American Bankers Association
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Hugh Carney
Vice President of Capital Policy
Office of Regulatory Policy
202-663-5324

September 24, 2015

By Email:

Mr. Robert de V. Frierson, Esq.
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: *Amendments to the Capital Plan and Stress Test Rules*

Dear Mr. Frierson:

The American Bankers Association[1] (ABA) is pleased to submit comments on the notice of proposed rulemaking,[2] titled "Amendments to the Capital Plan and Stress Test Rules" (Proposed Rule), published by the Board of Governors of the Federal Reserve System (Federal Reserve).

ABA welcomes and supports the Proposed Rule's elimination of the Basel I Tier 1 common ratio requirement, the indefinite delay of the Advanced Approaches for determining risk weighted assets in the Comprehensive Capital Assessment and Review (CCAR) and Dodd-Frank Act Stress Test (DFAST) framework, and the delayed incorporation of the Supplementary Leverage Ratio into the framework. We also appreciate the Federal Reserve's continuing commitment to improving the CCAR/DFAST framework and process, and we note that there have been significant process improvements made to date, including the earlier release of instructions and scenarios. While we appreciate and support several aspects of the Proposed Rule, other aspects of the Proposed Rule present concerns as described in further detail below. Moreover, the Proposed Rule—as well as recent commentary by Governor Daniel Tarullo[3]—notes that the Federal Reserve is considering a variety of issues related to the CCAR/DFAST rules that may

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[1] The American Bankers Association is the voice of the nation's $15 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $12 trillion in deposits and extend more than $8 trillion in loans.

[2] 80 Fed. Reg. 43,637 (July 23, 2015), available at http://www.gpo.gov/fdsys/pkg/FR-2015-07-23/pdf/2015-18038.pdf.

[3] Opening Statement by Gov. Daniel K. Tarullo (July 20, 2015), available at http://www.federalreserve.gov/newsevents/press/bcreg/tarullo-statement-20150720a2.htm.

result in changes the Federal Reserve would implement through a separate rulemaking.[4] In light of this ongoing review of the CCAR process, we highlight below other areas that we believe would benefit from additional consideration and further improvement that would enhance the supervisory value of the CCAR.

I. **The Proposed Rule should not include Volcker Rule deductions.**

The Proposed Rule incorporates statutory Volcker deductions even though the banking agencies have as yet proposed no changes to the regulatory capital rules to implement the deduction. The Volcker rule is a massive rulemaking by five regulatory agencies that applies to all banks regardless of size. The preamble to the final Volcker rule states—

> The Federal Banking agencies recognize that the regulatory capital rule imposes risk weights and deductions that do not correspond to the deduction for covered fund investments imposed by section 13 of the BHC Act. The Federal Banking agencies intend to review the interaction between the requirements of this rule and the requirements of the regulatory capital rule and expect to propose steps to reconcile the two rules.[5]

ABA is concerned that the Proposed Rule, which applies only to larger institutions and was issued only by the Federal Reserve, signals that the Federal Reserve, without the consensus of the other agencies, will be interpreting the Volcker rule to determine what exposures are covered funds and how those exposures should be deducted. We are also concerned that the Federal Reserve will be making Volcker determinations in the large bank context, out of view from the broader industry which may also be impacted. Accordingly, we believe it is premature for the Federal Reserve to incorporate the Volcker Rule deductions into the CCAR/DFAST framework. Without a notice and comment rulemaking to incorporate the Volcker Rule capital deduction into the regulatory capital rules, implementation of the deduction across covered bank holding companies (BHCs) would be inconsistent, and Federal Reserve determinations could have implications far beyond the scope of BHCs covered by the capital plan and stress test rules. Accordingly, ABA recommends delaying the Volcker Rule capital deductions in the CCAR process until the agencies have addressed the deduction under the regulatory capital framework subject to proper notice and comment.

II. **The Federal Reserve should relax fixed DFAST dividend assumptions for all banks.**

The Proposed Rule would "eliminate the fixed dividend assumptions for company-run stress tests"[6] for BHCs with consolidated assets of more than $10 billion but less than $50 billion. In

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[4] Proposed Rule, at 43,638.

[5] 79 Fed Reg 5731 (Jan 31, 2014) available at http://www.gpo.gov/fdsys/pkg/FR-2014-01-31/pdf/2013-31511.pdf.

[6] Proposed Rule, at 43,639.

removing the fixed assumptions, the Proposed Rule would allow these institutions instead to "incorporate their own dividend payment assumptions consistent with internal capital needs and projections."[7] However, the Proposed Rule would retain certain assumptions, including "no repurchase redemptions, or issuance of regulatory capital instruments."[8] These changes are designed to align better the stress test rules with the rules applicable to state member banks and the rules of other banking agencies.

