AMERICANS FOR FINANCIAL REFORM
ACCOUNTABILITY ★ FAIRNESS ★ SECURITY

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October 21, 2013

The Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

The Honorable Thomas J. Curry
Comptroller
Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219

The Honorable Martin Gruenberg
Acting Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

RE: Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and Their Subsidiary Insured Depository Institutions (Docket No. R-1460; Docket ID OCC-2013-0008; RIN 7100-AD 99)

To Whom it May Concern:

Americans for Financial Reform ("AFR") appreciates this opportunity to comment on the above-referenced notice of proposed rulemaking (the "Proposed Rule") by the Federal Deposit Insurance Corporation, the Federal Reserve Board, and the Office of the Comptroller of the Currency (the "Agencies"). AFR is a coalition of over 250 national, state, and local groups who have come together to advocate for reform of the financial industry. Members of AFR include consumer, civil rights, investor, retiree, community, labor, faith based, and business groups along with prominent independent experts.

AFR strongly supports the concept of the additional Supplementary Leverage Ratio (SLR) advanced in the Proposed Rule. Indeed, we recommended the addition of such a supplementary leverage buffer in our previous comments on the U.S. implementation of the Basel capital rules.[1] But as the questions in the proposal make clear, many critical details of the SLR remain to be determined. If the SLR is not properly applied to the full range of gross banking exposures, the SLR level is reduced, or banks are permitted to fulfill it using a definition of 'capital' which may not be loss absorbing, then its impact will be limited at best. But a forceful application of the 6 percent requirement contemplated here to the full range of gross bank exposures will clearly create significant benefits for financial stability.

At the same time, as a general matter, and as detailed in previous comments, AFR believes that the capital levels currently contemplated in the Basel III process are inadequate and fall well short of the amount of capital that would maximize social benefits. We believe that a careful examination of the evidence would find that the leverage ratios proposed in this rule also fall short of the benefit-maximizing capital levels. We thus urge the Agencies to reexamine the costs and benefits of the leverage capital requirements in this proposal using realistic assumptions concerning the net benefits of additional leverage capital, including the benefits of leverage capital metrics in preventing regulatory arbitrage. We believe such an analysis would support a higher leverage capital requirement than proposed here.

Below is a brief summary of major specific recommendations regarding this Proposed Rule:

- <u>Measurement of the denominator for the SLR capital charge:</u> In the past, leverage ratios have not been properly applied to off-balance-sheet obligations, and regulators have permitted extensive netting of gross transactions in determining the asset base for the leverage calculation. This seriously undermines the proper function of a leverage ratio, which is to ensure as far as possible a hard cap on total bank leverage. The SLR should apply to all gross exposures. At a minimum, the SLR denominator should be determined based on the revised Basel III leverage requirement base as outlined in the BCBS consultative document released in June 2013.[2] Furthermore, weaknesses in the June 2013 document should be addressed by strengthening protections concerning netting of derivatives, and standardized calculations of potential future exposures for derivatives should be significantly improved, as current standardized measures are too lax.

- <u>The SLR should be equalized between depository subsidiaries and the consolidated holding company:</u> The Proposed Rule suggests that the SLR will be set at 6 percent for insured depository subsidiaries of the holding company, but reduced to 5 percent at the consolidated holding company level. This is deeply misguided, as many of the large-scale

[1] Americans for Financial Reform, "Regulatory Capital Rules", October 22, 2012
[2] Basel Committee on Banking Supervision, Bank for International Settlements "Revised Basel III Leverage Ratio Framework and Disclosure Requirements", September 20, 2013

dealing activities that triggered the financial crisis and create the greatest need for a strong leverage ratio are located in non-depository subsidiaries. If the consolidated capital ratio is lower than the capital ratio at depository subsidiaries, then the depository subsidiaries will implicitly be serving as a source of strength to the rest of the holding company, which reverses the principles of U.S. banking law. The consolidated requirement should be increased to match the depository level.

- The SLR should be applied to all Advanced Approaches banking organizations, not just 'top-tier' BHCs over $700 billion. The 5 to 6 percent SLR proposed in this rule should apply to all large banks capable of competing in dealing and custody markets for which leverage ratios are a crucial protection. This would apply to all those banks subject to the Advanced Approaches, which would include all banks with over $250 billion in assets or $10 billion in cross-border assets. A graduated increase in this ratio could then be applied to the very largest banking institutions.

