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Via Electronic Delivery

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Re: Liquidity Coverage Ratio Rule: Treatment of Certain Municipal Obligations as High-Quality Liquid Assets
FRB Docket No. R–1616; RIN 7100–AF10
FDIC RIN 3064–AE77
OCC Docket ID OCC–2018–0013

Ladies and Gentlemen:

American Express Company (together with its subsidiaries, "American Express") appreciates the opportunity to provide comments to the Board of Governors of the Federal Reserve System (the "Federal Reserve"), Federal Deposit Insurance Corporation ("FDIC"), and Office of the Comptroller of the Currency ("OCC" and together the "Agencies") on an interim final rule to amend the Liquidity Coverage Ratio ("LCR") rules to incorporate certain municipal securities into the definition of high quality liquid assets ("HQLA") (the "Proposed Rule").[1]

American Express strongly supports the ongoing efforts of the Agencies to simplify and tailor the application of U.S. prudential regulatory requirements to reflect a firm's size,

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[1] *Liquidity Coverage Ratio Rule: Treatment of Certain Municipal Obligations as High-Quality Liquid Assets*, 83 Fed. Reg. 44451 (Aug. 31, 2018). The Agencies are required to promulgate the Proposed Rule pursuant to Section 403(b) of the recently enacted Economic Growth, Regulatory Relief, and Consumer Protection Act ("S.2155").

complexity, and systemic footprint.[2] We focus our comments here on the opportunity for the Agencies to refine the tailoring of the LCR rules through the Proposed Rule.

As implemented in the United States, the LCR rules are currently divided into two segments: the "Full" LCR and the "Modified" LCR. The Full LCR rules currently apply to "internationally active" BHCs – *i.e.*, a group that has been defined (since approximately 2003) as BHCs with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance sheet foreign exposure (the "250/10 Thresholds"), as well as certain of their depository institution subsidiaries.[3]

We have previously recommended and continue to believe that the 250/10 Thresholds are inappropriate for determining application of a variety of regulatory requirements (including the Full LCR) and that the Agencies should use a more appropriate metric.[4] Accordingly, we recommend that the Agencies use the opportunity of the Proposed Rule to, at a minimum, revise the segmentation of the LCR rules to eliminate the $10 billion foreign exposure threshold as a first step towards a broader tailoring of the Full LCR rules.

Based upon recent action both in the U.S. Congress and at the Basel Committee, including in particular the Basel Committee's action in December 2017 to finalize the Basel III set of reforms,[5] it is generally expected that the Agencies will engage in a broader exercise to revise existing U.S. capital and liquidity rules. However, these processes take time and the effective date of final versions of revised regulations could be years away. In the meantime, the thresholds for the Full LCR will remain misaligned unless the Agencies take action.

As an interim step, and without waiting for a broader future review of the scope and substance of the LCR rules, we strongly encourage the Agencies to eliminate the $10 billion foreign exposure threshold for application of the Full LCR. We believe the Agencies could eliminate this threshold through the Proposed Rule as part of the implementation of Section 403 of S.2155. Eliminating the $10 billion foreign exposure threshold now would be a first step towards better aligning the scope of the Full LCR with the firms it is intended to capture, and would be consistent with both the overall tenor of S.2155 as well as recent Federal Reserve and OCC action.[6]

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2 *See, e.g.*, Board of Governors of the Federal Reserve System, Staff Memo, April 5, 2018, available at https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180410a1.pdf (the "Staff Memo").

3 12 C.F.R. § 249.1(b).

4 *See, e.g.*, Liquidity Coverage Ratio Comment Letter of American Express, Jan. 31, 2014, accessed at https://www.regulations.gov/document?D=OCC-2013-0016-0051.

5 *See, e.g.*, Basel Committee on Banking Supervision, High Level Summary of Basel III reforms, December 2017, *at* https://www.bis.org/bcbs/publ/d424_hlsummary.pdf.

