June 25, 2018

VIA ELECTRONIC SUBMISSION

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street SW, suite 3E-218
Washington, DC 20219

Re: Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for U.S. Global Systemically Important Bank Holding Companies and Certain of Their Subsidiary Insured Depository Institutions; Total Loss-Absorbing Capacity Requirements for U.S. Global Systemically Important Bank Holding Companies (Federal Reserve Board Docket No. R-1604, RIN 7100 AF-03; OCC Docket ID OCC-2018-0002)

Ladies and Gentlemen:

The Financial Services Forum (the "Forum")[1] appreciates the opportunity to submit this letter to the Board of Governors of the Federal Reserve System (the "FRB") and the Office of the Comptroller of the Currency (the "OCC," and together with the FRB, the "Agencies") on the Agencies' notice of proposed rulemaking to modify certain aspects of the enhanced supplementary leverage ratio (the "eSLR") rule and to make conforming changes to the FRB's total loss absorbing capacity ("TLAC") rule. The eSLR aspects of the proposal are applicable exclusively to all of our

[1] The Financial Services Forum is an economic policy and advocacy organization whose members are the chief executive officers of the eight largest and most diversified financial institutions headquartered in the United States. Forum member institutions are a leading source of lending and investment in the United States and serve millions of consumers, businesses, investors, and communities throughout the country. The Forum promotes policies that support savings and investment, deep and liquid capital markets, a competitive global marketplace, and a sound financial system.

member institutions, the U.S. global systemically important bank holding companies ("GSIBs") and certain of their insured depository institution subsidiaries ("IDIs").[2] Ultimately, the ability of our member institutions to serve as a leading source of lending and investment for U.S. consumers, businesses, investors, and communities critically depends on the efficient calibration of regulation that accounts for and that balances effective costs and benefits. Financial regulations that do not adhere to these key principles result in an inefficient financial system that misallocates capital in a way that can have a detrimental effect on the businesses and households that we serve. In this letter, we describe how the proposal should be revised to adhere to these principles.

Executive Summary

We support and appreciate the Agencies' effort to recalibrate the eSLR rule to establish the role of leverage requirements as a backstop to risk-based capital and to more closely align the U.S. rules with the recently finalized Basel III standards.[3] Nonetheless, we believe there are additional changes that should be made to achieve more effectively the Agencies' policy objectives. In addition, the proposal raises important policy issues about the capital framework more generally that the Agencies should address in the near term. We offer the following summary observations and recommendations:

- **We support recalibration of leverage capital standards**. We agree with the Agencies that leverage requirements should act as a backstop, rather than as a binding constraint.[4] Therefore, we support the proposal and urge the Agencies to adopt it promptly, as it would help realign the eSLR as a backstop. However, we believe more needs to be done to ensure this policy objective is achieved.

- **This proposal is a positive step, but additional changes are necessary to help ensure that the regulatory system is efficient and supports economic growth**. Our member institutions are significantly better capitalized and substantially more resilient than they were prior to the 2007-2009 financial

2 83 Fed. Reg. 17317 (April 19, 2018).

3 Basel Committee on Banking Supervision ("Basel Committee"), *Basel III: Finalising post-crisis reforms*, Leverage Ratio (Dec. 2017) (adopting a GSIB leverage ratio buffer requirement) ("Basel III: Finalising post-crisis reforms").

4 Leverage requirements should not constrain banking organizations through the business cycle. Instead, leverage requirements are intended to avoid a build-up of excess leverage that could lead to a destabilizing deleveraging process during a subsequent economic contraction. *See* Basel Committee, *Basel III leverage ratio framework and disclosure requirements*, para. 2 (Jan. 2014).

crisis.[5] We agree with FRB Vice Chairman Randal Quarles that it is "an eminently natural and expected time to step back and assess" what changes should be made.[6] The proposed recalibration of the eSLR is a first step in this review process. In light of the improved strength and resiliency of the financial system, a critical element of this review must be a systematic analysis of prior decisions to be more stringent than the international standards the U.S. banking agencies helped negotiate, a practice sometimes referred to as "gold-plating." This broader review and recalibration, importantly, should include a reevaluation of the GSIB surcharge.

- **The tier 1 leverage and supplementary leverage ratio denominators should exclude risk-free assets**. Including risk-free assets in the "ordinary" tier 1 leverage ratio and supplementary leverage ratio ("SLR") denominators creates incentives for banking organizations to reduce participation in, or increase costs for, lower-risk, lower-return businesses and products that are essential for a vibrant and growing economy. Although the proposed re-calibration of the eSLR helps to avoid some of these perverse incentives in the short run, a more durable approach would be to remove risk-free assets from the leverage ratio denominators altogether.

