MEMORANDUM

TO: Public File - Notice of Public Rulemaking: Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring, (RIN 3064-AE04) ("Liquidity Coverage Ratio NPR")

FROM: Sue Dawley, Senior Attorney, Legal Division

DATE: February 20, 2014

SUBJECT: Meeting with Representatives from Capital One Financial Corporation, Comerica Bank, Fifth Third Bancorp, Huntington National Bank, KeyCorp, M&T Bank Corporation, PNC Financial Services Group, Inc., RBS Citizens Financial Group, TD Bank U.S. Holding Company, and U.S. Bancorp ("Regional Bank Group")

On February 10, 2014, FDIC staff, together with staff of the Board of Governors of the Federal Reserve System and the Office of the Comptroller of the Currency, met with representatives of the Regional Bank Group.

Representatives of the Regional Bank Group presented their concerns and views with regard to certain provisions of the Liquidity Coverage Ratio NPR, which was issued in the Federal Register of November 29, 2013 (78 FR 71818), including (1) daily calculation requirements, (2) the 21-day calculation period for modified LCR, (3) the threshold for modified LCR, (4) the treatment of public funds and collateralized deposits, (5) the treatment of government sponsored enterprise ("GSE") obligations, (6) operational deposits, and (7) the criteria for high quality liquid assets.

The FDIC representatives at this meeting were:

- Kyle Hadley, Section Chief for Examination Support, Capital Markets/RMS
- Eric Schatten, Policy Analyst, Capital Markets/RMS
- Greg Feder, Counsel, Legal Division
- Sue Dawley, Senior Attorney, Legal Division

The Regional Bank Group's representatives in attendance at this meeting were:

- Stephen Linehan, Executive Vice President and Treasurer, Capital One Financial Corporation
- John Barrow Rayburn, Director, Assistant General Counsel, Capital One Financial Corporation
- Jim J. Herzog II, Executive Vice President of Finance and Treasurer, Comerica Bank
- James C. Leonard, Treasurer, Fifth Third Bancorp
- Anthony M. Kuhns, Vice President, Senior Treasury Manager, Fifth Third Bancorp
- Michael C. Smith, Executive Vice President and Treasurer, Huntington National Bank

- Joseph M. Vayda, Corporate Treasurer, KeyCorp
- D. Scott Warman, Executive Vice President and Treasurer, M&T Bank Corporation
- Randall C. King, Executive Vice President, Head of Liability and Capital Management, The PNC Financial Services Group, Inc.
- Kieran J. Fallon, Senior Deputy General Counsel, The PNC Financial Services Group, Inc.
- Thomas H. Loeffler, Executive Vice President, Head of Funding & Liquidity, RBS Citizens Financial Group
- Scott G. Ferguson, Senior Vice President and Treasurer, TD Bank US Holding Company
- John C. Stern, Executive Vice President and Treasurer, U.S. Bancorp

Materials provided by the Regional Bank Group are attached.

Regional Bank Group
Liquidity Coverage Ratio

February 10, 2014

Meeting Objectives

- We appreciate the opportunity to meet in person to discuss the proposed Liquidity Coverage Ratio ("LCR") rules (the "Proposal") issued by the Board of Governors of the Federal Reserve System (the "Board"), the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency (collectively, the "Agencies")
- We support the fundamental objective of promoting liquidity risk resilience of banks, but certain aspects of the Proposal are inconsistent with this goal
- Our focus today is to provide perspectives on where aspects of the Proposal are particularly problematic and to provide alternative approaches that achieve regulatory objectives while helping avoid unintended and adverse consequences to the financial system
- Our regional bank group, as well as many of our regional banks, submitted more comprehensive comment letters on the Proposal
- This presentation highlights some of the key issues discussed in the regional bank group letter, and we would be happy to discuss any of the comments provided in that letter

