**American Express Company**
General Counsel's Office
200 Vesey Street
New York, NY 10285

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*Via Electronic Delivery*

Office of the Comptroller of the Currency
400 7th E Street, S.W., Suite 3E-218
Mail Stop 9W-11
Washington, DC 20219

Federal Deposit Insurance Corporation
550 17th Street, NW.
Washington, DC 20429

Board of Governors of the Federal Reserve System
20th Street & Constitution Ave., NW.
Washington, DC 20551

**Re: Liquidity Coverage Ratio; Liquidity Risk Measurement, Standards, and Monitoring**

Ladies and Gentlemen:

American Express Company ("American Express") appreciates the opportunity to provide comments to the Office of the Comptroller of the Currency (the "OCC"), the Federal Reserve Board (the "FRB") and the Federal Deposit Insurance Corporation (the "FDIC") (together, the "Agencies") in response to the proposed rule that would apply a liquidity coverage ratio ("LCR") to certain large U.S. banking organizations and specifically, a 30-day LCR to U.S. banking organizations with $250 billion or more in consolidated assets (the "Asset Threshold") or $10 billion or more in foreign exposures (the "Foreign Exposure Threshold" and together with the Asset Threshold, the "Thresholds").[1]

In this letter, we focus our comments on the Foreign Exposure Threshold and the treatment of prepaid products under the LCR. As discussed in detail below, we do not

[1] Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring, 78 Fed. Reg. 71818 (Nov. 29, 2013).

believe that the Agencies should apply the 30-day LCR based on the Foreign Exposure Threshold but, rather, should utilize a foreign exposure threshold that takes into account changes in industry structure, considerations of competitive equality across jurisdictions and differences between capital and liquidity regulation. In addition, we believe that certain prepaid products should be excluded from the LCR entirely, or, in the alternative, should be assigned outflow rates appropriate for their underlying stability, including during periods of liquidity stress.

## I. Revising and Updating the Thresholds

As noted, the proposed rule applies to U.S. banking organizations that meet or exceed the Asset or Foreign Exposure Thresholds. The Agencies do not, however, provide any reason or justification for applying the 30-day LCR based on the Thresholds. Rather, the proposed rule states that the 30-day LCR would not apply to U.S. banking organizations that have "opted in" to the Basel II advanced capital adequacy framework and requests comment on whether to apply the 30-day LCR to these banking organizations.[2] These statements suggest that the Thresholds are taken from the rulemaking process to implement the Basel II advanced approaches in the United States (the "Advanced Approaches Rules"), in which the Agencies determined to automatically apply the advanced approaches to "core" U.S. banking organizations that met the Thresholds.[3]

Applying the 30-day LCR using thresholds taken from an altogether unrelated rulemaking process that is over a decade old is not merited. The Thresholds were established in the context of a capital rulemaking process, an entirely different exercise than the liquidity focus of the proposed rule. Indeed, it is far from clear why quantitative thresholds for the application of regulatory capital standards can or should translate to the liquidity context. As the Agencies are aware, capital and liquidity are generally considered distinct areas of prudential regulation, and the Agencies should not seek to

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[2] Id. at 71821.

[3] *See* Risk-Based Capital Guidelines; Implementation of the New Basel Capital Accord, 68 Fed. Reg. 45900 (Aug. 4, 2003) (advance notice of proposed rulemaking); Risk-Based Capital Guidelines; Advanced Capital Adequacy Framework, 71 Fed. Reg. 55830 (Sept. 25, 2006) (joint notice of proposed rulemaking); Risk-Based Capital Standards: Advanced Capital Adequacy Framework – Basel II, 72 Fed. Reg. 69288 (Dec. 7, 2007) (Final rule). It is important to note that the automatic application of the advanced approaches based on quantitative thresholds appears to be inconsistent with the approach taken in the European Union, which permitted, but did not require, large and complex banking organizations to opt in to the advanced approaches. *See, e.g.*, Directive 2006/48, of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions, art. 76, 2006 O.J. (L 177) 1, 32.

conflate the two by applying the 30-day LCR to the same extent and in the same manner as the Basel II advanced approaches.

