KeyCorp

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Via Electronic Mail

Robert de V. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
regs.comments@federalreserve.gov
Docket No. R-1466
RIN 7100 AE-03

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
comments@FDIC.gov
RIN 3064-AE04

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street, SW
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Washington, DC 20219
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Docket ID OCC-2013-0016
RIN 1557 AD 74

Re: Notice of Proposed Rulemaking—Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring

Ladies and Gentlemen:

KeyCorp ("Key") appreciates the opportunity to comment on the proposed rules (the "Proposal"),[1] 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") to establish quantitative liquidity

[1] *Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring*, 78 Fed. Reg. 71,818 (Nov. 29, 2013).

standards based on the liquidity coverage ratio ("LCR") framework established by the Basel Committee on Banking Supervision (the "Basel Liquidity Framework").[2]

We are one of the nation's largest bank-based financial services companies with assets of approximately $93 billion. Key provides deposit, lending, cash management and investment services to individuals and small businesses through its wholly-owned subsidiary, KeyBank National Association.

In addition to this letter, Key also participated in the development of two joint comment letters. One of those letters was submitted by The Clearing House Association L.L.C., the American Bankers Association, the Securities Industry & Financial Markets Association, the Financial Services Roundtable, the Institute of International Bankers, and the Structured Finance Industry Group. The other letter was submitted by a group of regional banking organizations having assets of between $55 - $361 billion as of September 30, 2013. We support the comments and concerns raised by both of the joint comment letters. The comments and recommendations in this letter are intended to supplement those contained in above referenced letters.

The Proposal contains two sets of rules - one set jointly proposed by the Agencies would establish an LCR requirement (the "Full LCR") for certain banking organizations while the other, proposed only by the Board, would establish a modified LCR requirement (the "Modified LCR") for certain holding companies. Under the Proposal, Key would be required to adhere only to the Modified LCR.

The Proposal represents the first step of the Agencies in implementing the quantitative liquidity requirements of the Basel Liquidity Framework. The LCR's quantitative framework is a useful complement to Key's own liquidity stress testing and qualitative liquidity risk management practices. We support the fundamental objectives of the Basel Liquidity Framework and the Proposal.

However, we believe that certain changes to the Proposal are necessary to properly align its requirements with the liquidity risk profile of our organization, more closely reflect the actual liquidity and behaviors of customers and counterparties, and avoid unintended and adverse consequences. Accordingly, this letter addresses the following concerns related to the Modified LCR requirements that are most important to Key: (1) the treatment of obligations issued by U.S. government-sponsored enterprises ("GSEs"), (2) the treatment of collateralized public funds and (3) the frequency of calculation and reporting.

Treatment of GSE Securities

The Agencies acknowledge that some obligations issued and guaranteed by the GSEs ("GSE securities") consistently trade in very large volumes and generally have been highly liquid, including during times of stress.[3] As a result of these characteristics, GSE securities are a primary tool for liquidity risk management at Key and currently comprise a significant amount of our high quality liquid asset ("HQLA") portfolio. The Proposal, however, would treat these securities as Level 2A liquid assets subject to the 40% cap on total Level 2 liquid assets and a 15% haircut.

Key believes that the treatment of GSE securities under the Proposal does not adequately reflect the proven liquidity value[4] and pricing behavior that occurred, even in times of severe stress. Moreover, the characterization of GSE

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[2] Basel Committee on Banking Supervision, *Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools* (revised January 2013), available at http://www.bis.org/publ/bcbs238.pdf.
[3] *Proposal*, at 71,827.

[4] There are currently over $4 trillion in outstanding GSE securities, with an average daily trading volume in 2013 of almost $230 billion. See, data available at http://www.sifma.org/uploadedFiles/Research/Statistics/StatisticsFiles/SF-US-Agency-MBS-SIFMA.xls?n=44617 and http://www.sifma.org/uploadedFiles/Research/Statistics/StatisticsFiles/SF-USD-SF-Trading-Volume-SIFMA.xls?n=28157.

securities as Level 2A liquid assets is inconsistent with the enhanced liquidity standards the Board proposed[5] under Section 165 of the Dodd-Frank Act,[6] which would classify GSE securities as fully liquid (the "Enhanced Prudential Standards Proposal"). This treatment of GSE securities has the potential to negatively impact the availability and pricing of residential mortgages in the U.S. Accordingly, Key urges the Agencies to reconsider the treatment of GSE securities in the final rule by any one of the following suggestions 1) treating GSE securities as Level 1 liquid assets while the GSEs are under conservatorship, 2) by increasing the cap on total Level 2 liquid assets, or 3) by reducing the haircut applied to GSE securities to more appropriately reflect the proven liquidity value of these securities.