Detailed Discussion

Answers to Selected Questions

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

Since the financial crisis, there has been a wave of academic studies on the determinants of bank failure or distress during the crisis. Almost uniformly, these studies find that leverage ratios are one of the strongest predictors of bank financial distress. Leverage ratios far outperform other metrics including risk-based regulatory capital, which has essentially no relationship with bank failure.[3] These studies provide strong, indeed overwhelming, evidence that leverage ratios create micro-prudential benefits at the level of the individual bank and in terms of the propagation of shocks between banks.

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[3] International Monetary Fund (IMF), 2009, *Global Financial Stability Report,* Chapter 3, Detecting Systemic Risk (Washington, April 2009); Detragiache, Enrica, Asli Demirguc-Kunt, and Ouarda Merrouche, 2010, Bank Capital: Lessons from the Financial Crisis, IMF Working Paper 10/286 (Washington: International Monetary Fund, December 2010); Haldane, Andrew G., 2012, The Dog and the Frisbee, Bank of England Speech 596, resented at the Federal Reserve Bank of Kansas City's 36th economic policy symposium, Jackson Hole, Wyoming; Mayes, David G. and Stremmel, Hanno, 2012, The Effectiveness of Capital Adequacy Measures in Predicting Bank Distress , 2013 Financial Markets & Corporate Governance Conference,; Brealey, Richard A., Ian A. Cooper, and Evi Kaplanis, 2011, International Propagation of the Credit Crisis , SSRN Working Paper, April, 2011; Berger, Allen N., and Christa H.S. Bouwman, 2012, How Does Capital Affect Bank Performance During Financial Crises?, *Journal of Financial Economics (JFE),* Forthcoming; Blundell-Wignall, Adrian and Caroline Roulet, 2013, "Business models of banks, leverage and the distance-to-default", *OECD Journal No. 103: Financial Market Trends*, Vol 2012-2; Hogan, Thomas L., Neil Meredith, Zuhao Pan, 2013, "The Failure of Risk-Basked Capital Regulation," (Fairfax: Mercatus Center at George Mason University.)

Just as important, leverage limits at large banks create additional macro-prudential benefits for the financial system as a whole, by reducing so-called 'fire sale externalities'. The price externalities created by so-called 'fire sales' of collateral assets in response to stress conditions are a major contributor to financial instability. High leverage ratios at large dealer banks are a direct driver of the risk and level of fire sale externalities.[4] Reducing leverage ratios at large dealer banks will, all other things equal, reduce fire sale externalities and thus benefit financial stability.

Question 3: The agencies solicit commenters views on what economic data suggest about leverage ratios and risk-based capital ratios as predictors of bank distress and thus tools to prevent the failure of large systemically-important banking organizations.

See above, especially the studies cited in Footnote 3. These studies of the experience of the 2008 financial crisis demonstrate that leverage ratio is a strong predictor of bank distress. Furthermore, most studies find that risk-based regulatory capital ratios were essentially uncorrelated with financial distress during the global financial crisis. The most likely explanation of this divergence is that banks were able to arbitrage previous risk-based capital metrics, so that it was not an indicator of true bank leverage risks. Of course, reforms in risk measurement made in the Basel III proposal may address some of these issues, but it is still likely that risk-based metrics will be easier to arbitrage than a properly constructed leverage ratio. It is thus crucial to impose a strong leverage ratio along with risk-based capital metrics.

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?

AFR has not performed an analysis that would permit estimation of the 'optimal' leverage ratio. However, we strongly believe that capital requirements should be higher than those currently mandated in the Basel III process. Further, we believe the minimum SLRs in this Proposed Rule, while an improvement on current leverage ratios, are likely still not high enough to maximize social benefits.