Agenda – LCR Proposal

Daily Calculation Requirements

Adjustment to Outflow Window

Threshold for Modified LCR

Treatment of Public Funds and Other Collateralized Deposits

Treatment of GSE Obligations

Operational Deposits

Criteria for HQLA

Daily Calculation Requirements

- **Daily reporting is not necessary for regional banks given that our organizations:**
  - Are not reliant on potentially volatile short-term wholesale funding (see comment letter, pages 4-5); and
  - Have more stable and predictable liquidity inflows and outflows.
- **The Board has previously acknowledged these distinctions:**
  - Regional banks are not currently subject to the 4G daily liquidity reporting requirements
  - Under the Board's proposed complex liquidity monitoring report (FR 2052A), only G-SIBs would be subject to the daily liquidity monitoring reports
- **Moreover, daily calculation of the LCR and Modified LCR ratio, including determinations of peak outflows, is particularly problematic and burdensome for regional banks, especially in light of the short implementation time frame (Jan. 1, 2015) the Agencies have proposed**
  - Determining operational deposits, daily cash flow forecasts, and peak outflows requires obtaining individual customer account data from all systems and projecting cash flows based on transactions
  - Regional banks are not subject to the current 4G daily liquidity monitoring report, so have not previously been required to build systems capable of supporting a daily calculation of this type
  - The agencies' estimated 2,400 start up hours required to implement the rule significantly understates the burden given its scope and complexity
- **Whether a daily or monthly calculation is required, requirements to build the functionality and to report should be delayed**
  - The Basel Committee's recent release on LCR disclosure standards allow for flexibility to delay daily observations until 2017 to "ease implementation burdens"

Request: Limit the daily calculation requirement to those organizations subject to the Federal Reserve's daily liquidity reporting requirements, and require all other institutions to calculate the ratio on a monthly basis; in addition, delay any reporting requirements to 2017 and, at a minimum, no less than one year after the final rule is published

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Adjustment to Outflow Window

- **We support the use of cumulative net outflows over the period, rather than peak net cumulative cash outflows, and we support the 30% haircut to run-off factors in the Modified LCR**
- **We appreciate the intent of the agencies to lessen the burden in recognition of the more stable liquidity risk profiles and reduced complexity of regional banks**
- **However, the Modified LCR's 21-day approach makes the calculation and management of the LCR more challenging because most bank customers' activity is rooted in a monthly cycle**
- **Given that customer activity is rooted in a calendar-month cycle, banks manage maturities and refinancing with a monthly view in mind**
  - For example, banks can accurately estimate the time of the month when a large number of customer payments will be received and can time debt maturities based on that monthly timeframe
  - The 21-day look-forward will consistently omit key recurring activity that occurs during the monthly cycle and force banks to manage cashflow in an unnatural way to mitigate artificial volatility in their LCR ratio
- **Extending the number of forward-looking days and making the calculation based on a calendar month cycle would better align the rules with internal liquidity management and financial reporting cycles, would decrease the complexity of the modified calculation and increase the comparability of the base calculation between modified LCR and full LCR firms**

Request: Calculate the Modified LCR by taking 70% of the net cumulative cash outflow determined using a calendar-month cycle for the LCR calculation, in order to better reflect the monthly nature of many bank cash flow patterns (full LCR calculations should also use a calendar month projection period)

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Threshold for Modified LCR

- **It is important to take the significant differences between our regional banks and larger, more complex organizations into account when considering prudential reforms like the LCR**
- **The Basel III LCR was developed for "internationally active" banking organizations that have complex funding sources and structures – however, in capturing some regional banks by the proposed threshold at which the "full" LCR would apply, the Proposal fails to recognize key differences between regional banks and larger, more complex, and internationally active banks**
  - We appreciate that the Proposal specifically recognizes that the Modified LCR is more appropriate for banking organizations that are less complex in structure; less reliant on riskier forms of market funding; have simpler balance sheets; have liquidity risks easier for management and supervisors to monitor and address; and would not have as great a systemic impact as larger, more complex banking organizations if they experienced liquidity stress
  - All regional banks meet these criteria: Regional banks are not internationally active, have simpler and less volatile funding profiles and present less risk to financial stability, and thus, are more appropriately covered by the Modified LCR than the full LCR (see comment letter, pages 29-30 (appendix 1))
  - However, some regional banks are caught by the proposed cut-off for the full LCR
- **The "full" LCR requirement to calculate the LCR at depository institution subsidiaries is unnecessary for regional banks**
  - The relatively simple, bank-centric structure of regional banks makes any requirement to calculate the LCR at depository institution subsidiaries unnecessary
  - This is consistent with the fact that the vast majority of regional bank assets are held at our depository institution subsidiaries

Request: Harmonize the "full" LCR requirements with the thresholds used for the complex institution liquidity monitoring report, so that only G-SIBs would be subject to the "full" LCR

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Public Funds and Other Collateralized Deposits (1 of 2)

