SULLIVAN & CROMWELL LLP

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Bank Capital Requirements

Basel Committee Issues Final Rule Regarding Common Equity Surcharge for Global Systemically Important Banks

BACKGROUND

On November 4, 2011, the Basel Committee on Banking Supervision (the "*BCBS*")[1] released its final rule for a common equity surcharge on certain designated global systemically important banks ("*G-SIBs*"). The final rule is set forth in a document entitled *Global Systemically Important Banks: Assessment Methodology and Additional Loss Absorbency Requirement* (the "*Rule Text*", and the rules set forth therein, the "*Final Rule*"). The Rule Text was accompanied by a cover note (the "*Cover Note*") that summarizes differences between the Final Rule and the G-SIB surcharge rule as initially proposed in a July 2011 consultative document (the "*Consultative Document*", and the proposal set forth therein, the "*Proposal*")[2] and comments on the major themes of the public comments on the Proposal.

The Final Rule, like the Proposal, uses an indicator-based approach for determining when a G-SIB surcharge will be applied and adopted the Proposal's assessment methodology largely as proposed. The BCBS expressly rejected certain comments submitted on the Proposal (for example, comments calling for a reduction in the surcharge based on the presence of an effective and credible resolution regime) and refined the Final Rule as compared to the Proposal in respect of others (mostly through clarifications of aspects of certain of the individual indicators).

The BCBS also clarified several aspects of the periodic review process of the Final Rule's methodology, including how often the denominators of the indicators will be updated and the frequency of the periodic reviews of the indicator-based methodology.

G-SIB SURCHARGE PROPOSAL

Main Elements

The main elements of the Final Rule are as follows and, except where noted, have not changed from the Proposal:

- G-SIBs are subject to an additional progressive Common Equity Tier 1 ("*CET1*") surcharge, referred to in the Rule Text as a "loss absorbency requirement", ranging from 1% to 3.5% in addition to the Basel III 7% CET1 requirement.
- The exact amount of the surcharge depends on a bank's placement in one of five "*buckets*" (requiring a 1%, 1.5%, 2%, 2.5% and 3.5% surcharge, respectively) based on the bank's global systemic importance score determined in accordance with the Final Rule's indicator-based methodology. The BCBS stresses that the Final Rule sets out minimum surcharges; national jurisdictions are free to impose even higher surcharges.
- To determine the level of the surcharge – that is, which G-SIB bucket, if any, a bank is placed into – the Final Rule relies predominantly on a quantitative "*indicator-based approach*" comprising five broad categories: cross-jurisdictional activity; size; interconnectedness; substitutability/financial institution infrastructure (which, in the Proposal, was simply called "substitutability"); and complexity. The results of the indicator-based approach may be adjusted, to a limited extent and in rare circumstances, to reflect supervisory judgment.
- The surcharge will be implemented through an extension of the Basel III capital conservation buffer. The Basel III conservation buffer, consisting of 2.5% of risk-weighted assets, is divided into four bands. If banks fall into the bands within the buffer zone, they are subject to increasingly severe limitations on capital distributions. Although not spelled out explicitly, it appears that if a surcharge is applied, the capital conservation buffer of a G-SIB would expand, but still be divided into four equal bands, with the surcharge allocated proportionally across the four bands.[3]
- The top bucket requiring the highest 3.5% surcharge will initially be empty in order to provide a disincentive for G-SIBs to increase materially their global systemic importance in the future. If this empty bucket becomes populated at some point in the future, a new empty bucket will be added with a higher surcharge requirement.
- The surcharge requirement will be phased-in in parallel with the Basel III capital conservation and countercyclical buffers, beginning on January 1, 2016 and becoming fully effective on January 1, 2019. By analogy to the other Basel III capital conservation and countercyclical buffers phase-in provisions, this phase-in schedule apparently means that that an equal *pro rata* portion of the applicable G-SIB surcharge for a particular institution would be implemented each year starting on January 1, 2016 with full implementation by January 1, 2019. The Rule Text clarified that the cut-off score, the threshold scores for buckets and the denominators used to normalize the indicators will be fixed and disclosed by November 2014 based on year-end 2013 data.
- Final decisions concerning the applicability and implementation of the surcharge in general and with respect to particular institutions will no longer be solely left to national supervisory authorities, but will instead be made jointly at an international level by the Financial Stability Board (the "*FSB*")[4] and national authorities, in consultation with the BCBS.
- The surcharge may be met with CET1 only and will only be applied to G-SIBs at the consolidated group level. However, the Final Rule does not rule out the option for the host jurisdictions of subsidiaries to apply the requirements at the individual legal entity or consolidated level within their jurisdiction.

