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Via Electronic Delivery

Board of Governors of the Federal Reserve System
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Re: Prudential Standards for Large Bank Holding Companies and Savings and Loan Holding Companies
FRB Docket No. R-1627; RIN 7100-AF20

Proposed Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements
FRB Docket No. R-1628; RIN 7100-AF21
FDIC RIN 3064-AE96
OCC Docket ID OCC-2018—0037; RIN 1557-AE56

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 two related proposals to change the applicability thresholds for (i) certain regulatory capital and liquidity requirements and (ii) prudential standards for large bank holding companies and savings and loan holding companies (the "Proposed Rules").[1] The Proposed Rules are intended to reflect the

1 *See Prudential Standards for Large Bank Holding Companies and Savings and Loan Holding Companies*, 83 Fed. Reg. 61408 (Nov. 29, 2018) ("FRB Proposal"); *Proposed Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements*, 83 Fed. Reg. 66024 (Dec. 21, 2018) ("Interagency Proposal").

Agencies' work towards tailoring regulatory requirements, as well as the continued implementation of Section 401 of the Economic Growth, Regulatory Relief, and Consumer Protection Act ("EGRRCPA").

American Express strongly supports the ongoing efforts of the Agencies to simplify and tailor the application of U.S. prudential regulatory requirements and capital and liquidity rules to reflect a firm's size, complexity, and systemic footprint. We appreciate the work of the Agencies, and we view the Proposed Rules as a thoughtful and measured step towards achieving a supervisory segmentation of banking organizations that is more tailored to the complexity and risk profile of different organizations and business models – an appropriate *recalibration* but not a relaxation of expectations. We focus our comments here on opportunities for the Agencies to further refine the Proposed Rules to be more risk-sensitive while still meeting the goals of promoting safety and soundness and enhancing financial stability.

I. Implementation of Tailoring

a. The Agencies should Appropriately Index any Dollar-Based Thresholds to Increase over Time to Remain Consistent with the Purpose of the Proposed Rules and the Principles of Tailored Supervision

We believe that it is critical that any final rules incorporate an appropriate indexing of dollar-based thresholds. In particular, if dollar thresholds remain in the final rules, we recommend that the Agencies index each of the $75 billion risk-based indicator thresholds, as well as the $250 billion and $700 billion size thresholds, to an appropriate metric such as total assets of commercial banks, as published periodically by the Federal Reserve on the H.8 statistical release: Assets and Liabilities of Commercial Banks in the United States ("Commercial Bank Assets").[2]

As drafted, the Proposed Rules would segment the industry into four categories principally based upon where a firm measures relative to a series of fixed dollar thresholds for certain size and risk-based metrics. As firms reach different thresholds, different supervisory consequences may apply, including potentially moving into a category of heightened prudential requirements and/or capital and liquidity standards. We agree that subjecting firms to requirements of increasing stringency as they increase in complexity and risk profile is consistent with tailoring supervisory requirements to be more risk sensitive. However, holding those thresholds static over time would eventually defeat the purpose of that tailoring.

Tailoring is generally intended to align capital, liquidity, and prudential requirements to the size, complexity, and overall risk of banking organizations. Fixed dollar thresholds are inapposite to this purpose, because – even assuming they are set correctly at the particular moment when they are established – all fixed thresholds will necessarily become over-inclusive as individual firms and the financial industry grow with the passage of time. We respectfully submit that organic growth that reflects growth in the broader economy and the financial system without a material change to a firm's business model would not cause, for example, a

2 Federal Reserve Statistical Release: *Assets and Liabilities of Commercial Banks in the United States - H.8*, available at https://www.federalreserve.gov/releases/h8/.

hypothetical firm with $150 billion in total assets in 2015 that reaches $250 billion in assets in 2027, to experience a sudden change in its systemic risk profile.

