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Re: Proposed Supervisory Guidance on Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and their Subsidiary Insured Depository Institutions; Board Docket No. R-1460; OCC Docket Number OCC-2013-0008; 78 Federal Register51101 (August 20, 2013).

To Whom It May Concern:

The American Bankers Association, Financial Services Roundtable, and Securities Industry and Financial Markets Association (collectively, the Associations)[1] appreciate this opportunity to comment on the proposed leverage ratio rule issued by the Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, and the Federal Reserve Board (collectively, the Agencies) entitled, "*Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and their Subsidiary Insured Depository Institutions*"(U.S. Proposal).

The U.S. Proposal would require a supplementary leverage ratio (SLR) surcharge of Tier 1 capital on eight U.S. bank holding companies (Covered BHCs) identified as global systemically important banks (G-SIBs) and their insured depository institutions (IDIs). The U.S. Proposal would require a Covered BHC's IDI subsidiaries to maintain a Basel III SLR of at least 6% to be considered well-capitalized under the prompt corrective action framework. In addition, Covered BHCs would be subject to a leverage ratio of 5% (3% minimum plus 2% buffer). Failure to

[1]Descriptions of the Associations are provided in Appendix 1 to this letter.

maintain this level would result in limitations on dividend distributions and discretionary bonus payments.

The Associations agree that adequate levels of quality capital are an important safeguard that helps institutions and the financial system as whole withstand periods of stress. Additionally, we support the Agencies' efforts to implement a leverage ratio as a supplemental, backstop measure to the risk-based capital requirements, particularly to respond to unknown risks. However, we have very serious concerns about the timing and substance of the U.S. Proposal, and the negative consequences that will arise if the proposal is finalized in its current form. On June 26, 2013, the Basel Committee on Banking Supervision (Basel Committee or BCBS) issued a consultative document (International Proposal) that would recommend alteration of the exposures that are captured in the SLR's denominator.[2] Before the Agencies move forward with raising the level of the SLR, it is imperative for the Agencies to indicate clearly the exposures that will be captured in the denominator under the future framework.

Accordingly, the Associations believe that the Agencies should consider the U.S. Proposal only after the Basel Committee has finalized its recommended exposure measure and conducted a Quantitative Impact Study (QIS) to assess the effects of those final definitions, and the Agencies have determined whether to propose the incorporation of all or part of that revised exposure measure in the denominator of the U.S. SLR. If the Agencies do decide to make such a proposal, then they should also reconsider the amount of any increase in the U.S. SLR taking into account the new exposure measure. At the same time, the Associations request that the Agencies conduct an empirical study of such a proposal that would assess the cumulative impact of bank capital and other financial reform regulations on the ability of U.S. banking organizations to provide financial services to consumers and businesses at this hesitant stage of economic recovery and going forward. It is imperative that a complete assessment of the impacts of a revised leverage ratio calculation be fully understood and addressed before any recalibration of the future framework is considered.

The Associations support a leverage ratio that is a backstop to the risk-based standards, but we believe the U.S. Proposal would set that ratio higher than needed. We believe the risk-based capital measure should be the generally overriding constraint, with the leverage ratio serving as a strong backstop to the risk-based measure, capturing unknown and unknowable risks adequately. Unfortunately, the U.S. Proposal could reverse this intended relationship between the two types of capital requirements so that the leverage ratio would become the overriding requirement and the risk-based requirements would become the backstop. This is particularly the case should the Agencies adopt the BCBS denominator as well. Such a reversal would constitute a fundamental change to the regulatory capital regime. An excessive overriding constraint that is risk blind would create perverse incentives that would very likely result in damaging consequencesfor consumers and the financial system and work at cross-purposes with other regulatory goals.

[2] *See* Basel Committee on Banking Supervision, *Consultative Document: Revised Basel III Leverage Ratio Framework and Disclosure Requirements* (June 2013).*See also* Letter from the Global Financial Markets Association, American Bankers Association, Financial Services Roundtable, Institution of International Bankers, Institution of International Financial, and the International Swaps and Derivatives Association to the Secretariat of the BCBS re: Comments in Response to the Consultative Document on the Revised Basel III Leverage Ratio Framework and Disclosure Requirements (Sept. 20, 2013) [hereinafter the "Joint Trades Letter"].

For example, the prospect of an excessive, overriding leverage ratio would effectively require much more capital to be held for banks' least risky assets, such as cash and certain highly liquid, high quality corporate and government securities. This would create a perverse incentive to hold no more than the minimum required amount of such assets and reduce participation in activities that generate such assets. For example, bank demand for high-quality U.S. Treasury securities would be reduced, thereby constricting liquidity, increasing volatility in the markets for such debt instruments, and increasing the cost of government borrowing. Greater emphasis on the leverage ratio would also reduce the demand for other forms of low-risk debt and reduce the availability of lines of credit, thus constraining the pool of credit available to support economic growth.

Considering the detrimental impacts of the SLR becoming the overriding constraint for a greater number of banks, the Agencies should consider the following changes to avoid making the leverage ratio the generally overriding capital requirement. In particular, the Associations recommend the following modifications to the definition of "total leverage exposure," which are described in more detail in Section III of this comment letter:

- Exclude from the total leverage exposure measurecash claims on central banks;
- Exclude from the total leverage exposure measure low-risk and highly liquid Treasury securities;
- Replace the 100% credit conversion factor with the more granular Standardized Approaches credit conversion factors; and,
- Exclude from the total leverage exposure measure derivatives cleared on behalf of clients.