Initially, all G-SIBs will be selected from the group of 73 major international banks from which the BCBS collected data in January, 2011 (the "*BCBS Bank Sample*"). In the Cover Note, the BCBS noted that it had agreed that this number should be reviewed every three years. In addition, under the Final Rule, 29 banks will be designated as G-SIBs requiring a capital surcharge (up from 28 under the Proposal). The Final Rule, like the Proposal, does not name these banks, nor does it provide the threshold global systemic importance scores of the buckets. However, in an October 31, 2011 report to the G-20 leaders addressing the progress of financial regulatory reforms, the FSB identified the 29 banks that are systemically important using the Final Rule's methodology at this point, including eight U.S. banks.[5]

The Final Rule also contemplates eventually expanding the surcharge methodology to a wider group of systemically important financial institutions, including financial market infrastructures, insurance companies and other non-bank financial institutions that are not part of a banking group structure.

Quantitative Indicator-Based Measurement Approach

With few exceptions (which are discussed below in the section titled "Modifications and Clarifications"), the Final Rule carries forward the Proposal's indicator-based measurement approach. That approach designates G-SIBs and assigns them to surcharge buckets based on an evaluation of the impact of a failure of a bank on the wider financial system by first calculating a quantitative "*indicator-based score*" using data collected from banks.[6] A bank's indicator-based score is, in essence, a weighted ratio (x) with the bank's size and level of participation in certain activities and the amount of certain assets, as applicable, as the numerator and (y) the aggregate total of such factors with respect to all the banks in the BCBS Bank Sample as the denominator: the greater the ratio, the higher the global systemic importance of the bank.

The actual calculation of the indicator-based score is arrived at by breaking out five quantitative "*categories*", with each category assigned an equal 20% weight. The categories are: (i) cross-jurisdictional activity; (ii) size; (iii) interconnectedness; (iv) substitutability/financial institution infrastructure; and (v) complexity. Other than size, each of the categories is composed of either two or three equally weighted "*indicators*", which refer to specific types of activities that BCBS associates with global systemic importance.[7]

The maximum score in any category (that is, if the bank accounted for all of the activities in that category and the rest of the BCBS Bank Sample accounted for none) is normalized at 1; therefore, according to the BCBS at least, the maximum possible indicator-based score (that is, if the BCBS Bank Sample consisted of only one bank) is 5.[8] For each indicator (with the exception of the wholesale funding indicator), an "*indicator score*" is calculated by dividing the bank's raw measured amount relating to that indicator (the "*bank indicator amount*") by the aggregate raw measured amount summed across all banks in the BCBS Bank Sample relating to that indicator (the "*sample aggregate indicator amount*"). The resulting fraction is then weighted by the indicator weighting within each category. Then, all the weighted indicator scores are added to calculate a bank's indicator-based score.

The indicator-based methodology will be reviewed every three years.

Categories and Indicators

With few exceptions (which are discussed below in the section titled "Modifications and Clarifications"), the Final Rule did not alter the categories and indicators in the Proposal.[9]

Cross-Jurisdictional Activity This category is meant to measure the extent of a bank's activities outside its home or headquarters jurisdiction based on two indicators – cross-jurisdictional claims and cross-jurisdictional liabilities. BCBS believes that the systemic international impact from a bank's distress increases as its share of cross-jurisdictional assets and liabilities increases.

