BOARD OF GOVERNORS

OF THE

FEDERAL RESERVE SYSTEM

WASHINGTON, D.C. 20551

DIVISION OF SUPERVISION AND REGULATION

SR 17-11

October 23, 2017

TO THE OFFICER IN CHARGE OF SUPERVISION AT EACH FEDERAL RESERVE BANK

SUBJECT: Interagency Frequently Asked Questions on Implementation of the Liquidity Coverage Ratio (LCR) Rule

Applicability: This guidance applies to bank holding companies, savings and loan holding companies, and state member banks subject to the LCR or the modified LCR rules, as described below. The guidance does not apply to community banking organizations with $10 billion or less in consolidated assets.

The Federal Reserve, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency (collectively, the "agencies") are jointly issuing the attached Frequently Asked Questions ("FAQs") regarding implementation of the LCR and modified LCR rules.[1] In the attached FAQs, the agencies provide interpretations based on the facts and circumstances described in each question. The purpose of the FAQs is to clarify certain aspects of the existing LCR and modified LCR rules for supervised institutions and supervisory staff based on questions that the agencies have received since the rules were published. As the agencies issue additional FAQs in response to questions received, the Federal Reserve will periodically update the FAQ document that is attached to this SR letter. These and any subsequent FAQs also will be maintained on the Board's public website.[2]

The LCR rule applies to bank holding companies, savings and loan holding companies without significant insurance or commercial operations, and state member banks with $250 billion or more in total assets or $10 billion or more in on-balance sheet foreign exposure and to these holding companies' subsidiary depository institutions that have total consolidated assets of $10 billion or more. The modified LCR rule applies to bank holding companies and savings and loan holding companies without significant insurance or commercial operations that, in each case, have $50 billion or more in total consolidated assets but do not meet the thresholds stated above to be covered by the LCR rule.[3]

---

[1] *See* "Liquidity Coverage Ratio: Liquidity Risk Measurement Standards," 79 *Fed. Reg.* 61440 (Oct. 10, 2014), codified at 12 CFR part 249.

[2] *See* https://www.federalreserve.gov/supervisionreg/topics/liquidity-coverage-ratio-faqs.htm.

[3] *See* 12 CFR part 249 subpart G.

Reserve Banks are asked to distribute this letter to institutions in their districts that are subject to the LCR or modified LCR rules, as well as to their supervisory staff. Questions regarding this letter should be addressed to the following staff in the Board's Risk Policy Section: Christopher Powell, Supervisory Financial Analyst, at (202) 452-3442; and Peter Clifford, Manager, at (202) 785- 6057. In addition, questions may be sent via the Board's public website.[4]

Michael S. Gibson
Director

Attachment:

- *Liquidity Coverage Ratio: Frequently Asked Questions*

[4] http://www.federalreserve.gov/apps/contactus/feedback.aspx

Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation
Office of the Comptroller of the Currency

Liquidity Coverage Ratio FAQs

October 23, 2017

The Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board), and the Federal Deposit Insurance Corporation (FDIC) (collectively, the agencies) adopted a final Liquidity Coverage Ratio rule[1] (LCR rule) in September 2014 that implements a quantitative liquidity requirement consistent with the standard established by the Basel Committee on Banking Supervision.[2] These frequently asked questions (FAQs) were prepared by the staffs of the agencies based on questions that have been received since the LCR rule was published regarding how the LCR rule applies in specific situations.

The responses to the questions are intended to provide guidance about the requirements of the LCR rule, based upon the facts and circumstances presented in the questions. These FAQs do not represent new rules or regulations, nor do they amend any of the existing requirements of the LCR rule.

For purposes of these FAQs, section numbers refer to each agency's respective regulation. For example, section 32 refers to 12 CFR 50.32 for OCC-supervised institutions, 12 CFR 249.32 for Board-supervised institutions, and 12 CFR 329.32 for FDIC-supervised institutions.

