MEMORANDUM

TO: File Number S7-08-12

FROM: Valentina Minak Deng
Special Counsel
Office of Financial Responsibility, Division of Trading and Markets
U.S. Securities and Exchange Commission

DATE: September 25, 2013

RE: Meeting with SIFMA Representatives

On September 25, 2013, Commission staff met in-person with representatives of the Securities Industry and Financial Markets Association ("SIFMA") to discuss the proposed rules and rule amendments on capital, margin, and segregation requirements for security-based swap dealers and major security-based swap participants and capital requirements for broker-dealers (release number 34-68071).

Commission staff included Mark Attar, Michelle Danis, Valentina Deng, James Giles, Denise Landers, Ray Lombardo, Michael Macchiaroli, Thomas McGowan, John Ramsay, Adam Ray, Randall Roy, Christian Sabella, Sheila Swartz, and Charles Wilson. In addition, Marshall Levinson of the Financial Industry Regulatory Authority attended the meeting.

SIFMA representatives at the meeting included Patrick Dempsey (J.P. Morgan), Thomas Favia (Goldman Sachs), Keith Huebsch (Bank of America), Andrew Nash (Morgan Stanley), Pavlos Papegeorgiou (Morgan Stanley), Richard Seitz (Bank of America), Mary Kay Scucci (SIFMA), Randy Snook (SIFMA), Bill Tirrell (Bank of America), and Chris Van Woeart (Goldman Sachs).

LIQUIDITY
SEC PRESENTATION

SEPTEMBER 25, 2013

Agenda

- Overview
- Executive Summary
- Illustration of a firm's consolidated liquidity risk management
- New Regulatory Landscape
- Specific recommendations based on the Commission's proposed rule

  A. Firm-wide liquidity risk management recommendations:

  1. Recognition of liquid assets held by a B-D/SBSD parent
  2. Recognition of inter-company funding sources in B-D/SBSD stress tests
  3. Alignment of B-D/SBSD and BHC liquid asset standards

  B. Recommendations to improve the operation of the B-D/SBSD liquidity regime:

  1. Recognition of intraday liquidity requirements
  2. Stress period liquidity draw downs
  3. Appropriate phase-in arrangements
- Technical Annexes A-E

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Overview

- SIFMA members support the Commission's effort to require B-Ds and SBSDs to have adequate sources of liquidity to withstand stressed market conditions.

- SIFMA members support the Commission's general approach to liquidity stress testing in the proposed rule.

  - With the limited exceptions identified in this presentation, the stress assumptions identified in the Commission's proposed rule are appropriate for formulating stress tests.

- SIFMA recommendations are consistent with liquidity expectations in firms' resolution plans, which seek to ensure liquidity support for material legal entities in a crisis.

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Overview

- SIFMA's comments in this presentation address two categories of limitations in the Commission's proposed rule:

A. The Commission's proposed liquidity framework must be better integrated with consolidated liquidity risk management at firms subject to Federal Reserve liquidity requirements.

B. The Commission's proposed liquidity framework must better reflect some of the practical considerations of actually managing liquidity risk, which includes recognizing exceptions for intraday liquidity management, permitting liquidity reserve usage during stress events, and recognizing appropriate transition periods before full compliance with new regulations.

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Executive Summary

Firm-wide liquidity risk management recommendations:

1. The Commission's liquidity regime should recognize assets held by the parent for purposes of meeting entity-level B-D/SBSD liquidity requirements.
2. The Commission's liquidity stress tests applied to B-Ds and SBSDs should recognize inter-company funding sources where the parent organization is subject to regulatory liquidity requirements and stress tests on a consolidated basis.
3. The Commission's liquid asset standards for B-Ds and SBSDs should be aligned with the liquid asset standards imposed by the Federal Reserve for the consolidated organization.