- **The Proposal would have a dramatic punitive effect on banks that serve the public funds market and other deposit customers who require collateralization**
- **The proposed rule would treat secured public deposits and other collateralized deposits similarly to secured financing transactions, such as repos, and subject them to the adjusted HQLA unwind requirements – this requirement can result in significant negative impacts when such deposits are collateralized with Level 2 assets (see comment letter, page 31 (appendix 2) and slide 24)**
- **Public fund and other collateralized deposits are not susceptible to the type of short-term gaming the Agencies seek to address through the unwind requirements**
  - Public fund deposits generally are placed with banks through a Request for Proposal process, and are established in connection with other services the public sector seeks to obtain from the bank (e.g., treasury management services)
  - Similarly, other collateralized deposits generally are established in connection with other traditional banking services (e.g., treasury management and corporate trust services)
  - These processes and combination of services create very sticky customer relationships
- **The LCR will significantly reduce banks' willingness to take public fund and other collateralized deposits, which would require municipalities and other public depositors to seek alternatives; small banks may not be able to fill the void**
  - Small banks may not have the balance sheet room to absorb large amounts of these deposits
  - Municipal policies may prevent or limit placement in small banks
  - Corporate trust services may become significantly more expensive or unavailable

Request: Exempt public fund and other collateralized deposits from the adjusted HQLA requirement

Public Funds and Other Collateralized Deposits (2 of 2)

- **State law restricts the manner of collateral acceptable to secure deposits of public funds, and banks generally pledge GSE securities or FHLB letters of credit ("LCs") as collateral**

- **The outflow assumptions for public funds deposits do not properly reflect public depositors' behavior**
  - The proposed outflow assumptions for public fund deposits is 15% for deposits backed with GSE obligations, but the outflow amount for deposits backed with FHLB LCs is unclear

- **Data shows that, even during times of economic stress, public deposits remain stable**
  - The aggregate peak 90-day outflow rate of public fund deposits observed at NCC, WAMU, and WB, institutions that experienced extreme stress and were acquired during the recent crisis, was approximately 15.9% during the financial crisis
  - The type of high-quality collateral pledged also is not likely to affect the behavior of public fund deposits, especially given that GSE obligations and FHLB LCs both represent claims backed by a GSE

Request: Revise the outflow rates applicable to all collateralized public funds so that the required monthly outflow rate is no higher than 15%, a figure that more accurately reflects the observed behavior of public sector depositors during times of severe economic stress

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Treatment of GSE Obligations (1 of 2)

- **GSE obligations, one of the most liquid debt markets in the world and the primary tool for U.S. bank liquidity, should not have a hard cap (see slide 25)**
- **While the Agencies acknowledge that securities issued and guaranteed by the U.S. GSEs consistently trade in very large volumes and generally have been highly liquid, including during times of stress, the Proposal imposes a punitive hard cap of 40% on these securities**
  - We recognize that liquidity stockpiles should be diversified, but the Proposal likely would result in more concentrated stockpiles, which will create greater risks in stressed environments
  - By virtue of the cap, the next dollar of GSE obligations after 40% is considered worthless in terms of liquidity value
  - The hard cap on GSE obligations as Level 2A assets is inconsistent with their high liquidity value and with the Dodd-Frank Section 165 Proposal, which classifies these securities as fully liquid
- **We support the recommendation that GSE obligations be classified as Level 1 while the GSEs are in conservatorship**
- **We recommend modifying the structure of the 40% cap on Level 2A securities such that the treatment more closely mirrors observed liquidity during times of stress**
  - We would propose that GSE obligations be included in HQLA in excess of 40%, but with an additional haircut in addition to the proposed 15% haircut for GSE obligations in excess of 40%
  - A graduated cap system would allow for the inclusion of GSE obligations up to 80% but at an additional haircut, preventing satisfaction of the HQLA requirement solely from Level 2A GSE obligations and ensuring asset diversification

Request: Incorporate a graduated cap system into the cap on Level 2A securities (see next page for example)

A graduated cap would recognize the liquidity value of GSE obligations and permit greater diversification in liquidity management tools (2 of 2)

Haircut Percentage based on GSE % of HQLA - Example		
GSE % of HQLA	Additional Haircut	Total Haircut
Greater than 40% - less than 50%	5%	20%
50% - less than 60%	25%	40%
60% - less than 70%	45%	60%
70% - less than 80%	65%	80%
80% - 100%	85%	100%

- **A graduated cap system would allow for the inclusion of GSE obligations beyond 40%, but at an additional haircut up to a maximum of 80% HQLA, preventing satisfaction of the HQLA requirement solely from Level 2A GSE obligations**

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- **We agree with the objectives regarding operational deposits discussed in the preamble, but believe several criteria in the Proposal are ambiguous, duplicative, or unnecessary; are inconsistent with how operational deposits function; and would not further the purposes of the LCR**
  - The Proposal's treatment of operational deposits may cause the vast majority of operational deposits to not qualify for the Proposal's outflow assumptions for operational deposits