1. Outflow Amount for Liquidity Facilities to Public Sector Entities (PSEs) in Connection with Variable Rate Demand Note (VRDN) Programs

Question: What is the treatment of liquidity commitments a covered company extends to municipalities and other PSEs to support their VRDN programs?[3]

Answer:

The LCR rule requires a covered company to calculate its total net cash outflow amount by applying the rule's outflow and inflow rates to the covered company's funding sources, obligations (including liquidity commitments), and assets over a prospective 30 calendar-day period. Under section 32(e) of the LCR rule, the commitment outflow amount for a committed liquidity facility depends on the counterparty to which the facility has been extended. Under section 32(e)(1)(iv), a commitment outflow amount of 30 percent applies to the undrawn amount

[1] *See* 79 Fed. Reg. 61440 (October 10, 2014). The LCR rule is codified at 12 CFR part 50 (OCC), 12 CFR part 249 (Board), and 12 CFR part 329 (FDIC).

[2] Basel Committee on Banking Supervision, "Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools" (January 2013), available at *http://www.bis.org/publ/bcbs238.htm*.

[3] VRDNs are debt instruments issued by the customers of covered companies. Covered companies provide liquidity facilities to support the notes and may be obligated to purchase the notes from investors under some circumstances.

of a liquidity facility directly extended by a covered company to a wholesale customer or counterparty that is not a financial sector entity, which includes municipalities and other PSEs under the LCR rule. Therefore, the 30 percent outflow rate applies to a liquidity facility extended directly to a municipality or other PSE in support of its VRDN program.

Section 32(e)(1)(iv) also provides that the 30 percent outflow rate applies when the customer or counterparty to the facility is a special purpose entity (SPE) that is a consolidated subsidiary of a nonfinancial wholesale customer or counterparty. The 30 percent outflow rate applies only in cases where the SPE does not issue commercial paper or securities (other than equity securities issued to a company of which the SPE is a consolidated subsidiary) to finance its purchases or operations, as described under section 32(e)(1)(viii) of the LCR rule.

Lastly, if the liquidity facility has not been directly extended to a municipality or other PSE but rather to a counterparty that is an SPE described in section 32(e)(1)(viii) (that is, to an SPE that does not meet the requirements of section 32(e)(1)(iv)), a 100 percent outflow rate applies to the undrawn amount of the liquidity facility.

2. Outflow Amounts for Trusts

Question: What is the treatment for deposits placed at a covered company by a trust under the LCR rule? If a person appoints a covered company as trustee for a trust, the beneficiaries of which are members of the person's family, does the LCR rule require that the covered company apply an outflow rate to any deposits of the trust placed with the covered company?

Answer:

The LCR rule applies an outflow rate to deposits placed by the trust at the covered company. If the deposit account is in the name of the trust (for example, XYZ Trust for the Benefit of Minor Child), the applicable outflow rate is based on the characteristics of the trust.

Under section 3 of the LCR rule, the definition of retail customer or counterparty includes 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 effective date of the trust or within 25 years, if applicable under state law (that is, in states that have a rule against perpetuities). Funding from a retail customer or counterparty that is not in the form of a brokered deposit receives a 3 percent outflow rate if it is a fully insured deposit (provided the deposit otherwise satisfies the criteria for a stable retail deposit) and a 10 percent outflow rate if it is a partially insured deposit, as set forth in sections 32(a)(1) and (2), respectively. These outflow rates apply regardless of whether the deposit can be withdrawn within 30 calendar days of the calculation date. If the funding is in the form of a brokered deposit from a retail customer or counterparty, it would be subject to the outflow rates applicable to those deposits under section 32(g).

However, if the trust has a corporate trustee, such as the covered company in this example, deposits of the trust would be considered to be provided by a wholesale customer or counterparty

and subject to the outflow rates applicable to unsecured wholesale funding set forth in section 32(h) of the LCR rule. The applicable outflow rate depends on whether the entire amount of the deposit is covered by deposit insurance, whether the deposit is a brokered deposit, and whether the trustee is a financial sector entity.

