September 25, 2017

Via Electronic Mail

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
regs.comments@federalreserve.gov
Docket No. R-1537
RIN 7100-AE 83

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
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RIN 3064-AE 63

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Docket ID OCC-2017-0012
RIN 1557-AE 23

Re: Notice of Proposed Rulemaking—Regulatory Capital Rules: Retention of Certain Existing Transition Provisions

Ladies and Gentlemen:

We appreciate the opportunity to comment on the proposed rules (the "Proposal")[1] issued jointly by the Board of Governors of the Federal Reserve System ("Federal Reserve"), the Office of the Comptroller of the Currency ("OCC") and the Federal Deposit Insurance Corporation ("FDIC") (collectively, the "Agencies") that would extend some of the transition provisions under the Basel III regulatory capital rules for certain banking organizations. Our concerns, as discussed further below, are that the scope does not cover all banking organizations subject to the regulatory capital rules and that the Agencies continue to use arbitrary and rudimentary thresholds—rather than more dynamic, risk-sensitive alternatives—as a proxy for a banking organization's risk profile.

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[1] *Regulatory Capital Rules: Retention of Certain Existing Transition Provisions for Banking Organizations That Are Not Subject to the Advanced Approaches Capital Rules*, 82 Fed. Reg. 40,495 (Aug. 25, 2017) (hereinafter *Proposal*).

The Proposal explains that the freeze of the transition provisions[2] would be made in anticipation of a broader proposal to generally simplify the regulatory capital rules and reduce unnecessary burden. We welcome and support the Agencies' efforts to revisit the regulatory capital rules in order to assess whether and how the rules could be improved to avoid unnecessary burden and complexity for all covered banking organizations. The Agencies' efforts in this regard are consistent with the principles underlying Executive Order 13772[3] and the recommendations made in the related report released by the United States Department of the Treasury.[4]

The Agencies specifically seek comment on what modifications, if any, the Agencies should consider making to the proposed scope of application.[5] The scope of the Proposal should be expanded to cover all banking organizations subject to the regulatory capital rules. If the Agencies have determined that completing the transitions under the regulatory capital rules is not necessary for some banking organizations, then that treatment should apply to all banking organizations covered by the regulatory capital rules, regardless of size.[6] Moreover, by changing the transition provisions for only a subset of banking organizations, the Agencies are creating yet another regulatory capital standard, which would only increase the complexity of, and burden under, the regulatory capital rules, contrary to the purpose of the Agencies' efforts, the principles underlying the Executive Order and the Treasury Report.

The Proposal explains that the scope of the proposed transition period freeze would not extend to Advanced Approaches banking organizations because the current transitions remain appropriate "given the business models and risk profiles of such banking organizations."[7] The Proposal thereby implies that all Advanced Approaches banking organizations operate more complex, riskier business models and have similar risk profiles. That premise is not supported by the facts.

Regional banking organizations generally have similar business models and, thus, have risk profiles that are more similar to each other than they are to the risk profiles of U.S. global systemically important banks ("G-SIBs"). Regional banking organizations' business models are focused on core, traditional banking activities, such as deposit taking, consumer and commercial

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[2] Specifically, for banking organizations that are not subject to the Advanced Approaches, the Proposal would "freeze" at current levels the transition of, among other provisions, the threshold deductions from a banking organization's regulatory capital for significant common stock investments in the capital of unconsolidated financial institutions, mortgage servicing assets ("MSAs") and certain deferred tax assets.

[3] Executive Order 13772, *Core Principles for Regulating the United States Financial System*, 82 Fed. Reg. 9965 (Feb. 8, 2017) (establishing a set of core principles for regulating the U.S. financial system) (hereinafter *Executive Order*).

[4] U.S. Department of the Treasury, *A Financial System That Creates Economic Opportunities - Banks and Credit Unions* (June 2017), *available at* https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf (hereinafter *Treasury Report*).

[5] *Proposal*, at 40,498.

[6] Our organizations participated in the development of the comment letters submitted by The Clearing House Association L.L.C. and the American Bankers Association. We support the comments and concerns reflected in those letters and the recommendations in this letter are intended to highlight those aspects of the Proposal that present special concerns for the undersigned regional banking organizations.

[7] *Proposal*, at 40,497.

lending and asset management. Virtually all assets of regional banking organizations are held in their depository institution subsidiaries, which is not the case on average for the G-SIBs. Unlike the larger, more complex G-SIBs, regional banking organizations have limited capital markets, custody, clearing and derivative operations and have only limited foreign activities. As the data summarized below demonstrates, these meaningful differences in business model mean that the balance sheets and risk profiles of the undersigned Advanced Approaches regional banking organizations ("Excluded Regionals")[8] are very different from the balance sheets and risk profiles of the eight U.S. banking organizations identified as G-SIBs. On the other hand, this same data demonstrates that the balance sheets and risk profiles of Excluded Regionals are very similar to those of other regional banking organizations that are not covered by the Advanced Approaches ("Other Regionals") and, thus, are covered within the scope of the Proposal.[9] To highlight just a few key metrics:[10]

- Excluded Regionals and Other Regionals hold 61% and 67%, respectively, of their total assets in net loans and leases, as compared to G-SIBs which hold on average only 27% of their total assets in net loans and leases.