Description	Request
Criteria 1: The deposit must be subject to a minimum 30-calendar-day notice period or significant termination costs	Requirement should be clarified. Termination should relate to the agreement for operational services, not the deposit account agreement. Switching costs should include not just termination costs under the agreement (if any), but also other costs to the customer, incurred internally or otherwise, including costs related to IT and other operational changes and/or expenses related to moving operational services.
Criteria 2: There must not be significant volatility in the average balance of the deposits	Requirement should be removed. Could disqualify deposits based on normal variations in balances attributable to the nature of operational services. Changes in operational deposit balances not related to the underlying operational services should be addressed by the requirement that "excess deposits" be excluded, making this requirement unnecessary.
Criteria 5: The deposit account must not be designed to create an economic incentive for the customer to maintain excess funds therein through increased revenue, reduction in fees, or other offered economic incentives	Requirement should be removed. Concerns that changes in operational balances are not related to the underlying operational services would already be addressed by the requirement to exclude "excess deposits." In the alternative, the rule should be revised to make clear that an earnings credit rate or "ECR" is not a type of incentive that is intended to be prohibited. Clients offset operational services expenses through an "earnings credit rate", or "ECR." This helps clients offset operational services fees, strengthens customer relationships, and reduces attrition.
Criteria 6: The bank must demonstrate the deposit is empirically linked to operational services and it has a methodology for identifying any excess amount, which must be excluded from the operational deposit amount	Confirm in the final rule that the empirical assessment of excess operational deposits may be applied on a portfolio basis, rather than on a deposit-by-deposit or customer-by-customer basis. Too granular a focus would have material practical implications both on banks and supervisors.

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- **While Treasuries are Level 1 with no stipulations, other U.S. government guaranteed obligations (e.g., GNMAs) and GSE obligations are considered HQLA only if the bank can demonstrate that they are "liquid and readily-marketable". This means that the bank must demonstrate that the instruments are traded in an active secondary market with (i) more than two commercial market makers; (ii) a large number of non-market maker participants on the buying and selling side; (iii) timely and observable market prices; and (iv) a high trading volume**

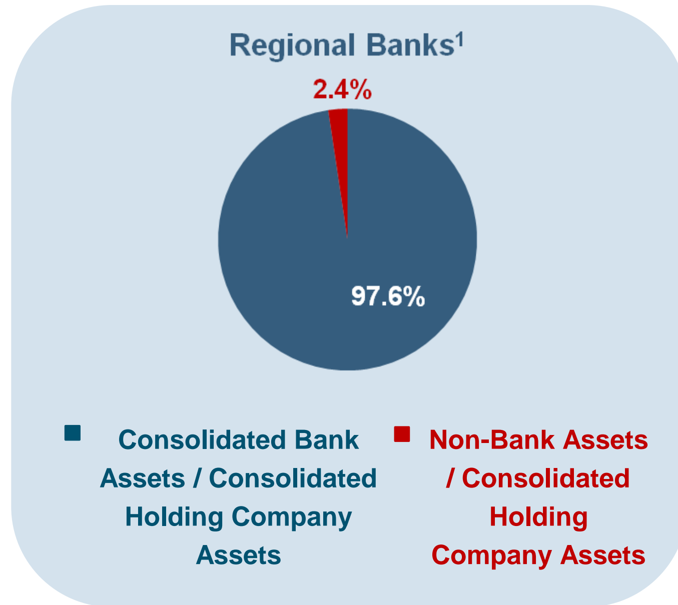
- **We believe these additional requirements are unnecessary for U.S. agency obligations and GSE obligations**
  - Agency obligations—like Treasuries—are backed by the full faith and credit of the United States
  - The GSEs receive capital support from the U.S. Treasury under the terms of the Preferred Stock Purchase Agreement
  - Both types of instruments have proven liquidity records and benefit from the same "flight to quality" characteristics as Treasuries

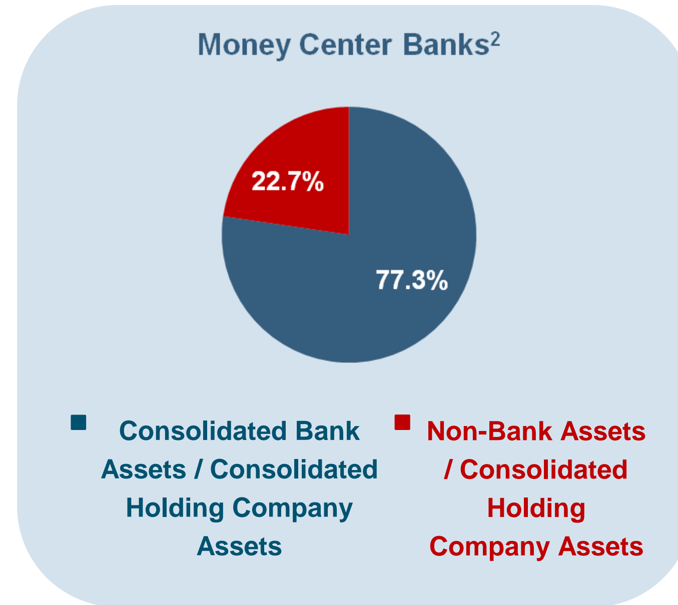
- **Agency-guaranteed debt and GSE obligations clearly exhibit the liquidity characteristics that make them eligible for as HQLA, without requiring banks to separately demonstrate that they are "liquid and readily-marketable"**