The maturity assumptions provided in section 31(a) apply regardless of whether the trust agreement prohibits funds from exiting the trust. For outflows subject to section 32(h), if the deposit can be withdrawn only upon the occurrence of a binding contingency specified in the deposit agreement and the contingency can occur within 30 calendar days of the calculation date, the LCR rule requires the covered company to assume that the outflow would occur within the 30 calendar-day calculation period. If the deposit is withdrawable on demand or upon notice under the deposit agreement between the covered company and the trust, the LCR rule requires the covered company to assume that the deposits would be withdrawn within the 30 calendar-day calculation period in accordance with the maturity assumptions provided in section 31(a).

3. Maturity Determination for Instruments with Remote Contingency Call Options

Question: A security may be issued with "remote contingency calls," meaning that the issuing company has the option to accelerate the maturity of the security, for events outside of the company's control, such as calls in the event of a change in applicable tax law or upon the requirement of the issuer to register as an investment company. For purposes of the LCR rule, should a covered company assume that the maturity of an obligation it has issued with a remote contingency call is the earliest date the covered company can exercise the option or the original maturity date at issuance?

Answer:

Section 31(a)(1)(iii) of the LCR rule provides that if a covered company has an option to reduce the maturity of an obligation, the covered company must assume that it will exercise the option at the earliest possible date. If the covered company's option to reduce the maturity of the obligation is entirely dependent on changes in laws or regulations that are beyond the control of the covered company such that the covered company may not exercise the option absent such events, the maturity of the obligation for purposes of the LCR rule is the original maturity date at issuance and is not affected by the option. Examples of such options include options triggered by tax law changes or changes in registration requirements under the Investment Company Act of 1940.

An option that requires regulatory approval prior to the exercise of the option is not entirely dependent on changes in laws or regulations that are beyond the control of the covered company. A covered company's request for regulatory approval to exercise the option is an action initiated by the company. Thus, the option would not be entirely dependent on changes in laws or regulations that are beyond the control of the covered company.

In the event of any changes in laws or regulations after which the covered company may exercise the option, the covered company must assume that it will exercise the option at the earliest possible date, as set forth under section 31(a)(1)(iii) of the LCR rule.

4. Outflow Amounts for Trust Ledger Deposit Account (TLDA) Programs and Custody Assets

Question: How does the LCR rule treat custody TLDA programs and securities and cash segregated under U.S. Securities and Exchange Commission (SEC) Rule 15c3-3?

Answer:

(a) If a covered company is the recipient of a TLDA, outflow amounts under section 32 apply.

In an arrangement involving a TLDA, a broker-dealer typically deposits cash in a bank's trust department consisting of customer funds maintained by the broker-dealer in accordance with 17 CFR 240.15c3-3 (SEC Rule 15c3-3).[4] The treatment of a TLDA at a covered company under the LCR rule depends on the relationship of the covered company to the broker-dealer placing the TLDA deposit. The LCR rule specifically excludes outflows and inflows between a covered company and a consolidated subsidiary of the covered company, or between two consolidated subsidiaries of a covered company, under sections 32(m) and 33(i). Therefore, if the broker-dealer is a consolidated subsidiary of the covered company holding the TLDA, or is a consolidated subsidiary of the covered company and placing deposits in the TLDA at a bank that is another consolidated subsidiary of the covered company, no outflow or inflow rate applies to the intragroup transaction.

If the broker-dealer is not a consolidated subsidiary of the covered company, TLDA deposits at the covered company are considered as one of the following depending on individual facts and circumstances: unsecured wholesale funding from a financial sector entity under section 32(h)(2), operational deposits under sections 32(h)(3) or (4), or other unsecured wholesale funding under section 32(h)(5).[5] The same outflow treatment would apply to any cash deposited in a SEC Rule 15c3-3 account at the covered company, regardless of whether that account was a TLDA.

