DISCOVER

Direct Dial: 224-405-4996
Email: TimothySchmidt@discover.com

January 22, 2019

Via Electronic Submission

Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, NW
Washington, D.C. 20551
Attention: Ann E. Misback, Secretary

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429
Attention: Robert E. Feldman, Executive Secretary

Office of the Comptroller of the Currency
400 7th Street, SW, Suite 3E-218
Washington, D.C. 20219
Attention: Legislative and Regulatory Activities Division

Re: Proposals to Tailor Prudential Standards for Large U.S. Banking Organizations
[FRB Docket No. R–1627 and RIN 7100-AF20]
[FRB Docket No. R-1628; FDIC RIN 3064-AE96; Docket ID OCC-2018-0037]
[FDIC RIN 3064–AE84]

To Whom It May Concern,

Discover Financial Services ("Discover") appreciates the opportunity to provide comments to the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency (the "Agencies") in connection with the Agencies' proposals to establish risk-based categories for determining applicability of certain prudential standards ("Proposals").[1] Discover is submitting one letter in response to all three Proposals because of the interrelatedness of the impacted regulations and underlying policy issues. As described in the Proposals, the Agencies are considering establishing four new categories of large U.S. banking institutions using risk-based criteria that would determine which such institutions would be subject to certain prudential standards related to capital, liquidity, risk management,

[1] This letter provides comments responsive to three interrelated proposals: November 29, 2018 proposal by the Federal Reserve to amend threshold for application of enhanced prudential standards (83 FR 61408); December 21, 2018 proposal by the Agencies to amend thresholds for determining applicability of requirements under regulatory capital rules, the liquidity coverage ratio rule, and the proposed net stable funding ratio rule (83 FR 66024); and December 28, 2018 proposal by the FDIC to amend company-run stress testing requirements for FDIC-supervised state nonmember banks and state savings associations (83 FR 67149).

stress testing, and counterparty credit limits. The FDIC has also proposed a rule that would amend the FDIC's existing stress testing regulations to change the minimum threshold for applicability from $10 billion to $250 billion, revise the frequency of required stress tests by FDIC-supervised institutions, and reduce the number of required stress testing scenarios from three to two. These Proposals are intended in part to implement statutory changes enacted as part of the Economic Growth, Regulatory Relief, and Consumer Protection Act ("EGRRCPA").

Discover strongly supports the Agencies' ongoing efforts to review post-crisis regulations to assess costs and benefits and ensure standards and resources are properly aligned to the risk characteristics of individual institutions. We believe these efforts are necessary not only to implement the changes mandated by the EGRRCPA, but also to improve the overall efficiency, transparency, and effectiveness of financial regulation. If adopted, the Proposals would help ensure resources are allocated where they are needed most, thereby bolstering the Agencies' important safety and soundness and financial stability goals.

Although we support the proposed regulatory modifications in the Proposals, we believe as a general matter that the enhanced prudential standards framework should not be applied to firms with less than $250 billion in assets unless the Federal Reserve makes a specific determination based on the individual characteristics and risk profile of the firms that would be subject to the rules. The Proposals define the lower bound for Category IV firms using only a simple asset size threshold of $100 billion, rather than any of the other criteria required to be considered under the EGRRCPA, such as capital structure, riskiness, complexity, financial activities, and other risk-related factors. The preambles include only general conclusions about banks with at least $100 billion in assets without assessing the characteristics of the specific firms that would be included in the proposed grouping. We think this approach overlooks the multi-factor analysis required under the EGRRCPA and the Agencies should therefore reconsider the minimum criteria for Category IV firms.

If the Agencies determine not to change the scope of the Category IV definition, then we urge the Agencies to move quickly to finalize the Proposals with only minimal changes as described below. The following sections outline our recommended changes assuming the scope of Category IV institutions is not changed, as well as broader comments on the Proposals and forthcoming related Agency rulemakings that are discussed in the Proposals. These recommendations can be broadly characterized as clarifications and principles-based enhancements to promote consistency among the various proposed reforms.

