Regulatory Capital Rule: Revisions to the Supplementary Leverage Ratio to Exclude Certain Central Bank Deposits of Banking Organizations Predominantly Engaged in Custody, Safekeeping and Asset Servicing Activities [R-1659]

Question 1

What alternative standard, if any, should be used to define a custodial banking organization instead of, or in conjunction with, an AUC-to-total asset ratio?

On page 8 of the proposed rule, the agencies considered both an AUC-to-total assets measure and an income-based measure.

An AUC-to-total assets would provide a measure of a banking organization's custodial and safekeeping business relative to its other businesses.

An income-based measure would show the percentage of a banking organization's income that it derives from custodial, safekeeping, and asset servicing activities. This approach analyses fiduciary and custody and safekeeping income as a percentage of income.

At the top of page 14 of the proposed rule, the agencies state: "The agencies' analysis revealed a significant positive correlation between the AUC-to-total asset measure and the income-based measure. The legislative history of section 402 suggests that members of Congress recognized the three institutions identified under either test as custodial banking organizations." Thus, the agencies should permit a custodial banking organization to qualify under either the:

AUC-to-income ≥ 30:1 ratio, or

Income ≥ 50% of income generated from custody, safekeeping and asset servicing activities.

What are the advantages or disadvantages of using an income-based approach to define a custodial banking organization?

In the full paragraph on page 16, the proposed rule states: "The agencies recognize that the ratio of AUC-to-total assets may fluctuate significantly during a stress environment as client securities decline in value or as clients liquidate custodial securities and deposit the cash with the banking organization (thus increasing the banking organization's total assets)." The agencies conclude: "Consistent with the analysis described above, this analysis demonstrated a clear separation between the lowest observed AUC-to-total assets ratios of The Bank of New York Mellon, Northern Trust Corporation, and State Street Corporation under stress conditions, and the highest observed AUC-to-total asset ratio among other advanced approaches banking organizations." The agencies continue to describe the justification for the AUC-to-total assets with their analysis on page 17.

Yet, the agencies did not provide a stress analysis using the income method. The difference; is that, the AUC-to-total assets computation only measures the period of time that the funds are invested in securities. The income method is more accurate in a stress environment because it measures:

a. The income generated while the custodial banking organization has the funds invested in both:

The holding company while invested funds are invested in securities.

The subsidiary bank after liquidation of the securities into cash.

b. Clients' funds over a longer period of time. For instance, a client may have funds invested over a twelve-month period of time:

2 months as cash in the subsidiary bank.

10 months in qualified investments with the bank holding company.

The AUC-to-total assets measures a 10-month period.

The income method measures a 12-month period since the income is earned by the holding company when the funds are invested in securities and by the subsidiary bank after the securities have been liquidated into cash. The income method fluctuates less significantly during a stress environment.

If a client invested funds over a twelve-month period of time:
10 months as cash in the subsidiary bank.
2 months in qualified investments with the bank holding company.
The AUC-to-total assets measures a 2-month period.

The income method measures a 12-month period since the income is earned by the holding company when the funds are invested in qualified securities and by the subsidiary bank after the securities have been liquidated into cash.

The linkage of accounts between the bank holding company and the subsidiary bank result in the income method as the better, less volatile, gauge of qualifying a custodial banking organization than the AUC-to-total asset measurement. If the agencies are going to select only one method to qualify a custodial banking organization, it should be the income method.

What are the commenters' views on the potential increased reporting burden of requiring new regulatory reporting line items to distinguish between income derived from custodial, safekeeping, and asset servicing activities and income derived from fiduciary activities, consistent with the requirements of section 402?

In the first paragraph on page 15 of the proposed rule, the agencies state that they "...are not proposing to use an income-based measure because such an approach would increase reporting burden for banking organizations subject to the supplementary leverage ratio... Banking organizations do not currently report income from custodial, safekeeping, and asset servicing activities separately from income derived from fiduciary activities."

A holding company, and the subsidiary bank, could simply assign a specific, general ledger account number for each income source.