We have set forth in the below sections of this letter specific comments and recommendations regarding five topics of the U.S. Proposal.

- Section I explains why the Agencies should wait to finalize the U.S. Proposal until the BCBS finalizes its proposed changes to the denominator of the Basel III SLR.
- Section II discusses how the U.S. Proposal would make the SLR an overriding constraint for many institutions and the negative consequences that would result.
- Section III recommends amendments that should be made to the denominator.
- Section IV discusses modifications to the definition of capital used for the numerator of the U.S. SLR.
- Section V outlines some preliminary concerns about how amendments to enlarge the Basel leverage ratio denominator would interact with the U.S. Proposal's leverage ratio increase.

- Section VI responds to specific questions asked in the proposal.

I. <u>The Agencies should wait to finalize the U.S. SLR until the BCBS finalizes its proposed changes to the denominator of the Basel III SLR</u>

The Agencies have proposed to increase substantially the calibration of the SLR in the U.S. Proposal—from 3 percent to 5 and 6 percent[3]—based on a definition of the denominator that was adopted by the BCBS in 2010.[4] With that 2010 denominator, the proposed increase in calibration would produce a known amount of required capital for institutions to which it would apply, which the Agencies presumably estimated when they fixed the amount of the proposed increase in calibration.[5]

But the Agencies are at the same time working with the BCBS in proposing to enlarge the denominator of the Basel III SLR.[6] The Associations reiterate their concerns with the BCBS proposal. We are hopeful that the BCBS will make necessary changes to more accurately capture the exposures of banks and that the Agencies will be supportive of the need for these changes to this global standard. The Associations support the need for an internationally consistent measurement. In this context, it would be premature for the Agencies to settle now on a specific increase in the calibration of the SLR adopted in the U.S. before the BCBS first settles on the final definition of the denominator of that ratio. Indeed, to do so would truly be "putting the cart before the horse" – in essence making an increase-in-calibration decision without knowing the amount of increased capital that would result from an enlarged denominator, and without understanding the consequences that might flow from such a decision. Further, the Associations believe that any final calibration should be set at an international level to ensure global consistency.

As described in Section II in this comment, where the leverage ratio becomes such an overriding constraint, it will have very substantial negative consequences on the ability of an institution to hold lower risk assets.[7] The Associations do not believe that the Agencies intend to make the SLR such a dominant and overriding constraint for the overwhelming majority of U.S. institutions to which it applies.

Additionally, there is no urgency to adopting the U.S. Proposal now as opposed to re-proposing the U.S. calibration after the BCBS denominator is finalized. Banks already are holding significantly more capital due to the U.S. Basel III final risk-based rules, which increased the required amount of capital, narrowed the type of instruments that count as capital, and expanded

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[3]Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and Their Subsidiary Insured Depository Institutions, 78 Fed. Reg. 51,101, 51,113–15 (Aug. 20, 2013).
[4]*See id.*at51,104–05.
[5]*See, e.g., id.*at 51,107.
[6]*See* Basel Committee on Banking Supervision, *Consultative Document: Revised Basel III Leverage Ratio Framework and Disclosure Requirements* (June 2013) [hereinafter the "BCBS Exposure Measure Proposal"].
[7]*See also* Letter from the Global Financial Markets Association, American Bankers Association, Financial Services Roundtable, Institution of International Bankers, Institution of International Financial, and the International Swaps and Derivatives Association to the Secretariat of the BCBS re: Comments in Response to the Consultative Document on the Revised Basel III Leverage Ratio Framework and Disclosure Requirements (Sept. 20, 2013) [hereinafter the "Joint Trades Letter"].

the risk-weighted denominator.[8] As the U.S. Proposal notes, larger, systemically important banks are also subject to a range of additional supervisory measures "to mitigate the threat to financial stability posed by systemically-important financial companies," including heightened supervisory expectations, stress testing requirements, orderly liquidation authority, stronger regulation of major BHCs, and enhanced regulation of over-the-counter derivatives.[9] We also understand that several more rules are expected to be released in the U.S. by the end of 2013 for these same banks, including risk-based capital buffers and liquidity requirements. Thus, there is no immediate need for the proposed increase in the U.S. SLR; a modest delay would in no way impair banks' safety and soundness, particularly considering the 2018 effective date.

In this context, the Associations urge the Agencies to wait until the BCBS finalizes its proposed change to the denominator of the SLR before finalizing the U.S. leverage ratio. If the final change adopted by the BCBS is substantial, and if the Agencies are inclined to incorporate such a substantial change in the denominator of the U.S. leverage ratio, then they should re-propose the U.S. leverage ratio for notice and comment with (1) that proposed change to the denominator, and (2) any change in calibration to the ratio that they still believe is necessary taking into account the substantial proposed change to the denominator applied on a globally consistent basis.

II. The U.S. Proposal will detrimentally affect decision making and lead to negative consequences

In proposing the level of the U.S. SLR, the Agencies state that they took into account the complementary nature of leverage capital requirements and risk-based capital requirements. The Agencies have indicated that they believe the U.S. Basel III final rule strengthens the risk-based standards considerably more than it strengthens the leverage requirements. Accordingly, the U.S. Proposal states "the stringency of the leverage and risk-based standards should be more closely calibrated to each other so that they remain in an effective complementary relationship." However, the Associations do not believe that the U.S. Proposal maintains a complementary relationship. Instead, the U.S. Proposal would elevate leverage as the overriding constraint for some large U.S. banking organizations, de-emphasizing the risk-sensitive management of bank exposures.

