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Via Electronic Delivery

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Re: Proposed Capital Simplification Amendments
Docket No. R–1576; RIN 7100 AE–74

Ladies and Gentlemen:

The undersigned banking organizations appreciate the opportunity to provide comments to the Board of Governors of the Federal Reserve System (the "Federal Reserve"), the Federal Deposit Insurance Corporation (the "FDIC"), and the Office of the Comptroller of the Currency (the "OCC") (together, the "Agencies") in response to the Agencies' notice of proposed rulemaking proposing to revise the applicable regulatory capital rules for certain depository institutions and bank holding companies (the "Proposed Rule"). [1]

The Proposed Rule is intended to clarify and simplify certain generally applicable elements of the capital rules. The intention of the Agencies is to meaningfully reduce regulatory burden and complexity, while at the same time maintaining safety and soundness and the quality and quantity of regulatory capital in the banking system.

1 *Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996*, 82 Fed. Reg. 49984 (Oct. 27, 2017).

We strongly support the efforts of the Federal Reserve and other Agencies to reduce regulatory burden by simplifying and tailoring the application of regulatory capital rules. We focus our comments here on the scope of the Proposed Rule.

Under the Proposed Rule, the clarifying revisions to the capital rules would not be applicable to bank holding companies ("BHCs") that are currently subject to the U.S. "advanced approaches" capital rules – *i.e.*, BHCs with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance sheet foreign exposure (the "250/10 Thresholds").[2]

As described in greater detail below, we believe that the Agencies should use the opportunity of the Proposed Rule to eliminate the use of the 250/10 Thresholds for determining application of the advanced approaches.[3] We also believe that the Agencies should make similar changes in other rulemakings that use the 250/10 Thresholds, such as the Liquidity Coverage Ratio. These thresholds do not appropriately reflect the complexity, business models, international activity or actual risk profiles of banking organizations. For example, as the Treasury Department's Office of Financial Research has recently noted: "size alone does not equate to risk to financial stability."[4] Similarly, the Federal Reserve has recently recognized that foreign exposure may arise from business activities that are not complex, and as a result a metric aimed at accounting for complexity that is based solely on the size of a firm's foreign exposures may be over-inclusive.[5]

We believe that the use of alternative measures to determine application of the advanced approaches, such as the systemic indicator approach used to identify global systemically important banks ("G-SIBs"), would ensure that the scope of coverage of the advanced approaches capital rules is and remains properly calibrated to achieve the purpose of tailoring capital rules based on firms' size, complexity, and risk profile.

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2 12 C.F.R. § 217.100(b)(1).

3 We also believes that the Agencies should eliminate use of the 250/10 Thresholds elsewhere as a proxy for complexity in segmenting the industry generally for supervisory purposes.

4 *See* OFR Viewpoint, *Size Alone is Not Sufficient to Identify Systemically Important Banks*, Oct. 26, 2017, available at https://www.financialresearch.gov/viewpoint-papers/files/OFRvp_17-04_Systemically-Important-Banks.pdf.

5 *Amendments to the Capital Plan and Stress Test Rules; Regulations Y and YY*, 82 Fed. Reg. 9308, 9312 (Feb. 3, 2017).

I. The Use of Static, Outdated, and Non-Risk-Sensitive Thresholds Results in an Inappropriate Segmentation of the Industry

We strongly agree with the Agencies that it is appropriate to tailor capital rules or other supervisory expectations based upon the complexity, risk profile, or systemic importance of banking organizations. To achieve the proper tailoring, however, it is critical that the criteria used to identify those firms be sufficiently sophisticated, dynamic, and risk-sensitive to avoid being or becoming overly inclusive.

The 250/10 Thresholds are static, arbitrary measures that are unique to the United States and were developed in 2003 – prior to the 2008-09 Financial Crisis – to identify those "internationally active" banking organizations to which the U.S. advanced approaches capital rules would apply. Post-crisis, the Basel Committee on Banking Supervision (the "Basel Committee") and the Federal Reserve have developed a far-more comprehensive measure for size, complexity, and overall systemic risk of individual banks. The continued (and expanding) use of the pre-crisis 250/10 Thresholds, when more sophisticated, comprehensive, and internationally recognized tools are available, is inappropriate.