Furthermore, on page 29, in the first paragraph of the proposed rule, the agencies state: "The proposed rule, once final, may require changes to the following reports:

1. Consolidated Reports of Condition and Income for a Bank with Domestic and Foreign Offices (FFIEC 031);

2. Consolidated Reports of Condition and Income for a Bank with Domestic Offices Only (FFIEC 041);

3. Consolidated Reports of Condition and Income for a Bank with Domestic Offices Only and Total Assets Less Than $1 Billion (FFIEC 051) (OMP Control Nos. 1557-0081 (OCC), 7100-0036 (Board), 3064-052 (FDIC);

4. The Risk-Based Capital Reporting for Institutions Subject to the Advanced Capital Adequacy Framework (FFIEC 101; OMB Control Nos. 1557-0239 (OCC), 7100-039 (Board), and 3064-0159 (FDIC);

5. And the Consolidated Financial Statements for Holding Companies (FR Y-9C; OMB Control Nos. 7100-0128 (Board)).

The agencies listed five reporting changes that may be required under the AUC-to-total assets, proposed rule. However, the agencies did not identify the reporting changes that may be required using the income method.

Question 3

Under the proposed rule, a custodial banking organization holding company or its subsidiary depository institutions would be immediately disqualified as a custodial banking organization holding company if the four-quarter average of the holding company's AUC-to-total asset ratio falls below the 30:1 ratio and would no longer be permitted to adjust its supplementary leverage ratio under the proposed rule. The use of a four-quarter average of AUC-to-total assets measure should generally prevent an unforeseen disqualification of a custodial banking organization holding company and its subsidiary depository institutions.

What would be the advantages and disadvantages of delaying the timing of a banking organization losing its status as a "custodial banking organization," to minimize market disruptions during a stress environment?

What would be an appropriate amount of time for such a delay?

If the agencies decide to include the AUC-to-total asset approach along with the income measurement, the AUC-to-total assets and income approach should have the same qualifying period of time.

Question 4

What changes, if any should the agencies consider with respect to the proposed definition of "custodial banking organization?"

One page 1 of the proposed rule, the Summary section states: "Section 402 directs these agencies to amend the supplementary leverage ratio of the regulatory capital rule to exclude certain funds of banking organizations deposited with central banks if the banking organization is predominantly engaged in custody, safekeeping, and asset servicing activities."

On page 7 of the proposed rule, the second paragraph states: "Under the proposal, a depository institution holding company would be considered predominately engaged in custody, safekeeping, and asset servicing activities if the U.S. top-tier depository institution holding company in the organization has a ratio of assets under custody (AUC)-to-total assets of at least 30:1. The proposal would define such a depository institution holding company, together with any subsidiary depository institution, as a "custodial banking organization."

The agencies maintained, in the definition of a custodial banking organization, the phrase: "asset servicing activities."

In the first paragraph under Section C on page10, the proposed rule states: "Banking organizations typically provide custody, safekeeping, and asset servicing to their fiduciary accounts."

Additionally, on page 12, Section II A, the proposed rule states:

"The proposal would define a depository institution holding company predominately engaged in custody, safekeeping, and asset servicing activities, together with any subsidiary depository institution, as a "custodial banking organization." The phrase "predominately engaged in custodial, safekeeping, and asset servicing activities" suggests that the banking organization's business model is primarily focused on custody, safekeeping and asset servicing activities, as compared to its other commercial lending, investment banking, or other banking activities."

In the first paragraph page 23, the proposed rule, states: "The proposal would define a fiduciary or custodial and safekeeping account as an account administered by a custodial banking organization for which the custodial banking organization provides fiduciary or custodial and safekeeping services, as authorized by applicable federal and state law."

The agencies left out "asset servicing activities" from the definition of both:

i. A fiduciary or custodial and safekeeping account.
ii. The custodial banking organization.

Question 8

"What alternative definitions, if any should the agencies consider to define a fiduciary or custodial and safekeeping account and why?

Section 402 includes as its definition "asset servicing activities" that should be included in the definition of both a:

Fiduciary or custodial and safekeeping account.
Custodial banking organization.