(b) If a covered company has securities and cash segregated under SEC Rule 15c3-3, inflow amounts under section 33(g) apply.

(i) Inflow amount under section 33(g)

Under section 33(g), a covered company that has a consolidated broker-dealer subsidiary may, under limited circumstances, include an inflow amount from the anticipated return of assets held at a third-party institution that is not a consolidated subsidiary of the covered company. Section 33(g) allows a covered company with a consolidated broker-dealer subsidiary to include in its LCR calculation an inflow amount for the fair value of all assets released from broker-dealer segregated accounts, such as assets placed in a TLDA, maintained in accordance with statutory

[4] SEC Rule 15c3-3 is a customer protection rule that requires broker-dealers to hold customer funds and securities in a segregated account.

[5] See sections 3 and 4(b) of the LCR rule for operational deposit requirements.

or regulatory requirements for the protection of customer trading assets. As discussed in the Supplementary Information section of the LCR rule, the purpose of section 33(g) is to offset certain broker-dealer outflow amounts incurred due to the net changes in broker-dealer client positions of cash, margin loans, and client shorts under sections 32(h), (j) and 33(f).

(ii) Segregated cash excluded under SEC Rule 15c3-3

Inflows cannot be recognized under section 33(g) of the LCR rule with respect to any amounts placed by a broker-dealer that cannot be used to satisfy the minimum amount required to be segregated under SEC Rule 15c3-3.[6] For example, if, for purposes of SEC Rule 15c3-3, the broker-dealer is an "affiliate" of the bank where the TLDA is maintained, the broker-dealer must exclude the total amount of such cash deposits when determining the amount segregated under SEC Rule 15c3-3 because SEC Rule 15c3-3 requires such deposits to be placed with an unaffiliated institution.[7] Accordingly, such assets are not maintained in accordance with regulatory requirements for the protection of customer trading assets for purposes of section 33(g).

(iii) Securities segregated included under SEC Rule 15c3-3

If a covered company is holding securities in custody in an SEC Rule 15c3-3 account from an affiliated broker-dealer, such securities are included when determining the segregated amount under SEC Rule 15c3-3.[8] Thus, a broker-dealer may meet its SEC Rule 15c3-3 required segregation amount by using the value of the securities, and a covered company consolidating the net cash outflows of that broker-dealer may accordingly recognize an inflow under section 33(g) of the LCR rule.

(c) If a covered company holds securities to meet segregation requirements under SEC Rule 15c3-3, the assets do not qualify as eligible High-Quality Liquid Assets (HQLA).

For purposes of the LCR rule, securities that are held to satisfy a broker-dealer's required segregation amount under SEC Rule 15c3-3 are considered to be subject to restrictions on the ability of the covered company to monetize the assets and are not eligible HQLA under section 22 of the LCR rule.

---

[6] The rule requires a broker-dealer to compute periodically the amount of funds obtained from customers or through the use of customer securities (credits) and compare it to the total amount it has extended to finance customer transactions (debits). If credits exceed debits, the broker-dealer is required to have an amount of cash or cash-equivalent securities (for example, U.S. Treasuries) at least equal to the excess segregated in an account for the exclusive benefit of customers.

[7] 17 CFR 240.15c3-3(e)(5).

[8] 17 CFR 240.15c3-3(e)(1).

5. Treatment of Multicurrency Deposit Balances

Question: How should a covered company treat multicurrency balances when determining whether the entire amount of the balances is covered by FDIC deposit insurance and thus a "stable retail deposit" under the LCR rule? For example, a retail customer, as defined in section 3 of the LCR rule, holds two deposit accounts at a covered company: a $250,000 account in the New York branch and a €100,000 account in the London branch.