At the time the thresholds were first established, the Federal Reserve made clear that the implementation in the United States of standards for "internationally active" banking organizations was intended to reach only the "largest, most complex banks," *i.e.*, those that were the "most complex banking institutions" and were truly "internationally active."[6] These thresholds may have been an appropriate proxy at the time for identifying a group seemingly equivalent to today's G-SIBs, but like all fixed asset size thresholds, they were destined to become improper measures over time. However, not only do the 250/10 Thresholds continue to be used for purposes of the advanced approaches, they are increasingly being used by the Agencies in other contexts – whether by using the thresholds themselves, or through reference to the current scope of advanced approaches banking organizations.

Unfortunately, because they are static, outdated, and not risk sensitive, these thresholds now capture certain regional and other traditional banking organizations that,

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6 *Testimony of Vice Chairman Roger W. Ferguson, Jr., Basel II*, Before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, June 18, 2003, *available at* http://www.federalreserve.gov/boarddocs/testimony/2003/20030618/default.htm; *see also* Federal Reserve, *Capital Standards for Banks: The Evolving Basel Accord*, 89 Fed. Res. Bull. 395 (Sept. 2003).

due to their business models and limited risk profiles, do not warrant application of the same rules that apply to the "most complex banking institutions," such as the U.S. G-SIBs.

Segmenting the U.S. financial services industry in this manner causes the inappropriate imposition of unnecessary regulatory requirements on institutions outside of the group of G-SIBs solely because they have crossed one or more arbitrary thresholds. This results in incongruent groupings of banking organizations that are not aligned with business models or corresponding risk profiles. However, vast differences exist between the firm-specific business models and systemic risk profiles of traditional banking organizations and the G-SIBs. As a result of the 250/10 Thresholds not taking into account these differences, regulatory requirements that use these thresholds are not being appropriately calibrated to the risk profile of individual institutions and unnecessary regulatory obligations and supervisory expectations are being imposed on traditional banking organizations.

It is important to note that the 250/10 Thresholds currently capture banking organizations with significantly divergent characteristics. Two distinct groups – the largest and most complex banking organizations, as well as regional and other traditional banking organizations – are both captured under this same 250/10 Threshold. However, there is a wide gulf between these two groups, especially in terms of business model and risk profile. For example:

• Relative to larger and more complex organizations (such as the U.S. G-SIBs), traditional banking organizations have relatively simple organizational structures, primarily focusing on traditional retail and commercial banking products and services, and have only limited trading and capital markets operations. Broker-dealers and other nonbank operations outside of service-providing affiliates comprise only a small portion of their overall operations.

• Traditional banking organizations' exposure to capital markets and derivatives activities pale in comparison to that of U.S. G-SIBs.

Accordingly, and as discussed further below, we believe that the advanced approaches rules should eliminate their reliance on the 250/10 Thresholds in favor of a more appropriate metric that ensures a more sophisticated calibration of regulatory requirements based on banking organizations' business models and actual risk profile.

Notably, reconsidering the continued relevance of the 250/10 Thresholds, and their application to regional and other traditional banking organizations, would be consistent with recent Congressional direction included in the House Committee on Appropriation's report accompanying the 2016 Financial Services and General Government Appropriations Bill, which was incorporated into the 2016 Consolidated Appropriations Act enacted in December 2015, which provides:

> *Basel Standards.*—The Committee is concerned that the U.S. prudential regulators have inappropriately applied several standards developed by the Basel Committee on Bank[ing] Supervision (Basel), which are explicitly designed for only the most internationally active, globally systemic, and highly complex banking organizations to less complex organizations, like regional banking organizations, which have only limited foreign exposure and do not pose a threat to the U.S. or global financial system. The Committee encourages Treasury and other prudential regulators to reexamine the impact of certain liquidity and capital standards as they apply to U.S. regional banks and other less complex organizations.[7]