- Excluded Regionals and Other Regionals have only 1% and less than 1%, respectively, of their total assets on average held in non-bank broker-dealer subsidiaries, whereas G-SIBs on average hold 24% of their total assets in non-bank broker-dealer subsidiaries.

- Excluded Regionals and Other Regionals each have an average ratio of total trading assets to total assets of only 1%, whereas G-SIBs on average have a ratio of total trading assets to total assets of 15%. Similarly, Covered Regionals and Other Regionals each have an average ratio of total trading liabilities to total liabilities of less than 1%, whereas G-SIBs on average have a ratio of total trading liabilities to total liabilities of 7%.

- Excluded Regionals and Other Regionals have an average ratio of notional value of derivative contracts to total assets of only 77% and 50%, respectively, as compared to on average 2,095% for the G-SIBs.

- Excluded Regionals and Other Regionals have an average reliance on wholesale funding ratio of only 22% and 14%, respectively, whereas the G-SIBs have an average reliance on wholesale funding ratio of 41%.

- Excluded Regionals and Other Regionals have an average ratio of core deposits to total liabilities of 72% and 83%, respectively, as compared to G-SIBs, for which this ratio on average is only 33%.

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[8] These are Capital One Financial Corporation, The PNC Financial Services Group, Inc. and U.S. Bancorp.

[9] The banking organizations referenced here include 10 U.S. regional bank holding companies with asset of $50 billion or more that are not covered by the Advanced Approaches. Intermediate holding companies of foreign banking organizations and savings and loan holding companies are excluded for purposes of this comparison.

[10] Sources for these metrics include the Consolidated Financial Statements for Holding Companies (FR Y-9C), Bank Holding Company Performance Report (FR BHCPR) and the Banking Organization Systemic Risk Report (FR Y-15). All data is as of June 30, 2017.

- Excluded Regionals and Other Regionals have an average ratio of average foreign loans to average total loans of only 2% and 1%, respectively, as compared to 17% on average for the G-SIBs.

- Finally, the highest systemic indicator score for an Excluded Regional is only 44, which is less than one third of the lowest systemic indicator score for a G-SIB, which is 150.

Regional banking organizations operate on either side of the $250 billion asset line that is used to identify Advanced Approaches banking organizations. These data clearly demonstrate that the Thresholds do not appropriately distinguish between banking organizations based on business model or risk profile, but rather they differentiate almost entirely based on size. It would be more appropriate—both from a regulatory standpoint and standpoint of Main Street customers who are the focus of the regional banks' business models—to replace the arbitrary, outdated Thresholds with a more risk-sensitive alternative that focuses on business model and risk profile when tailoring regulations.[11] In light of the Agencies' broader effort to review the regulatory capital rules, now is the appropriate time for the Agencies to review and revisit the use of the Thresholds.

The systemic indicator score is a more useful and better-calibrated measure of the complexity and risk inherent in a banking organization's business model that we and other regional banking organizations have consistently recommended the Agencies consider in lieu of the Thresholds.[12] The systemic indicator score was specifically designed to reflect banking organization's complexity and risk profile based on a weighted average of 12 indicators across five categories correlated with systemic risk—size, interconnectedness, substitutability, complexity and cross-jurisdictional activity.[13] In contrast to the rudimentary, static Thresholds, the systemic indicator score is both more risk-sensitive and dynamic.[14] It is, therefore, a more suitable measure for tailoring the application of the regulatory capital rules, among other prudential standards. The fact that there are banking organizations with assets of less than $250 billion that are, nonetheless, identified as G-SIBs using the systemic indicator score further underscores the fact that asset-based thresholds are not an appropriate delineator of risk or complexity. Instead of the

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[11] The thresholds, which are unique to the United States, were first established by the Agencies in 2003 to identify those banking organizations that were "internationally active" and to which the Advanced Approaches under the regulatory capital rules should apply on a mandatory basis. *See Risk-Based Capital Guidelines; Implementation of New Basel Capital Accord*, 68 Fed. Reg. 45,900 (Aug. 4, 2003). The Thresholds have never been adjusted or otherwise comprehensively reviewed (not even for the effect of inflation in the intervening 14 years).

[12] *See, e.g.*, Letter from 10 Regional Banking Organizations to the Agencies Regarding the Proposed Rules to Implement the Basel III Net Stable Funding Ratio (Aug. 5, 2016) (commenting that the scope of the proposal should be tailored to more appropriately reflect a banking organization's complexity and overall risk profile).

[13] *See Regulatory Capital Rules: Implementation of Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies*, 80 Fed. Reg. 49,082 (Aug. 14, 2015).