We have focused this letter on issues that are key priorities for our member institutions to help ensure that the final rule supports continued economic growth. We also support the joint comments submitted by The Clearing House Association L.L.C., the Securities Industry and Financial Markets Association, the Financial Services Roundtable, and the International Swaps and Derivatives Association, including the comments on changes to the TLAC SLR and long-term debt SLR requirements.

***

[5] Former FRB Chair Janet L. Yellen, Financial Stability a Decade after the Onset of the Crisis, Speech Before "Fostering a Dynamic Global Recovery" Symposium (Aug. 25, 2017) ("The evidence shows that reforms since the crisis have made the financial system substantially safer.").

[6] FRB Vice Chairman Randal K. Quarles, Early Observations on Improving the Effectiveness of Post-Crisis Regulation, Speech Before Amer. Bar. Ass'n Banking Law Comm. (Jan. 19, 2018) ("Amer. Bar. Ass'n Speech").

To expand on the executive summary, below is a more detailed discussion that:

(1) elaborates on our support for the proposed recalibration of the eSLR;

(2) suggests that the FRB reevaluate the GSIB surcharge;

(3) explains our recommendation that the tier 1 leverage ratio and SLR denominators be revised to exclude risk-free assets, which effectively would eliminate the material disincentive to hold risk-free assets that would continue to exist under the eSLR proposal; and

(4) recommends that the eSLR for IDI subsidiaries of GSIBs be implemented as a buffer, rather than as part of the prompt corrective action ("PCA") framework.

We support recalibration of leverage capital standards. We support the proposed revisions to the eSLR, as well as the corresponding changes to the FRB's TLAC rule. At present, the eSLR serves as the binding capital constraint for four of eight of our top-tier bank holding companies and each of the eight respective lead IDI subsidiaries. Under the proposed revisions, the Agencies note that the eSLR would remain the binding constraint for one of our holding companies and three of the lead IDI subsidiaries.[7] Because leverage ratios do not differentiate the amount of capital required by the relative risk of an underlying exposure, we agree with the Agencies that "[l]everage capital requirements should generally act as a backstop to the risk-based requirements" rather than as a binding constraint.[8] We also agree with the Agencies that making the eSLR a binding constraint creates disincentives to provide custody, treasury, and clearing services to our customers,[9] activities that are essential to a vibrant and growing economy. We commend the Agencies for proposing revisions to their rules that are designed to avoid such distortive results, but reiterate that even with the proposed revisions, the eSLR would remain a binding constraint for a number of our institutions, either at the holding company level or at the IDI level. Finally, we note that the proposal would not appreciably lower the amount of required capital for our institutions. Indeed, according to the FRB's analysis, the proposal would reduce our collective amount of required tier 1 capital at the holding company level by 0.04%.[10] At the IDI level, we acknowledge that the FRB has

---

[7] 83 Fed. Reg. at 17321.

[8] *Id.* at 17319. *See also* Former FRB Governor Daniel K. Tarullo, Departing Thoughts, Speech at Princeton University (April 4, 2017) (noting that "[t]he complementarity of risk-based capital requirements and leverage ratios suggests that there should be some proportionality between the two" and that "it would be sensible for the banking agencies to consider altering the enhanced supplementary leverage ratio requirement so that it would be set with an eye toward the risk-based surcharge").

[9] 83 Fed. Reg. at 17319-20.

[10] *Id.* at 17321 n.27; Staff Memo to the FRB, at 2 (April 5, 2018) ("Staff Memo").

estimated the proposal would reduce the amount of required tier 1 capital across the lead IDI subsidiaries by approximately $121 billion,[11] but this result is partially due to material over-calibration of the IDI requirement (which is even more stringent than the holding company requirement).[12] Moreover, as FRB Vice Chairman Quarles has noted, the FRB's "overall capital regime prevents this capital from being distributed out of the banking organization as a whole" and in fact "would only allow the firm to move that capital to different subsidiaries within the firm."[13] Similarly, the ability of an IDI to reduce capital also is mitigated by other existing leverage and risk-based capital requirements.