Size Size is the only category that contains only one indicator. The bank indicator amount for the size indicator is the bank's exposure measure, as used to calculate the leverage ratio under Basel III. Generally speaking, the exposure measure under such Basel III ratio is the sum of a bank's on-balance sheet assets and certain off-balance sheet items.

Interconnectedness The interconnectedness category is composed of three indicators, intra-financial system assets, intra-financial system liabilities and the wholesale funding ratio, all of which seek to measure the degree to which a bank is financially intertwined with other financial institutions. The BCBS takes the view that the network of contractual obligations among financial institutions increases the likelihood of distress at one institution causing systemic effects. The many references to financial institutions appear to refer to all financial institutions, not just to large and interconnected ones.

Substitutability/Financial Institution Infrastructure The Final Rule implements the substitutability category of systemic importance by identifying as indicators three specific types of financial services – assets under custody, payments cleared and settled through payment systems and the values of underwritten transactions in debt and equity markets. The BCBS believes that distress at a major provider of these financial services may cause systemic effects.

Complexity The Final Rule identifies business, structural and operational complexity of a bank as a factor in the cost and time needed to resolve the bank, and therefore a factor in the systemic impact of a bank's failure. However, the BCBS has chosen to define individual indicators of the complexity category through types of financial activities and types of assets that it believes are indicative of bank complexity, namely, OTC derivatives notional value, Level 3 assets and held for trading and available for sale instruments.

Supervisory Judgment

The Final Rule maintained the supervisory judgment framework laid out in the Proposal. The Final Rule allows an overlay of supervisory judgment over the indicator-based score in determining the G-SIB surcharges, but establishes several principles for supervisory judgment, which include that the bar for judgmental adjustment should be high and used only in exceptional cases.[10]

The Final Rule identifies several ancillary quantitative indicators that may not be captured by the indicator-based measurement approach and may only be used to support the supervisory judgment overlay (for example, with respect to cross-jurisdictional activity, non-domestic revenue as a proportion of total revenue and cross-jurisdictional claims and liabilities as a proportion of total assets and liabilities).[11] In addition to the ancillary quantitative indicators, the Final Rule provides a limited role for qualitative judgment that captures information that cannot be easily quantified.

The Final Rule's process of incorporating the indicator-based score and supervisory judgment into a final global systemic importance score appears to contemplate that, in certain instances, surcharge decisions with respect to banks will no longer be the sole purview of national regulators, but, rather, of the FSB, home and host national authorities and the BCBS. The Final Rule contemplates that every year, after the mechanical application of the indicator-based approach to each of the sample banks, a supervisor may propose adjustments to the indicator-based score of individual banks based on supervisory judgment, even apparently if that supervisor is not a home- or host-country supervisor, albeit taking into account the views of the bank's home and major host supervisors. After adjustments are proposed by such national authorities, the BCBS will develop recommendations for the FSB regarding the systemic importance score of each bank, and the process will end with the "FSB and national authorities, in consultation with the BCBS [making] final decisions" regarding each bank's systemic importance score. How this process will work in practice is unclear, as discussed in the section titled "Concluding Observations".

MODIFICATIONS AND CLARIFICATIONS

As noted above, the Final Rule made few substantive modifications to the Proposal. It did, however, clarify some aspects of the Proposal. Some of the most significant of these modifications and clarifications are as follows:

- ***Indicators.***
  - The BCBS added text to the intra-financial system assets and intra-financial system liabilities indicators limiting all of the component transactions measured by these indicators (including repos) to transactions with financial institutions.[12] In the Proposal, repos, unlike the other listed indicator elements, were not limited to financial institution counterparties.[13] In addition, in the intra-financial system liabilities indicator, the BCBS replaced the "securities issued by the bank that are owned by other financial institutions" component with "all marketable securities issued by the bank". Because securities issued by banks are traded on secondary markets, the BCBS was concerned that banks would not be able to report which of those securities were held by "other financial institutions."[14]
  - The BCBS believed that the "trading book value and available for sale value" indicator could be confusing because "trading book" is a regulatory construct and "available for sale" is an accounting one. As a result, it was possible that the trading book could include securities accounted for in the available for sale category. The BCBS, therefore, replaced the term "trading book" with "held for trading."[15]
  - In addition, the BCBS agreed to make the following changes (which have not yet been implemented in the Final Rule), subject to additional testing that will be concluded by March 2012, to ensure that the changes do not give rise to results that are not "intuitively plausible":

- The "wholesale funding ratio" indicator will be replaced with "all marketable securities issued by banks."[16] Reasons cited for this change include the confusion caused by the fact the wholesale funding ratio uses a different normalization method from the other indicators.[17] The BCBS also agreed to look into the possibility of limiting securities captured by this indicator (as revised) to those with a maturity of one year or less. The BCBS noted that such a limit would be consistent with the definition of stable funding in the Basel III liquidity framework's Net Stable Funding Ratio.[18]
- Because of difficulties in collecting payments data from banks on a payment system basis for purposes of determining a bank's "payment cleared and settled through payments systems" indicator score, the BCBS proposes to collect it on a currency basis.[19] It is unclear from the Cover Note, however, precisely what collecting payments data "on a currency basis" will entail.
- The BCBS agreed to remove from the "held for trading and available for sale value" indicator those assets that qualify for inclusion in the stock of high-quality liquid assets under the Basel III liquidity framework's Liquidity Coverage Ratio ("*LCR*") on the grounds that (i) these qualifying liquid assets, if sold quickly, are less likely to depress market prices than other assets held for trading or available for sale and (ii) doing so is responsive to the view that banks should not be penalized for holding liquid assets to meet the LCR requirement.[20]

- ***The Periodic Refinement of the Assessment Methodology.***
  - The Consultative Document stated that the Proposal's indicator-based methodology will be reviewed every three to five years.[21] In light of comments to the effect that it would be appropriate to have a short review period to ensure ongoing suitability and effectiveness of the assessment methodology, the BCBS agreed that it would be appropriate to conduct a review every three years.[22] The first three-year review will be conducted by November 2017.[23]
  - Although the BCBS indicated that it would review the G-SIB methodology every three years, it "reconfirmed" that it does not intend to conduct a "fundamental review" of the methodology every three years and stated that it believes that the number of buckets, the increments of the additional loss absorbency between the four non-empty buckets (that is, 0.5%) and the requirements for the current top-populated bucket (that is, 2.5%) should be maintained.[24] It would, therefore, appear that the BCBS does not intend to revisit the calibration of the surcharge every three years.
  - The BCBS also clarified that the sample of 73 banks currently being tracked should be reviewed every three years, and that the denominators of indicators will be fixed between review periods, thereby implying that the denominators will be "reset" every three years.[25]

- ***Disclosure/Transparency.***
  - Many commenters criticized the Proposal for a lack of transparency, and claimed that this lack of transparency prevented banks from determining, in advance and with any accuracy, the size of the capital surcharge under the Proposal applicable to them. In response, the BCBS stressed that it will disclose the values of the buckets' thresholds and the denominators of the indicators and the cut-off score for a bank to be a G-SIB by November 2014 based on end-2013 data. The BCBS stated that this disclosure will provide banks subject to the surcharge requirement with an appropriate capital planning horizon and address concerns about transparency.[26] In addition, the BCBS stated its expectation that all banks in the sample will publicly disclose the relevant data when the G-SIB policy is implemented.[27] Nevertheless, it is unclear the extent to which these measures will ameliorate concerns with the transparency of the Final Rule given that, among other things, a bank cannot predict what its capital surcharge will be in future years without the ability to accurately model the values of the denominators of the various indicators for all of the sample banks (because the value of the denominators is reset every three years). Moreover, as noted above, the 73 banks whose data make up those denominators and the associated thresholds of the buckets may also change every three years. Given the current lack of concrete criteria for changing the thresholds and the number and identity of sample banks, these potential

changes will also likely make it difficult for banks to predict, with accuracy, the size of the capital surcharge applicable to them.