Our concern is compounded because the Advanced Approaches Rules themselves provide little explanation of how or why the Agencies originally selected the Thresholds. For example, the Agencies' 2006 joint notice of proposed rulemaking does not provide any substantive explanation of how or why the Thresholds were selected. The only rationale offered is not in the Advanced Approaches Rules themselves, but in a 2003 speech by then-FRB Vice Chair Roger Ferguson, in which the Vice Chair suggested that the Thresholds were designed to "account for 95 percent [of foreign assets held by the top fifty domestic U.S. banking organizations]" and to capture a subset of "internationally active" U.S. banking organizations of sufficient "size, complexity and international activity."[4]

If indeed that was the rationale for application of the Thresholds to capital standards a decade ago, this rationale no longer holds true. The U.S. banking sector has undergone significant structural changes in the past decade, particularly with respect to the size of the largest banking organizations and the proportion of industry assets held by these organizations. Total U.S. banking sector assets have increased from approximately $9.5 trillion in 2003 to $14.5 trillion in 2012,[5] and the percentage of total banking sector assets held by the ten largest U.S. banking organizations has likewise increased, from 39.7 percent in 2003 to 50.1 percent in 2010.[6]

In light of these significant structural changes, the Agencies' original assumptions regarding the number of "core" banking organizations no longer appear to hold, reinforcing the view that the Thresholds should be updated. In its 2003 advance notice of proposed rulemaking, the Agencies anticipated that there would be ten "core" banking organizations covered by the Thresholds,[7] but by the end of 2007, there were 12,[8] and

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4 Roger W. Ferguson, Jr., Vice Chairman, Fed. Reserve Bd., Basel II – a Realist's Perspective, Address Before the Risk Management Association Conference on Capital Management (April 9, 2003), *available at* http://www.federalreserve.gov/boarddocs/speeches/2003/20030409/default.htm.

5 Source: SNL Financial.

6 *See, e.g.*, Robert M. Adams, Federal Reserve Board of Governors, Consolidation and Merger Activity in the United States Banking Industry from 2000 through 2010 (2012), *available at* http://www.federalreserve.gov/pubs/feds/2012/201251/201251pap.pdf.

7 Risk-Based Capital Guidelines; Implementation of New Basel Capital Accord, 68 Fed. Reg. 45900, 45906 (Aug. 4, 2003).

today there are approximately 18. In fact, ten U.S. banking organizations currently appear to hold approximately 95 percent of foreign exposures.[9] Vice Chair Ferguson suggested that the Thresholds were originally selected because the resulting core banks would hold 95 percent of foreign exposures, and the data appear to suggest that this objective could be achieved by applying the 30-day LCR to these ten banking organizations.

Given the significant changes in industry structure and the resulting increase in the number of core banking organizations, American Express believes that the Agencies should consider alternative approaches to the application of the 30-day LCR. For example, the Agencies could apply the 30-day LCR based on a revised Foreign Exposure Threshold and the 21-day LCR to other U.S. BHCs with $50 billion or more in assets. Alternatively, the Agencies could establish a rebuttable presumption that the 30-day LCR applies to a banking organization that meets the Foreign Exposure Threshold, with a banking organization able to rebut the presumption if it can demonstrate that application of the 30-day LCR would be inappropriate given its size, complexity and mix of activities.

The Agencies could also seek to align the proposed rule with the FRB's recently proposed liquidity reporting framework and thereby apply the 30-day LCR to U.S. banking organizations designated as global systemically important banks ("G-SIBs") and the 21-day LCR to other U.S. BHCs with $50 billion or more in assets. The proposed liquidity reporting framework would require G-SIBs to submit the Complex Institution Liquidity Monitoring Report ("FR 2052a") and U.S. BHCs with assets greater than $50 billion that are not G-SIBs to submit the Liquidity Monitoring Report ("FR 2052b") on a monthly basis.[10] The FRB takes a bifurcated approach to application of the FR 2052 reports, requiring the larger, more complex and systemically important U.S. G-SIBs to submit the more detailed FR 2052a on a daily basis, while permitting smaller banking

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[8] *See* U.S. Government Accountability Office, Risk-Based Capital: New Basel II Rules Reduced Certain Competitive Concerns, but Bank Regulators Should Address Remaining Uncertainties 14 (Sept. 2008).

[9] Federal Financial Institutions Examination Council, E.16 Statistical Release (September 30, 2013). This release aggregates data from the FFIEC 009 reports, which are used to formulate the $10 billion in foreign exposures standard for core banks. The ten banking organizations include Bank of America, Bank of New York Mellon, Citigroup, Deutsche Bank Trust Corp. (Taunus Corp.), Goldman Sachs, HSBC, JPMorgan Chase, Morgan Stanley, State Street, and Wells Fargo.