Leverage as the overriding constraint

Where a leverage ratio is the binding constraint, banking organizations' risk appetites are bound by risk insensitive measures that do not incentivize prudent risk management. Where risk-based standards are the binding constraint, banking organizations' risk appetites and regulators' risk-based standards reinforce one another to promote economic growth as well as safety and soundness, since risk management decision-making and risk-based standards are generally aligned (although of course the risk-based capital requirement may still override the bank's risk appetite). Similarly, risk-based regulatory capital standards, unlike risk-blind leverage ratios, promote business line diversity, as each banking organization manages its exposures through risk

[8] Regulatory Capital Rules, 78 Fed. Reg. 62,018 (Oct. 11, 2013).
[9] U.S. Proposal, 78 Fed. Reg. at 51,103.

determinations that reflect an organization's strategic goals and competitive opportunities as well as regulatory capital requirements.

There are several ways in which leverage can act as a binding constraint at different institutions. For instance, a banking organization may have a capital shortfall against the standards in the U.S. Proposal, while another bank may meet the revised standards but find that low-risk, low-return business lines are constrained by leverage at the individual business line level. In each case, however, the leverage ratio will likely drive bank's behavior and decision-making in ways that are often at odds with both prudent risk management practices and with the ability to economically provide certain financial services.

The following represent some ways in which the U.S. proposed leverage ratio can act as the binding constraint for banks:

1. Growth constraint. Where a banking organization comfortably passes both risk-based and SLR requirements today, the bank will still have to manage its long-term growth to the more-constraining actual and projected regulatory capital measure. When a bank is closer to its SLR limit, as opposed to its risk-based limit, it will act as though it is leverage-constrained, which is counter to the leverage ratio acting as a complement to risk-based capital. The bank's risk appetite will be constrained over a longer term by the requirement to manage to risk-insensitive leverage.

2. Business line constraint. Even where a banking organization as a whole meets the U.S. Proposal's SLR requirements, the bank must still allocate capital internally to specific business lines. Many of the U.S. G-SIBs' core activities – such as market-making in U.S. federal and state government debt, providing unfunded commitments to corporate clients (including smaller banks who in turn provide financing to small-to-medium businesses), and facilitating customer clearing of derivatives, and the provision of trust, custody, and asset administration services – are low-risk, low-return businesses. At the business line level, the SLR may well act as the binding constraint for these low-risk, low-return business lines and products, forcing banks to reduce volumes and/or raise prices to meet associated SLR capital requirements. Different banks will respond to these pressures differently, based on their specific balance sheet composition and funding profile.[10]

3. Immediate operating constraint. In other cases, a U.S. banking organization may meet a 5% or 6% SLR today, but without a comfortable "buffer" to manage quarter-to-quarter fluctuations in capital or exposures. In this case, the banking organization maybe required to restructure its balance sheets and business operations now in order to build comfortable buffers above minimum SLR requirements, particularly in light of AOCI-related capital volatility in the numerator and customer deposit volatility and unpredictability in the denominator which will require banks to hold a higher buffer.

4. Immediate capital constraint. Finally, some U.S. banking organizations do not meet a 5% or 6% SLR today, as applicable. These organizations would be required to restructure

[10]Board Governor Stein has highlighted the competitive implications of SFT market concentration if leverage is elevated as the binding capital constraint. *See*Jeremy C. Stein, "The Fire-Sales Problem and Securities Financing Transactions," October 4, 2013, pp. 10-11.

their balance sheets and business operations immediately to meet the revised SLR requirements. Although the SLR would not technically be a requirement until 2018, the market would force banking organizations to meet long-term capital standards sooner than later, punishing the banks that are last to reach the new requirements, making the revised SLR an immediate constraint. For example, investors and research analysts currently focus on fully-loaded Basel III, Standardized Approach and supplementary leverage capital ratio estimates, effectively ignoring transitional periods and arrangements allowed by the final rule.

Impact of leverage as the overriding constraint

The SLR was set at 3% by the Basel Committee at the same time as the Basel III risk-based levels were developed. The Basel Committee understood that the SLR, which has a bigger denominator than the broadly applicable U.S. GAAP leverage ratio, would act as a backstop to the risk-based standard when it was set at 3%. Any level above 3% would start to make the SLR the overriding constraint. An overriding leverage ratio would create perverse incentives that would very likely result in damaging consequences.

First, the Associations are deeply concerned that the U.S. Proposal will place the U.S. banking sector at a significant competitive disadvantage internationally. The U.S. Chamber of Commerce separately raised this same concern its response letter to the U.S. Proposal, dated September 23, 2013.[11] The Dodd-Frank regulatory framework has already imposed significant costs on the U.S. banking industry. U.S. banks face foreign competition everyday business products. The unilateral application of a higher leverage ratio to U.S. G-SIBs, and the higher resulting costs, will favor the movement of U.S. companies to foreign competitors for funding and banking needs. Our concerns about international competitiveness reinforces the need for the Agencies to delay calibrating the supplemental leverage ratio until after the Basel Committee finishes its work on the supplemental leverage ratio so that the international competitive consequences will be known before U.S. regulators act.