[14] The data underlying the systemic indicator score is updated periodically. Bank holding companies with total consolidated assets of $50 billion or more file a quarterly report with the Federal Reserve—the Banking Organization Systemic Risk Report (FR Y-15)—which collects data across the five components underlying the systemic indicator score. The aggregate systemic indicators used as the denominators to calculate the score are updated annually.

Thresholds, the Agencies should consider utilizing the systemic indicator score to more appropriately align the scope of the Proposal—and regulatory capital requirements more broadly—with banking organizations' business models and risk profiles. Doing so would help support U.S. economic growth while continuing to ensure the safety and soundness of banking organizations and the stability of the U.S. financial system.

In proposing changes to the U.S. regulatory capital rules, the Agencies may seek to maintain consistency with the regulatory capital standards developed by the Basel Committee on Banking Supervision ("Basel Committee"). Consistency with those standards, however, does not necessarily need to result in the customer impacts, competitive inequities and other concerns raised in this letter. Moreover, because Basel Committee standards generally are intended to apply only to internationally active banking organizations,[15] it would be appropriate for the Agencies to revisit and revise, as recommended above, the scope of application in the United States for Basel Committee standards for "internationally active" banking organizations. Applying these standards only to U.S. G-SIBs would still ensure that U.S. banking organizations that represent approximately 86% of cross-jurisdictional claims and 92% of cross-jurisdictional liabilities (both as reported on the June 30, 2017, FR Y-15 Banking Organization Systemic Risk Report) would remain subject to rules adopted in the United States to implement Basel Committee standards, and including the Excluded Regionals in the population of "internationally active" banks would only increase these two metrics by 1% to 87% and 93%.

In addition to revisiting the Thresholds, there are other aspects of the regulatory capital rules that we recommend the Agencies consider reviewing and revisiting as part of the broader effort to simplify and reduce burden under the regulatory capital rules. For example, we believe that the Agencies should use this review to reassess the scope, terms and consequences of the deductions for significant common stock investments in unconsolidated financial institutions and MSAs. The purpose of the deduction for significant common stock investments in unconsolidated financial institutions is to limit the "double counting" of regulatory capital and to protect against interconnectivity and procyclicality.[16] However, the definition of the term "financial institution" under the regulatory capital rules is broader than necessary to achieve that purpose or to otherwise ensure U.S. financial stability. Accordingly, the "financial institution" definition should be revised to limit its scope to entities that are engaged in financial activities as principal and that are subject to prudential capital requirements. Financial activities conducted as principal, rather than as agent, present greater risk—both to the banking organization holding the investment and the broader financial system. Limiting the scope to entities subject to prudential capital requirements would more appropriately address the "double counting" concerns underlying the deduction.

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[15] *See, e.g.*, Basel Committee, *The New Basel Capital Accord* (Jan. 8, 2001), ¶ 1, *available at* http://www.bis.org/publ/bcbsca03.pdf.

[16] Basel Committee, *Strengthening the resilience of the banking sector* (Dec. 17, 2009), ¶ 101, *available at* http://www.bis.org/publ/bcbs164.pdf.

The treatment of MSAs, assets that are central to mortgage lending in the United States, under the regulatory capital rules also should be revisited as part of the Agencies' effort.[17] MSAs are subject to the threshold deductions and MSAs that are not deducted will, effective January 1, 2018, receive a risk weight (250%) that is five times greater than the risk weight for most residential mortgages and two-and-one-half times greater than the risk weight for most other retail and commercial loans under the Standardized Approach. This treatment of MSAs is unduly punitive, overstates the risks inherent in these assets and encourages the migration of mortgage servicing out of the banking sector into the shadow banking system. Regulatory capital treatment that is more in line with the historical treatment and actual risk profile of MSAs would be more appropriate.[18] These and other adjustments to "right size" the regulatory capital rules would support U.S. economic growth and could be appropriately balanced with the goal of promoting safety and soundness and U.S. financial stability.

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The undersigned regional banking organizations thank the Agencies for the opportunity to comment on the Proposal and respectfully ask for consideration of the recommendations and suggestions in this letter. If you have any questions regarding the content of this letter or would like more information on the same, please do not hesitate to contact any of the individuals listed in Attachment 1 to this letter.

Sincerely,

Capital One Financial Corporation
The PNC Financial Services Group, Inc.
U.S. Bancorp

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[17] Notably, under the Proposal, items that are subject to the threshold deductions, such as MSAs, but that are not deducted would continue to receive the transitional 100% risk weight, rather than the fully-phased in 250% risk weight (effective January 1, 2018). The disparity in risk-weighted asset treatment resulting from the Proposal creates a disincentive for Advanced Approaches banking organizations to engage in mortgage lending that, in turn, could hinder growth of home ownership and, thus, the U.S. economy.

[18] U.S. banking organizations have developed sophisticated risk management systems to appropriately manage the market risks associated with MSAs, and also have invested significant sums to enhance mortgage servicing capabilities, particularly in the loss mitigation and default areas.

Attachment 1

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