Similarly, revisiting the use of the 250/10 Thresholds would be consistent with the direction provided in the U.S. Department of the Treasury's June 2017 report on regulatory reform, which noted:

> Most critically, regulatory burdens must be appropriately tailored based on the size and complexity of a financial organization's business model and take into account risk and impact. In particular, the use of arbitrary asset thresholds to apply regulation has resulted in a "one-size-fits all" approach that has prevented regulators from focusing on a banking organization's most serious risks.
> . . .
> Insufficient tailoring results in bank regulators misallocating staff time and resources by focusing on firms that do not present the greatest risks to the financial system. Further, the magnitude of regulatory requirements applicable to regional, mid-sized, and community banks that do not present risks to the financial system requires such banks to expend resources on building and maintaining a costly compliance infrastructure, when such resources would be better spent on lending and serving customers.[8]

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7 H.R. Rep. No. 114-194 (2015), at 10.

8 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.

Fundamentally, static balance-sheet-based thresholds are a poor proxy for risk or complexity, and the Agencies have far better and more sophisticated tools at their disposal. As discussed below, we believe an appropriate alternative approach would be to replace the 250/10 Thresholds in the advanced approaches with a more sophisticated, dynamic measure that would ensure that the scope of the rules – and any derivative uses of that scope for other regulatory initiatives – remain properly calibrated to capture only the largest and most complex global banking organizations, such as the systemic indicator approach used to identify G-SIBs.

II. More Sophisticated Methods Exist to Calibrate Regulatory Requirements

The international regulatory community and the Agencies have developed more sophisticated, dynamic tools that we believe should be leveraged to better calibrate regulatory requirements, such as the advanced approaches, based on the actual risk profile of banking organizations. Specifically, the Agencies participated in the international development of the systemic indicator approach,[9] which the Federal Reserve has implemented in the United States for identifying G-SIBs.[10] The systemic indicator approach takes into account not only size, but also interconnectedness, substitutability, complexity, and cross-jurisdictional activity. Moreover, the systemic indicator approach is far more sensitive and dynamic than a thresholds-based approach because the comprehensive set of attributes that the systemic indicator approach takes into consideration, and the denominators that are used to evaluate those attributes, are updated periodically.[11] Such an approach would ensure, both initially and over time, a more appropriate calibration of regulatory requirements based on banking organizations' business models and actual risk profile.

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9 Basel Committee, *Global systemically important banks: updated assessment methodology and the higher loss absorbency requirement* (July 2013).

10 *See Regulatory Capital Rules: Implementation of Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Final Rule*, 80 Fed. Reg. 49,802 (Aug. 14, 2015).

11 The Federal Reserve's FR Y-15 Banking Organization Systemic Risk Report, which collects data comprising the five components underlying the systemic indicator approach (size, interconnectedness, substitutability, complexity, and cross-jurisdictional activity), is submitted by bank holding companies with total consolidated assets of $50 billion or more on a quarterly basis. The aggregate systemic indicators used as the denominators to calculate a banking organization's systemic indicator score are updated on an annual basis.

A cursory review of the systemic indicator approach quickly demonstrates that it provides much more powerful insights into complexity, international activities and the actual risk profile of a banking organization than the rudimentary asset- and on-balance sheet foreign exposure-based measures incorporated into the 250/10 Thresholds. The systemic indicator data also highlight the vast difference between traditional banking organizations and the largest, most complex banking organizations (such as the U.S. G-SIBs), and why continuing to rely on the 250/10 Thresholds for the scope of the advanced approaches and other regulatory initiatives is no longer appropriate. For example, based upon publicly available information:

• As for size, the eight U.S. banking organizations identified as G-SIBs account for 76% of total exposures for all U.S. bank holding companies required to submit the Federal Reserve's FR Y-15 Banking Organization Systemic Risk Report ("FR Y-15 Filers"),[12] and whereas the smallest non-custody G-SIB has total exposures of $1.28 trillion, the largest traditional banking organization has only $539 billion.