Treatment of Public Funds

Under the Proposal, the treatment of deposits placed by states and municipalities, which, under state law must be collateralized[7] (so called "preferred deposits"[8]), is punitive and more stringent than required under the Basel Liquidity Framework. As a result, we likely would limit the amount of preferred deposits we accept, further reduce the interest we pay on preferred deposits, or eliminate earnings credits we extend to state and municipal depositors. Key believes the treatment of preferred deposits under the Proposal is unintended and inappropriate, and urges the Agencies to modify the treatment of these deposits in the final rule.

The Agencies explain in the Proposal that the requirement to calculate the adjusted excess HQLA amount would prevent a banking organization from manipulating its HQLA portfolio by engaging in transactions, such as certain repurchase or reverse repurchase transactions, because the HQLA amount, including the caps and haircuts, would be calculated both before and after unwinding those transactions.[9]

For purposes of the adjusted excess HQLA calculation, the Proposal would treat preferred deposits collateralized with, for example, GSE securities, in the same manner as repurchase agreements.[10] Preferred deposits, therefore, would be subject to both an outflow assumption (generally 15%, when secured by GSE securities) and the adjusted excess HQLA provision that would require banking organizations to assume that the transaction is unwound. As the example included as Attachment 1 illustrates, this (i) results in a banking organization having fewer Level 1 liquid assets—which count towards the LCR without limit—and more Level 2A GSE securities—which are subject to a 40% cap and a 15% haircut and (ii) could result in a negative HQLA amount.

While Key supports the Agencies' goal of preventing banking organizations from manipulating their stock of HQLA, preferred deposits simply do not raise this concern. In contrast to repurchase agreements or other collateral swaps, preferred deposits represent a part of long-term relationships with state and municipal governments—generally established through a request for proposals process. These deposits are generally placed with banks in

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[5] *Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies; Proposed Rule*, 77 Fed. Reg 594 (Jan. 5, 2012).

[6] Public Law 111-203, 124 Stat. 1376, 1423 (2010) (codified at 12 U.S.C. § 5365).

[7] *See, e.g.*, Ohio Rev. Code §§. 135.18, 135.181, and 135.37. Under Ohio law, a bank cannot accept deposits of public moneys from a political subdivision or county, unless the bank pledges collateral for the repayment of all public moneys to be deposited in the institution. The law also specifies the types of securities eligible to be pledged as collateral under that requirement, including, among other types of securities, GSE securities, Treasury securities, and U.S. government agency securities. *See generally*, Ohio Rev. Code § 135.18.

[8] *See* 12 U.S.C. § 1813(m)(4).

[9] *Proposal*, at 71,831.

[10] *See* §__.21(f)(2) and *See* §__.3. Preferred deposits would fall into this broad definition. However, we believe that result was unintentional, as preferred deposits, although secured with collateral that gives the counterparty a priority interest, do not otherwise share the characteristics of the types of transactions this definition was intended to capture.

connection with other services the public sector customer seeks to obtain from the bank (e.g., payments and receivables treasury management services), and are not susceptible to the type of short-term gaming the Agencies seek to prohibit.

Accordingly, Key believes the Agencies should clearly exclude preferred deposits from the requirement to unwind HQLA-for-HQLA transactions in the final rule. In addition, we believe the Agencies should consider reducing the 15% outflow assumption associated with preferred deposits secured by GSEs as they present a neutral liquidity risk position due to over-collateralization required by clients.

Frequency of Calculation and Reporting

Under the Proposal, Key would be required to calculate the Modified LCR on a daily basis. We believe the requirement to calculate the ratio on a daily basis is both unnecessary and unduly burdensome for us, especially in light of the January 1, 2015, implementation time frame the Agencies have proposed.

In our view, we do not present the same funding complexity and liquidity risk as larger, more complex banking organizations, such as banking organizations that have been designated as global systemically important banks ("G-SIBs"). As a result of this simpler funding profile, there is no need to rely to a significant extent on more volatile, short-term sources of wholesale funding. Consequently, liquidity inflows and outflows are more stable and predictable than those of larger and more complex organizations, allowing liquidity risk management and monitoring (by regional banks and their supervisors) to be conducted through traditional means. Based on this, we believe that a daily calculation requirement for regional banks is unnecessary.

Key recognizes that the capability to calculate the ratio on a more frequent basis than monthly in times of stress may have significant utility for management and supervisors. Key also firmly believes that during a liquidity stress event, management of liquidity will be based on current market conditions and cash flow expectations unique to each organization. Therefore, we believe that establishing daily liquidity risk management requirements for banking organizations similar to Key would more appropriately be left to the supervisory process, as a one-size-fits-all approach would not take the individual characteristics of banking organizations or the stress event appropriately into account.