Second, a generally overriding leverage ratio would encourage institutions to hold assets that are higher yielding yet more risky. As a practical matter, riskier assets will tend to produce a higher relative return on capital than safer assets. This is fundamentally at odds with prudent risk management and safe and sound banking practices.

Third—and this is a corollary to the second point—the steepness of the requirement in the U.S. Proposal would discourage banks from holding low-earning cash and cash equivalent securities, such as U.S. Treasuries, and from participating as intermediaries in certain markets. This would harm U.S. banks and other market participants by reducing liquidity in both the primary and secondary markets for these securities and increasing the cost of funding for even the highest rated sovereign issuers.

Moreover, an overriding leverage ratio effectively penalizes firms for holding risk-free or very low risk assets, such as cash and government securities. This goes against the intent of the

[11] *See*Letter from The Center for Capital Markets Competitiveness, U.S. Chamber of Commerce, re: Regulatory Capital Rules: Regulatory Capital, Enhanced SupplementaryLeverage Ratio Standards for Certain Bank Holding Companies andtheir Subsidiary Insured Depository Institutions; (Sept. 23, 2013)

improvements to liquidity risk management put forth by the Basel Committee and endorsed by the G20 and by the U.S. regulators. Under the proposed leverage ratio requirement banks will be penalized for complying with the Liquidity Coverage Ratio (LCR), which requires that banks hold a buffer of high quality liquid assets (HQLA) against expected stressed outflows. A higher SLR will also penalize banks for holding a liquidity buffer above the minimum LCR requirements. The need for enhanced liquidity management was a key lesson of the crisis. A binding leverage ratio undercuts attempts to make financial institution liquidity more robust.

Fourth, the U.S. Proposal's powerful disincentive to hold low risk assets is likely to have negative consequences for bank customers. For example, currently, many low risk, low yielding activities only generate the return on equity desired if a bank enters into a large volume of such activities. If the leverage ratio becomes the overriding constraint, banks will be incentivized to shed such products.

Fifth, and perhaps most disconcerting from a systemic risk perspective, the perverse incentives the U.S. Proposal would have on bank practices could lead to fewer bank business models. The U.S. banking sector is remarkably diverse. Even among the largest banks, business lines, practices, and risk appetites vary greatly to fit customers' needs. By applying a simple "one-size-fits-all" requirement, the banking agencies will push banks to fit the rule and homogenize their business models. The end result will be a less diverse banking sector that is less able to meet the needs of customers. A less diverse banking system will be less able to withstand stress and be more vulnerable to financial contagion.

To avoid these undesirable consequences, the Associations strongly urge the Agencies to revisit the U.S. Proposal, as stated in section I above, after the BCBS finalizes its proposed change to the denominator of the SLR, and then only following a complete QIS assessing the cumulative impact of bank capital and other financial reform regulations on the ability of U.S. banking organizations to provide financial services to consumers and businesses at this delicate stage of economic recovery and going forward. This study is particularly important given the high proportion of low-risk exposures that banks take on in order to serve the economy that could be negatively impacted by the SLR. Any final calibration of the SLR should be enacted only after carefully assessing any reasonable potential consequences.

III. Improvements to total leverage exposure measure

As discussed above, if the banking agencies move forward with the U.S. Proposal, it is likely that the SLR will become the overriding minimum capital requirement for a number of U.S. G-SIBs. An overriding leverage ratio could force commercial banks that hold mainly corporate and retail lending assets to constrain credit. This could conflict with other government policies intended to promote growth among retail or small and medium sized enterprises, rendering such policies less effective. A higher leverage ratio therefore must be carefully examined to assess the potential consequences on the broader economy to avoid recessionary or negatively pro-cyclical impacts.

At the same time, in the wake of the financial crisis, regulators have substantially increased requirements for banks to hold ever higher levels of liquid assets to deal with unexpected future funding pressures. For example, the LCR would require banks to hold sufficient unencumbered HQLA to cover the total net cash outflows over a 30-day period under the prescribed stress scenario.[12] An overriding leverage ratio would create pressure to shed liquid assets above the absolute minimum required by the LCR, which is fundamentally at cross purposes with this regulatory initiative. It also creates pressures for banks to curtail activities that put liquid assets on their balance sheets, such as, in periods of market stress, avoiding the deposit of cash as nervous investors de-risk and engage in a "flight to quality."