Request: Remove the requirement that banks demonstrate that U.S. agency guaranteed debt and GSE obligations are "liquid and readily-marketable"

Appendix

Virtually all the assets of regional banks are held by their depository institution subsidiaries





Source: SNL

[1]Regional Banks include: USB, COF, PNC, BBT, STI, FITB, RF, KEY, MTB, CMA, HBAN, TD, BBVA, Citizens (the bank vs. non-bank split for BBVA, TD, and Citizens is derived from their U.S. bank holding companies)

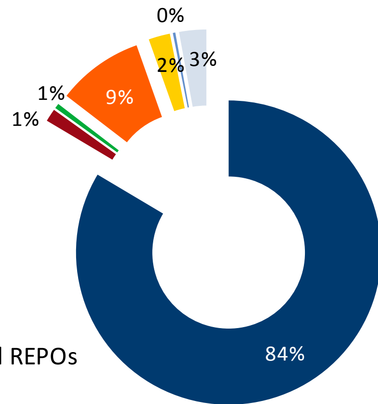
[2] Money Center Banks include: JPM, BAC, C, and WFC

Q4 2012

Regional banks fund principally through deposits and focus on traditional lending

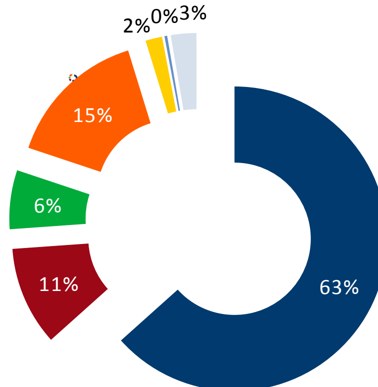
3Q 2013 Funding Liabilities

Regional Banks



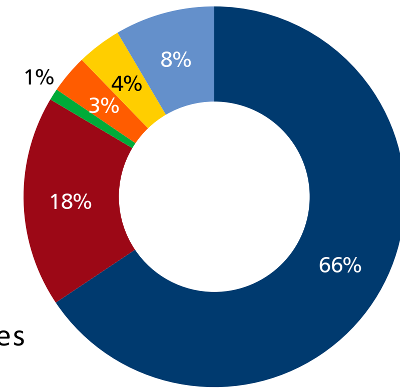
- Core Deposits
- Fed Funds Purchased and REPOs
- Trading Liabilities
- Other Borrowed Money (Incl. Mortgage / Lease Debt)
- Sub Debt
- Trust Preferreds
- Brokered Deposits

Big 4



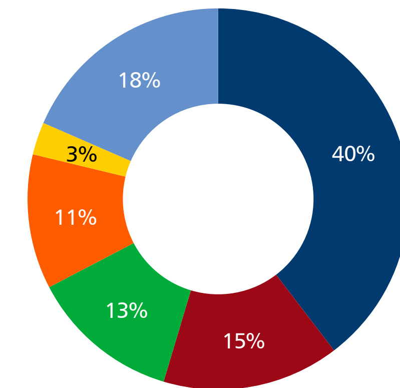
3Q 2013 Total Assets

Regional Banks



- Net Loans and Leases
- Securities
- Trading Assets
- Cash and Due
- Intangibles
- Other Assets