Recommendations to improve the operation of the B-D/SBSD liquidity regime:

1. The Commission's liquidity regime should require firms to meet liquidity standards on a day-end basis, not on an intraday basis.
2. The Commission's liquidity regime should permit firms to draw down liquidity reserves during a stress event, rather than maintain a 100% liquidity reserve at all times.
3. The Commission should adopt an appropriate phase-in schedule for liquidity requirements based on the liquidity phase-in schedule for bank holding companies.

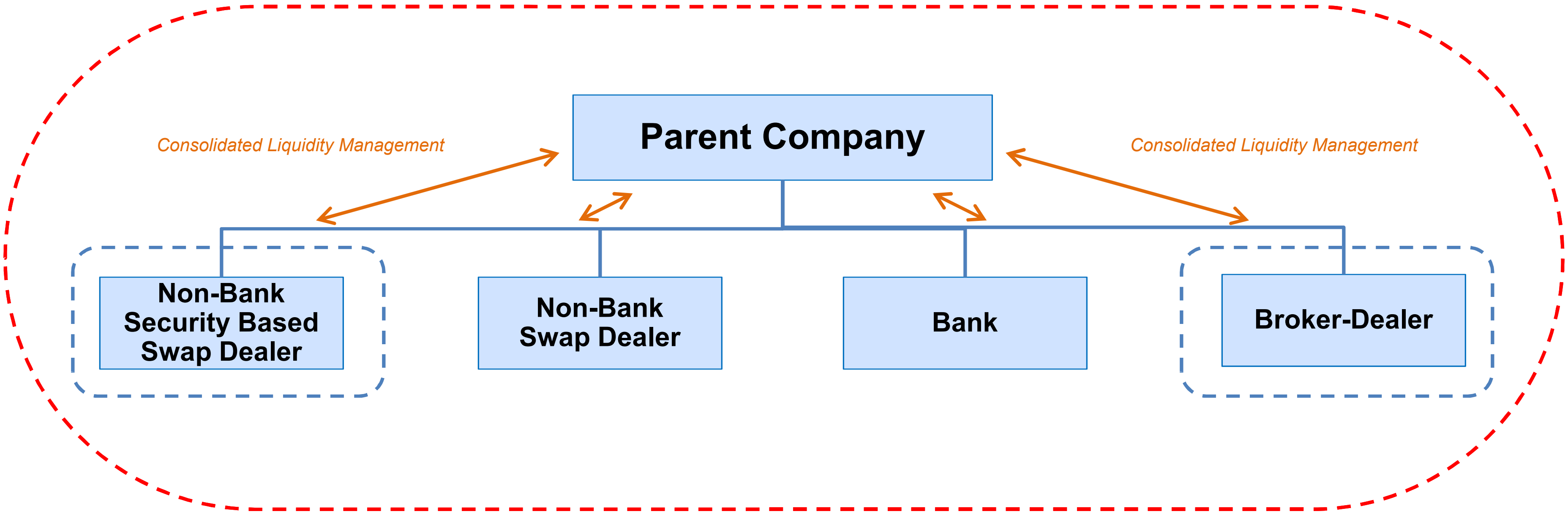
Illustration of a firm's consolidated liquidity risk management

Fed Liquidity Regime

- Applies on a consolidated basis
- Aligned with international standards
- Fed LCR NPR expected 2H 2013, with full implementation by 2015

SEC Liquidity Regime

- Applies to legal entities within a consolidated structure
- Not aligned with international standards
- Modifications could be made to SEC regime to facilitate consolidated liquidity risk management while ensuring adequate entity-level liquidity



SIFMA recommendations

- Integrated liquidity risk management supporting the consolidated organization and B-Ds/SBSDs
- Consistent liquid asset standards at all levels of the organization
- Efficient allocation of liquidity reserves to avoid excess, trapped liquidity pools

