amount</i> § 33(f)(2)						
<p>The inflow rate depends on whether the banking organization has or will have available the asset that it will be required to deliver and the type of assets being exchanged pursuant to the asset exchange between the banking organization and the counterparty.</p>		<p>Inflow amount = fair value of the following types of assets that the banking organization will receive from a counterparty pursuant to an asset exchange × the following applicable inflow rates</p>				
		<p>Banking organization has rehypothecated the assets underlying the asset exchange, and the assets will not be returned within 30 days of the calculation date</p> <p style="text-align: center;"> Yes No * </p>				
		Any assets	Level 1 assets	Level 2A assets	Level 2B assets	Not HQLAs
Where the banking organization must post these assets to a counterparty pursuant to the asset exchange:	Level 1 assets	0%	0%	0%	0%	0%†
	Level 2A assets	0%	15%	0%	0%	0%†
	Level 2B assets	0%	50%	35%	0%	0%†
	Not HQLAs	0%	100%	85%	50%	0%†

† The Agencies noted that “[a]sset exchanges can give rise to a change in a covered company’s liquidity, such as where the [banking organization] is obligated to provide higher-quality assets in return for less liquid, lower-quality assets.” Where the banking organization will receive assets that are of the lowest quality (*i.e.*, not HQLAs), there will be no inflows no matter what type of assets are given to the counterparty.

* Under § 31(a)(3) of the final rule, the maturity date of the asset exchange cannot be earlier than the maturity date of the transaction or obligation for which the collateral was reused.

Prescribed *Outflow and Inflow Rates* (cont.)

Type of Outflow or Inflow		Outflow	Inflow
Outflows	Foreign central bank borrowing outflow amount § 32(k)		
	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 in accordance with secured funding outflow rate under § 32(j).		
	Other contractual outflow amount § 32(l)		
	Operating expenses of the banking organization (such as rents, utilities, and other similar payments).	0%	
	Funding or amounts payable by the banking organization to counterparties under legally binding agreements that are not described above.	100%	
Inflows	Securities cash inflow amount § 33(e)		
	Contractual payments due to the banking organization on securities it owns that are not HQLAs.		100%

Prescribed *Outflow and Inflow Rates* (cont.)

Type of Outflow or Inflow	Inflow
Broker-dealer segregated account inflow amount § 33(g)	
<p>Fair value of assets released from broker-dealer segregated accounts maintained in accordance with statutory or regulatory requirements for the protection of customer trading assets (e.g., SEC Rule 15c3-3).</p> <ul style="list-style-type: none"> ▪ This amount is calculated as follows: <ul style="list-style-type: none"> ▪ fair value of the required balance as of the calculation date <p>minus</p> <ul style="list-style-type: none"> ▪ fair value of customer reserve account as of 30 calendar days from the calculation date (assuming changes to customer cash and collateral positions in accordance with outflows / inflows specified in the final rule) 	
<ul style="list-style-type: none"> ▪ If the result > 0, the difference is the segregated account inflow amount. 	100%
<ul style="list-style-type: none"> ▪ If the result is ≤ 0, no assets would be released from segregated accounts. 	0%

Prescribed *Outflow and Inflow Rates* (cont.)

Type of Inflow	Inflow
Other excluded cash inflows § 33(a)(4)-(6)	
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 <u>or</u> 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 with respect to any transaction that has no contractual maturity date or that matures > 30 calendar days from the calculation date. See page 53 .	0%
Other cash inflow amounts § 33(h)	
Other cash inflow amounts that are not described above.	0%

Exclusion for intragroup transactions (§§ 32(m), 33(i)). In calculating its outflows and 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.

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

Falling Below 100% LCR During Periods of Stress

- A banking organization must generally maintain, on a consolidated basis, an LCR of $\geq 100\%$ (once the LCR is fully phased in).
 - However, the 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:** Banking organizations that must calculate LCR on a **monthly** basis must promptly consult with the supervisory agency to determine whether the banking organization must provide to the agency a plan for achieving compliance with the minimum LCR and all other requirements of the Final Rule, if:
 - the banking organization's LCR is ***below the required minimum*** for any calculation date that is the last business day of the applicable calendar month; or
 - the agency has determined that the banking organization is otherwise ***materially noncompliant*** with the requirements of the Final Rule.