Key, unlike some larger and more complex banking organizations, is not subject to the Board's detailed fourth-generation ("4G") daily liquidity reporting requirements. We believe the Board correctly requires only U.S. banking organizations that have been designated as G-SIBs, but not other banking organizations, to provide daily liquidity reporting under the Board's 4G reporting program. Calculating the Modified LCR on a daily-basis requires extensive system enhancements Key currently does not have in place. Implementing those system enhancements would be very challenging, expensive, and time consuming. The burden associated with developing and testing systems capable of the daily calculation is magnified by the Agencies' proposed 2015 implementation date.

We note that the Board clearly recognizes the different liquidity calculation and reporting capabilities of bank holding companies with both the limited scope of the daily 4G liquidity report and with the scope of its proposed FR 2052a (daily reporting) and FR 2052b (monthly reporting) liquidity reporting requirements.[11] Banking organizations that are subject to the 4G liquidity report would be subject to daily reporting on the FR 2052a and have had considerable lead time (relative to us) to prepare for and build the systems capable of supporting a daily calculation.

Monthly calculation frequency for similar organizations would be consistent with the Board's proposed rule to implement the enhanced liquidity standards required under section 165(b)(1)(A)(ii) of the Dodd-Frank Act,[12] which would require covered companies to conduct internal liquidity stress tests at least monthly.[13]

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[11] *See, Proposed Agency Information Collection Activities; Comment Request*, 78 Fed. Reg. 57,634 (Sep. 19, 2013).

[12] *See*, 12 U.S.C § 5365(b)(1)(A)(ii).

[13] *See*, Proposed 12 C.F.R. § 252.56(a)(2), *Enhanced Prudential Standards Proposal*, at 647.

Key therefore, respectfully requests that the Agencies, in adopting final rules to implement the Proposal, limit the daily calculation requirement only to banking organizations currently subject by the Board to daily liquidity reporting requirements and permit all other banking organizations subject to the Proposal to calculate the ratio on a monthly basis. This approach would more consistently match the daily calculation requirement to banking organizations that already have extensive systems and processes in place to support the daily calculation.

Regardless of whether the Agencies ultimately determine to require the calculation to be done on a daily or monthly basis, we respectfully request that banking organizations that are not subject by the Federal Reserve to daily liquidity reporting requirements be given sufficient additional time after the Agencies adopt final rules to build and test the systems needed to support the daily or monthly calculation. Accordingly, we believe that delaying the implementation of the daily or monthly calculation until January 1, 2017 would appropriately reflect the different liquidity calculation and reporting capabilities of banking organizations subject to the Proposal.

Key thanks the Agencies for the opportunity to comment on the Proposal and respectfully asks for consideration of the recommendations and suggestions in this letter. If you have any questions regarding the content of this letter or would like more information on this subject, please do not hesitate to contact me.

Sincerely,

Joseph M. Vayda
Treasurer
KeyCorp

Attachment 1 - Effect of Proposed Treatment of Preferred Deposits on Liquidity

		Example $10 Billion Non-determinate maturity Public Funds Deposit Secured by $11 billion of Level 2A assets (e.g. GSE Securities)		
		Calculation		$ in Billions
Balance at Fed	A		$	0.4
Required Reserves	B		$	0.8
Unencumbered Level 1 Assets (market value)	C		$	8.0
Unencumbered Level 2 Assets (market value)	D		$	10.0
Unencumbered Level 2B Assets (market value)	E		$	-
Level 1 liquid asset Amount	F	A+C-B	$	7.6
Level 2 liquid asset Amount	G	D*.85	$	8.5
Level 2b liquid asset Amount	H	E*.5	$	-
Unwind of Secured Funding Transaction			The Public Fund deposit is unwound. Cash is reduced by $10 billion. Adjusted Level 2a assets are increased by $9.35 billion ($11 billion of 2a freed up *.85)	
Adjusted Level 1 liquid asset amount	I	F-10	$	(2.4)
Adjusted Level 2 liquid asset amount	J	G+9.35	$	17.9
Adjusted Level 2b liquid asset amount	K	H	$	-
<u>Unadjusted excess HQLA amount calculation</u>				
Level 2 Cap excess amount	L	MAX(G+H-.6667*F,0)	$	3.4
Level 2b Cap excess amount	M	MAX(H-L-0.1765*(F+G),0)	$	-
Unadjusted excess HQLA amount	N	L+M	$	3.4
<u>Adjusted excess HQLA amount calculation</u>				
Adjusted Level 2 Cap excess amount	O	MAX(J+K-.6667*I,0)	$	19.5
Adjusted Level 2b Cap excess amount	P	MAX(K-O-0.1765*(I+J),0)	$	-
Adjusted excess HQLA amount	Q	O+P	$	19.5
Calculation of HQLA amount	**R**	**F+G+H-the greater of N or Q**	**$**	**(3.4)**