

# COMMITTEE ON CAPITAL MARKETS REGULATION

June 11, 2014

Mr. Robert de V. Frierson, Secretary  
Attention: Docket No. R-1460; RIN 7100-AD99  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, NW  
Washington, DC 20551

Mr. Robert E. Feldman, Executive Secretary  
Attention: RIN 3064-AE01  
Federal Deposit Insurance Corporation  
550 17<sup>th</sup> Street, NW  
Washington, DC 20429

Legislative and Regulatory Activities Division  
Attention: Docket ID OCC-2013-0008; RIN 1557-AD69  
Office of the Comptroller of the Currency  
400 7<sup>th</sup> Street SW, Suite 3E-218  
Mail Stop 9W-11  
Washington, DC 20219

VIA ELECTRONIC MAIL: [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov); [comments@fdic.gov](mailto:comments@fdic.gov);  
[regs.comments@occ.treas.gov](mailto:regs.comments@occ.treas.gov)

Re: Regulatory Capital Rules: Regulatory Capital, Proposed Revisions to the Supplementary Leverage Ratio (the “**Proposed Rule**”)

Dear Sir or Madam:

The Committee on Capital Markets Regulation (the “**Committee**”) is grateful for the opportunity to comment on the Proposed Rule, released jointly by the Board of Governors of the Federal Reserve System (the “**Board**”), the Federal Deposit Insurance Corporation (the “**FDIC**”), and the Office of the Comptroller of the Currency (the “**OCC**,” and together with the Board and the FDIC, the “**Agencies**”).

Founded in 2006, the Committee is dedicated to enhancing the competitiveness of U.S. capital markets and ensuring the stability of the U.S. financial system. Our membership includes thirty-five leaders drawn from the finance, investment, business, law, accounting, and academic communities. The Committee is chaired jointly by R. Glenn Hubbard (Dean, Columbia Business School) and John L. Thornton (Chairman, The Brookings Institution) and directed by Hal S. Scott (Nomura Professor and Director of the Program on International Financial Systems, Harvard Law School). The Committee is an independent and nonpartisan 501(c)(3) research organization, financed by contributions from individuals, foundations, and corporations.

The recently adopted U.S. enhanced supplementary leverage ratio requires the eight U.S. bank holding companies that have been designated as “global systemically important banks” by

the Financial Stability Board to hold a 2% buffer above the minimum supplementary leverage ratio of 3%, for a total of 5% tier-1 capital against their total leverage exposure and requires their insured depository institution subsidiaries to hold 6% tier-1 capital (“**covered U.S. banking organizations**”).<sup>1</sup> The enhanced supplementary leverage ratio significantly exceeds the internationally agreed requirements of the Basel Committee on Banking Supervision’s (“**Basel Committee**”) leverage ratio framework, which establishes a minimum leverage requirement of 3% tier-1 capital to total leverage exposure.<sup>2</sup>

The Proposed Rule would revise the definition of total leverage exposure in the U.S. supplementary leverage ratio.<sup>3</sup> It would incorporate in total leverage exposure the effective notional principal amount of sold credit derivatives (with some hedge recognition), modify the calculation of total leverage exposure for repo-style transactions and certain derivatives, and revise the credit conversion factors applied to certain off-balance sheet exposures.<sup>4</sup>

While the Committee welcomes the changes, which are consistent with recent Basel Committee revisions to the Basel III definition of total leverage exposure,<sup>5</sup> the higher 5% U.S. enhanced supplementary leverage ratio applicable to covered U.S. banking organizations continues to require substantially more tier-1 capital to be held against total leverage exposure than would be required by the 3% Basel III leverage ratio. Indeed, the Federal Reserve notes that the U.S. supplementary leverage ratio would be the binding constraint on most covered U.S. banking organizations.<sup>6</sup>

The Committee believes that the U.S. supplementary leverage ratio should act solely as a backstop to the Basel III minimum risk-weighted capital requirements, which should be the binding constraint. A binding leverage ratio would impose the same regulatory capital requirement for both high- and low-risk assets, and would therefore incentivize management to increase return on equity by abandoning lower-margin business lines in favor of systemically riskier activities. The U.S. supplementary leverage ratio would also conflict with the Basel Committee’s liquidity coverage ratio, which, if adopted as proposed by the Agencies, would require banking organizations to maintain a reserve of high quality liquid assets (“HQLA”) sufficient to meet their liabilities over a 30-day horizon.<sup>7</sup> Because the supplementary leverage ratio would effectively penalize HQLA with higher capital charges per unit of risk, covered U.S. banking organizations would be incentivized to reduce their inventories of these assets. For further detail regarding the Committee’s concerns that the U.S. supplementary leverage ratio would not materially contribute to reducing systemic risk and may indeed reduce the

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<sup>1</sup> See generally, Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and Their Subsidiary Insured Depository Institutions, 79 Fed. Reg. 24528 (May 1, 2014).

<sup>2</sup> See BCBS, *Revised Basel III: Leverage Ratio Framework and Disclosure Requirements* (Jan. 2014), available at <http://www.bis.org/publ/bcbs270.htm>.

<sup>3</sup> Regulatory Capital Rules: Regulatory Capital, Proposed Revisions to the Supplementary Leverage Ratio, 79 Fed. Reg. 24596 (May 1, 2014).

<sup>4</sup> *Ibid.*

<sup>5</sup> See BCBS, Consultative Document: *Revised Basel III Leverage Ratio Framework and Disclosure Requirements* (June 2013), available at <http://www.bis.org/publ/bcbs251.htm>.

<sup>6</sup> Federal Reserve Board, *Transcript of Open Board Meeting* at 6, April 8, 2014

<sup>7</sup> Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards and Monitoring: Proposed Rule, 78 Fed. Reg. 71818 (Nov. 29, 2013).

competitiveness of U.S. capital markets, the Agencies may refer to the Committee's comment letter to the Agencies regarding their initial proposal for a U.S. supplementary leverage ratio.<sup>8</sup>

Thus, while the Committee agrees with defining total leverage exposure in a manner consistent with the Basel III leverage ratio, we would like the U.S. supplementary leverage ratio to require only 3% in tier-1 capital to be held against total leverage exposure, consistent with the Basel III leverage framework. This would ensure that the U.S. supplementary leverage ratio acts as a backstop to risk-based capital adequacy standards rather than as a binding constraint. Alternatively, the Agencies could exempt effectively risk-free government assets from the Proposed Rule's definition of total leverage exposure, including exemptions for central bank deposits or other purchases of government securities, as discussed at the Federal Reserve Open Board Meeting.<sup>9</sup> Such an exemption would have the same effect of ensuring that the U.S. supplementary leverage ratio acts as a backstop and not a binding constraint.

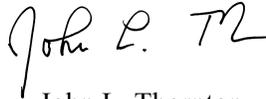
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Thank you very much for your consideration of the Committee's opinion. Should you have any questions or concerns, please do not hesitate to contact the Committee's Director, Prof. Hal S. Scott ([hscott@law.harvard.edu](mailto:hscott@law.harvard.edu)) at your convenience.

Respectfully submitted,



R. Glenn Hubbard  
Co-CHAIR



John L. Thornton  
Co-CHAIR



Hal S. Scott  
DIRECTOR

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<sup>8</sup> See Letter from the Comm. On Capital Mkts. Reg. to Robert de V. Frierson, Secretary, Board of Governors of the Federal Reserve System (Oct. 21, 2013), *available at* <http://capmktreg.org/wp-content/uploads/2013/11/CCMR-suppl.leverage.comment.ltr-10-21-2013.pdf>

<sup>9</sup> See Note 7 at 14.