American Bankers Association
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Office of the Comptroller of the Currency
400 7th Street, S.W., Suite 3E-218
Mail Stop 9W-11
Washington, D.C. 20219
Attention: Legislative and Regulatory Activities Division
Docket ID OCC-2013-0016
RIN 1557 AD 74

Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, N.W.
Washington, D.C. 20551
Attention: Robert de V. Frierson, Secretary
Docket No. R-1466
RIN 7100-AE03

Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
Attention: Robert E. Feldman, Executive Secretary
RIN 3064-AE04

Re: Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring

Ladies and Gentlemen:

The American Bankers Association[1] (ABA) appreciates the opportunity to comment on the notice of proposed rulemaking issued by the Federal Deposit Insurance Corporation (FDIC), the Board of Governors of the Federal Reserve System (Federal Reserve) and the Office of the Comptroller of the Currency (OCC, and collectively, the Agencies), entitled *Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring* (Proposal), which implements a Liquidity Coverage Ratio (LCR) in the United States.[2]

The Proposal would introduce a quantitative liquidity requirement for internationally active banking organizations, their consolidated subsidiary depository institutions with $10 billion or more in total assets, and nonbank financial companies designated by the Financial Stability Oversight Council for supervision by the Federal Reserve that do not have substantial insurance activities. As part of the proposal, the Federal Reserve proposes to implement a modified LCR

[1] ABA represents banks of all sizes and charters and is the voice for the nation's $14 trillion banking industry and its two million employees.
[2] 78 Fed. Reg. 71818 (Nov. 29, 2013).

(Modified LCR) as an enhanced prudential standard for bank holding companies and savings and loan holding companies with consolidated assets of $50 billion or more that are not otherwise subject to the Proposal (collectively, Covered Companies). Under the proposal, Covered Companies would be required to hold a buffer of high quality liquid assets (HQLA) equal to the amount of funds assumed to leave the bank in a period of stress, net of assumed inflows.

The purpose of this letter is to highlight key industry concerns with the Proposal. We support the recommendations of the comment letter we submitted jointly with The Clearing House Association L.L.C., the Securities Industry & Financial Markets Association (SIFMA), the Financial Services Roundtable, the Institute of International Bankers and the Structured Finance Industry Group (SFIG), (Joint Letter), which provides detailed technical comments on all aspects of the Proposal. Additionally, we refer the Agencies to the letter submitted by ABA's Corporate Trust Committee (Corporate Trust Letter), for a description of the concerns of ABA members providing corporate trust services. Members of ABA's Corporate Trust Committee provide more than ninety percent of corporate trust services in the U.S.

I. Overview

Recent trauma to financial institutions demonstrates the long understood and important role that robust liquidity risk measurement, monitoring and management plays in making both individual banks and the U.S. financial system more resilient. Accordingly, ABA concurs with the Agencies' concern for appropriate liquidity management. The benefits of liquidity risk management through complex and prescriptive requirements, however, has not been demonstrated as actually improving liquidity in practice, and such complex and prescriptive proposals need to be considered in view of the cost to bank customers and the U.S. economy, particularly when compared with other approaches that might yield better results with less economic damage.

We generally support the LCR's underlying philosophy. However, we have significant concerns with the Proposal as currently drafted. Most fundamentally, ABA is concerned about the apparent lack of empirical data to support many of the Proposal's provisions and the Agencies' limited consideration of the impact of the proposal on U.S. markets and customers of U.S. banks. In addition, the approach to liquidity management in the Proposal does not recognize the benefit dynamic markets provide to our economy. Instead, the Proposal picks winners and losers among today's current asset classes, freezing in time today's methods of capital formation.

Other, better approaches to promote liquidity should be considered, with the whole effort subjected to rigorous evaluation based upon adequate data and inclusive consultations. In fact, through supervisory processes, the Agencies already capture and analyze liquidity data from our largest institutions. Because the Proposal represents the first time a quantitative liquidity standard would be implemented in this country, and will likely lead to major changes in bank portfolios and the provision of financial services, there is significant uncertainty regarding its potential impact on the U.S. banking industry, bank customers, financial markets, and the overall economy. Before proceeding, then, the Agencies should better understand and inform the public about the implications of the Proposal and seek to mitigate its substantive unintended consequences prior to finalizing and implementing the LCR.

