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Legislative and Regulatory Activities Division,
Office of the Comptroller of the Currency, 400 7th Street SW
Suite 3E-218, Mail Stop 9W-11
Washington, DC 20219
Docket ID OCC-2013-0008

Robert de V. Frierson
Secretary, Board of Governors of the Federal Reserve System,
20th Street & Constitution Avenue, NW
Washington, DC 20551
Docket No. R–1460

Robert E. Feldman, Executive
Secretary, Attention: Comments, Federal
Deposit Insurance Corporation, 550 17th Street NW
Washington, DC 20429
RIN 3064–AE01

Re: Regulation H and Q - Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and their Subsidiary Insured Depository Institutions

Dear Sirs:

Guggenheim Partners Investment Management, LLC appreciates the opportunity to provide comments on the recent joint notice of proposed rulemaking titled: "Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and Their Subsidiary Insured Depository Institutions" (FRS Docket No. R-1460; OCC- 2013-0008 and FDIC RIN 3064-AE0) (the “proposal”); issued by 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”).

About Guggenheim Partners Investment Management

Guggenheim Partners Investment Management, LCC is the investment management division of Guggenheim Partners, LLC, which is a global, full service financial services firm.

We manage approximately $110 billion in total assets[1] on behalf of institutional and individual clients. Our institutional clients include insurance companies, public sector and corporate pension plans, foundations, endowments, and other institutions around the world.

Executive Summary

We commend the Agencies' desire to discourage excessive risk-taking and provide additional capital buffers for the largest banks. Guggenheim Partners Investment Management believes that, unfortunately, the current proposal will have unintended consequences that will result in more systemic risk and in a less stable and lower-credit-quality banking system for all participants. While the proposal is far ranging and there are numerous questions in the request for comments, we will limit our comments to those aspects with which we have direct experience as users (*i.e.*; borrowers) of short-term securities financing arrangements.

The proposal directly affects short-term securities financing transactions including repurchase agreements ("repos"), reverse repos, and revolving loans, among others, by imposing additional capital requirements on large US banks and bank holding companies when they enter into these arrangements. Increased capital requirements would encourage banks to reduce their participation in securities financing transactions. This view is corroborated by industry comments to the recent Basel Committee on Banking Supervision revised Basel III leverage ratio framework and disclosure requirements ("the Basel III Proposal"), which would likewise result in increased capital requirements related to securities financing transactions.[2]

Securities financing transactions play a vital role in ensuring systemic stability and creating necessary liquidity for mutual funds and their individual investors as well as for insurance companies and their policy-holders. As a sophisticated, professional investment manager, we use a variety of securities financing transactions to manage risk in our portfolios and to be confident of being able to deliver liquidity to our fund shareholders and insurance clients when they need it.

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[1] Data as of June 30, 2013

[2] See *Letter* from Global Financial Markets Association, American Bankers Association, Financial Services Roundtable, Institute of International Bankers, Institute of International Finance, and the International Swaps and Derivatives Association (collectively, the "Associations"), to Secretariat of the Basel Committee on Banking Supervision, Bank for International Settlements (Sept. 20, 2013), at p. 7, available at
http://www2.isda.org/attachment/NTkwMA==/GFMA%20Joint%20Trades%20Basel%20III%20Leverage%20Ratio%20Comment%20Letter.pdf

We understand the desire to reduce leverage in the banking system and to strengthen the balance sheets of regulated entities. However, there is a clear and societally-important role for short-term financing in our financial system. As noted in industry comments to the Basel III Proposal, "... such a strong disincentive to participate in [securities financing transactions] . . . is likely to make those markets less liquid and more volatile . . . ."[3] To limit excessively the most reputable institutions providing this financing in the hopes of ensuring greater systemic stability is likely to produce unexpected and negative consequences for investors and the public.

For mutual fund investors, 401k participants and other fund investors, repurchase agreements and other forms of committed liquidity facilities help fund managers make orderly payments when investors sell shares. They protect these investors against liquidity constraints and potential additional costs when large numbers of investors request redemptions simultaneously. Limiting liquidity at the moment when it is needed introduces an element of systemic risk that we believe is counter to the intention of this regulatory proposal.