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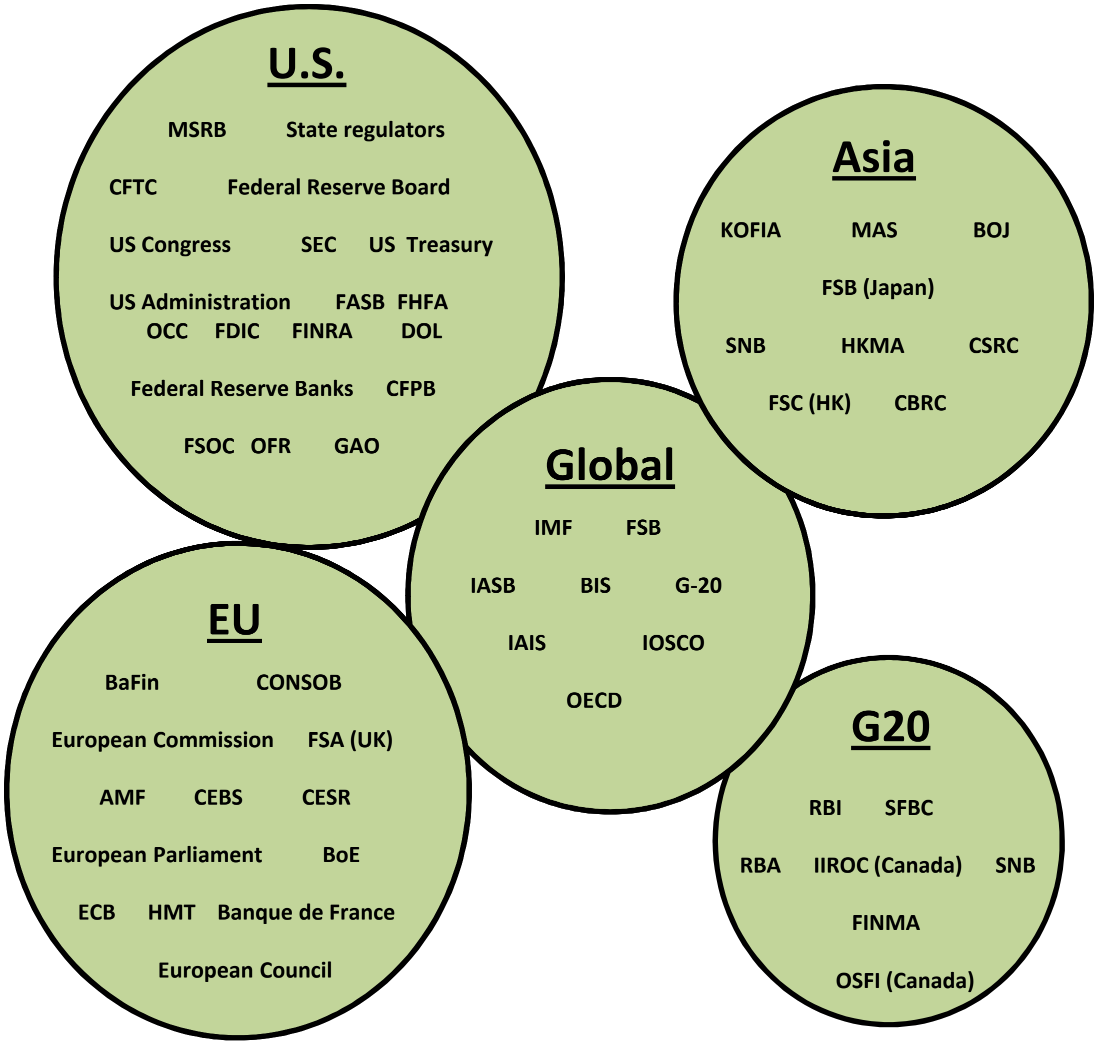
The New Regulatory Landscape



FINAL

FSOC: Authority to Require Supervision/Regulation of Non-Bank Firms

FRB: Annual Capital Plans for U.S. Bank Holding Companies with $50+ billion in Consolidated Assets
FRB: Market Risk Capital Rule
FRB: Basel III Capital Requirements