I. The Agencies should take immediate action to provide clarity for proposed Category IV firms on the regulatory requirements applicable in 2019.

Under the Proposals, Discover would be considered a Category IV firm. As such, Discover would be subject to supervisory capital stress tests every two years rather than annually and would no longer be subject to the liquidity coverage ratio ("LCR") rule. As discussed below, Discover strongly supports adoption of both of these changes. Moreover, to ensure Category IV firms are able to realize this relief in 2019 and to avoid devoting finite resources to regulations or requirements that may no longer be applicable, we recommend the Federal Reserve act immediately to implement interim changes, outlined here, during the pendency of its rulemaking.

First, we request the Federal Reserve, as soon as possible, suspend supervisory stress testing and CCAR requirements for Category IV firms during the pendency of the Proposals. With respect to capital stress testing, the Federal Reserve's Vice Chairman for Supervision, Randal Quarles, has indicated on multiple occasions that he expects the Federal Reserve to move promptly to make 2019 an "off-cycle" year such that Category IV firms would not be subject to supervisory stress tests or the Federal Reserve's Comprehensive Capital Analysis and Review ("CCAR") process, in favor of "more normal-course supervisory tools." Firms that participate in CCAR must invest significant resources to prepare for the stress test months before receiving the scenarios and instructions. An immediate suspension of CCAR requirements for 2019 would align with the proposed framework for supervisory stress tests in future years and help firms avoid unnecessary resource expenditure.

Second, we request the Federal Reserve should immediately suspend LCR disclosure requirements for all proposed Category IV firms. Under the current LCR rule, Category IV firms will be required to begin public disclosures of their LCR calculations beginning in the first quarter of 2019. Given the Agencies' proposal not to apply the LCR rule to Category IV firms in recognition of their lower risk profile, an immediate suspension of disclosure requirements would eliminate unnecessary resource burdens associated with the filing of disclosures that would, if the proposal is adopted, only be made temporarily during the pendency of the rulemaking.

II. The Agencies should ensure any forthcoming changes to capital planning and stress testing rules, guidance and instructions are aligned with broader tailoring objectives.

Discover strongly supports the proposed elimination of Dodd-Frank Act company-run stress testing requirements for Category IV firms and their bank subsidiaries. We also support reducing the frequency of supervisory stress tests to every other year for Category IV firms. These modifications should reduce unnecessary burdens on both regulated institutions and the Agencies, freeing up resources to focus on more critical risks without diminishing the robust capital planning and oversight programs that have been put into place over the past decade. That said, the Proposals leave important details about the broader regulatory framework for capital planning unclear, such as the Federal Reserve's proposed "stress capital buffer" regulation and changes to its CCAR program. As a result, it is difficult for us to provide fully informed comments at this time. Nevertheless, we strongly urge the Agencies to ensure forthcoming changes to regulatory capital rules and related guidance are properly aligned with their broader tailoring objectives.

Specifically, we recommend the Agencies adhere to the following principles in developing future regulatory changes in this area:

- The Federal Reserve should not apply CCAR or the stress buffer framework to proposed Category IV firms and instead use the normal supervisory process to assess the safety and soundness of such firms' internal capital planning processes

- If the stress buffer framework is applied to Category IV firms, the Federal Reserve should provide such firms with the option to elect a supervisory stress test during an "off-cycle" year if the firm wishes to refresh its stress buffer requirements

- Regulatory expectations for internal "forward-looking" capital assessments by Category IV firms should be clearly articulated, but principles-based to allow such firms sufficient and appropriate flexibility to design internal assessments based on the firm's individual characteristics and needs

- Capital plan rules should permit greater flexibility for a firm to adjust capital distribution amounts between capital plan submissions, so long as the firm's capital levels remain above regulatory minimums inclusive of stress buffer requirements

- The Federal Reserve should revise applicable rules, guidance and instructions to streamline documentation and governance requirements for a Category IV firm's capital plan and stress test submissions

- The Federal Reserve should continue efforts to improve stress test transparency and minimize period-over-period volatility driven by changes to Federal Reserve modeling practices

The Agencies should utilize public notice and comment processes where appropriate to ensure any material changes to capital and stress testing expectations reflect the input of all stakeholders.