Securities financing transactions are key tools that help insurance companies match the timing of cash flows between their steady inflows from premium payments and their more episodic and less predictable outflows to make attractive investments and pay claims. If the buffer of securities financing transactions is less available, insurance company portfolio managers may find themselves having to make unplanned sales of portfolio assets or build up excessive cash in their portfolios.

In the below we address several of the specific questions listed in the request for comments. We focus on our participation in these markets as a borrower, and not as a bank or a dealer.

Question 1: *How would proposed strengthening of the supplementary leverage ratio for covered BHCs and their subsidiary IDIs contribute to financial stability and thus economic growth?*

(1) Less market stability and lower returns on investment;

The proposal would actually *reduce* overall financial stability, in exchange for lower leverage ratios for individual banks. These two ideas: lower leverage, but greater systemic risk; are not contradictory. The proposal will reduce liquidity and flexibility for mutual fund managers and insurance companies and the result will be markets that are less liquid at the very moment liquidity is needed.

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[3] *Id.*

When mutual fund redemptions rise because individual investors desire liquidity, investment managers are required to meet those redemption requests immediately. If many requests come at once, the investment manager will use securities financing arrangements to smooth out the flow of capital, rather than be forced to sell investments in a rapid or disorderly fashion. If securities financing arrangements are less accessible, an investment manager may incur higher costs related to the forced sale of underlying securities. This has the potential to set off a destructive downward spiral in the prices of mutual fund assets that will cascade into the broader markets.

(2) Dampener on capital formation and economic growth;

This proposal will reduce liquidity overall in the financial system, and the natural result will be downward pressure on asset prices. Lower liquidity will increase the cost of capital for both publicly-traded and private companies, which ultimately reduces the growth potential of the economy.

The proposal will force mutual funds and other asset managers to increase the amount of cash in their portfolios to levels that have an economic impact on investors. Cash management is a critical component of any investment management firm: first, to have enough liquidity available quickly to meet redemption requests; and second, to have access to short-term financing to bridge differences in timing between fund inflows and investment opportunities. If the short-term securities financing is no longer available or economically feasible, mutual funds and insurers will curtail their investment activities and build up more cash within their portfolios. They will also be likely to have to forego certain investment opportunities because short-term financing will be unavailable. Higher cash holdings may appear to reduce systemic risk, but the economic friction they create reduces overall productivity and increases cost throughout the economy. Withholding cash from the market means too little money in actual investments, and a reduction in overall fund returns. The returns are not profit just to the fund manager, but flow through to reduced returns for individual mutual fund investors, pension funds and 401k plan participants. For insurance companies, the reduced returns and higher costs could translate into increased premiums for policy-holders.

Asset managers may respond by either making more speculative investments to try to regain the returns that have been lost, or they will return less to their investors. The former results in more systemic risk and volatility as investors push into more aggressive investments, the latter results in lower economic growth as investors' returns drop, capital markets become less efficient, and new capital formation becomes more expensive.

Question 7: *How would this proposal affect counterparty incentives and behavior?*

(1) Smaller (non-big bank) counterparties for the SFT market;

As borrowers in securities financing transactions, we think that the proposal would result in the entrance of smaller, less-experienced, and less well-capitalized counterparties who may fall outside existing regulatory oversight. Short-term securities financing transactions will not go away – but insufficient oversight of new counterparties could result in additional systemic risk.

(2) Larger banks holding lower quality assets;

Perversely, this proposal could become the binding constraint for large banks and incentivize our counterparties, the larger banks, to hold the lowest quality assets possible within the constraints of the other credit quality regulations. Because this regulation makes securities financing transactions more costly to banks (from a balance sheet and return on assets standpoint), banks will likely focus on the highest margin portion of the securities financing business, and that means accepting lower-quality collateral against which they can lend at higher rates and at shorter maturities.

Why accept treasuries when the balance sheet "cost" is the same as accepting high yield bonds and the bank can charge more for the latter? The proposal could encourage large-bank counterparties to move to a lower credit quality mix than they currently have. This conclusion is mirrored in industry comments to the Basel III Proposal: "a binding leverage ratio – or one that has a very real prospect of becoming binding – would encourage institutions to hold assets that are more, rather than less, risky; with a "one-size-fits-all" requirement, riskier assets will produce a higher relative return on capital than safer assets[4].