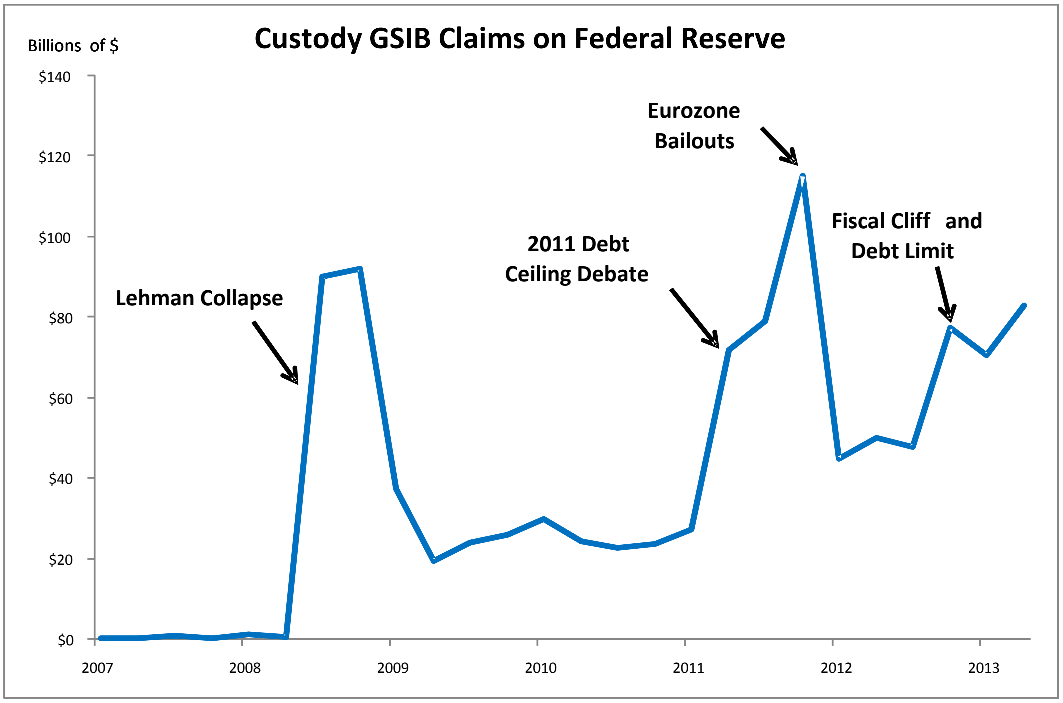
To avoid these perverse results, the Associations recommend fully excluding from the total leverage exposure measure cash claims on central banks as well as U.S. Treasuries. Excluding these exposures from the SLR would better align the SLR with truly significant risk exposures and eliminate or greatly reduce the U.S. Proposal's incentives to shun cash and other high quality, highly liquid assets. In addition, the credit conversion factors (CCFs) for other off-balance sheet assets in the total leverage exposure measure should be recalibrated to measure actual exposures better to avoid constraining credit in the broader economy.

Exclude cash claims on central banks from the total leverage exposure measure

As a starting point, the total leverage exposure measure for on-balance sheet assets should exclude cash claims on central banks, including both cash on deposit and currency. Cash is, by definition, the most liquid, riskless asset and has no credit loss of value during times of stress. The Basel III LCR, for example, assesses the liquidity of assets by how easily and immediately they may be converted into cash.[13]

Deposits provide crucial funding for all banks, but as cash on deposit surges, bank leverage ratios drop. Worse, sudden changes in cash deposit flows make banks' leverage ratios volatile. In times of economic stress, customers tend to flood the banking system with deposits rather than deploy their resources in riskier assets. This can cause significant volatility in on-balance sheet assets. For example, many banks, especially custody banks, saw huge temporary deposit inflows at different points during the financial crisis (see table below).[14] Because of the short term nature of these deposits banks typical place cash they receive on deposit with a central bank.

[12] BCBS LCR Framework, at ¶ 23.
[13] *See, e.g.*, BCBS LCR Framework, at ¶ 1.
[14] The operational nature of custody deposits is recognized in the Basel III LCR and reflects the need for customers to leave deposits with the bank "in order to facilitate their access to and ability to use payment and settlement systems and otherwise make payments.



The graph above used the total balances due from Federal Reserve Banks as shown by the reporting bank's books for the fully consolidated bank. Includes reserve and other balances and the amount of reserve balances actually passed through to a Federal Reserve Bank by the reporting bank on behalf of its respondent depository institutions plus balances of the bank's Edge and Agreement subsidiaries with a Federal Reserve Bank.

Other than by using extraordinary measures, banks have limited control over when customers in times of stress choose to deposit cash rather than invest in other assets, and the leverage ratio should not penalize banks for conducting this core banking function for customers. In effect, banks that absorb deposits in times of crisis act as shock absorbers for the broader economy, providing a calming influence to bank depositors.

Any greater emphasis on the SLR should allow for banks to manage unpredictable spikes in depositswithout having to resort to such draconian measures as turning customers away, which could magnify systemic implications of any crisis. Refusing cash deposits could pose a significant reputational risk to the institution and could, in some cases, undermine the ability to support normal day-to-day payment, clearing and settlement activities.[15] It would be impossible for G-SIBs to maintain long-term customer relationships with customers if they turn away deposits in times of stress or if they seek to constrain access to a customer's operational accounts. On the other hand, simply accepting surges in deposits may cause sudden declines in a bank's leverage ratios and a breach of regulatoryrequirements.

Such a result makes no policy sense. Deposits that result in cash claims on central banks simply do not generate the type of risk of loss that capital is meant to offset. Indeed, such additional cash results in nochangeat all to the credit risk profile of an institution. It simply does not represent an economic"exposure," and as a result, cash claims on central banks should be excluded from the "exposure measure." Such a simple, blanket exclusion would address the concerns raised when spikes in deposits during times of stress cause precipitous declines in a

[15]This includes the rebalancing of investment portfolios across asset classes, the purchase or sale of mutual fund units and private investments in venture capital and other similar funds.

bank's leverage ratio. It would also remove the leverage ratio's penalty for holding cash in excess of minimum liquidity requirements, thereby directly promoting safety and soundness. And it would be fully consistent with the intent of section 616 of the Dodd-Frank Act, which requires the Agencies to "seek to" make capital requirements for depository institutions and their holding companies countercyclical.