The FRB should reevaluate the GSIB surcharge. The proposal raises important questions about the calibration and role of the GSIB surcharge, which we urge the FRB to reconsider. In particular, basing the eSLR as well as the proposed revisions to the FRB's TLAC SLR requirements on the GSIB surcharge makes more acute the need to evaluate whether the GSIB surcharge itself is appropriately calibrated.[14] Further to this point, the GSIB surcharge, as implemented by the FRB, should be updated to reflect significant improvements to the resiliency and resolvability of our firms since its adoption in July 2015, as acknowledged by FRB Vice Chairman Quarles during Congressional testimony on April 17, 2018.[15]

This update is needed now because the GSIB surcharge is based on the assumption that it was necessary to "reduce the likelihood that the failure or material financial distress of [a GSIB] will again pose a threat to U.S. financial stability" and to decrease the likelihood of failure in the first instance.[16] This dual-rationale of improving resiliency and resolvability of GSIBs also has been used to justify other post-crisis regulations, which have resulted in duplicative regulatory requirements that address the same risks, as discussed below.

---

[11] 83 Fed. Reg. at 17321; Staff Memo, at 6.

[12] 83 Fed. Reg. at 17321.

[13] Liquidity Regulation and the Size of the Fed's Balance Sheet, Speech Before Hoover Inst. Monetary Policy Conference (May 4, 2018). *See also* Staff Memo, at 6 (noting that the proposal would "provide additional flexibility at the IDI level," but that "the current risk-based capital requirements, supervisory stress testing constraints, and other limitations applicable at the holding company level would continue to be binding and limit the amount of capital that GSIBs could distribute to investors").

[14] The FRB's stress capital buffer proposal also raises similar issues, on which the Forum also has commented. *See* 83 Fed. Reg. 18160 (April 25, 2018).

[15] Testimony of FRB Vice Chairman Randal K. Quarles Before the H. Comm. on Fin. Services (April 17, 2018) ("House Testimony").

[16] 80 Fed. Reg. 49082, 49092 (Aug. 14, 2015).

As a result, the GSIB surcharge as currently implemented is miscalibrated and imposes costs that outweigh the incremental benefits. In this case, the surcharge unnecessarily raises costs that impede the ability of our member institutions to provide credit to support growth of the real economy. As FRB Vice Chairman Quarles has emphasized, at this stage in our nation's economic recovery, these types of impediments could imperil the sustainability of economic growth.[17] FRB Chairman Jerome Powell has made a similar point, noting the potential for "laws, regulations, and supervisory practices [to] be adjusted in a way that preserves the gains in safety and soundness but helps financial institutions devote as much of their resources as possible to supporting economic growth."[18] Consequently, we agree with Vice Chairman Quarles's statement that the FRB should consider whether it is possible to achieve its stated financial stability objective "using fewer tools."[19] The main reasons the GSIB surcharge has become redundant and needs to be recalibrated are the following.

- The GSIB capital surcharge does not reflect the enhancements to resiliency, liquidity, and resolvability that have been achieved since the surcharge was adopted, such as: enhancements to living wills; minimum margin and capital requirements related to non-cleared swaps and security-based swaps; TLAC; qualified financial contract ("QFC") contractual stay requirements; and improved supervisory practices.[20]

- In addition, when adopting the GSIB surcharge, the FRB stated it would periodically reevaluate the method 2, gold-plated version that it uses "[t]o ensure changes in economic growth do not unduly affect firms' systemic risk scores."[21] Further, method 2 relies on a flawed methodology to calculate a

[17] An Assessment of the U.S. Economy, Speech Before 34th Annual NABE Economic Policy Conference (Feb. 26, 2018) (noting that the "sustainability of the recent upturn in growth will depend importantly" on developments in factors such as capital investment).

[18] Brief Remarks at The Global Finance Forum (April 20, 2017) (also expressing his support for adjustments "designed to enhance the efficiency and effectiveness of regulation without sacrificing safety and soundness or undermining macroprudential goals").

[19] American Bar Ass'n Speech (also noting that "if we have a choice between two methods of equal effectiveness in achieving a goal, we should strive to choose the one that is less burdensome for both the system and the regulators").

[20] For example, Vice Chairman Quarles has stated that the GSIBs have made "substantial progress" with their living wills to improve their resolvability. House Testimony. In addition, minimum margin and capital requirements related to non-cleared swaps and security-based swaps were finalized in late 2015, 80 Fed. Reg. 74840 (Nov. 30, 2015); TLAC requirements for GSIBs were finalized on January 24, 2017, 82 Fed. Reg. 8266 (Jan. 24, 2017); and QFC stay requirements were finalized on September 12, 2017, 82 Fed. Reg. 42882 (Sept. 12, 2017).

[21] 80 Fed. Reg. at 49088.

> firm's use of short-term wholesale funding, underscoring the need to reconsider method 2.

In sum, now is the appropriate time to revisit the GSIB surcharge so as to avoid hindering economic growth, bring efficiencies to the post-crisis regulatory framework, and recalibrate the gold-plating represented by method 2.