FDIC: Orderly Liquidation Authority
FDIC: Risk-Based Capital Guidelines

FDIC/OCC: Stress Testing Requirements

UPCOMING

SEC/FRB/FDIC/OCC/CFTC: Final rule on margin and capital requirements

FSOC: Studies/reports on contingent capital, prompt corrective action, and haircuts on the claims of secured creditors

FRB: Liquidity rules

OLA: Rules for SIPC/BD liquidation

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Specific Recommendations:
A. Firm-wide liquidity risk management recommendations

1. The Commission’s liquidity regime should recognize assets held by the parent for purposes of meeting entity-level B-D/SBSD liquidity requirements. [See Slides 9-10]

2. The Commission’s liquidity stress tests applied to B-Ds and SBSDs should recognize inter-company funding sources where the parent organization is subject to regulatory liquidity requirements and stress tests on a consolidated basis. [See Slides 11-12]

3. The Commission’s liquid asset standards for B-Ds and SBSDs should be aligned with the liquid asset standards imposed by the Federal Reserve for the consolidated organization. [See Slides 13-14]

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A. Firm-wide liquidity risk management recommendations

1. **The Commission's liquidity regime should recognize assets held by the parent for purposes of meeting entity-level B-D/SBSD liquidity requirements.**

   Background: Firms often manage liquidity by holding their liquidity reserves at the parent company, where they can be deployed as necessary to support funding needs across the organization. This approach is efficient from an economic perspective and also ensures that there is are adequate liquidity reserves to support the consolidated organization's activities.

   Approach for the SEC's liquidity regime for B-Ds and SBSDs:

   - Require B-Ds and SBSDs to calculate entity-specific liquidity requirements, but permit B-Ds and SBSDs to include liquid assets held by the parent organization towards that liquidity requirement, if (1) the parent is otherwise subject to regulatory stress-tested liquidity standards and (2) the parent maintains a sufficient liquidity reserve to meet requirements of its consolidated organization, including the B-D/SBSD.

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A. Firm-wide liquidity risk management recommendations

Advantages of SIFMA's proposed approach:

1. Integrates Federal Reserve BHC-level liquidity requirements with Commission liquidity requirements for B-Ds and SBSDs.

2. Ensures adequate liquidity support for B-Ds and SBSDs, tested on both a consolidated basis at the BHC level and on an entity basis at the B-Ds and SBSDs.

3. Addresses policy concerns from the financial crisis identified in the Commission's proposal: (a) inadequate stress test liquidity reserve calculations and (b) inadequate liquidity pools maintained by organizations. *See* 77 Fed. Reg. at 70,252 (Nov. 23, 2012).

4. Permits a firm to efficiently manage and allocate liquidity reserves on a consolidated basis, reducing the downsides of "trapped" liquidity pools.

5. Aligns with current liquidity practices, reducing operational and other burdens associated with the SEC's proposal and associated costs to counterparties and customers.

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A. Firm-wide liquidity risk management recommendations

2. The Commission's liquidity stress tests applied to B-Ds and SBSDs should recognize inter-company funding sources where the parent organization is subject to regulatory liquidity requirements and stress tests on a consolidated basis.

Background: Parent organizations currently manage liquidity reserves to support their consolidated organizations, and forthcoming Federal Reserve requirements will require BHCs to maintain liquidity pools against consolidated firm risk. The SEC proposed rule, by contrast, would require a B-D or SBSD to conduct its stress test assuming the absence of "a material amount of new unsecured funding, including *intercompany* advances and unfunded committed lines of credit."

Recommended approach for the SEC's liquidity regime for B-Ds and SBSDs:

- The Commission's proposed liquidity stress testing regime should recognize intercompany advances and unfunded committed lines of credit, where such advances or lines of credit are provided by a parent subject to consolidated liquidity regulatory standards and stress tests. [See Technical Annex A for recommended rule language.]

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A. Firm-wide liquidity risk management recommendations

Advantages of SIFMA's proposed approach:

1. Integrates Federal Reserve BHC-level liquidity requirements with Commission liquidity requirements for B-Ds and SBSDs.