In previous comments to the Basel Committee, we have outlined the faulty assumptions used in determining the levels of required capital for large systemically significant financial institutions (G-SIBs).[5] The models used by regulators to examine the benefits of higher capital ratios for our largest banks did not include any costs of financial distress short of bank failure, did not properly

[4] Duarte, Fernando, and Thomas M. Eisenbach, 2013, "Fire-Sale Spillovers and Systemic Risk," *Federal Reserve Bank of New York Staff Paper,* Staff Report No. 645.
[5] Americans for Financial Reform, 2011, Comment on Global Systemically Important Banks: Assessment Methodology and the Additional Loss Absorbency Requirement.

estimate the costs of G-SIB failure, did not incorporate government support into estimates of failure probabilities, and had other issues besides. Further, the estimated costs of higher capital ratios assumed an inappropriately high return on equity (15 percent), assumed no relationship between returns on equity demanded by investors and the capitalization or soundness of the bank, and further assumed that 100 percent of additional funding costs would be passed on directly to real economy customers in the form of higher final lending spreads. These are all highly unrealistic assumptions.

It should also be noted that Basel analyses have not specifically examined leverage ratios, focusing instead on risk weighted capital metrics. There has been no systematic examination of the possibility of arbitrage of risk-weighted metrics and the way that this risk would be reduced by higher leverage ratios. The studies discussed above indicate that arbitrage risk for risk-weighted capital metrics is a very serious issue indeed, as those metrics appear to have lost most of their value as an indicator of bank soundness by the time of the 2008 financial crisis.

The specific 5 percent SLR for the largest consolidated BHCs proposed in this rule still appears too low. For example, according to the Long-Term Economic Impact study of the Basel Committee, the average ratio of total tangible common equity and reserves to total assets averaged 5.3 percent in OECD countries between 1980 and 2007.[6] While this figure may not be exactly comparable to the current leverage ratio definition, it still indicates that the 5 percent SLR here would not represent an unusual increase in total capital over historic norms. Since historic norms have led to an unacceptably high risk of financial crises, regulators should seek to exceed them significantly, particularly at the very largest BHCs under discussion in this rule.

We recommend the Agencies reexamine the optimal level of leverage capital with an analysis that is based on more realistic assumptions as regards costs and benefits than those used in the Basel analysis, including the benefits of increased financial stability that occur prior to bank failure (e.g. the prevention of fire sales), more realistic target returns on equity that vary with bank capitalization, and more realistic assumptions concerning the impact of capital requirements on lending spreads. The Agencies should also examine the level of realized financial losses during the 2008-09 financial crisis, adjusted for government support, to determine whether the leverage ratios provided here create sufficient protection.[7] We believe that such an analysis would support a higher SLR than recommended in this Proposed Rule, particularly for the very largest banks.

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[6] See page 16, Footnote 19, Basel Committee on Banking Supervision, Bank for International Settlements, 2010, "An Assessment of the Long-Term Economic Impact of Stronger Capital and Liquidity Requirements,"BCBS 173, August, 2010 .

[7] See e.g.,Strah, Scott, Jennifer Hynes, and Sanders Shaffer, The Impact of the Recent Financial Crisis on the Capital Positions of Large U.S. Financial Institutions: An Empirical Analysis, Federal Reserve Bank of Boston, July 16, 2013. This study does not adjust for the impact of government support on bank capital, but it still finds that eight major institutions had capital losses in excess of 450 basis points, as a percentage of risk weighted assets.

At a minimum, we urge the Agencies to set the SLR at 6 percent for the consolidated bank holding company, equating the BHC leverage requirement with the requirement for insured depository subsidiaries. As discussed below, a failure to do this would make the leverage ratio weakest precisely where it should be strongest, at broker-dealer subsidiaries, and would endanger the BHC's capacity to be a 'source of strength' to its insured depositories.

Question 5, continued: In particular, with regard to with regard to covered BHCs, what are the advantages and disadvantages of establishing the minimum supplementary leverage ratio at 5 percent for all covered BHCs vs. establishing the amount between 4 and 5.5 percent according to each 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 on 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 thse institutions would face in meeting the proposed well-capitalized threshold of 6 percent beginning January 1, 2018.

This proposal to set the minimum SLR at 3 percent and use the Basel G-SIB risk-based surcharge as the leverage add-on for each bank lacks apparent justification. In the aggregate, it would also represent a significant cut in the leverage ratios required in this Proposed Rule. Currently, only two U.S. banks have the full 2.5 percent risk-based surcharge. All other banks affected by this proposal would have a surcharge under 2 percent. As discussed above, the Basel G-SIB surcharge is itself based on faulty assumptions and is too low. The Agencies should be seeking to raise the SLR in this proposal, not cut it.