Exclude U.S. Treasuries from the total leverage exposure measure

For very similar reasons, the total leverage exposure measure should also exclude U.S. Treasury securities. These securities are highly liquidand can be easily and immediately converted into cash at little or no loss of value during times of economic stress. An exclusion from the total leverage exposure measure for U.S. Treasuries would be appropriate in this context to avoid the powerful disincentive to shed such assets absent an exclusion.

Moreover, in the United States, banks provide financial services to U.S. Public Sector Enterprises (PSEs) including demand deposits, time deposits, and a variety of traditional banking services. These PSEs include states, counties, large cities, public utilities, public hospitals, and public universities. Many of these customers receive earnings credit on the deposits and use this credit to pay for essential banking services. Virtually all of these customers are legally required to maintain deposits that are collateralized with U.S. government obligations. That is, a bank holding PSE deposits is required to purchase U.S. Treasuries to collateralize the deposits. If U.S. Treasuries are not excluded from the total exposure measure, the cost of this additional capital will result in higher costs being passed on to the PSEs. Excluding the U.S. Treasuries from the total leverage exposure measure would avoid such an inappropriate result.

Adopt the Standardized Approaches' credit conversion factors

The SLR expressly requires that certain off-balance sheet exposures be included in the total leverage exposure measure, generally by applying a uniform 100 percent CCF. The 100 percent CCF is a blunt measure that grossly overstates actual exposure for most off-balance sheet items. Rather than adopt this approach, the Associations strongly urge the Agencies to conduct a study to assess the appropriateness of the 100 percent CCF for different types of off-balance sheet exposures, and adjust the total leverage ratio exposure measure accordingly to reflect actual exposure better. In the alternative, any final rule should draw on other Basel Committee precedent in a very similar context to calibrate the CCF better: such an adjusted CCF should be based on the exposure categories reflected in the Standardized Approach.

G-SIBs play a crucial financial intermediary role through the extension of credit either in funded loan form or in an unfunded manner via lending commitments. Bank commitment activity covers a very broad range of customers and activities, including retail borrowers through products such as mortgage and consumer loan commitments, municipal and government finance, trade and infrastructure finance, and the provision of backstop credit facilities to corporate customers. Given the size and importance of these activities to banks, issuers, and investors alike, it is crucial that the leverage ratio appropriately and accuratelycapture the amount of actual exposure resulting from these off-balance sheet commitments; any overstatement of such exposures will needlessly increase the capital cost of these important intermediary activities in ways that could have substantial negative consequences for credit availability.[16]

Should the Agencies move forward with a final rule, they should adopt the CCF exposure categories in the Basel II Standardized Approaches. Thus, for example, trade finance instruments should receive a 20 percent CCF for short-term, self-liquidating letters of credit arising from the movement of goods and a 50 percent CCF for transaction related contingent items. These figures, rather than the flat 100 percent CCF in the proposal, better reflect the fact that certain off-balance sheet items will not convert to on-balance sheet exposures. These CCFs are reasonable proxies for exposure measures, because they estimate the drawn amount of a commitment—and they are much better measures of actual exposure than the blunt risk insensitive 100 percent CCF set forth in the U.S. Proposal. Moreover the CCFs in the Standardized Approaches are not risk-weights but instead estimates of actual exposure amounts. As a result, the use of the better calibrated actual exposures in the Standardized Approaches—rather than a blunt and inflated 100 percent CCF—would be far more consistent with the rationale underlying the total leverage exposure measure.

Exclude client cleared transactions

The Associations strongly support the Committee's goal to ensure that banks' exposures to central counterparties (CCPs) are adequately capitalized "while also—in support of the G20 mandate to clear centrally all standardized over the counter derivatives—preserving incentives for central clearing."[17] The U.S. Proposal could significantly undercut these goals by imposing higher capital requirements on derivatives cleared on behalf of clients through CCPs (client cleared transactions) than on bilateral, uncleared derivatives. To avoid penalizing these nearly riskless transactions that facilitate central clearing, the U.S. Proposal should be modified to exclude client cleared transactions. In the alternative, the U.S. Proposal should exclude the CCP leg of a client cleared transaction because the clearing member bank does not guarantee the CCP's performance to the client, and should recognize collateral offsets and netting for the client leg of a client cleared transaction.[18] These recommended approaches are discussed in greater detail in the Associations' response to the International Proposal.[19]

[16] To put the off-balance sheet commitment aspect into context, from a scale and economic impact perspective we note the following. In the United States, the FDIC publishes a listing of all unused commitments extended by the banks under their purview. Such unused commitments include revolving, open-end lines of credit, commitments secured and not secured by real estate, credit card lines, and others. The total unused commitments extended by the 6,940 FDIC-covered banks in the United States stood at almost $6 trillion dollars as of 30 June 2013. *See* FDIC, Statistics on Depository Institutions Report (report for all national institutions on total unused commitments) (search conducted 16 September 2013).

[17] *See* Basel Committee on Banking Supervision, *Consultative Document: Capital treatment of bank exposures to central counterparties*¶ 3 (June 2013, rev. July 2013) [hereinafter "BCBS Central Counterparties Consultative Document"].

[18] To be clear, the Associations recognize that a house trade, where a clearing member bank trades on its own behalf as principal, would be included in the Exposure Measure. Likewise, the CCP leg of a client cleared transaction would be included in the Exposure Measure if the clearing member bank guarantees the performance of the CCP to the client.