2. Addresses the Commission's policy concerns about inadequate liquidity stress tests and inadequate liquidity reserves, since both stress tests and liquidity reserves would reflect regulatory requirements applied on a consolidated basis and at an entity level.

3. Appropriately recognizes inter-company liquidity support arrangements, which are consistent with current practices.

4. Preserves firms' ability to manage liquidity on a consolidated basis and avoids "trapped" liquidity pools.

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A. Firm-wide liquidity risk management recommendations

3. The Commission's liquid asset standards for B-Ds and SBSDs should be aligned with the liquid asset standards imposed by the Federal Reserve for the consolidated organization.

Background: The Federal Reserve has proposed standards for "highly liquid assets" in its Section 165 proposed rule, and the Federal Reserve is expected to propose rules in the coming months to implement Basel Committee's LCR, which relies on a "high quality liquid assets" (HQLA) standard. By contrast, the Commission has proposed a narrower liquid asset standard, limited to "cash, obligations of the United States, or obligations fully guaranteed as to principal and interest by the United States."

Recommended approach for the SEC's liquidity regime for B-Ds and SBSDs:

- The Commission's liquidity regime for B-Ds and SBSDs should apply the same liquid asset standards proposed by the Federal Reserve for the consolidated organization's liquidity requirements. [See Technical Annex B for Dodd Frank Section 165 highly liquid asset definition.]

A. Firm-wide liquidity risk management recommendations

Advantages of SIFMA's proposed approach:

1. Aligns Federal Reserve BHC-level liquid asset standards with Commission liquid asset standards for B-Ds and SBSDs – no policy justification for different standards.

2. Ensures that a rigorous, consistent liquid asset standard is applied throughout regulated banking and securities organizations.

3. Avoid the anomalous outcome where a firm is encouraged to keep a particular type of liquid asset at one level of the consolidated organization and move other classes of liquid assets to other levels of the organization – the goal should be to keep liquidity reserves flexible and available for use throughout the organization.

4. Ensures a level playing field between B-D/SBSDs within BHCs and those that exist on a standalone basis.

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Specific Recommendations:
B. Recommendations to improve the operation of the B-D/SBSD liquidity regime

1. The Commission's liquidity regime should require firms to meet liquidity standards on a day-end basis, not on an intraday basis. [See Slides 16-17]

2. The Commission's liquidity regime should permit firms to draw down liquidity reserves during a stress event, rather than maintain a 100% liquidity reserve at all times. [See Slides 18-19]

3. The Commission should adopt an appropriate phase-in schedule for liquidity requirements based on the liquidity phase-in schedule for bank holding companies. [See Slides 20-21]

B. Recommendations to improve the operation of the B-D/SBSD liquidity regime

1. **The Commission's liquidity regime should require firms to meet liquidity standards on a day-end basis, not on an intraday basis.**

   Background: The Commission's proposed rule would require a B-D/SBSD to maintain its liquidity reserve "at all times," although "securities in the liquidity reserve can be used to meet delivery requirements as long as cash or other acceptable securities of equal or greater value are moved into the liquidity pool contemporaneously." As proposed, this requirement is too strict, as it fails to permit firms to use liquidity reserves on an intra-day basis to meet immediate funding requirements without raising new sources of liquidity contemporaneously.

   Recommended approach for the SEC's liquidity regime for B-Ds and SBSDs:

   - The Commission's liquidity regime for B-Ds and SBSDs should require B-D/SBSDs to meet the liquidity standards "at the end of each business day." [See Technical Annex C for recommended rule language.]

B. Recommendations to improve the operation of the B-D/SBSD liquidity regime

Advantages of SIFMA's proposed approach:

1. Permits firms to meet actual, immediate funding needs by using available liquidity reserves – the ultimate purpose of effective liquidity risk management.

2. Intraday liquidity is required for timely and efficient daily settlement of transactions (i.e., daily substitution is required to assist operational settlements).