Should the Agencies wish to further graduate the minimum SLR by bank size, we would recommend using the 6 percent SLR recommended for IDIs in this proposal as a base for all Advanced Approaches banking entities, and then adding additional leverage surcharges to that base for the very largest banks.

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.

The maximally loss absorbing and most reliable definition of capital should be used. This would be common equity tier 1 (CET1) capital. A departure from CET 1 capital requires more complex regulatory policing of alternative capital instruments to ensure that they are compatible with the bank remaining a going concern and maintaining market confidence during times of financial stress. The final Basel rules for U.S. banks do use Tier 1 (as opposed to CET 1) capital for the supplementary leverage ratio of 3 percent, a decision that in our opinion weakens this leverage base. However, CET 1 capital is used for all other relevant buffers and surcharges applying to Advanced Approaches banks, including the capital conservation buffer, the countercyclical buffer, and the G-SIB surcharge. We suggest that precedent be followed here.

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

The next section contains an extensive discussion of the definition of total leverage exposure. Essentially, AFR favors using the leverage exposure definition advanced by the Basel Committee in its June 2013 consultative document, but significantly restricting derivatives netting permitted under that proposal, and substantially improving the standardized measurement of potential future exposures for derivatives.

Question 13: The proposed scope of application is U.S. top-tier BHCs with more than $700 billion in total assets or more than $10 trillion in assets under custody and their subsidiary IDIs. Should the proposed requirements also be applied to other advanced approaches banking organizations?

AFR believes that the proposed requirements should be applied to all advanced approaches banking organizations (over $250 billion in assets). This would increase coverage for the proposal from the largest eight to roughly the largest fifteen U.S. banking organizations.

Measurement of the Denominator For the Leverage Capital Charge

Leverage ratios work well because they create a floor on maximum bank leverage. However, this floor will not be reliable if exposures that are nominally off balance sheet are not capitalized through the leverage ratio, or if banks are permitted to reduce their level of gross exposures through extensive netting procedures.

In general AFR feels that it is dangerous to permit banks to reduce leverage capital exposures through bilateral netting agreements. In every case, when closely examined netting protections rely on complex assumptions regarding the functioning of legal procedures and/or settlement mechanisms under the stress of a counterparty default. Often these assumptions involve cross-border exposures. Many such procedures demonstrably failed during the financial crisis. Just as important, closeout netting is intended to provide protection when a counter party fails with offsetting positions still in place. Without additional guarantees, it provides no protection in a case where counterparties engage in a ‘run’ on a dealer and close or novate one side of a previously offsetting position while leaving the other side in place. Such runs can occur quickly, in a matter of days or weeks, allowing no time to raise additional bank capital or for regulators to respond to the change in a bank’s position.

The security provided by the leverage ratio should not be made dependent on technical assumptions regarding settlement or on the assumption that potentially disastrous bank runs will not occur. If netting is permitted, it must rest on ironclad guarantees concerning both closeout procedures and simultaneous settlement of both of the two offsetting positions, comparable to those required under IFRS accounting rules.

As the Agencies point out, the Supplementary Leverage Ratio finalized under U.S. Basel III rules already includes many off balance sheet exposures that are not incorporated in the U.S. generally applicable leverage ratio, and the experience of the financial crisis shows that such exposures are particularly important to include for the large banking entities targeted in this Proposed Rule (CFR 51104-51105). However, the finalized Basel III SLR still fell far short of full gross measurement of derivatives transactions and apparently excluded most securities financing transactions. Furthermore, the Agencies also stated that the Basel SLR remained a work in progress and that U.S. regulators continued to consult with the Basel Committee to assess the details of the leverage ratio.[8]

The Basel Committee has now released a further consultative paper on the SLR that goes into much greater detail.[9] Released in June, 2013 elements of this latest Basel iteration of the SLR base include full coverage of current gross securities financing exposures, a ban on netting collateral with derivatives exposures, some reduction in permitted derivatives netting, charges for bank indemnifications of clients for the value of securities financing collateral, and full coverage of most off-balance sheet exposures, with consolidation of any entities that must be consolidated for accounting or regulatory purposes for leverage capital purposes as well. Some serious issues do remain in this framework, as discussed below. However, it provides a valuable benchmark for the SLR. **At minimum, the Agencies should fully adopt the SLR coverage under the June 2013 Basel consultative document**.