III. We support the proposals to tailor liquidity risk management standards for Category IV banks and recommend minor additional revisions to streamline governance expectations.

Discover strongly supports the proposed elimination of "modified" liquidity coverage ratio ("LCR") and net stable funding ratio ("NSFR") requirements for Category IV firms. These rules are unnecessary to ensure prudent liquidity levels at firms that do not present significant systemic risk. The international standards upon which the LCR and NSFR rules are based were designed by the Basel Committee on Banking Supervision to apply to large "internationally active" banking organizations, which by definition does not include any Category IV firms.

We are also supportive of the proposal to tailor the liquidity risk management requirements in Regulation YY. However, we believe the standards could be further improved by streamlining additional governance requirements in the rule. For example, the rule should permit an institution's board of directors to delegate primary responsibility for overseeing liquidity risk to its independent risk committee, including requirements to approve liquidity policies and review quarterly risk reports. This change would align the oversight of liquidity risk with other risks under the enterprise risk management standards in Regulation YY while continuing to ensure strong independent board-level oversight. Additionally, the Federal Reserve should eliminate the provision in the rule that requires the board or its risk committee to review or approve certain operational documents, such as cash flow projection methodologies and liquidity risk "procedures," which are more appropriately implemented and managed by senior management.

IV. The Federal Reserve should ensure application of its LFI Rating System does not undercut the tailoring objectives in its Proposals.

While the Proposals would implement key changes to right-size regulatory standards based on considerations of an institution's risk profile, it is important that these objectives carry over into the Agencies' supervisory programs. For example, the Federal Reserve recently adopted a new Large Financial Institution ("LFI") supervisory rating system that applies to all bank holding companies with at least $100 billion of assets. Deficiencies in any of the LFI system's three primary components, including capital planning and positions and liquidity risk management, would trigger significant consequences including the loss of "well managed" status. To ensure the LFI rating system does not inadvertently undercut the Agencies' broader tailoring objectives, the Federal Reserve should ensure ratings are assigned based on criteria that are appropriately differentiated based on institution risk profile and level of complexity. To that end, the Federal Reserve's forthcoming guidance on board governance expectations and business line risk management should embed risk-tier concepts and scaled expectations using the same or similar criteria and categories outlined in the Proposals. Additionally, the Federal Reserve should expressly clarify that the proposed requirement for Category IV firms to continue submitting monthly FR 2052a liquidity risk reports will not implicitly bind those firms to the LCR rule's quantitative requirements.

V. The Agencies should continue to pursue additional opportunities to tailor the regulatory framework based on institution risk profile.

In addition to the specific areas addressed in the Proposals, we recommend the Agencies continue and expand upon their broader efforts to assess the current regulatory framework and identify additional opportunities to tailor standards based on institution risk profile. Some examples of additional areas that would benefit from more tailoring in the near term include: resolution planning, Volcker Rule compliance, model risk management standards, and regulatory reporting and disclosure obligations (e.g., Category IV firms should not be required to file quarterly Pillar III capital disclosures).

Discover appreciates the Agencies' attention to these very important policy issues and we strongly support ongoing efforts to make financial regulation more efficient and effective. We hope the Agencies will carefully consider our comments and recommendations as they work to finalize the Proposals, and as they move forward with broader efforts to improve the regulatory framework for U.S. financial institutions. Discover remains committed to maintaining strong enterprise-wide processes for thoughtfully assessing and managing capital, liquidity, and other risks in a prudent manner. However, we believe there are significant opportunities to recalibrate the existing regulatory constraints without sacrificing safety and soundness. The Proposals are an important step in that direction and we urge the Agencies to act swiftly to adopt them with the modifications outlined herein.

Sincerely,

[redacted]

Timothy J. Schmidt
Senior Vice President and Treasurer