3. Ensures compliance with liquidity requirements on a daily basis.

4. Standard anti-evasion requirements segregates and removes ability to use customer funds intraday. This would alleviate any Commission concerns about improper uses of liquidity reserves on an intraday basis.

5. Consistent with Dodd-Frank proposal which does not limit the use of liquidity reserves intra-day.

6. Aligns with use of Intraday liquidity to settle tri-party repo transactions. Note: Intraday liquidity associated with tri-party repo settlement is controlled by clearing banks. Intraday credit will be capped at 10% by Q4 2014 by both clearing banks. [See Technical Annex D for FRB estimated intraday risk reduction.]

B. Recommendations to improve the operation of the B-D/SBSD liquidity regime

2. The Commission's liquidity regime should permit firms to draw down liquidity reserves during a stress event, rather than maintain a 100% liquidity reserve at all times.

Background: The Commission's proposed rule would require a B-D/SBSD to maintain its liquidity reserve "at all times," which SIFMA members interpret to apply even during stress events. Liquidity reserves provide firms with protection in a crisis and should be used to meet funding requirements in stress scenarios. Recognizing the need to dip into liquidity reserves is consistent with the Basel Committee's LCR framework.

Recommended approach for the SEC's liquidity regime for B-Ds and SBSDs:

- The Basel LCR guidance states that while firms will be required to maintain ratios of >100%, "During a period of financial stress, however, banks may use their stock of HQLA, thereby falling below 100%, as maintaining the LCR at 100% under such circumstances could produce undue negative effects on the bank and other market participants. Supervisors will subsequently assess this situation and will adjust their response flexibly according to the circumstances."
- We are supportive of this concept and accordingly believe that global regulators, including the Commission, should put in place procedures to assess situations where a firm has fallen below a 100% ratio and respond flexibly according to circumstances to mitigate risks to the firm and the broader financial system. As per Basel LCR guidance, "supervisors should allow for differentiated responses to a reported LCR below 100%. Any supervisory response should be proportionate with the drivers, magnitude, duration and frequency of the reported shortfall."
- The Commission's liquidity regime for B-Ds and SBSDs should require firms to meet the liquidity standards, but provide flexibility during periods of stress when B-Ds and SBSDs would be expected to make use of their liquidity reserves. The Commission should receive affirmative notification if a firm falls below a 100% ratio and have transparency into firms' usage of liquidity reserves during periods of stress.

B. Recommendations to improve the operation of the B-D/SBSD liquidity regime

Advantages of SIFMA's proposed approach:

1. Permits firms to manage funding needs in a crisis and thereby avoid worsening the effects of a market stress event.

2. Ensures that firms will still be required to maintain full liquidity reserves consistently, except where there is a valid reason to dip into the reserves.

3. Gives the Commission transparency by requiring firms to report their liquidity reserve usage to the Commission in times of market stress.

B. Recommendations to improve the operation of the B-D/SBSD liquidity regime

3. The Commission should adopt a phase-in schedule for liquidity requirements based on the liquidity phase-in schedules for bank holding companies.

Background: The Commission's proposed rule does not indicate how soon B-D/SBSDs would be required to come into compliance with the liquidity requirements. Firms are currently working towards compliance with the Basel Committee's LCR, which recognizes a staggered, multi-year transition period before full compliance.

Recommended approach for the SEC's liquidity regime for B-Ds and SBSDs:

- The Commission should recognize a phase-in period for B-D/SBSD liquidity requirements that aligns with Basel Committee's LCR phase-in period. [See Technical Annex E for recommended rule language.]

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B. Recommendations to improve the operation of the B-D/SBSD liquidity regime

Advantages of SIFMA's proposed approach:

1. Recognizes that firms require time to come into full compliance with new regulations that alter their funding structures.

2. Ensures that firms will still be required to maintain appropriate liquidity reserves in advance of a stress event.

Technical Annex A

Recommended Edits to Liquidity Stress Test (Page 411 (ANC) and *Page 447 (SBSD))*

(f) Liquidity requirements.