In the first paragraph on page 7 of the proposed rule, the agencies state that they were directed by Section 402 "...to amend the capital rule to exclude from the supplementary leverage ratio certain central bank deposits of custodial banks. Section 402 defines a custodial bank as any depository institution holding company predominantly engaged in custody, safekeeping, and asset servicing activities, including any insured depository institution ("IDI") subsidiary of such a holding company."

The agencies state that they were given:

A directive – to amend the capital rule

A definition – predominately engaged in:

Custody

Safekeeping

Asset servicing activities

By removing "asset servicing activities," the agencies eliminated one third of the Congressional definition. The agencies should include as the definition of a custodial banking organization:

Custody

Safekeeping

Asset servicing activities

Further, page 1 of the proposed rule Summary section reads: "Section 402 directs these agencies to amend the supplementary leverage ratio of the regulatory capital rule to exclude certain funds of banking organizations deposited with central banks if the banking organization is predominantly engaged in custody, safekeeping, and asset servicing activities."

The agencies omitted "asset servicing activities" from the definition of both:

The custodial banking organization.

A fiduciary or custodial and safekeeping account.

Texico Bancshares Corporation's ("TBC") regulators have the ability block or impair TBC's custodial banking program as outlined in the second paragraph on page 28 of the proposed rule that states:

"Regulatory capital supports a depository institution subsidiary's ability to absorb unexpected losses. The capital standards and other constraints applicable at the custodial banking organization holding company level are expected to limit the amount of capital that such a holding company could distribute or allocate for other purposes, thus limiting any safety and soundness or financial stability concerns for the holding company as a whole. In addition, the agencies have regulatory and supervisory tools to constrain the ability of a depository institution to make capital distributions."

TBC's Reg H filing proposes that it invest custodial funds at the St. Louis Federal Reserve Bank in risk-free, Interest On Excess Reserves and it should be permitted to distribute those profits.

If TBC is profitable as a custodial bank, its Interest On Excess Reserve program reduces the likelihood of a default as compared with a program that generates income from:

Consumer loans

Commercial loans

Consumer mortgages

Commercial mortgages

Public policy:

Removing the loan or mortgage default risk and using the income method to define a custodial banking organization enhances TBC's ability to:

Support the State Department and/or,

Attempt to improve relations with Israel, other countries and the United States.

Sincerely,

Craig Heath

Craig Heath, President
Texico Bancshares Corporation

cc:

State Department

Texico Bancshares Corporation
P.O. Box 12
Texico IL 62889-0012
P: 618.266.7670

June 22, 2019

State Department
Harry S Truman Building
2201 C St NW
Washington, DC 20520

Re: Proposal to assist the State Department

Dear Sir / Madam:

As you will see in the enclosed documents, three banking agencies propose to redefine a custodial banking organization. If the State Department thinks Texico Bancshares Corporation ("TBC") could help it achieve its mission, it is encouraged to:

1. File a comment with the Federal Reserve Board of Governors. Instructions how to file a comment are provided at the bottom of page 1 and the top of page 2 of the enclosed "Advance notice of proposed rulemaking."
   _ http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm
   _ Scroll down to "Regulatory Capital Rule: Revisions to the Supplementary Leverage Ratio to Exclude Certain Central Bank Deposits of Banking Organizations Predominantly Engaged in Custody, Safekeeping and Asset Servicing Activities [R-1659].
   _ Closing date for comments is 7-1-2019.

2. Ask the agencies to:
   Allow a custodial banking organization to be defined as "predominately engaged in custody, safekeeping and asset servicing if $\geq$ 50% of its income is generated from these activities ("Income" method).

   Include "asset servicing activities" in the definition of both:
   The custodial banking organization.
   A fiduciary or custodial and safekeeping account.

   Allow the distribution of profits that are generated from risk-free instruments.

3. Explain to the agencies that it's worth the effort to implement programs that:
   Support the State Department and/or,
   Attempt to improve relations with Israel, other countries and the United States.

Sincerely,

Craig Heath

Craig Heath, President
Texico Bancshares Corporation

cc:
Board of Governors of the Federal Reserve System

Enclosures:
Agencies advance notice of proposed rulemaking
TBC's comments to agencies' advance notice of proposed rulemaking