[19] *See* Joint Trades Letter, at 32–36.

IV. Improvements to the definition of capital

Although the U.S. Proposal uses tier 1 capital in the numerator of the SLR, the Agencies requested comment on whether it would be more appropriate to use a different numerator, potentially common equity tier 1 (CET1) capital, instead.

The Associations strongly believe that tier 1 is the proper measure of the numerator, not CET1. Tier 1 capital—including but not limited to CET1 capital—is expressly designed to absorb unexpected losses on a going concern basis. Moreover, the Basel III final rule strengthened the definition of tier 1 capital to ensure that all of its elements are sufficiently loss absorbent for going concerns. Thus, tier 1 capital consists predominantly of common shares, retained earnings, and instruments that are subordinated, have fully discretionary noncumulative dividends, and have neither a maturity date nor an incentive to redeem. In addition, tier 1 capital no longer includes hybrid instruments that did not adequately absorb losses during the financial crisis. Given these characteristics, tier 1 capital is the appropriate “backstop” numerator for the leverage ratio; there is no need to deviate from it in any SLR final rule.

However, the Associations note that the use of tier 1 capital contributes to the volatility of the SLR. As part of the Basel III final rule, Advanced Approaches banks will have unrealized gains and losses flow through to tier 1 capital, greatly increasing the volatility of capital ratios (risk-based and leverage). This volatility will force banks to hold a “volatility buffer” of capital above any set regulatory capital levels. The Associations recognize the importance of having a single definition of tier 1 capital for both risk based and leverage requirements but urge the Agencies to revisit the treatment of unrealized gains and losses for large banks under the risk-based regime. At the very least, the Agencies should consider the volatility brought in through the inclusion of unrealized gains and losses into capital when recalibrating the SLR.

V. Interaction with the Basel Committee proposal titled “Revised Basel III leverage ratio framework and disclosure requirements.”

On June 26, 2013, the BCBS issued a consultative document that would greatly expand the exposures that are captured in the SLR’s denominator. The Associations provided a joint comment on the International Proposal. In addition to the issues raised above,the Associations recommended to the Basel Committee the following modifications:

- In derivatives transactions, (1) recognize the exposure-reducing effect of cash collateral received where such collateral is subject to legally enforceable collateral agreements, and (2) extend the recognition of legally enforceable netting in the measure of potential future exposure;

- Consistent with the first recommended modification, recognize that cash collateral provided to a counterparty in a derivatives transaction reduces the cash assets of the collateral provider for purposes of the leverage ratio calculation—“grossing up” of these assets should not be required;

- For written credit derivatives, (1) recognize a broader range of offsetting hedges in calculating the additional notional amount for written credit derivative exposures, and (2) limit the exposure of a written credit derivative to the maximum amount that could be lost on such a transaction;

- Measure securities financing transactions (SFTs) in a manner that appropriately recognizes legally enforceable rights of setoff by adopting universal and conservative guidelines for netting SFTs with the same counterparty, thus providing a consistent measurement methodology regardless of differences in the applicable accounting frameworks; and,

- Exclude a derivative trade cleared through a central counterparty (CCP) on behalf of a client (client cleared transaction), or alternatively, exclude the CCP leg of a client cleared transaction and appropriately recognize collateral and netting for the client leg of a client cleared transaction.

We urge the Agencies to consider these modifications in their engagement with the Basel Committee.

VI. Response to specific questions

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?

Greater emphasis on the SLR runs counter to the goal of improving financial stability. As discussed in Section II of this letter, the U.S. Proposal, particularly when combined with the International Proposal, would lead to the SLR becoming the overridingcapital constraint for a significant number of banks. Because it is risk-blind, the SLR will distort banks' decision making relative to the composition of their assets and business models that may increase risk within the banking system. Moreover, the inclusion of unrealized gains and losses in the numerator and claims on central banks in the denominator serve to increase the inherent volatility of the SLR as a capital measure. As a result of this volatility, regulatory capital will be much more prone to market fluctuations and will reduce the ability of banks to be a shock absorber for the broader economy.

Question 4: Would the proposal create any risk-reducing incentives and around what specific activities? Would the proposal create incentives for subject banking organizations to take additional risk and if so, would this effect be expected to limit the safety-and-soundness benefits of the proposal?

Assuming that the heightened requirements would influence banks subject to the proposal, the U.S. Proposal would encourage institutions to hold assets that are higher yielding and therefore on balance involving correspondingly higher risks. Likewise, banks will be discouraged from holding cash and cash equivalent securities, such as U.S. Treasuries, and from participating as intermediaries in certain markets. This would harm U.S. banks and other market participants by reducing liquidity in both the primary and secondary markets for these securities and increasing the cost of funding for even the highest rated sovereign issuers. For further discussion see Section II of this letter.

Question 5: What are commenters' views on the proposed calibration of the leverage standards? Is the proposed 6 percent well-capitalized standard for subsidiary IDIs and the proposed 5 percent minimum supplementary leverage ratio plus leverage buffer for covered BHCs appropriate or should these requirements be higher or lower? In particular with regard to covered BHCs, what are the advantages and disadvantages of establishing the minimum supplementary leverage ratio plus leverage buffer at 5 percent for all covered BHC's versus establishing the amount between 4 and 5.5 percent according to each covered BHC's risk-based capital surcharge (that is, to reflect the minimum supplementary leverage ratio of 3 percent plus between 1 and 2.5 percent depending upon each covered BHC's risk-based capital surcharge)? With respect to the subsidiary IDIs of covered BHCs, the agencies seek commenters' views on what, if any, specific challenges these institutions would face in meeting the proposed well-capitalized threshold of 6 percent beginning on January 1, 2018.