The leverage ratio denominators should exclude risk-free assets. The Agencies request comment on excluding central bank reserves from the denominator of the SLR.[22] As mentioned earlier, we agree that the calibration of the eSLR should not "create incentives for banking organizations bound by the eSLR standards to reduce participation in or increase costs for lower-risk, lower-return businesses, such as secured repo financing, central clearing services for market participants, and taking custody deposits."[23] Further, the distortive effects caused by wholesale inclusion of risk-free assets in the denominator are most acute during times of stress,[24] a result that would seem to be at odds with broader financial stability policy goals. A range of policy tools is available to reduce this distortive effect of wholesale inclusion.[25] For example, the Treasury Department recommends excluding central bank reserves, U.S. Treasury securities, and initial margin for centrally cleared derivatives from the leverage ratio denominator.[26] We strongly support the Treasury Department's recommendation and, more generally, believe that the Agencies should explore the policy tools available to reduce the negative effects caused by including risk-free assets in the denominator.

---

[22] 83 Fed. Reg. at 17322 (Question 5). Since the Agencies released the eSLR proposal, the Economic Growth, Regulatory Relief, and Consumer Protection Act, S. 2155, has become law. This legislation requires the FRB and other federal banking regulators to review the SLR's denominator. *See* Economic Growth, Regulatory Relief, and Consumer Protection Act, S. 2155, 115th Cong. § 402 (2018).

[23] 83 Fed. Reg. at 17319-20.

[24] *See, e.g.,* Basel III: Finalising post-crisis reforms, Leverage Ratio, at 144 para. 26 (Dec. 2017).

[25] *See* Darrell Duffie, *Post-Crisis Bank Regulations and Financial Market Liquidity*, Lecture at Banca d'Italia 46 (Sept. 15, 2017) (recommending the SLR recognize broader netting of U.S. Treasury securities in repurchase agreements); *see also* Meraj Allahrakha, Jill Cetina, and Benjamin Munyan, Office of Financial Research, *Do Higher Capital Standards Always Reduce Bank Risk? The Impact of the Basel Leverage Ratio on the U.S. Triparty Repo Market* 33 (Nov. 10, 2016) (finding that the leverage ratio "as a risk-insensitive capital standard may encourage firms to increase the risk profile" of activities and that their findings "are relevant to ongoing policy discussions internationally about potentially increasing leverage ratio requirements for G-SIBs").

[26] U.S. Department of the Treasury, *A Financial System That Creates Economic Opportunities, Banks and Credit Unions, Report to President Donald J. Trump, Executive Order 13772 on Core Principles for Regulating the United States Financial System* 14 (June 2017).

Although, in the short run, recalibration of the eSLR helps to avoid some of these perverse incentives, a more durable approach would be to also exclude risk-free assets from the leverage ratio denominators altogether. In particular, excluding risk-free assets from the leverage ratio denominators would have the benefit of ensuring that such activities are never counted toward either leverage ratio; accordingly, leverage capital standards would not distort incentives to engage in those important businesses. Indeed, the merit of excluding risk-free assets from the SLR denominator in particular is illustrated by the fact that, according to the FRB's analysis, even with the proposed recalibration, the eSLR would remain the binding constraint for one of our holding companies and three of the lead IDI subsidiaries, which is contrary to the goal of leverage requirements serving as a backstop to risk-based capital.

The eSLR requirement for IDIs should be a buffer, not part of the PCA framework. The Agencies solicited comment on whether the IDI-level eSLR should be formulated as a capital buffer requirement, *i.e.*, the same way that it applies to a GSIB holding company, rather than as a part of the PCA framework.[27] We support the alternative, buffer approach for IDIs.

The Agencies' PCA framework historically has used fixed ratios to establish uniform standards across IDIs. Continuing to maintain the IDI-level eSLR as a part of the PCA framework potentially could result in different standards for IDIs with similar capital profiles, because GSIB IDIs could (and likely would) have different GSIB surcharges. In fact, identical IDIs could be held to different standards simply by virtue of their affiliation with GSIB holding companies with different GSIB surcharges. On the other hand, revision of the IDI-level eSLR to be a buffer would harmonize and align with the eSLR requirement for holding companies. Furthermore, because the proposed minimum levels would not change, capital requirements for GSIB IDI subsidiaries would not be meaningfully lower.

* * *

Thank you for considering these comments. Please feel free to contact the undersigned (KFromer@fsforum.com) with any questions.

[27] 83 Fed. Reg. at 17322 (Question 6).

Respectfully submitted,

Kevin Fromer
President and CEO
The Financial Services Forum