We are supportive of broad, internationally consistent standards for internationally active banks. However, we do not believe that the Proposal achieves the necessary balance between international harmonization and the need to tailor the standard to U.S. institutions and markets. We recognize that the Basel Committee on Banking Supervision (BCBS), and, by extension, the Agencies, view the LCR developed and agreed to by the BCBS as a minimum standard. Given the novelty of the LCR, and the limited data offered to rationalize the Proposal's very restrictive approach, however, we encourage the Agencies not to expand upon the international standard, and instead to seek to address isolated concerns through the supervisory process.

Further, ABA and its members urge the Agencies to consider the cumulative impact of the myriad of laws and regulations that have been passed and promulgated in the last five years - rather than evaluating any one particular regulation in isolation. We strongly reiterate the Joint Letter's discussion of this point. It is a long-established principle of medicine that treatments must be considered in their totality, with drug and treatment interactions acknowledged and carefully considered, avoiding overmedicating the patient lest more harm than good results. That principle is just as important for financial regulation that affects the economy of the nation. We anticipate that the LCR requirements will interact with other rules in ways that may magnify the concerns raised by the Proposal, or those in other rulemakings. This bears special consideration in the implementation of an LCR requirement, in part, because of the relative novelty of a quantitative liquidity standard, but also because the costs associated with liquidity regulation are uncertain (except for the fact that they will be high), and all of the ramifications of the proposals may not be fully understood.

Lastly, we strongly encourage the Agencies to consider the impact of the Proposal to not only the institutions it covers, but to the industry as a whole. Once the proposal is finalized, we expect supervisory expectations regarding liquidity management to adjust across the industry —even for the smallest banks.[3] Accordingly, whatever framework is finalized for the LCR should be workable across the banking industry, as the LCR's established definitions and assumptions will be referenced by examiners, investors, customers, as well as bank owners and banking management.

II. Summary of Industry Concerns[4]

ABA is concerned that the Proposal's approach is unnecessarily restrictive and not calibrated properly for either U.S. financial markets or the likely behavior of bank counterparties during times of stress. For example, during the recent financial stress consumers and business customers alike considered U.S. financial institutions to be among the safest places to put their cash, so that large amounts of deposits *flowed into* the banking system.[5] Yet the Proposal assumes significant *outflows* from banks during stress. The outflow assumptions of the Proposal are clearly and demonstrably a departure from reality and produce a result that will be harmful to the U.S.

[3] In fact we have heard from several of our community bank members – one with $100 million in assets – that their examiners expect them to be in compliance with the LCR going forward.

[4] Please see the Joint Letter for a comprehensive discussion of industry concerns beyond the scope of this letter.

[5] According to FDIC Call Report data, $620 billion flowed into banks from December 31, 2007 to December 31, 2008. This inflow represented an *increase* in deposits of 7.4 percent.

economy. The cost of such a constraining liquidity regime will be reduced availability of financial resources and an economy that structurally underperforms its true potential.

a. High Quality Liquid Assets

We have significant concerns with the Proposal's limited definition of what may comprise HQLA. Under the proposed rules, there are three tiers of assets eligible as HQLA, with U.S. Treasuries and balances held at the Federal Reserve considered the most liquid, or Level 1. Other securities are eligible as HQLA through Levels 2A and 2B, although in limited amounts and with haircuts of 15 percent and 50 percent, respectively. These include securities issued by Government Sponsored Enterprises (GSEs)[6] and certain high quality corporate debt.

ABA believes that such a narrow definition of HQLA, among other things, fails to recognize the important and valuable depth and breadth of U.S. financial markets, and will create significant market distortions. Specifically, the narrow definition of HQLA would cause all Covered Companies to seek the same sources of HQLA. We expect an increase in the likelihood of highly correlated "herd" behavior – especially in times of overall system stress. It is easy to envision a liquidity crisis prompted by a narrow definition of HQLA. Further, discouraging bank investment in debt securities other than Treasuries would decrease liquidity in disfavored markets, such as those for municipal securities, corporate debt and secondary mortgages, among others. Lastly, we strongly encourage the Agencies to provide a mechanism to recognize the dynamism of U.S. markets by allowing for future asset classes to be available for liquidity management.