6 *See, e.g.*, Single-Counterparty Credit Limits for Bank Holding Companies and Foreign Banking Organizations: Final Rule, *available at* https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180614a1.pdf. While the proposed rule would have included reliance on the 250/10 Thresholds, the press release accompanying the final rule noted that "[c]onsistent with the recently passed Economic Growth, Regulatory Reform, and Consumer Protection Act, the limits in the final rule will apply only to GSIBs and bank holding

As Federal Reserve Vice Chairman for Supervision Quarles noted recently: "the metrics used to identify internationally active firms – $250 billion in total assets or $10 billion in on-balance-sheet foreign exposures – were formulated well over a decade ago, were the result of a defensible but not ineluctable analysis, and have not been refined since then. We should explore ways to bring these criteria into better alignment with our objectives."[7] Similarly, we strongly agree with the sentiments of Vice Chairman for Supervision Quarles that "there are additional tailoring opportunities with respect to large firms that are not G-SIBs to ensure that applicable regulation matches their risk" and that "for less complex and less interconnected firms with assets greater than $100 billion, there may be opportunities to modify aspects of the standardized liquidity requirements as well as expectations around internal liquidity stress tests and liquidity risk management."[8]

The $10 billion foreign exposure threshold was incorporated into the U.S. LCR rules in an effort to apply the Full LCR rules to internationally active firms.[9] At the time that the 250/10 Thresholds (which are unique to the United States) were first established in 2003, the Federal Reserve made clear that the implementation in the United States of standards for "internationally active" banking organizations was intended to reach only the "largest, most complex banks," *i.e.*, those that were the "most complex banking institutions" and were truly "internationally active."[10]

That threshold may have been an appropriate proxy in 2003 for identifying a group seemingly equivalent to today's G-SIBs, but like all fixed asset size thresholds, the 2003 concept of foreign exposure as a proxy for complexity, risk profile, and international activity was

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companies with at least $250 billion in total consolidated assets" – aligning with S.2155 while eliminating reliance on the $10 billion foreign exposure threshold.

See also OCC Guidelines Establishing Standards for Recovery Planning by Certain Large Insured National Banks, Insured Federal Savings Associations, and Insured Federal Branches; Technical Amendments, 83 Fed. Reg. 47313 (Sept. 19, 2018), increasing the threshold for application of the OCC's recovery planning guidelines from $50 billion to $250 billion in total consolidated assets and noting the change aligns with S.2155 and "would provide necessary and appropriate burden relief to the affected banks while retaining the requirements for the largest, most complex institutions."

7 Randal K. Quarles, Vice Chairman for Supervision, *Early Observations on Improving the Effectiveness of Post-Crisis Regulation*, to the ABA Banking Law Committee Annual Meeting, Jan. 19, 2018, *available at* https://www.federalreserve.gov/newsevents/speech/quarles20180119a.htm ("VC Quarles January 2018 ABA Speech"); Vice Chairman for Supervision Quarles, *Getting It Right: Factors for Tailoring Supervision and Regulation of Large Financial Institutions*, to the American Bankers Association Summer Leadership Meeting, July 18, 2018, available at https://www.federalreserve.gov/newsevents/speech/quarles20180718a.htm ("VC Quarles July 2018 ABA Speech").

8 Randal K. Quarles, Vice Chairman for Supervision, *Semiannual Supervision and Regulation Testimony*, Before the Committee on Financial Services, U.S. House of Representatives, April 17, 2018, *available at* https://www.federalreserve.gov/newsevents/testimony/quarles20180417a.htm.

9 *See Liquidity Coverage Ratio: Liquidity Risk Measurement Standards*, 79 Fed. Reg. 61440, 61445 (Oct. 10, 2014).

10 *Testimony of Vice Chairman Roger W. Ferguson, Jr., Basel II*, Before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, June 18, 2003, *available at* http://www.federalreserve.gov/boarddocs/testimony/2003/20030618/default.htm; *see also* Federal Reserve, *Capital Standards for Banks: The Evolving Basel Accord*, 89 Fed. Res. Bull. 395 (Sept. 2003).

destined to become over-inclusive with time. Today, two distinct groups – the largest and most complex banking organizations, as well as traditional and limited purpose banking organizations – are either captured, or soon will be. However, these groups are dramatically different, especially in terms of business model and risk profile. For example:

- Relative to larger and more complex organizations (such as the U.S. G-SIBs), traditional and limited purpose banking organizations have relatively simple organizational structures, primarily focusing on traditional retail and commercial banking products and services, and have only limited trading and capital markets operations. Broker-dealers and other nonbank operations outside of service-providing affiliates comprise only a small portion of their overall operations.

- Traditional and limited purpose banking organizations' exposure to capital markets and derivatives activities pale in comparison to that of U.S. G-SIBs.