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

- **Required Liquidity Compliance Plan:** Banking organizations that must calculate LCR on a **daily** basis must promptly provide the supervisory agency with a plan for achieving compliance with the minimum LCR in the Final Rule and all other additional requirements, if:
 - the banking organization's LCR is below the minimum requirement for **three consecutive business days**; or
 - if the agency has determined that the banking organization is otherwise **materially noncompliant** with the requirements of the Final Rule.

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;
 - A plan for remediating any operational or management issues that contributed to noncompliance;
 - An estimated time frame 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 liquidity standard and other requirements of the final rule.
- 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.

Relationship Between U.S. LCR Final Rule and 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 \geq \$50 billion U.S. BHCs, \geq \$50 billion FBOs and nonbank SIFIs.
- **Domestic and FBO Final Rules:** In February 2014, the Federal Reserve finalized enhanced prudential standards for
 - \geq \$50 billion U.S. BHCs and U.S. nonbank SIFIs;
 - \geq \$50 billion FBOs and foreign nonbank SIFIs; and
 - $>$ \$10 billion in global assets FBOs.
- **Qualitative Liquidity Framework:** The domestic and FBO final rules introduce 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 92](#).
 - The **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 final rule are part of the second stage.

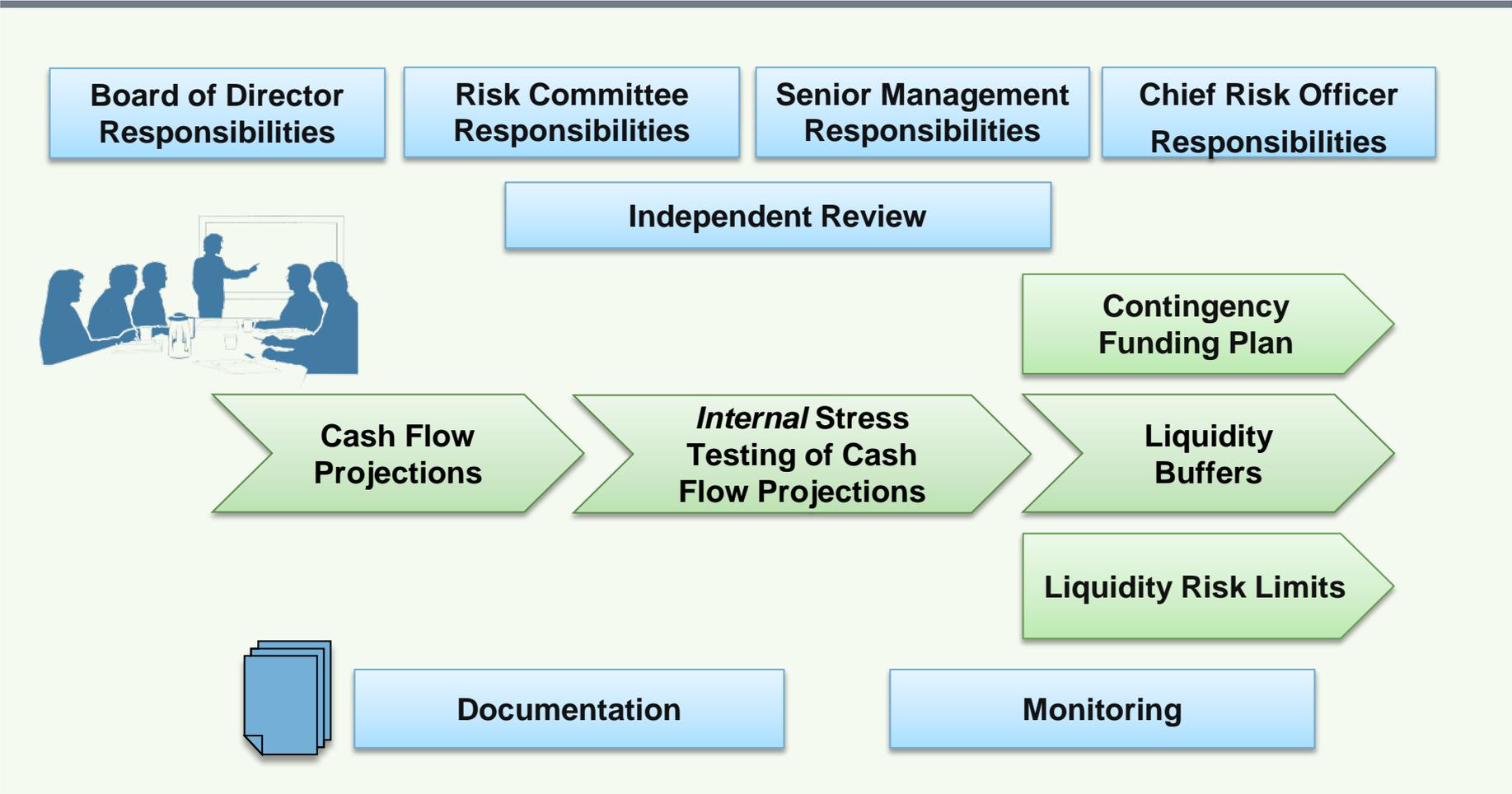
Related Resources: Davis Polk’s memoranda on the final rules for the qualitative liquidity framework are available at the following links:

- [Domestic final rule](#) | [Large FBO final rule for foreign banks](#) | [Foreign banks with limited U.S. footprint](#)
- [U.S. liquidity buffer requirement for foreign banks](#)

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

- According to the Agencies, the qualitative and quantitative liquidity requirements are intended to complement each other.
- The LCR is based on a **standardized supervisory** stress scenario.
- While the LCR establishes one scenario for stress testing, the 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 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 Dodd-Frank *Qualitative* Liquidity Framework



U.S. LCR Final Rule vs. Dodd-Frank *Qualitative* Liquidity Framework

Topic	U.S. LCR Final Rule	Dodd-Frank <i>Qualitative</i> Liquidity Framework
Assets Eligible for Liquidity Buffer	<ul style="list-style-type: none"> ▪ 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. 	<ul style="list-style-type: none"> ▪ 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	<ul style="list-style-type: none"> ▪ 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. 	<ul style="list-style-type: none"> ▪ 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 Final Rule vs. Dodd-Frank *Qualitative* Liquidity Framework *(cont.)*

Topic	U.S. LCR Final Rule	Proposed Dodd-Frank <i>Qualitative</i> Liquidity Framework
Duration of Stress Period	<ul style="list-style-type: none"> 30 days (on a continuous basis) 	<ul style="list-style-type: none"> 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	<ul style="list-style-type: none"> A banking organization subject to the full LCR must calculate LCR on each business day. A banking organization subject to modified LCR must calculate LCR monthly. 	<ul style="list-style-type: none"> 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	<ul style="list-style-type: none"> A banking organization must notify its primary federal banking regulator on any business day when its LCR is < 100%. If required to calculate on a monthly basis, a banking organization must promptly consult with regulators to determine whether it must submit a compliance plan when its LCR is below < 100%. If required to calculate on a daily basis, the banking organization must submit a liquidity compliance plan if its LCR is < 100% for three consecutive business days. 	<ul style="list-style-type: none"> 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.

Basel Committee's Public Disclosure Standards for the LCR

Not Part of U.S. LCR Final Rule

- The Agencies will issue a separate proposal addressing regulatory reporting and disclosure requirements for the LCR.

Basel Committee's LCR Disclosure Proposal

- In January 2014, the Basel Committee finalized 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, and concurrently with, the publication of their financial statements, irrespective of whether the financial statements are audited.
- **Location of Disclosures:** A banking organization's LCR disclosures either must be included in its published financial reports or, at a minimum, 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 Standards: 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.
 - Banking organizations must publish the number of data points used in calculating the average figures.
 - National regulators may allow banking organizations to calculate averages based on **monthly** figures up to the first reporting period after January 1, 2017, after which averages must be based on daily data.
- **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.
 - For most data items, both unweighted and weighted values of the LCR components must be disclosed.
 - 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.
 - Total HQLAs and total net cash outflows must be disclosed as the adjusted value, *i.e.*, the value after haircuts and/or any applicable caps are applied.

Basel Committee's LCR Disclosure Standards: 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 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;
 - Derivative 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?

- **Net Stable Funding Ratio (NSFR):** In January 2014, the Basel Committee proposed revisions to the NSFR—Basel III's longer-term structural liquidity standard—and stated that it intends for the NSFR, including any revisions, to “become a minimum standard” by January 1, 2018.
 - **U.S. Implementation:** The Agencies stated that they anticipate issuing a proposal to implement the NSFR in the United States once the Basel Committee adopts a final international version.
- **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:
 - Directly accounting for reliance on such funding in the G-SIB risk-based capital surcharge, and
 - Setting minimum collateral haircuts for securities financing transactions.

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