The BCBS also explicitly rejected a number of comments on the Proposal:

- Many commenters urged the BCBS to reduce the capital surcharge applicable to a G-SIB to the extent it had a credible recovery and resolution plan. Although the BCBS acknowledged that nations are making progress in establishing national resolution and recovery regimes, after internal discussions, the BCBS determined not to reduce the amount of a G-SIB's indicator-based score or G-SIB surcharge based on the presence of a national resolution and recovery regime (and, therefore, the Committee did not amend the Proposal to address this issue).[28] The BCBS noted, however, that it agreed that national supervisors could impose *higher* capital surcharges beyond the additional loss-absorbency requirements for those G-SIBs that are not subject to an effective and credible recovery and resolution plan.[29]
- Some commenters challenged the utility of imposing additional loss absorbency requirements on G-SIBs, especially in light of recent regulatory reform efforts including Basel III. In response, the BCBS reiterated its view that an additional surcharge was called for given, for instance, the purported negative externalities created by G-SIBs and moral hazard costs associated with the perception of implicit government support.[30]
- Commenters had criticized the Proposal's purported lack of empirical justification for the size of the surcharge. In response, the BCBS directed these commenters to the analysis it published in Annex 2 of the Consultative Document and noted that its analysis suggested that an additional loss absorbency requirement in the range of 1% to 8% of risk-weighted assets would be appropriate.[31] Many banks, however, found the empirical analysis in Annex 2 conclusory and unpersuasive.
- The BCBS broadly attempted to address commenters' concerns with the appropriateness of many of the individual indicators by noting that

  > "[t]he indicators do not measure precisely specific attributes of G-SIBs, but, rather, are proxies designed to identify the main aspects of G-SIB status. In that context, the [BCBS]'s guiding principle was that the indicators should be considered as a suite of approximate measures that capture the potential impact of a G-SIB's distress or failure on the broader financial system."[32]

- The BCBS rejected all comments that called for the use of more risk-sensitive indicators in measuring a bank's exposures, on the grounds that the "indicators should not be considered as risk metrics or prescriptive ratios" and the focus should be on the impact of the bank's distress or failure should that occur.[33]
- At least one commenter argued that the cross-jurisdictional liabilities indicator was flawed because it encouraged banks to fund foreign claims with home country liabilities (because these liabilities are not counted toward a bank's cross-jurisdictional indicator score under both the Proposal and Final Rule), a purportedly objectively riskier practice than funding these claims with local currency liabilities. Although the BCBS discussed the issue raised by this comment "at length", the BCBS ultimately determined not to amend the Proposal to address this issue stating that, even if funded locally, the local entity has a funding advantage by virtue of being supported and that the crisis showed that foreign subsidiaries might not be isolated from problems at the parent level and that "spillover" could occur.[34]
- Several commenters argued that the market for underwriting services is deep and competitive and, thus, the "values of underwritten transactions in debt and equity markets" should not be an indicator. In response, the BCBS indicated it believes that "this indicator captures the importance of banks in the global capital markets regardless of the underwriting markets' competitiveness. [The BCBS] continues to believe that the value of underwritten transactions is an effective indicator for capturing the global activity of investment banks."[35] No change was therefore made to this indicator.

- Many commenters stressed that OTC derivatives' notional value should focus on net rather than gross value. In response, the BCBS noted that the objective of "this type of indicator" is to obtain an indication of a banks' relative complexity and "[t]hat is why derivative positions measured on a gross notional basis was selected as an indicator."[36] As a result, no change was made to the "OTC derivatives notional value" indicator.