(1) Liquidity stress test. A broker or dealer whose application, including amendments, has been approved, in whole or in part, to calculate net capital under Appendix E of this section must run a liquidity stress test at least monthly, the results of which must be provided within ten business days to senior management that has responsibility to oversee risk management at the broker or dealer. The assumptions underlying the liquidity stress test must be reviewed at least quarterly by senior management that has responsibility to oversee risk management at the broker or dealer and at least annually by senior management of the broker or dealer. The liquidity stress test must include, at a minimum, the following assumed conditions lasting for 30 consecutive days:

- (A) A stress event that includes a decline in creditworthiness of the broker or dealer severe enough to trigger contractual credit-related commitment provisions of counterparty agreements;
- (B) The loss of all existing unsecured funding at the earlier of its maturity or put date and an inability to acquire a material amount of new unsecured funding from third parties or non-affiliates, ~~including intercompany advances and unfunded committed lines of credit~~;
- (C) The potential for a material net loss of secured funding for less liquid assets, (defined as: all securities excluding obligations of the United States or its Mortgage Agencies, or obligations fully guaranteed as to principal and interest by the United States or its Mortgage Agencies or highly rated sovereign debt);

- (2) Stress test of consolidated entity. The broker or dealer must justify and document any differences in the assumptions used in the liquidity stress test of the broker or dealer from those used in the liquidity stress test of the consolidated entity of which the broker or dealer is a part.

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Technical Annex B

Harmonize the SEC liquid collateral definition with Dodd Frank Section 165

- 165 (g) *Highly liquid assets* means:
  - (1) Cash;
  - (2) Securities issued or guaranteed by the U.S. Government, a U.S. Government agency, or a U.S. government-sponsored entity; and
  - (3) Any other asset that the covered company demonstrates to the satisfaction of the Federal Reserve:
    - (i) Has low credit risk and low market risk;
    - (ii) Is traded in an active secondary two-way market that has observable market prices, committed market makers, a large number of market participants, and a high trading volume; and
    - (iii) Is the type of asset that investors historically have purchased in periods of financial market distress during which market liquidity is impaired.

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Technical Annex C

Recommended Edits to Liquidity Stress Test (Page 411 (ANC) and *Page 447 (SBSD))*

- (3) Liquidity reserves. The broker or dealer must maintain ~~at all times~~ liquidity reserves based on the results of the liquidity stress test. The liquidity reserves must be unencumbered and free of any liens ~~at all times~~. Eligible assets to include in liquidity reserves should be the same as those used in the liquidity stress test of the consolidated entity of which the broker or dealer is a part. The broker or dealer must justify and document any differences in the eligible assets for inclusion in the liquidity reserves from those used in the liquidity reserves of the consolidated entity. ~~used to satisfy the liquidity stress test must be:~~