ABA supports the rationale behind the proposed change that dividends made at the holding company level are limited because they are funded by the subsidiary bank that is subjected to dividend restrictions. Furthermore, ABA believes that given the similarities in business models for larger BHCs—especially where holding company dividends are primarily funded through dividends distributed by bank subsidiaries—this provision should be extended to apply to all banking organizations covered by the Federal Reserve's DFAST rules, including those over the $50 billion threshold arbitrarily set by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Additionally, this change, as currently proposed, enhances the stress testing processes at only certain BHCs by incorporating more realistic capital actions, thus increasing the value to risk management and strategic planning. Since the recent economic recession, BHCs have developed more prudent risk management frameworks and capital policies that are designed to be more responsive to deteriorating conditions. By expanding this proposed change to banks with assets over the $50 billion threshold, dividend payment assumptions in a stress scenario would most closely resemble the actions that are dictated by an individual BHC's policies and frameworks, as well as "consistent with internal capital needs and projections" for banks with assets over the $50 billion threshold. Ultimately, ABA believes that capital action assumptions in stress scenarios for purposes of DFAST and CCAR (as discussed further below) for all tested BHCs should be primarily determined by the limitations/requirements under applicable regulations (to ensure alignment and uniformity) and consistent with banks' internal capital management policies to reflect more credible outcomes. We believe that such an adjustment could be accomplished with minimal changes to the disclosure framework.[9]

III. Interaction of capital buffers and the Federal Reserve's practice of using a BHC's baseline capital actions to assess capital plans across all scenarios.

The Federal Reserve's practice with respect to its quantitative analysis under CCAR is to use a BHC's planned capital actions under the BHC baseline scenario as the capital actions that are subject to supervisory evaluation under the supervisory adverse and severely adverse scenarios. That is, the Federal Reserve assesses whether a BHC could continue to meet the minimum capital ratios specified under the rules throughout the planning horizon, even if adverse or

[7] *Id.*

[8] *Id.*

[9] Detailed disclosures of banks' internal capital policies should not be considered.

severely adverse stress conditions emerged *and* the BHC did not reduce planned capital distributions.[10]

We believe that this uniform assumption regarding a BHC maintaining its capital distributions planned under its baseline scenario throughout the supervisory stress scenarios is inappropriate, for two reasons. First, this practice fails to take into account that BHCs operate subject to internal capital management policies approved by their boards of directors that, among other things, include policy limits that would limit capital distributions and preserve capital in times of stress. Second, the Federal Reserve's practice of using baseline capital actions to evaluate a BHC's capacity to meet minimum regulatory capital requirements under stress is inconsistent with the requirements of the capital conservation buffer and the risk-based capital surcharge (G-SIB surcharge) applicable to BHCs that have been identified as global systemically important BHCs.[11] Under those rules, BHCs must maintain regulatory capital ratios above the regulatory minimums plus the applicable buffer amount(s) in order avoid limitations on capital distributions (including repurchases and divided payments) as well as limitations on discretionary bonus payments to executive officers.[12]

In response to comments regarding the limitations under the capital conservation buffer raised in connection with the Federal Reserve's June 2014 proposal to revise the CCAR/DFAST rules, the Federal Reserve acknowledged that the treatment, for the purposes of the CCAR/DFAST framework, of the limitations on capital distribution under the capital conservation buffer was under consideration and that the Federal Reserve would address the issue in due course.[13] Accordingly, the Federal Reserve determined, for purposes of the CCAR 2015 exercise, not to consider the limitations under the capital conservation buffer when performing its post-stress capital analysis of a BHC's planned capital distributions.[14] While the effects of the capital conservation buffer on BHCs' capital distributions would likely have been limited given the short overlap of the CCAR 2015 planning horizon and the phase-in of the requirement, the multi-year phase-in of the capital conservation buffer and G-SIB surcharge requirements overlaps with each quarter of the planning horizon for the upcoming CCAR 2016 exercise.[15]

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[10] See, e.g., Federal Reserve, Comprehensive Capital Analysis and Review 2015 Summary Instructions and Guidance (Oct. 17, 2014), at 14 and 28 (CCAR 2015 Instructions).

[11] The capital conservation buffer and G-SIB surcharge requirements are scheduled to be phased in beginning on January 1, 2016, becoming fully effective January 1, 2019.

[12] See, e.g., 12 C.F.R. § 217.11(a)(4).

[13] Capital Plan and Stress Test Rules, 79 Fed. Reg. 64,026, 64,038-64,039 (Oct. 27, 2014).

[14] CCAR 2015 Instructions, at 29, n. 43.

[15] For CCAR 2016, the nine-quarter planning horizon will cover the period from the first quarter of 2016 through the first quarter of 2018. Over the course of that nine-quarter period, the capital conservation buffer, for example, will phase in, starting with a 0.625 percent requirement in 2016 to 1.875 percent requirement in 2018.