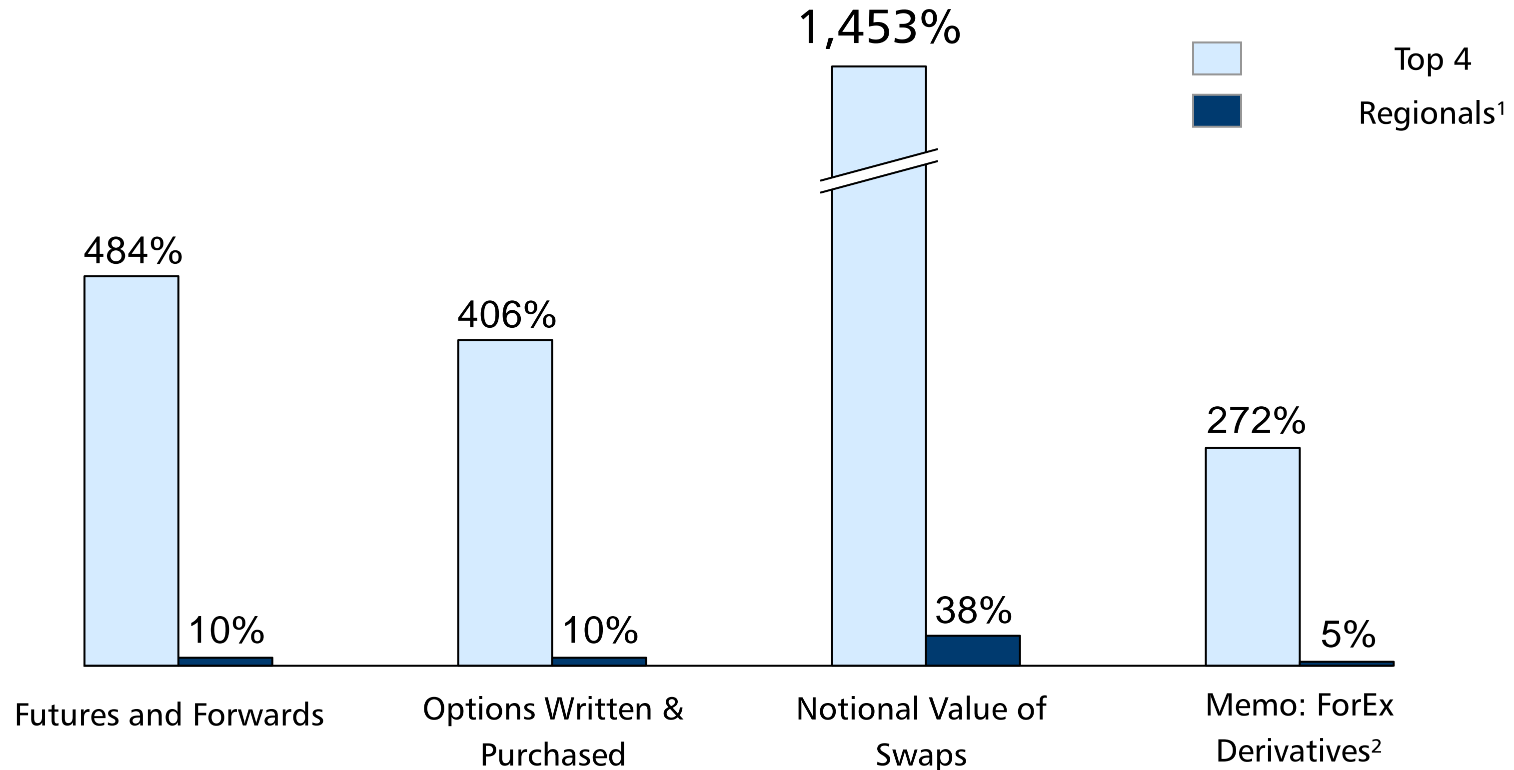
Big 4



Source: SNL Financial, Regulatory Data; weight-averaged by assets

Notes: Big 4 banks include JPM, BofA, Citi, Wells Fargo; Regional Banks include US Bank, PNC, SunTrust, BB&T, Regions, Fifth Third, Key, M&T.; Consumer Deposits includes NOW and Other Transactional accounts, MMDA and Other Savings, Retail Time, Jumbo Time, Non Interest Bearing, and Deposits in Foreign Offices.