(3) Over-exposure to individual counterparties;

The proposal also may impede good fiduciary decision-making and result in an asset manager being overly-exposed to a single counterparty. The large banks, that are the subject of the proposal, will find that securities financing transactions are more costly to them in terms of their balance sheet and return on equity and, as a result, may limit the availability (or the best terms) of this financing to only those asset managers to whom they provide other lines of service. Asset managers may respond by directing more and more business to single large bank in order to be able to get the best terms for securities financing transactions.

Question 8: *The agencies seek commenters' views on the macroeconomic implications of the proposal, particularly the potential effects the proposal could have on the allocation of credit*

[4] *Id* at 6

and the volume of lending. For example, could a strengthened leverage ratio requirement as proposed cause a shift in favor of lending to individuals and businesses as opposed to markets-based activity by banking organizations? If covered BHCs were better capitalized as a group, to what extent would this improve their ability to serve as a source of credit to the economy during periods of economic stress? Conversely, to what extent would the proposal create incentives for banking organizations to shrink or otherwise modify their activities?

The proposal has the potential to artificially create the same type of tight liquidity conditions that prevailed in 2007-2008, when a "run on repo" accelerated the financial crisis. The source of the tightening and the reasons for the run will be different, but the effect could be the same.

During the crisis, banks became concerned about the value and riskiness of the collateral (initially residential mortgage backed securities) that was being used in repo transactions. Accordingly, they demanded more compensation from borrowers to make loans that were collateralized by those securities. That "higher price" was charged in the form of higher haircuts on the value of the collateral. During the crisis, haircuts surged. As banks required more compensation (in the form of higher haircuts) to transact in the repo market, repo financing dried up, and the wider market for short-term financing almost disappeared.

The current proposal may end with the same result, but for different reasons.

Banks are likely to again require more compensation to participate in the repo markets, but this time it will be because the balance sheet cost to them will be higher. The additional compensation may come in the form of both higher interest rates on securities financing transactions, shorter terms, and higher haircuts on collateral pledged for those loans. In response to the Basel III Proposal, industry commenters predicted that "as banks reduce their participation in the [securities financing transactions] market or reduce the number of transactions, and the market become more expensive and less liquid, other financial institutions and firms will find it more difficult to manage their cash balances."[5]

The large banks are the major providers of short-term financing and there are few alternatives for larger institutional investors, such as Guggenheim Partners Investment Management, whose clients require us to interact only with highly-rated institutions. As suggested by industry participants in response to the Basel III Proposal, "[t]he overall [securities financing transactions] market also will suffer increased operational risk as the liquidity of the market

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[5] *Id. at* 8.

decreases and the remaining participants become more concentrated."[6] We could again see a "famine of liquidity" which could drive up prices of even the safest assets.

High-quality borrowers (like life insurance companies and those that manage life insurance assets) will be greatly affected – because such borrowers typically pledge the highest-quality collateral and need the longest and most certain securities financing arrangements. Lack of liquidity, shorter durations, and fewer lenders all create uncertainty.

Sub section of question 8: *If covered BHC's were better capitalized as a group, to what extent would this improve their ability to serve as a source of credit during periods of economic stress? Conversely, to what extent would the proposal create incentives for banking organizations to shrink or otherwise modify their activities?*

We previously address in detail the extent to which the proposal would create incentives for banking organizations to shrink or otherwise modify their activities. The proposal appears to have already caused banking organizations to 1) reduce allocation of their balance sheet to repurchase agreements and revolving lending ; 2) shorten maturities for agreements; 3) charge higher prices either in terms of interest rates or haircuts; and 4) limit access to only their best customers.

Guggenheim Partners Investment Management thanks the Agencies for the opportunity to comment on these proposed rules on supplementary leverage ratios for securities financing transactions. If you have any questions, please do not hesitate to contact me at 310-576-1262.

Yours sincerely,

B. Scott Minerd
Global Chief Investment Officer

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[6] *Id.*