CONCLUDING OBSERVATIONS

Although the Final Rule clarified many aspects of the Proposal, important questions regarding the application and impact of Final Rule remain unanswered. As was the case with the Proposal, various aspects of the process for determining the final systemic importance score remain unclear:

- The Final Rule does not set out a clear notice and response process for national authorities in the event that certain national authorities propose an adjustment based on supervisory judgment, and other national authorities wish to respond.
- In addition, it fails to specify the mechanics of how the FSB, the BCBS, and the national regulators are to resolve any differences of opinion in applying supervisory judgment to a bank's systemic importance score.

The quantitative indicators set out in the Final Rule also raise a number of issues (which the indicators in the Proposal also raised) that the BCBS appears not to have addressed in the Rule Text or Cover Note, including:

- Many of the indicators under categories other than size correlate with size, thus, potentially creating a duplicative effect that may distort size as a component of a bank's score.
- The use of the Basel III exposure measure to calculate the bank indicator amount for the size indicator raises outstanding questions in regard to that measure relating to netting and off-balance sheet exposures.[37]
- The "assets under custody" and "payments cleared and settled through payment systems" indicators that are included in the substitutability category will disproportionately affect a small number of banks that specialize in those activities.

Other issues raised by the Final Rule (several of which were also raised by the Proposal) include:

- With respect to the U.S., the Board of Governors of the Federal Reserve System has, for practical purposes, made the Basel III capital requirements effective immediately by generally conditioning dividend increases and expansion applications on immediate compliance therewith. It remains to be seen whether it will adopt a similar approach with respect to the G-SIB surcharge.
- The BCBS did not provide an empirical justification of the relationship between the various indicators, weightings of the indicators and the resultant capital surcharges, on the one hand, and a reduction in the probability of failure of G-SIBs, on the other. In the view of some commenters, this failure undermined the transparency and credibility of the Proposal and thus the Final Rule.
- In addition to the capital surcharge, the Rule Text, like the Consultative Document, suggests that the BCBS is continuing to consider other prudential measures for global systemically important financial institutions, such as large exposure restrictions and liquidity measures. As was the case with the Proposal, no time frame is provided for when such proposals may be forthcoming.[38]
- Section 165 of the Dodd-Frank Act requires the Federal Reserve to adopt rules (which are expected shortly) subjecting U.S. bank holding companies with more than $50 billion in total consolidated assets to "more stringent" capital requirements. Exactly how U.S. regulators will implement and

harmonize the Final Rule with the requirements of Section 165 of the Dodd-Frank Act remains to be seen.

- As was the case with the Proposal, the Final Rule could have profound implications for the business models of the world's leading banks. Among other things, the Final Rule could promote the "originate to distribute" approach, encourage agency activities and discourage acquisitions (including acquisitions of troubled or failed institutions) and organic expansion. The indicator-based approach of the Final Rule may very well have the effect of discouraging banks from engaging in one or more of the activities measured by the indicators at the margin, especially when a particular bank's score is at or near a threshold between buckets, in order to avoid entering into a higher surcharge bucket. Some portion of the business measured by the indicators may also migrate to the less transparent "shadow banking" sector, which could have negative implications for the health of the financial system as a whole.

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ENDNOTES

[1] The BCBS is a committee of banking supervisory authorities which was established by the central bank governors of the Group of Ten countries at the end of 1974. On December 15, 2010, the BCBS released the final revised framework for strengthening international capital and liquidity regulation, officially identified by the Basel Committee as "*Basel III*" and set forth in two documents: *Basel III: A global regulatory framework for more resilient banks and banking systems* and *Basel III: International framework for liquidity risk measurement, standards and monitoring. See* Sullivan & Cromwell LLP's memorandum to clients, dated December 31, 2010, titled *Basel III Capital and Liquidity Framework: Basel Committee Issues Final Revisions to International Regulation of Bank Capital and Liquidity*.