The Associations do not support raising the SLR requirements until: 1) finalization of the SLR's denominator by the Basel Committee and clarity from the U.S. regulators asto whether such changes will apply in the U.S.; and 2) a quantitative assessment is conducted and evaluated ofthe cumulative impact of bank capital and other financial reforms on the ability of U.S. banking organizations to provide financial services to consumers and businesses.

The Agencies also solicit comments on meeting the higher levels beginning in 2018. The Associations note that while implementation periods are appreciated, investors often demand that banks meet regulatory capital requirement early, and market participants have already requested SLR estimates under both the U.S. and international proposals. Furthermore, implementation of a standard is often accelerated through the stress testing process. The Associations believe that the stress testing requirements should evaluate whether institutions meet regulatory minimums. As a result, the heightened standards, which add a conservation buffer and raise the well-capitalized standard, should not be required to be met under the stress testing requirements.

Question 6: The agencies solicit commenters' views on whether a strengthened leverage ratio requirement would enhance the competitive position of U.S. banking organizations relative to foreign banking organizations by enhancing the relative safety of the U.S. banking system. Alternatively, could the proposed strengthened leverage ratio requirement place U.S. banking organizations at a competitive disadvantage relative to foreign banking organizations and if so, in what areas?

U.S. G-SIBs are by definition global banks. They compete for loans against other G-SIBs and any differences in regulations and supervision—including unilateral higher leverage requirements by U.S. regulators—creates competitive disparities, particularly where such requirements are superfluous and in fact inhibit the ability of banks to serve their customers.

Such competitive disparities may be difficult to observe immediately in today's global economic landscape. Many banks in Europe, for example, continue to suffer from weak economic conditions and have had to shrink and forgo lending opportunities. However, these conditions will normalize, and as they do the advantage shifts to those institutions that have lower yet prudently adequate capital requirements, since these capital requirements are part of business decision-making. If U.S. banks are singled out to meet significantly higher leverage ratio requirements than their non-U.S. peers, U.S. banks will be at a persistent competitive disadvantage. Each dollar of loans from a U.S. bank will be more expensive from a capital perspective than a dollar of loans from a European competitor. U.S. banks will be compelled either to pass that higher cost onto customers or shrink the availability of credit. As a result many borrowers will favor non-U.S. banks to meet their credit and other borrowing needs.

> **Question 10: The agencies are interested in comment on the appropriate measure of capital that should be used as the numerator of the supplementary leverage ratio. Among the many measures of capital used by banks, regulators and the market, the agencies considered the following measures: (1) common equity tier 1 capital, (2) tier 1 capital, (3) total capital, and (4) tangible equity (as these terms are defined in the agencies' capital regulations as of the date of the issuance of this proposed rule, including the 2013 rule). What are the advantages and disadvantages of each of these as well as alternative measures?**

As discussed in section IV of this letter, tier 1 capital is the proper base for the numerator, not CET1. Tier 1 capital—including but not limited to CET1 capital—is expressly designed to absorb unexpected losses on a going concern basis. Moreover, the Basel III final rule strengthened the definition of tier 1 to ensure that all of its elements are sufficiently loss absorbent for going concern banks. Thus, tier 1 capital consists predominantly of common shares, retained earnings, and instruments that are subordinated, have fully discretionary noncumulative dividends, and have neither a maturity date nor an incentive to redeem. In addition, tier 1 capital no longer includes hybrid instruments that did not adequately absorb losses during the financial crisis. Given these characteristics, tier 1 capital is the appropriate "backstop" numerator for the leverage ratio; there is no need to deviate from it in any final rule.

> **Question 11: What, if any, alternatives to the definition of total leverage exposure should be considered and why?**

As discussed above, considering the detrimental impacts of greater emphasis on the SLR the Associations strongly believe that changes should be made to the definition of "total leverage exposure,"including:

- Excluding from the total leverage exposure measurecash claims on central banks;

- Excluding from the total leverage exposure measure risk-free or very low-risk and highly liquid assets, such as Treasuries, or, at the very least, discount such assets according to their relative levels of liquidity similar to the categories of eligible assets under the Standardize Approach;

- Replacing the 100% CCF with the more granular Standardized Approaches CCFs; and,

- Excluding from the total leverage exposure measure derivatives cleared on behalf of clients.

Thank you for considering the concerns and recommendations raised in this letter. If you have any questions or need further information, please contact any of the following:

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Respectfully submitted,

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Appendix 1

The Associations

American Bankers Association: The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $14 trillion banking industry and its 2 million employees. Learn more at www.aba.com.

Financial Services Roundtable: The Financial Services Roundtable represents 100 integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the Chief Executive Officer. Roundtable member companies provide fuel for America's economic engine, accounting directly for $98.4 trillion in managed assets, $1.1 trillion in revenue, and 2.4 million jobs. For more information, visit www.fsround.org.

Securities Industry and Financial Markets Association: The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C. is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit www.sifma.org.