Steps the Agencies could take to cause less market distortions include:

- **Treat GSE Securities as Level 1 HQLA:** The market for GSE securities is among the deepest and most liquid in the world and demonstrably meets the criteria required for Level 1 Assets. The Agencies stated in previous guidance:

  > It is the intention of the agencies for institutions to maintain a buffer of liquid assets that are of such high quality that they can be easily and immediately converted into cash. Additionally, these assets should have little or no loss in value when converted into cash. In addition to the example used in the policy statement, other examples of high-quality liquid assets may include government guaranteed debt, excess reserves at the Federal Reserve, and securities issued **by U.S. government sponsored agencies**. [Emphasis added][7]

  The Agencies should explain any change from currently applicable guidance the industry upon which the industry relies. Additionally, the exclusion of GSE securities from Level 1 has broader implications for the U.S. economy. Discouraging bank investment in mortgage backed securities issued by GSEs,

[6] GSEs include the Federal Home Loan Mortgage Corporation (FHLMC), The Federal National Mortgage Association (FNMA) and the Federal Home Loan Bank System.
[7] Interagency Policy Statement on Funding and Liquidity Risk Management (2010)

which support the U.S. housing market, will make mortgages less liquid and more costly for borrowers.

- **Expand the Definition of HQLA to Include—**

  Cash: The Proposal does not recognize "cash" outside of excess reserves held at the Federal Reserve, thereby excluding vault cash at depository institutions and all cash at broker-dealers. This is an overly restrictive approach which significantly underestimates an institution's available liquidity. Vault cash is held primarily to meet the day-to-day cash demands of customers and is a fundamental feature of daily bank liquidity management.

  Municipal Securities: The deep, liquid markets for obligations of U.S. municipalities strongly support their inclusion as HQLA. Additionally, banks are key investors in this market; discouraging bank investment in municipal securities will make funding for state and local entities more difficult and increase funding costs for municipal issuers, causing unnecessary harm to financial instruments with a high performing liquidity record.

- **Exclude Collateralized Deposits from the LCR Calculation**. The current classification of collateralized deposits as "secured funding" creates significant distortions, which arise from the requirement to unwind secured funding transactions for purposes of determining a bank's level of HQLA. While unwinding certain transactions, such as repurchase agreements, to ensure an institution has a viable portfolio of HQLA to use in times of stress makes sense, it is not appropriate for municipal or other collateralized deposits which, as discussed below, are stable, relationship-based deposits.[8]

b. Outflows

Outflows should be properly and accurately calibrated to reflect both a bank's real liquidity position and the U.S. historical behavior of various funding mechanisms during times of stress. We note that the LCR requires banks to maintain at all times liquidity sufficient to withstand an assumed stress scenario; the more *unrealistic* the stress scenario is, the more excess liquidity will be trapped in the system as a whole, at all times, employed in a less than optimal manner for the economy. The cost of maintaining unnecessary liquidity will be borne directly by bank customers in the form of reduced access to liquid instruments, credit, and other financial services because of banks' need to maintain unnecessary levels of HQLA. We understand the intent of the LCR is to re-price liquidity, however, the Agencies need to base achievement of this goal on realistic and informed assumptions in order to avoid the very real potential to inflict unnecessary harm on bank customers.

[8]In addition to state and local deposits, certain trust and custody deposits are also required by law to be collateralized.

Below are steps we urge the Agencies take to achieve a more balanced and realistic approach:[9]

- **Expand the Definition of Operational Services.** ABA appreciates that the Agencies recognize deposits held in connection with the provision of operational products and services as stable. The Proposal unnecessarily excludes a wide range of deposits that are, in fact, "operational." We urge the Agencies to expand the definition of "operational services" and "operational deposits" to include fundamental banking services such as correspondent banking and corporate trust.[10]

- **Limit the Definition of "Secured Funding" to Repurchase Agreements.** Grouping collateralized deposits with repurchase agreements creates unnecessary complexity and distortions, with respect to both the collateral (as noted above) and the rates at which the deposits are assumed to run-off. The Proposal provides that deposits backed by securities eligible as collateral under the state laws which govern the deposits, but not considered HQLA, are given a 100 percent run-off rate, which is completely at odds with experience. Moreover, there is some confusion within the industry regarding the Proposal's treatment of deposits secured by FHLB letters of credit, which can be read as either a 40 percent or 100 percent run-off rate. Neither of those fits the historical behavior of these deposits.

  Deposits are collateralized *not* so that banks can hold the collateral, but to satisfy the many requirements secured depositors face under applicable law. Treating those deposits based on the nature of the collateral supporting them, turns on its head the depositor relationship. Instead, the Agencies should treat collateralized deposits as deposits, taking into consideration the historical behavior of the depositor.