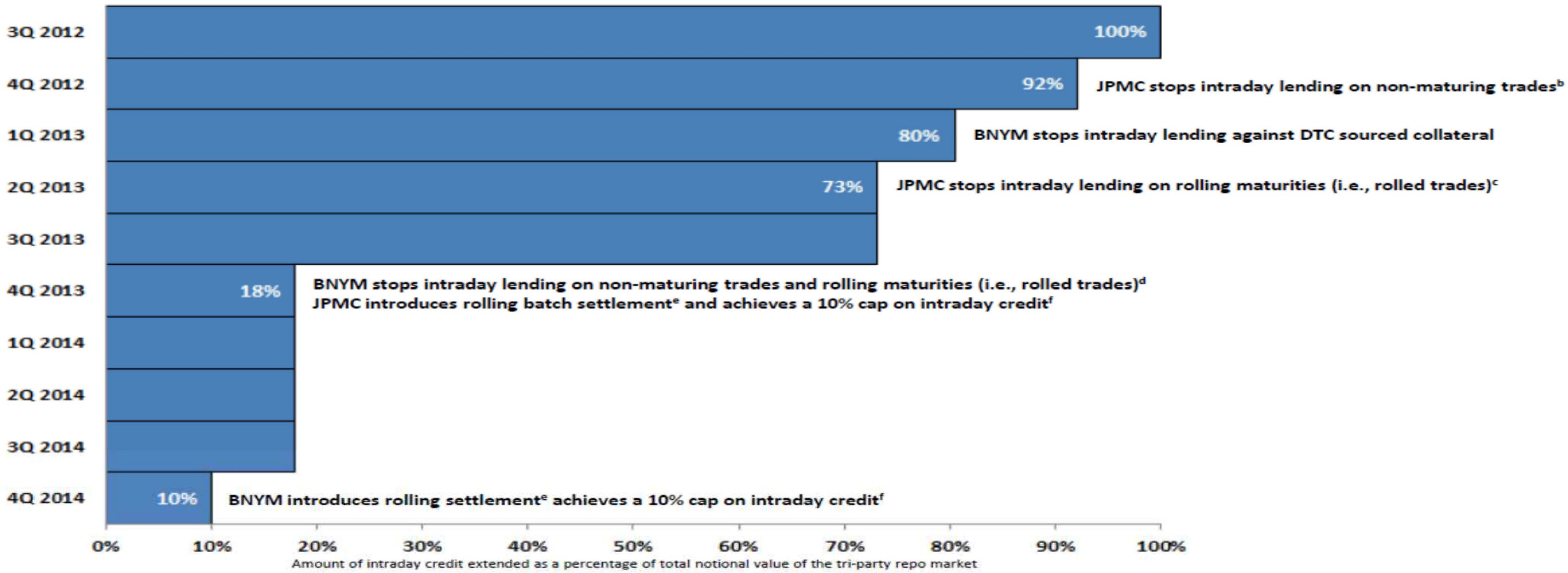
  ~~(A) Cash, obligations of the United States, or obligations fully guaranteed as to principal and interest by the United States; and~~

  ~~(B) Unencumbered and free of any liens at all times~~.

- Securities in the liquidity reserve can be used to meet delivery requirements as long as cash or other acceptable securities of equal or greater value are moved into the liquidity pool ~~contemporaneously~~ by the end of the business day.

Technical Annex D

FRBNY Estimate of the Path of Clearing Bank Intraday Credit Risk Reduction in the Tri-Party Repo Market[a]



[a]Estimate based on current plans made public by JP Morgan Chase (JPMC) as of January 22, 2013 and Bank of New York Mellon (BNYM) as of November 26, 2012.
[b]Intraday credit is extended only on trades maturing on that day (overnight and other maturing trades).
[c]This change eliminates intraday lending on maturing trades that are being renewed with the same counterparty, collateral, and value.
[d]This change eliminates intraday lending on maturing trades that are being renewed with the same counterparty and collateral. Where there are decreases in dollar value, intraday credit is extended on the delta.
[e]JPMC and BNYM are introducing individual and distinct rolling settlement processes to facilitate the end of day settlement for their respective customers.
[f]The 10% cap is a goal established by the industry Task Force in May 2010; see its report.

February 26, 2013

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Technical Annex E

Recommended Edits to Liquidity Stress Test (Page 411 (ANC) and *Page 447 (SBSD))*

(f) Liquidity requirements.

(5) Phase-in Requirements. Security-based swap dealers will be required to begin maintaining a liquidity reserve on January 1st, 2015 with a minimum requirement set at 60%. Subsequently the requirement will rise in equal annual steps to reach 100% on January 1st, 2019. The approach is intended to ensure that the new requirements will be implemented without disruption to the ongoing operation of US capital markets. The introduction will also be consistent with new liquidity requirements proposed by the Basel Committee on Banking Supervision ("BCBS") as defined by the Liquidity Coverage Ratio ("LCR").

	January 1, 2015	January 1, 2016	January 1, 2017	January 1, 2018	January 1, 2019
Minimum Liquidity Reserve	60%	70%	80%	90%	100%

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