Answer:

Section 3 of the LCR rule defines a "stable retail deposit" to include a retail deposit that is entirely covered by deposit insurance. A covered company must only consider the retail customer's deposit amounts in branches located in a state, as that term is defined in the Federal Deposit Insurance Act,[9] when determining whether the customer's deposit balance is entirely covered by FDIC deposit insurance for purposes of the LCR rule. A covered company must not include a retail customer's deposit amounts in branches that are not in any state, which are not covered by FDIC deposit insurance.[10] In the above example, assuming no other U.S. deposits are attributable to the retail customer, the $250,000 deposit in the New York branch would receive the 3 percent outflow rate set forth under section 32(a)(1), if it otherwise qualifies as a stable retail deposit under section 3 of the LCR rule. The €100,000 deposit held in the London branch, which is not an FDIC-insured deposit, would receive a 10 percent outflow rate under section 32(a)(2).

6. Treatment of Inflows from Secured Loans to Retail Clients with Open Maturities

Question: What inflow rate should a covered company apply to margin loans to retail customers or counterparties? What inflow rate should apply to margin loans to retail customers or counterparties that do not have a stated maturity?

Answer:

The cash inflow amount for a margin loan with a retail customer or counterparty is determined under section 33(c), which applies to retail cash inflow amounts, rather than section 33(f),[11] which applies only to wholesale customers.

A covered company may not include margin loans to retail clients with no stated maturity in its inflow amounts under the LCR rule. Under section 33(a)(6), a covered company must exclude from its inflow amounts any amounts payable to a covered company with respect to any transaction that has no contractual maturity date (as determined by section 31). Moreover, the provisions in section 31 of the LCR rule would not cause these transactions to be treated as if

[9] 12 U.S.C. § 1813(a)(3).

[10] 12 CFR 330.3(e).

[11] Section 33(f) sets forth the secured lending and asset exchange cash inflow amounts.

they matured within the LCR rule's 30-day window. Therefore, inflows from such transactions are not eligible for inclusion in a covered company's inflow amounts.

7. Securities Lending as a Form of Evidence of Ability to Monetize

Question: The LCR rule requires a covered company to demonstrate the operational capability to monetize its eligible HQLA. Can a covered company demonstrate its ability to monetize eligible HQLA through securities lending transactions?

Answer:

Yes, a covered company may demonstrate its ability to monetize eligible HQLA through securities lending transactions. As discussed in the Supplementary Information section of the LCR rule, the agencies expect a covered company to demonstrate periodic monetization through actual sales or repurchase agreements.[12] Similar to a repurchase agreement, the lending of a security that would otherwise be eligible HQLA for cash proceeds is one way for a covered company to demonstrate the ability to monetize the eligible HQLA. To be included as eligible HQLA, an asset must meet all the requirements of section 22 of the LCR rule, including being unencumbered.

8. Foreign Withdrawable Reserves

Question: The LCR rule allows "foreign [central bank] withdrawable reserves" to be included as level 1 liquid assets if they can be withdrawn without restriction from a central bank. May deposits held at a foreign central bank that may be freely used as collateral qualify as "foreign withdrawable reserves" under the LCR rule?

Answer:

Foreign withdrawable reserves are treated as level 1 liquid assets under section 20(a)(2) of the LCR rule. Under section 3 of the LCR rule, foreign withdrawable reserves are defined as balances held by, or on behalf of, a covered company at a foreign central bank that are not subject to restrictions on the covered company's ability to use the reserves. For example, a covered company may treat balances held at a foreign central bank as foreign withdrawable reserves in instances where the foreign central bank: (i) requires a covered company directly, or through a subsidiary, to maintain reserves at the foreign central bank on an ongoing basis; (ii) provides that such reserves may be used without restriction as collateral for loans provided by the foreign central bank in an amount up to the full value of the reserves; and (iii) has stated that the unrestricted use of the proceeds of the collateralized loan is equivalent to a withdrawal.

For the entire balance of the foreign withdrawable reserves to be treated as eligible HQLA, covered companies must also take into account section 22, including assessing whether the reserves would be fully available during times of stress without statutory, regulatory, contractual, or supervisory restrictions.

[12] 79 Fed. Reg. at 61467 (October 10, 2014).