  The best and most correct formulation would be to exclude these deposits, as recommended above. A decidedly second-best alternative—but an improvement over the Proposal, would be to (1) exclude these deposits from the collateral unwind, (2) net the fair value of the collateral banks hold against these deposits, and (3) apply a consistent, counterparty specific run-off rate to any remaining balance (e.g. if a bank has $100 in municipal deposits backed by $95 in Agency MBS, a 15 percent run off rate would apply only to the $5 that remains after netting).

c. Other Concerns

Daily Reporting. ABA is concerned about the requirement to calculate the LCR on a daily basis. Given existing systems capabilities it will be operationally challenging to provide daily observations. Significant information technology resources will be required to make daily calculations possible, and we believe that the objectives of the LCR can be met with monthly calculations. Therefore, we strongly urge the agencies to require monthly calculations, with daily reporting only as needed, through the supervisory process.

[9] See the Joint Trade letter, which addresses concerns regarding the outflow treatments of other important products and funding instruments such as brokered deposits, affiliated retail sweeps, and derivatives.
[10] For discussions on corporate trust and correspondent banking under the proposal, please see the Joint Letter and the letter submitted by ABA's Corporate Trust Committee, respectively.

"Peak day" approach.[11] The Proposal's peak day approach is not currently practical. Among other things, the Proposal would require banks to assume that all demand deposits run-off on the first day of the stress. Given the rolling nature of the calculation, this essentially means that banks are holding liquidity against the false assumption that the vast majority of demand deposits—and three percent of all retail deposits—run from the largest U.S. institutions on a daily basis. Not only is this logistically impossible, but it belies the historical pattern in which deposits flow into these institutions and the U.S. banking system generally during times of stress. Accordingly, we urge the Agencies to withdraw the Proposal's peak day approach in any initial adoption of an LCR.

Modified LCR. ABA appreciates the Federal Reserve's recognition that not all institutions face the same liquidity risks. We urge the Federal Reserve to articulate the justification for applying the LCR to institutions covered by the modified LCR, particularly in light of other efforts to monitor and strengthen liquidity management, including Section 165 of the Dodd-Frank Act and the recently finalized FR 2052 reporting regime. Further, we note that the vast majority of institutions have never gathered data nor calculated their LCRs on an official basis, and, as such, do not currently have the necessary systems in place to do so. The Proposal's compliance timeframe is unrealistically short to allow these institutions to develop the necessary systems, which might be at least physically possible (if unreasonable) were full compliance not to be required until 2017.

Additionally, the proposal to comply with the LCR on a 21-day basis poses significant operational problems and would make Covered Companies' LCRs extremely volatile. We do not understand the logic or reasoning behind the selection of the 21-day time frame. Currently, customer activity is rooted in a calendar-month cycle, leading banking organizations also to manage maturities and refinancing on a calendar month basis. For example, banking organizations can accurately estimate the time of the month when large volumes of customer payments will be received and can time debt maturities based on that monthly time frame. The 21-day forward-looking stress period required under the Modified LCR would consistently omit key recurring payment activity that occurs on the calendar-month cycle and force banking organizations to manage cash flow in an abnormal manner to mitigate volatility in their ratio.

Accordingly, the Agencies should revise the proposed 21-day stress period under any Modified LCR to a calendar-month cycle. Under this approach the Modified LCR would be calculated using the Federal Reserve's proposed outflow assumptions (based on 70% of the proposed outflow rates under the full LCR) over the course of a calendar-month projection period. Modifying the projection period in this way would better align a Modified LCR with customer payment practices and established internal liquidity management and financial reporting cycles.

III. Conclusion

Overall, we do not believe the Proposal is properly calibrated to either U.S. markets or the liquidity risks bank face. An approach that is overly restrictive and not backed by data to support

[11] § 30 of the Proposal, "The largest difference between cumulative net outflows and cumulative inflows, as calculated for each of the next 30-calander days after the calculation date."

the assumptions and policy decisions will have significant unintended consequences for banks, their customers, and the US economy.

We urge the Agencies to take a more balanced, holistic, approach as they finalize the LCR and be mindful of the significant potential for unintended, adverse impacts. This includes consideration of the impact on the industry generally, not just the banks to which this rule will directly and immediately apply.

If you have any questions about the foregoing, please do not hesitate to contact the undersigned or Alison Touhey at atouhey@aba.com or (202) 663-5182.

Sincerely,

Cecelia A. Calaby
Senior Vice President