[10] Proposed Agency Information Collection Activities; Comment Request, 78 Fed. Reg. 57,634 (Sept. 19, 2013).

organizations to submit the FR 2052b on a monthly basis. The Agencies should consider aligning application of the LCR with the FR 2052 reports by applying the 30-day LCR to the U.S. G-SIBs and their depository institution subsidiaries and the 21-day modified LCR to other U.S. BHCs with $50 billion or more in assets, as such an approach would appropriately apply the 30-day LCR and the 2052a reporting requirement to the most systemically important U.S. banking organizations.

In offering these suggestions, we note that the proposed rule indicates the Agencies are cognizant of the merits of alternative approaches to applying the 30-day LCR. The Agencies specifically requested comment on alternative approaches to application of the 30-day LCR, and the OCC analyzed the costs and benefits of alternative approaches to scoping.[11] American Express encourages the Agencies to give thoughtful consideration to these alternatives, particularly those that would apply the 30-day LCR only to the largest, most complex banking organizations, which in the view of American Express, is a more appropriate policy response than to apply the 30-day LCR to any banking organization that meets the Foreign Exposures Threshold.

## II. Treatment of Prepaid Products

### A. Background on Prepaid Products

American Express issues a variety of prepaid products in the United States, including Travelers Cheques and general purpose reloadable ("GPR") prepaid cards.[12] American Express conducts its prepaid products business through nonbank subsidiaries, which hold state money transmitter licenses in every state where they are required for the products and services that American Express provides.[13]

Under state law, a money transmitter license permits a nonbank company to receive, hold and transmit funds for its customers, subject to strict limitations. Unlike

[11] *See, e.g.*, 78 Fed. Reg. 71855-56 (OCC considered alternative approaches to application of the LCR, including application of the 30-day LCR only to institutions designated as global systemically important banks).

[12] Travelers Cheques allow customers to carry a secure payment instrument backed by American Express, particularly when traveling abroad. GPR prepaid cards may be used at any merchant that accepts American Express, and can be reloaded with additional funds by the cardholder. American Express issues several different GPR prepaid cards, including Bluebird by American Express and American Express Serve.

[13] Nearly every state requires some sort of money transmitter license except South Carolina and Montana.

banks, which receive deposits with the expectation that only a small portion of those funds will be held in reserve, money transmitters must at all times hold cash or qualifying investments equal to or greater than the money transmitter's outstanding obligations. Most state laws use the term "permissible investments" to refer collectively to the assets (including cash) that a money transmitter may hold to meet this requirement.[14] Permissible investments held by a money transmitter generally may not be subject to security interests or restrictions on the money transmitter's right to transfer the permissible investments. This requirement ensures that a licensed money transmitter at all times has funds on hand (in the form of cash or an investment that can be quickly liquidated) to satisfy its money transmission obligations. With respect to prepaid products issued pursuant to a money transmitter license, the licensee must at all times hold permissible investments equal to the outstanding balances on the money transmitter's prepaid products.

Because money transmitters are essentially required under state law to set aside funds to be transmitted on a dollar for dollar basis, may only invest in funds in a limited set of permissible investments and in many cases are deemed to hold assets on behalf of customers, they do not engage in the type of fractional-reserve banking that characterizes the banking industry. Banks, by contrast, may deploy funds received as deposits to make investments or other expenditures, including illiquid investments. The funds received by the bank become the bank's own funds, to be used for any lawful purpose including loans and general corporate purposes and subject only to the bank's obligation to repay the customer.

### B. Exclusion of Prepaid Products from LCR

Given the above-described characteristics, American Express respectfully submits that prepaid products issued through nonbank money transmitter subsidiaries should be excluded from the LCR calculation entirely. Specifically, American Express believes that a prepaid product should be excluded from the LCR if the issuing banking organization issues the prepaid product through a nonbank subsidiary that is licensed as a money transmitter in states where such a license is required to issue prepaid products.