• With respect to the amount of over-the-counter ("OTC") derivatives, an important measure of complexity, U.S. G-SIBs account for 98% of the notional value of all OTC derivatives for all FR Y-15 Filers, and the smallest non-custody G-SIB has OTC derivatives with a notional value of $5.6 trillion, compared to the largest traditional banking organization, which has only $278 billion. Similarly, U.S. G-SIBs accounted for 87% of trading and available-for-sale securities (less high quality liquid assets) for all FR Y-15 Filers; the smallest non-custody G-SIB has $135 billion of such securities, compared to only $16 billion for the largest traditional banking organization.

• As for international activities, the U.S. G-SIBs account for 94% of all cross-jurisdictional claims and 95% of all cross-jurisdictional liabilities for FR Y-15 Filers, representing the vast majority of all international claims and liabilities for FR Y-15 Filers. No traditional banking organization has cross-jurisdictional claims or liabilities exceeding 1% of the aggregate amounts for FR Y-15 filers, consistent with the domestic focus and limited international activity of traditional banking organizations.

In addition to size, complexity and international activity, the remaining systemic indicators similarly demonstrate the vast gulf between U.S. G-SIBs and regional and traditional banking organizations. Perhaps more telling are the ultimate scores of systemic importance when calculated using the systemic indicator data. For example:

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[12] All FR Y-15 data in this letter are as of December 31, 2014.

• Under the Federal Reserve's systemic indicator methodology a U.S. bank holding company is deemed to be a G-SIB if its systemic indicator score is 130 or more. Based upon public information, the G-SIB cutoff (130) is more than three times greater than the systemic indicator score of the largest non-custody U.S. banking organization that is not identified as a G-SIB (39); and

• The average systemic indicator score of the eight U.S. G-SIBs (280) is over seven times greater than that of the largest non-custody U.S. banking organization that is not a G-SIB (39).[13]

The systemic indicators and score data make it clear that the U.S. G-SIBs are significantly more complex and internationally active than traditional and regional banking organizations.[14] In light of the stark differences between U.S. G-SIBs and regional and traditional banking organizations and the policy goals of tailoring regulatory capital requirements based upon the size, complexity, and risk profile of banking organizations, we believe that the Agencies should eliminate use of the 250/10 Thresholds in the advanced approaches and that the systemic indicator approach should be applied instead.

III. Conclusion

We respectfully submit that, for the reasons described above, the Agencies should forego their continued use of the static, outdated 250/10 Thresholds in favor of relying upon the more tailored systemic indicator approach in identifying firms to be subject to the advanced approaches capital rules. We believe that these changes would produce a segmentation of the U.S. financial services industry that more appropriately captures the

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[13] Systemic indicator scores were calculated based on FR Y-15 reports as of December 31, 2014, and the Basel Committee's 2014 systemic indicator denominators (converted into U.S. Dollars based on the spot USD/EUR exchange rate prevailing on December 30, 2014). A report compiled by the Office of Financial Research ("OFR") draws similar conclusions using the Basel Committee's essentially identical methodology. *See* Allahrakha et al., Office of Financial Research Brief, *Systemic Importance Indicators for 33 U.S. Bank Holding Companies: An Overview of Recent Data* (Feb. 12, 2015), *available at* http://financialresearch.gov/briefs/files/2015-02-12-systemicimportance-indicators-for-us-bank-holding-companies.pdf.

[14] More generally, we believe it is especially critical for the U.S. banking agencies to keep these very real differences between U.S. G-SIBs and regional and other traditional banking organizations in mind, particularly given the increasing use of the 250/10 Thresholds outside the context of the Basel Committee's standards.

risk associated with covered organizations, asset classes, and liabilities, and thus would result in a supervisory focus that is better aligned to the objectives of the Agencies.

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Thank you for considering our comment letter. We appreciate the opportunity to share our views with the Agencies and would be happy to discuss any of them further at your convenience. Contact information for each of the undersigned is included in the Annex.

Sincerely,

American Express Company
Deere & Company

Annex

Contact Information

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