As a result of the threshold not taking into account these differences, regulatory requirements that use these thresholds – and in particular the $10 billion foreign exposure threshold – are not appropriately calibrated to the risk profile of individual institutions. Consequently, unnecessary regulatory obligations and supervisory expectations intended for the largest and most complex institutions are being imposed on traditional and limited purpose banking organizations.

I. Revisiting the 250/10 Thresholds is Consistent with Recent Legislative and Regulatory Developments

Notably, reconsidering the continued relevance of the $10 billion foreign exposure threshold would be consistent with several recent legislative and regulatory developments. As Vice Chairman for Supervision Quarles noted in January, "now is an eminently natural and expected time to step back and assess [the body of post-crisis regulation] . . . to ensure that they are working as intended and . . . it is inevitable that we will be able to improve them, especially with the benefit of experience and hindsight."[11]

S. 2155

Enacted on May 24, 2018, S.2155, among other things, amends Section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act to raise the systemically important financial institution designation threshold for application of "enhanced prudential standards" ("EPS") from $50 billion in total consolidated assets to $250 billion. Upon enactment of these changes, BHCs with less than $100 billion in total consolidated assets were immediately excluded from application of the EPS, and BHCs with total consolidated assets between $100 billion and $250 billion will be excluded from EPS effective November 24, 2019, absent express action by the Federal Reserve.

Enactment of S. 2155 is an important milestone towards achieving a broader right-sizing of post-crisis regulation. It would be similarly timely, appropriate, and consistent with the

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[11] *See* VC Quarles January 2018 ABA Speech.

efforts of the Agencies and Congress[12] to reevaluate the use of the $10 billion foreign exposure threshold for applying the Full LCR rules.

We are appreciative of the Federal Reserve's July 6, 2018, statement regarding its intention to be consistent and raise the threshold to $100 billion in total consolidated assets for the enhanced prudential standards in Regulation YY, LCR, and capital requirements.[13] We would further offer that banking organizations with foreign exposures likewise do not necessarily have complex structures, and are not dependent on short-term wholesale funding. Rather, they frequently engage in traditional commercial banking activities and rely on relatively stable sources of funding.

As noted above, Vice Chairman for Supervision Quarles recently observed that, in connection with the S.2155 tailoring exercise, "for less complex and less interconnected firms with assets greater than $100 billion, there may be opportunities to modify aspects of the standardized liquidity requirements as well as expectations around internal liquidity stress tests and liquidity risk management." We strongly agree with this sentiment and believe that this is an appropriate opportunity to take an important first step towards doing so by eliminating the $10 billion foreign exposure threshold.

Federal Reserve – CCAR Qualitative Relief

The Federal Reserve has already taken action to eliminate the use of the $10 billion foreign exposure threshold when finalizing various rules. First, in the 2017 final rule eliminating the CCAR qualitative assessment for large and noncomplex firms, the Federal Reserve replaced that threshold with a threshold that includes whether a firm is a U.S. G-SIB for purposes of identifying which firms would remain subject to the CCAR qualitative assessment.[14] In support of that action, the Federal Reserve recognized that foreign exposure may arise from business activities that are not complex, and as a result a metric aimed at accounting for complexity that is based solely on the size of a firm's foreign exposures may be over-inclusive.[15]

Federal Reserve – Single Counterparty Credit Limits

Similarly, as noted above, the Federal Reserve's recent final rule implementing single counterparty credit limits (the "SCCL Final Rule") eliminated its use of the $10 billion foreign exposure threshold in order to align with S.2155. The proposed rule would have included reliance on the 250/10 Thresholds in segmenting the banking industry for purposes of the SCCL. However, the press release accompanying the SCCL Final Rule noted that "[c]onsistent with the recently passed Economic Growth, Regulatory Reform, and Consumer Protection Act, the limits

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12 *See, e.g.*, Statement of Senator Toomey: "[The EPS threshold] shouldn't be automatically based on the size of the institution; it should be driven by the conduct of the institution, the kind of business they do. . . . I intend to work with regulators to basically have this SIFI designation reflect the activity of the institution rather than just the size." Congressional Record at S1720, March 14, 2018.

13 *See* Federal Reserve, *Statement regarding the impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act*, available at https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180706b1.pdf.

14 *Amendments to the Capital Plan and Stress Test Rules; Regulations Y and YY*, 82 Fed. Reg. 9308, 9312 (Feb. 3, 2017).