Indeed, permissible investments held by a money transmitter are analogous to collateral posted for secured funding transactions. In a secured funding transaction, the collateral poster has limited control as to the disposition of the assets, which are posted

[14] The assets that qualify as permissible investments vary by state. However, they almost always include only high-grade, low-risk assets. Examples include cash, Treasury bonds, state government bonds, or highly-rated private securities.

for the purpose of funding the transaction. Similarly, a money transmitter is subject to a *de facto* restriction on the disposition of permissible investments. A money transmitter cannot use permissible investments for purposes other than satisfying its money transmission obligations (including a prepaid product issuer's obligations in connection with the product) because doing so would bring the money transmitter out of compliance with money transmitter laws.

Because of the functional similarity between permissible investments and collateral posted for secured funding transactions, outstanding money transmission obligations should be treated similarly to liabilities corresponding to collateral posted in secured funding transactions. A banking organization is not subject to collateral outflows under Section __.32(f)(5) to the extent that such collateral does not qualify as high-quality liquid assets in the first instance. This supports the view that to the extent that permissible investments held by a money transmitter in respect of prepaid products generally do not qualify as high-quality liquid assets, the liabilities associated with these products should be excluded from the denominator of the LCR.

C. Outflow Rate for Prepaid Product Liabilities

If the Agencies are unwilling to exclude prepaid products meeting the aforementioned conditions from the LCR, American Express respectfully submits that the liabilities arising from these prepaid products (the "Prepaid Product Liabilities") should be assigned outflow rates that reflect their actual characteristics, including their performance during periods of liquidity stress.

Under Section __.32(a)(3) of the proposed rule, funding from retail customers or counterparties that is not a retail deposit or a brokered deposit provided by a retail customer or counterparty would receive a 100 percent outflow rate. American Express believes that it would be inappropriate to apply a 100 percent outflow rate to the Prepaid Product Liabilities, which have demonstrated a high degree of persistency throughout economic cycles, including during the recent financial crisis. This persistency reflects the tenor of the portfolio, where 55 percent of the Travelers Cheques currently outstanding were sold over six years ago, suggesting significant stability from a funding outflow perspective. The Agencies specifically solicited comment on whether the proposed outflow rates for retail funding reflect industry experience, and the data demonstrate that applying a 100 percent outflow rate to the Prepaid Product Liabilities would be inappropriate and unwarranted.

It is important to note that certain American Express prepaid products demonstrate characteristics that support the view that these products should receive an outflow rate of significantly less than 100 percent. For example, certain prepaid products are covered by FDIC pass-through insurance, which reduces the probability that

customers will remove prepaid product funds during a time of stress.[15] In addition, as discussed above, a number of state laws require that money transmitters hold funds equal to the money transmitter's outstanding prepaid liabilities and invest these funds in high-grade, low-risk assets, providing an added measure of protection and confidence to customers that funds will be available during periods of stress.

In sum, American Express believes the Prepaid Product Liabilities have demonstrated stability throughout economic cycles, including during periods of liquidity stress, and merit an outflow rate of significantly less than 100 percent. This view is further supported by the fact that certain American Express prepaid products have characteristics, such as pass-through FDIC insurance, that reduce the probability that customers will remove funds in times of stress.

## III. Conclusion

American Express respectfully submits that for the reasons described above, certain changes are merited to the final LCR. First, we believe that the Agencies should not apply the 30-day LCR based on the Foreign Exposure Threshold, as it fails to take proper account of changes in industry structure, considerations of competitive equality across jurisdictions and differences between capital and liquidity regulation. Instead, the Agencies should consider alternative approaches to the application of the 30-day LCR based on a foreign exposures threshold. Second, we believe that the assets and liabilities associated with prepaid products issued through nonbank money transmitter subsidiaries should be excluded from the LCR or, in the alternative, assigned outflow rates of significantly less than 100 percent that are commensurate with their underlying stability. This view is supported by the unique attributes of the state money transmitter regulatory regime applicable to these products, as well as their demonstrated stability during periods of stress.

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[15] Bluebird by American Express and American Express Serve products provide pass-through FDIC insurance to customers.

Thank you for considering our comment letter. We appreciate the opportunity to share our views with the Agencies and would be happy to discuss any of them further at your convenience. If we may be of further assistance, please contact me at 212-640-3532 or juliana.s.o'reilly@aexp.com.

Sincerely,

Juliana S. O'Reilly
Managing and Chief Bank Regulatory Counsel

cc:

Jeffrey C. Campbell
Timothy J. Heine
David L. Yowan