Accordingly, we urge the Federal Reserve to address this issue in advance of the forthcoming CCAR 2016 exercise. In evaluating whether a BHC would be capable of continuing to meet minimum capital ratios specified under the rules throughout the planning horizon under stressed economic conditions, the Federal Reserve could consider measures to preserve capital, such as internal capital management policies, the capital conservation buffer, and the G-SIB surcharge. Consistent with the purpose of the buffer and surcharge requirements under the regulatory capital rules, i.e., to ensure that BHCs build up capital buffers outside periods of stress which can be drawn down as losses are incurred,[16] the buffer and surcharge requirements should continue to be excluded from the Federal Reserve's post-stress analysis. BHCs' capital plans should continue to be evaluated relative only to the minimum regulatory capital requirements.

IV. The Federal Reserve should provide greater transparency of the standards and factors being considered in its qualitative review.

In recent years, the Federal Reserve's review of large banks' CCAR submissions has put greater emphasis on qualitative factors. In many cases the qualitative factors being considered by the Federal Reserve are not obvious or transparent. In August 2013, the Federal Reserve issued an extremely useful document[17] outlining supervisory expectations and range of practices. However this document has not been updated recently.[18] ABA encourages the Federal Reserve to update supervisory expectations and range of practices annually in a manner that provides further context of individual bank results and supports individual bank efforts to enhance their stress testing framework. Moreover, releasing these supervisory expectations sufficiently in advance of the exercise's start date is critical.

[16] See Basel Committee on Banking Supervision, Basel III: A global regulatory framework for more resilient banks and banking systems (rev. June 2011), ¶ 122, available at http://www.bis.org/publ/bcbs189.pdf. See also Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule; Final Rule, 78 Fed. Reg. 62,018, 62,034 (Oct. 11, 2013) (noting that the capital conservation buffer is intended to be used by banking organizations at a time when they are experiencing losses).

[17] Federal Reserve, Capital Planning at Large Bank Holding Companies: Supervisory Expectations and Range of Current Practice (Aug. 19, 2013), available at http://www.federalreserve.gov/bankinforeg/bcreg20130819a1.pdf.

[18] We appreciate the Federal Reserve including an overview of common themes identified by supervisors during CCAR 2014 as part of the CCAR 2015 Instructions. *See* CCAR 2015 Instructions, at App. A. However, this discussion is not as extensive as the Federal Reserve's Supervisory Expectations and Range of Current Practice document.

V. **The Federal Reserve should reconsider its uniform tax rate assumption.**

For purposes of CCAR and DFAST, the Federal Reserve continues to apply a simplified uniform tax rate to projected pre-tax results for all BHCs when calculating net income or loss.[19] We believe that this assumption can have a material impact on after tax income, and accordingly on the calculation of capital positions and the Federal Reserve's assessment of and decision to object or not object to a BHC's capital plan.

There are several important fact patterns that can result in the simplifying tax assumption materially understating ending capital. First, with regard to tax-preferred investments, a BHC's tax expense is not merely determined by applying a tax rate to pre-tax income or loss. There are tax expense components that are not a function of income, such as low income housing credits, new markets credits and municipal security income. Many BHCs have significant investments that generate these tax benefits and have lower tax rates. Second, a BHC's recoverable tax history is an important factor, since tax benefits from operating losses and credits can be monetized through loss carrybacks. Such monetized benefits would result in a current tax benefit and not in incremental deferred tax assets (DTAs). Third, many BHCs enter the measurement period with a net deferred tax liability (DTL). Operating losses would initially decrease the DTL. Such losses absorbed by a DTL would not result in an incrementally DTA. Fourth, the threshold limitation capacity is an important consideration because the mechanics associated with determining the amount of DTA subject to the various capital limitations are affected by the individual level of DTAs and DTLs in the calculation. Further, different BHCs will have different threshold limitations. Fifth, international activities can have an impact on marginal tax rates. Although many DFAST banks operate primarily within the U.S. and have a marginal federal tax rate of 35%, plus some additional percentage for state taxes, several of the larger filers have material international activities, and it is very possible that significant portions of income or loss are being taxed at generally lower marginal rates.

To address the concern that the simplifying assumption may be inappropriately affecting the capital calculations, we recommend the BHC base tax calculations be used as a starting point. The calculations are prepared by the BHC's in accordance with Generally Accepted Accounting Principles (GAAP). The simplified rate should only be applied to the marginal changes in pre-tax income (loss) and to the marginal change in pre-tax other comprehensive income (OCI) calculated by the Federal Reserve for stress testing. The related capital worksheet calculations would need to be adjusted to reflect this change in approach. Alternatively, selected additional tax information may need to be included in the submissions to allow the Federal Reserve to enhance the tax calculations.

[19] See Board of Governors of the Federal Reserve System; Dodd-Frank Act Stress Test 2015: Supervisory Stress Test Methodology and Results; page 13.

Thank you for considering the concerns raised in this letter. If you have questions please contact Hugh Carney, Vice President of Capital Policy, at 202 663 5324 (hcarney@aba.com).

Respectfully Submitted,

Hugh C Carney

Hugh C. Carney
Vice President of Capital Policy
American Bankers Association
1120 Connecticut Avenue
Washington, D.C. 20036