Below, we go into some additional detail regarding some key coverage issues for the SLR denominator, in some cases giving recommendations for going beyond the June 2013 consultative document definitions.

Coverage of off balance sheet exposures

AFR strongly supports the application of the leverage ratio to off balance sheet transactions. As the Agencies note, such supposedly ‘off balance sheet’ exposures played a central role in triggering the financial crisis. The Proposed Rule indicates that the SLR will cover 100 percent of most off balance sheet exposures, and 10 percent of commitments that can legally be canceled unconditionally by the bank. Drawing on the June 2013 Basel consultative document, such commitments should apply to any related or subsidiary entity that had to be consolidated for any purpose, either under regulatory capital definitions or accounting rules. The justification for the limitation on capital charges related to ‘unconditionally cancellable’ commitments is that the

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[8] Office of the Comptroller of the Currency, United States Treasury, Final Regulatory Capital Rules, P. 61.
[9] Basel Committee on Banking Supervision, Bank for International Settlements, Consultative Document “Revised Basel III Leverage Ratio Framework and Disclosure Requirements", BCBS 251, June, 2013.

bank can avoid these commitments unilaterally. However, it is unclear why the charge for such commitments should be reduced before the bank has actually canceled the commitment. If the bank wishes to avoid capital charges for the commitment, it can simply cancel it to free up capital.

More broadly, the coverage of 'off balance sheet' exposures should incorporate a greater understanding of market expectations. Conceptually, the leverage requirement should be applied to any commitment if a failure to meet that commitment would cause harm to the bank's reputation (such as a credit downgrade, or a less of counterparty confidence). This may include informal but publicized commitments as well as formal commitments, and could certainly include commitments that the bank could legally cancel unilaterally. A clear example is Bear Stearns assistance to its troubled hedge funds in early 2008. There was no legal obligation to assist these funds, but the assistance was necessary to retain market confidence.

Coverage of Derivatives Exposures

<u>Netting of derivatives exposures:</u> The June 2013 consultative document continues to permit substantial netting of derivatives exposures. The proposal permits full bilateral netting of current mark-to-market exposures under conditions that appear close to existing GAAP requirements, and also permits netting of 60 percent of potential future exposures.

As discussed above, AFR feels that the netting of derivatives exposures for leverage capital purposes creates major risks for proper capitalization of dealer operations and regulatory permission for such netting should require extremely strong protections. We are disappointed at the continuing permissiveness in netting rules, and urge the Agencies to reexamine this issue and strengthen requisites for bilateral netting to qualify for favorable capital treatment.

Even if netting is permitted for current market-to-market exposure, it is difficult to see why it is permitted at all for future exposures. As offsetting exposures that exist currently may not exist in the future, the only possible justification for permitting netting of future exposures would be an ironclad guarantee that all assets and liabilities in the netting set will be settled on a net basis and recognized simultaneously. (Such a guarantee is required for netting under IFRS accounting rules). Yet there is no such requirement in the June 2013 Basel document. Absent such a requirement, we urge the Agencies to eliminate any bilateral netting benefit for potential future exposures. That is, the add-on for potential future exposure in Paragraph 10 of Appendix A of the June 2013 Basel consultative document referenced in Footnote 9 should be changed to be equal to the gross PFE, instead of the weighted average of 40 percent gross/60 percent net that is currently in the BCBS recommendation.

<u>Measurement of derivatives future exposures:</u> A central issue in applying capital charges to derivatives exposures is the prediction of the potential future exposure that could be created by

changes in market valuations of the assets underlying the derivative. The current mark to market exposure of a derivative may be very low while still exposing a bank to very large future risks and large implicit leverage.

The Agencies have properly required regulated entities to calculate such potential future exposures using a standardized approach, instead of and in addition to their own internal models. However, as discussed in the AFR comment on the Basel capital rules, the standardized approaches include multipliers for future exposures that appear very low.[10] The standardized approaches assume low market volatilities, so that e.g. future exposures for short-term interest rate derivatives are zero, and also have puzzlingly low exposure levels for credit derivatives.

In general, standardized approaches for derivatives future exposure should be based on realized market volatilities during previous stress periods. They should also include an allowance for the possibility of illiquidity, particularly for complex customized derivatives. In addition, hedging benefits should only be permitted for derivatives written on the same or extremely similar underlying assets.