Regional banks have limited off-balance sheet derivatives

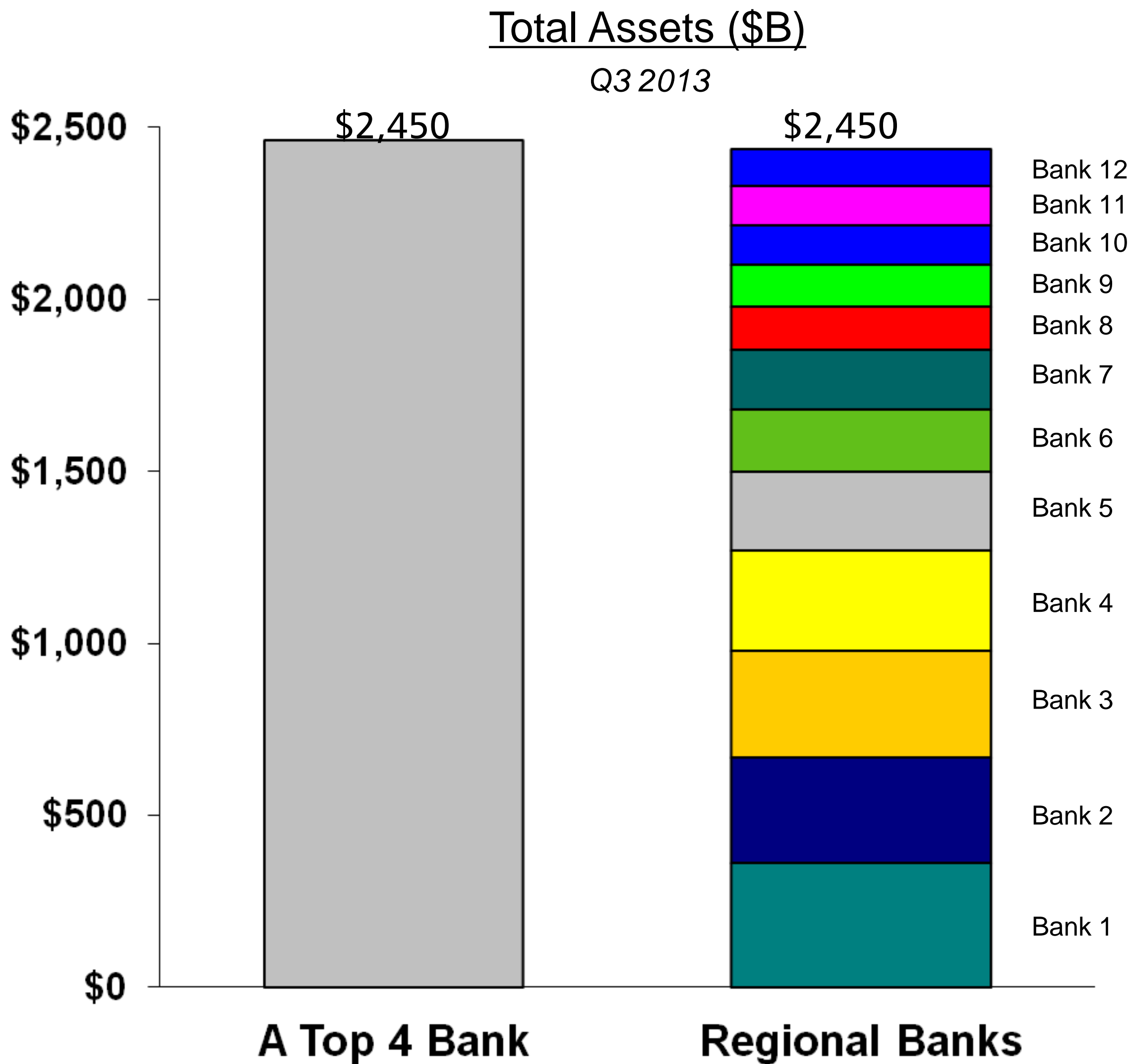


Source: SNL Financial, Regulatory Data; weight-averaged by assets

1) Capital One, US Bank, PNC, Regions, SunTrust, Fifth-Third, BBVA, BB&T, Comerica, Citizens, Key, Huntington, M&T, TD

2) Sum of ForEx Futures, Forwards, Options Written, Options Purchased and Notional Swaps