15 *Id.*

in the final rule will apply only to GSIBs and bank holding companies with at least $250 billion in total consolidated assets."[16] The Federal Reserve thus affirmatively aligned the scope of the SCCL Final Rule with S.2155 while eliminating reliance on the outdated $10 billion foreign exposure threshold.

U.S. Department of the Treasury

The current Administration has also expressed its desire to leave behind static asset thresholds as triggers for systemic designations or application of enhanced prudential standards. Specifically, in its June 2017 Report on Regulatory Reform, the Treasury Department commented on the need to revisit "arbitrary" asset thresholds:

> Most critically, regulatory burdens must be appropriately tailored based on the size and complexity of a financial organization's business model and take into account risk and impact. In particular, the use of arbitrary asset thresholds to apply regulation has resulted in a "one-size-fits all" approach that has prevented regulators from focusing on a banking organization's most serious risks.
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> Insufficient tailoring results in bank regulators misallocating staff time and resources by focusing on firms that do not present the greatest risks to the financial system. Further, the magnitude of regulatory requirements applicable to regional, mid-sized, and community banks that do not present risks to the financial system requires such banks to expend resources on building and maintaining a costly compliance infrastructure, when such resources would be better spent on lending and serving customers.[17]

The Treasury Department's Office of Financial Research ("OFR") has also publicly supported revisiting the static asset threshold approach. For example, in its recent 2017 Annual Report to Congress, OFR stated: "A multifactor approach that captures risk is superior to using asset size alone to determine the systemic footprint of U.S. banks. . . . For U.S. banks with traditional business models, an asset-size threshold for determining whether to apply heightened regulatory standards could create misaligned regulatory compliance costs."[18]

U.S. House of Representatives

Finally, revisiting the use of the $10 billion foreign exposure threshold would also be consistent with Congressional direction in the House Committee on Appropriation's report accompanying the 2016 Financial Services and General Government Appropriations Bill, which

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16 Press Release, SCCL Final Rule, available at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180614a.htm.

17 U.S. Department of the Treasury, *A Financial System That Creates Economic Opportunities: Banks and Credit Unions*, June 2017, *available at* https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf.

18 OFR 2017 Annual Report to Congress. *Key Findings from Research and Analysis: Assessing the Systemic Importance of Banks*, Dec. 5, 2017, available at https://www.financialresearch.gov/annual-reports/2017-annual-report/.

was incorporated into the 2016 Consolidated Appropriations Act enacted in December 2015, which provides:

> *Basel Standards.*—The Committee is concerned that the U.S. prudential regulators have inappropriately applied several standards developed by the Basel Committee on Bank[ing] Supervision (Basel), which are explicitly designed for only the most internationally active, globally systemic, and highly complex banking organizations to less complex organizations, like regional banking organizations, which have only limited foreign exposure and do not pose a threat to the U.S. or global financial system. The Committee encourages Treasury and other prudential regulators to reexamine the impact of certain liquidity and capital standards as they apply to U.S. regional banks and other less complex organizations.[19]

Fundamentally, static balance-sheet-based thresholds are a poor proxy for risk or complexity and are ripe for reconsideration. We believe the 250/10 Thresholds are outdated and generally should be replaced with a more dynamic and risk-sensitive measure. In the meantime, eliminating the $10 billion foreign exposure threshold would be an interim, but important, step to help ensure that the scope of the Full LCR rules is properly calibrated to capture only the largest and most complex global banking organizations.

II. Conclusion

We respectfully submit that, for the reasons described above, the Agencies should use the opportunity of the Proposed Rule to forego their continued use of the static, outdated $10 billion foreign exposure threshold to determine application of the Full LCR rules. We believe this change would be an important first step towards producing a segmentation of the U.S. financial services industry that more appropriately captures the risk associated with covered organizations, asset classes, and liabilities, and thus would result in a supervisory focus that is better aligned to the objectives of the Agencies.

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[19] H.R. Rep. No. 114-194 (2015), at 10.

Thank you for considering our comment letter. We appreciate the opportunity to share our views with the Federal Reserve and would be happy to discuss any of them further at your convenience. If we may be of further assistance, please contact me at 212-640-2396 or david.l.yowan@aexp.com.

Sincerely,

David L. Yowan
Executive Vice President &
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cc: Jeff Campbell
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