[2] BCBS, *Global systemically important banks: Assessment methodology and the additional loss absorbency requirement*, July 19, 2011. For additional information regarding the Proposal and related issues, see Sullivan & Cromwell LLP's memorandum to clients, dated July 26, 2011, titled *Regulatory Capital Surcharge for Global Systemically Important Banks* (the "*Proposal Memo*").

[3] *See* Paragraphs 90-92 of the Rule Text.

[4] The FSB was established in April 2009 by the G-20 as the successor to the Financial Stability Forum founded in 1999 by the G-7 Finance Ministers. *See* FSB, *Policy Measures to Address Systemically Important Financial Institutions*, November 4, 2011.

[5] The eight U.S. banks are Bank of America, Bank of New York Mellon, Citigroup, Goldman Sachs, JPMorgan Chase, Morgan Stanley, State Street and Wells Fargo.

[6] *See* Paragraphs 14-17 of the Rule Text.

[7] *See* Paragraphs 18-51 of the Rule Text.

[8] At least one commenter noted that the "wholesale funding ratio" individual indicator could result in a bank's receiving a score greater than 1 for that indicator. The wholesale funding ratio is calculated by dividing total liabilities less retail funding by total liabilities and then normalizing that result by the average ratio across all banks in the sample. Because the wholesale funding ratio indicator is normalized using the average (rather than the sum) of the numerators of the sample banks' wholesale funding ratio indicator scores, it is possible for a bank to have a score for this indicator of greater than 1 (which would happen any time a bank had a wholesale funding ratio greater than the average).

[9] The categories and individual indicators discussed herein are discussed in additional detail in the Proposal Memo.

[10] *See* Paragraph 56 of the Rule Text.

[11] *See* Table 2 and Paragraphs 57-63 of the Rule Text.

[12] *See* Paragraphs 30 and 31 of the Rule Text.

[13] *See* Paragraphs 30 and 31 of the Consultative Document.

[14] *See* Paragraph 31 of the Rule Text; Paragraph 12 of the Cover Note.

[15] *See* Paragraph 14 of the Cover Note; Paragraphs 50 and 51 of the Rule Text.

[16] *See* Paragraphs 16 and 17 of the Cover Note.

[17] For a discussion of potential issues that may have given rise to the "confusion" cited by the BCBS, see footnote 8 of this memorandum.

[18] *See* Paragraph 17 of the Cover Note.

[19] *See* Paragraph 18 of the Cover Note.

[20] *See* Paragraph 19 of the Cover Note.

ENDNOTES (continued)

[21] *See* Paragraph 70 of the Consultative Document.

[22] *See* Paragraph 20 of the Cover Note.

[23] *See* Paragraph 25 of the Cover Note.

[24] *See* Paragraph 22 of the Cover Note.

[25] *See* Paragraph 20 of the Cover Note.

[26] *See* Paragraph 25 of the Cover Note.

[27] *See* Paragraph 27 of the Cover Note.

[28] *See* Paragraphs 42-44 of the Cover Note.

[29] *See* Paragraph 44 of the Cover Note.

[30] *See* Paragraph 29 of the Cover Note.

[31] *See* Paragraph 30 of the Cover Note.

[32] *See* Paragraph 7 of the Cover Note.

[33] *See* Paragraph 8 of the Cover Note.

[34] *See* Paragraphs 33 and 34 of the Cover Note.

[35] *See* Paragraph 39 of the Cover Note.

[36] *See* Paragraphs 40 and 41 of the Cover Note.

[37] For more detail regarding the exposure measure, see Sullivan and Cromwell LLP's memorandum to clients, dated December 31, 2010, titled *Basel III Capital and Liquidity Framework: Basel Committee Issues Final Revisions to International Regulation of Bank Capital and Liquidity*.

[38] *See* Paragraph 7, footnote 4 of the Rule Text.

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