It would take many regional banks to reach the size of the largest U.S. bank



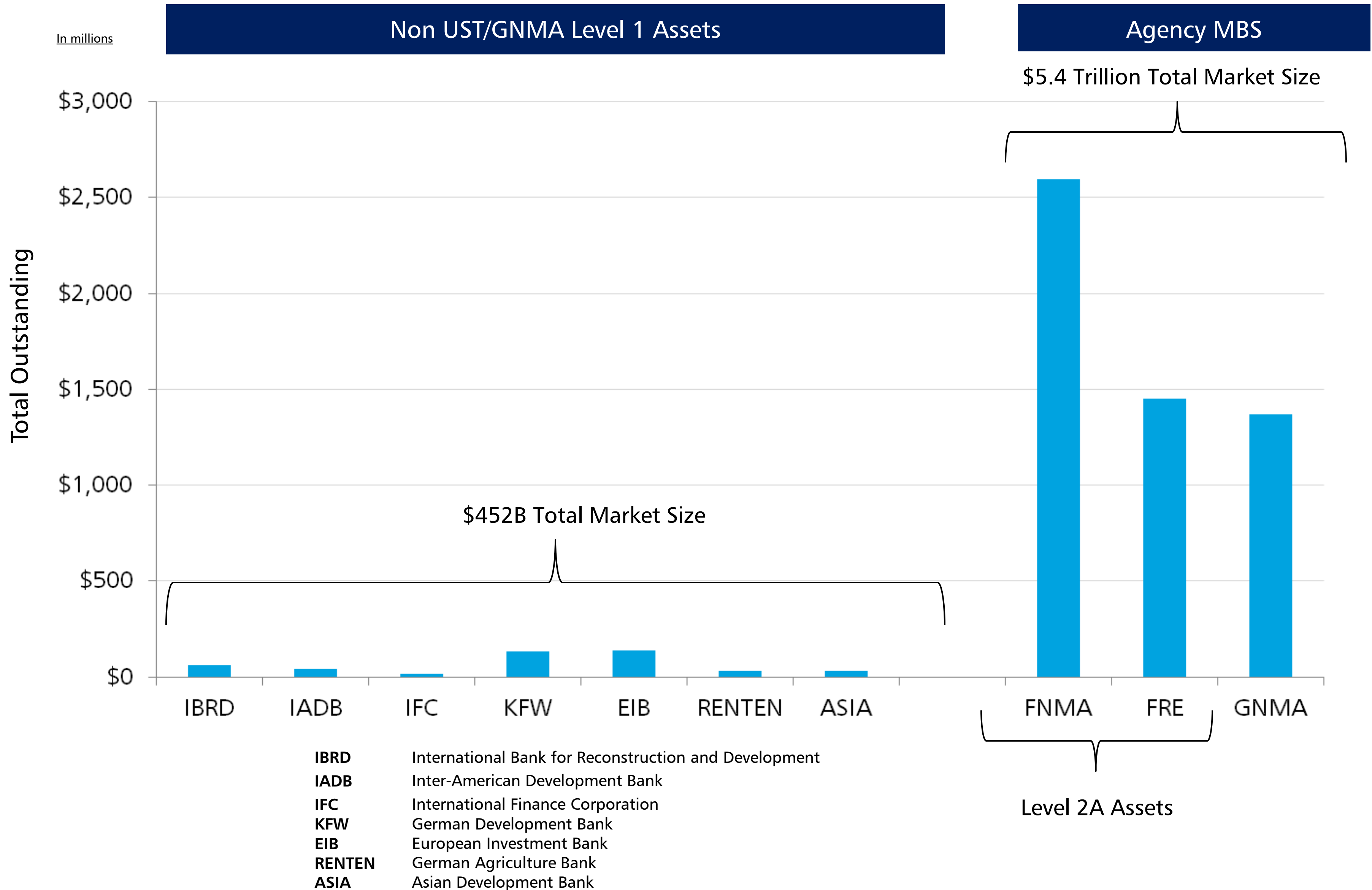
Source: SNL

Collateralized deposit requirements can result in a negative LCR making the business unattractive

- An institution with $10B in non-determinant public fund deposits secured by $11B of Level 2A assets would experience a negative liquidity effect from the public fund deposits

Public Fund's Effect on Liquidity		
Assumptions	Calculation	Result ($B)
Unencumbered Level 1 Assets (a)	-	8
Unencumbered Level 2 Assets (b)	-	10
Unencumbered Level 2B Assets (c)	-	0
Level 1 Liquid Asset Amount (d)	a	8
Level 2 Liquid Asset Amount (e)	b * .85	8.5
Level 2b Liquid Asset Amount (f)	c * .5	0
Secured Funding Position is Unwound		
Adjusted Level 1 Liquid Asset Amount (g)	d - 10	-2
Adjusted Level 2 Liquid Asset Amount (h)	e + ($11B * .85)	17.85
Adjusted Level 2b Liquid Asset Amount (i)	f	0
Unadjusted Excess HQLA Calculation		
Level 2 Cap Excess Amount (j)	MAX (e + f -.6667*d, 0)	3.1664
Level 2b Cap Excess Amount (k)	MAX (f – j - .1765 * (d + e), 0)	0
Unadjusted Excess HQLA Amount (l)	j + k	3.1664
Adjusted Excess HQLA Calculation		
Adjusted Level 2 Cap Excess Amount (m)	MAX (h + i - .6667 * g, 0)	19.1834
Adjusted Level 2b Cap Excess Amount (n)	MAX (i – m - .1765 * (g + h), 0)	0
Adjusted Excess HQLA Amount (o)	m + n	19.1834
Calculation of HQLA Amount	**d + e + f – MAX (l, o)**	**-2.6834**

The 40% cap on GSE obligations incents U.S. banks to invest in less liquid bonds used for foreign infrastructure, instead of more liquid bonds used to provide affordable housing in the United States



IBRD	International Bank for Reconstruction and Development
IADB	Inter-American Development Bank
IFC	International Finance Corporation
KFW	German Development Bank
EIB	European Investment Bank
RENTEN	German Agriculture Bank
ASIA	Asian Development Bank