The Basel Committee is reexamining this issue and has proposed a non-internal models approach that addresses some of the issues with the current standardized approach.[11] An important advance in this approach is that it uses market inputs from past stress periods to determine volatilities and exposures for different asset classes. We urge the Agencies to adopt this approach in determining the potential future derivatives exposure to which the SLR will be applied. It is particularly important to select high-stress periods for determining future exposure metrics, as government regulators should require capital provisioning for 'tail risk' periods when the taxpayer could be exposed. Any failure to use stressed inputs could also lead to pro-cyclical capital provisioning.

However, a remaining weakness in the Basel approach is the use of excessively broad hedging sets for potential future exposures. It is first of all dubious to permit recognition of future hedging benefits for leverage capital purposes, for the same reason that netting benefits are problematic for future derivatives exposures. The offsetting exposure may not remain with the bank in the future. Hedging benefits are in any case a risk adjustment and in many cases inappropriate for the application of a leverage ratio (as opposed to a risk-based charge). However, if any hedging benefits are recognized they should be limited to instruments written on either the same underlying asset or an extremely similar one.

Unfortunately, the Basel proposal for standardized exposure measurements would allow hedging between instruments that are only broadly or vaguely similar, particular in the area of credit and

[10] See pp. 13-14, Americans for Financial Reform, "Comment on Regulatory Capital Rules", October 22, 2012.
[11] Basel Committee on Banking Supervision, Bank for International Settlements, Consultative Document, "The Non-Internal Model Method for Capitalising Counterparty Credit Risk Exposures.", BCBS 254, June, 2013.

commodity derivatives.[12] In reforming standardized metrics for derivatives exposures, we urge the regulators to reexamine the recommended Basel approach and institute much more stringent requirements for hedging-based reductions in capital charges.

Coverage of Securities Financing Transactions

The June 2013 Basel consultative document addresses a serious weakness in previous iterations of the supplementary leverage ratio by fully covering securities financing transactions such as repurchase and reverse repurchase agreements. In general, the treatment of such exposures in the 2013 document appears correct. In particular, the Basel Committee correctly proposes that the bank capitalize the entire gross exposure of repo and securities lending transactions, without accounting netting of payables against receivables. (Some netting benefits are recognized for counterparty credit risk). This approach is a logical result of treating repo exposures as loan exposures, and AFR strongly supports it for inclusion in the proposed SLR.

Industry lobbyists have criticized this decision, claiming that it inappropriately ignores the ways in which closeout netting reduces risk.[13] The issues here are similar to those discussed above regarding netting generally. In the case of repo netting, the claim that closeout protections are adequate is particularly ironic given the failure of tri-party repo during the crisis, and continuing concerns regarding the volume of intra-day credit granted by repo intermediaries. Indeed, the industry letter admits that clearing technology does not permit actual simultaneous settlement of repo transactions on different collateral.[14] The gaps in repo settlement were not a mere technical issue as they were central to the solvency threat to tri-party repo banks during the crisis. This is an example of the way in which netting relies on seemingly inoccuous technical assumptions that may turn out to be highly questionable during a crisis.

We would also emphasize the benefits of full capitalization of gross securities lending exposures in reducing fire sale externalities, as discussed in the response to Question 1 above. Netting out collateral received in securities lending exposures will only increase the incentive to sell that collateral immediately in times of financial stress. In effect, allowing netting for SFTs replaces a stronger bank capital position with an implicit assumption that the bank may sell collateral to raise capital during a stress period. Such fire sales can be highly destabilizing.

An additional element of the Basel consultative document is a requirement that leverage capital requirements apply to indemnifications or guarantees for the value of repo collateral provided by

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[12] Id., See page 4 – credit hedging permits partial offset between credit derivatives on different names, commodity derivatives hedging allows offset between all commodities in a broad asset class such as energy.
[13] Global Financial Markets Association (GFMA), 2013, Comments in Response to the Consultative Document on the Revised Basel III Leverage Ratio Framework and Disclosure Requirements.
[14] Id Page 30 - "Currently, most systems are equipped to settle transactions in different securities separately; that is, only on an individual basis at gross amounts. Offsetting securities transactions cannot be settled simultaneously"

custodial banks acting as agents. This is clearly a credit exposure on the part of the bank, and AFR strongly supports its inclusion in the leverage capital base for the proposed SLR.

The SLR applying to the consolidated holding company should at least equal the SLR applying to depository subsidiaries

Strangely, the Proposed Rule would apply a 6 percent SLR to insured depository institutions (IDIs) within a holding company, but only a 5 percent SLR to the full consolidated holding company. No clear justification for this decision is given in the rule.

AFR strongly disagrees with the proposition that leverage ratios should be lower for the consolidated holding company. Leverage ratios are most valuable in capitalizing large exposures that might not be subjected to appropriate capitalization under risk-based capital charges. Besides off balance sheet exposures, the most obvious example of such a case is large-scale dealer operations, which often have a 'matched book' approach and do not face adequate capital charges under risk-based capital approaches.[15] Such dealer operations will generally be located at broker-dealer subsidiaries. Leverage ratios are thus a crucial constraint to apply to these firms. Undercapitalization at broker-dealer firms was a crucial contributor to the financial crisis.[16] Finally, it is these broker-dealers which drive fire sale externalities by selling their inventory of securities when they are under financial stress due to overleveraging. Thus, higher leverage ratios at broker-dealers are particularly beneficial.

These factors would seem to call for the application of a leverage ratio to broker-dealer firms that is at least as high as the ratio applied to depositories. Instead, by applying a 6 percent SLR to IDIs and a 5 percent SLR to the entire consolidated holding company, this Proposed Rule would permit non-IDI subsidiaries of the holding company (and the holding company as a whole) to hold less leverage capital than the depository subsidiaries. This does not properly target leverage capital protections, and would seem to run counter to the spirit of the source of strength doctrine, as recently re-affirmed in Section 616(d) of the Dodd Frank Act. Certainly, requiring lower capital levels for the BHC as a whole than its subsidiaries IDIs, particularly lower capital levels for broker-dealer subsidiaries who were found to be systematically undercapitalized during the financial crisis, would make it more difficult for the banking entity to support its depository subsidiaries.

We urge the Agencies to reconsider this decision and apply the SLR determined as appropriate for IDIs – or a higher one -- to the entire consolidated BHC.

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[15] This point was made in an October 4th, 2013 speech by Federal Reserve Governor Jeremy Stein at the Federal Reserve Bank of New York Workshop on Fire Sales as a Driver of Systemic Risk in Triparty Repo and other Secured Funding Markets.

[16] Rosengren, Eric S., Risk of Financial Runs- Implications of Financial Stability, Speech given at "Building a Financial Structure for a More Stable and Equitable Economy," the 22nd Annual Hyman P. Minsky Conference on the State of the U.S. and World Economies, New York, New York, April 17, 2013

Thank you for the opportunity to comment on these Proposed Rules. Should you have any questions, please contact Marcus Stanley, AFR's Policy Director, at marcus@ourfinancialsecurity.org or (202) 466-3672.

Following are the partners of Americans for Financial Reform.

All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.

- AARP
- A New Way Forward
- AFL-CIO
- AFSCME
- Alliance For Justice
- American Income Life Insurance
- American Sustainable Business Council
- Americans for Democratic Action, Inc
- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Center for Effective Government
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos

- Economic Policy Institute
- Essential Action
- Green America
- Greenlining Institute
- Good Business International
- HNMA Funding Company
- Home Actions
- Housing Counseling Services
- Home Defender's League
- Information Press
- Institute for Agriculture and Trade Policy
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America
- Lawyers' Committee for Civil Rights Under Law
- Main Street Alliance
- Move On
- NAACP
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Council of Women's Organizations
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Resource Center
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United
- National People's Action
- National Urban League
- Next Step
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO National Network
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law

- SEIU
- State Voices
- Taxpayer’s for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club
- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS
- U.S. Public Interest Research Group
- UNITE HERE
- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now
- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

List of State and Local Partners

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina

- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)
- Cooperative Fund of New England, Wilmington NC
- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- Neighborhood Economic Development Advocacy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action

- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- New Yorkers for Responsible Lending
- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY
- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG

Small Businesses

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Environmental Planning
- Hayden & Craig, PLLC
- Mid City Animal Hospital, Pheonix AZ
- The Holographic Repatterning Institute at Austin

- UNET