Accordingly, we believe that it is critical that any dollar thresholds used in the final rules be appropriately indexed to grow over time generally in line with growth in the financial system. A firm whose overall size and business lines grow in line with growth in the broader financial system is unlikely to have a changing systemic risk profile that would warrant shifting that firm to a heightened level of capital and liquidity expectations and prudential requirements simply because that firm crossed a fixed threshold that was set years earlier.

Indexing each of the thresholds in the Proposed Rules to growth in Commercial Bank Assets, for example, would be more consistent with the objectives of tailoring. The Commercial Bank Assets metric is a publicly observable metric that the Federal Reserve currently publishes on a periodic basis. Growth in Commercial Bank Assets as reported by the Federal Reserve should logically correlate to growth in financial system assets, and accordingly metrics indexed to that growth should grow in line with the industry, and so should continue to align with the risk cohort they were intended to capture when first set.

To maintain the appropriate tailoring, indexing would occur automatically on an annual basis, and would be the greater of: (i) zero; or (ii) the aggregate percent increase in Commercial Bank Assets from a baseline year (*e.g.*, 2018). Indexing would reflect the aggregate change from a baseline year, rather than year-over-year change, in order to avoid significant fluctuations as economic conditions change.

b. The Agencies should Refine the Cross-Jurisdictional Activity Calculation to Avoid Inequitable Outcomes

The Proposed Rules would introduce a new risk-based indicator: "cross-jurisdictional activity," which would be defined as the sum of cross-jurisdictional claims (assets) and cross-jurisdictional liabilities as reported on the Federal Reserve's form FR Y-15.[3] We understand the Agencies' view that consideration of cross-jurisdictional activity is appropriate to help "promote competitive equality among U.S. banking organizations and their foreign peers and competitors" while applying standards that reflect the risk profile of the firms.[4] However, below we suggest certain refinements to the definition of cross-jurisdictional activity that are necessary to avoid competitively *inequitable* outcomes.

i. Cross-Jurisdictional Liabilities should Exclude Operating Payables Arising in the Ordinary Course of Business

Including all cross-jurisdictional liabilities in the definition of cross-jurisdictional activity has the potential to impact American Express in a unique and inequitable way because our business model involves American Express being directly obligated for merchant payables. Our cross-jurisdictional claims and liabilities do not reflect complex cross-border business activities, transactions, relationships, or capital markets instruments – the majority of our cross-

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3 FRB Proposal at 61414.

4 *See* FRB Proposal at 61410.

jurisdictional activity represents routine card transactions: Card Member receivables and loans on the "cross-jurisdictional claims" side of the calculation, and merchant payables on the "cross-jurisdictional liabilities" side.

The treatment of merchant payables as foreign liabilities, however, disproportionately impacts American Express. American Express uniquely maintains an integrated network involving direct relationships with both Card Members (as a card issuer) and merchants (as an acquirer), and handles all key aspects of those relationships. Among these relationships on the merchant side is retaining and handling merchant payables directly. For example, where an American Express Card Member uses a card to make a payment in a foreign jurisdiction, American Express retains the obligation to pay that foreign merchant directly. Although the timing can vary with local practice, American Express typically pays its foreign merchants within several days of a transaction. In the meantime, however, that foreign card transaction generally would create a foreign liability for American Express.

By comparison, the same transaction typically does not create a foreign liability for our card-issuing peers with a different business model. A banking organization that is only a card issuer and not a merchant acquirer (and thus distinct from American Express) will also have cardholders who use a card to make a payment in a foreign jurisdiction. In that structure, the issuer typically will rely on a third party merchant acquirer, which sits outside of the banking system, to face the merchant and pay the merchant directly. The issuer may thus have a liability to the third party, which is generally a U.S.-based entity, but not to the merchant. Accordingly, even a foreign card transaction with a foreign merchant would not create a foreign liability for this issuer.

Notably, the American Express structure does not change the nature of the obligation to the merchant, nor does it change the nature of the risk to American Express.

The Proposed Rules would thus treat the same liability to the same merchant as "cross-jurisdictional activity" when held by American Express, but not when held by a banking organization that is only a card issuer. This outcome disproportionately punishes American Express for its unique business model while running counter to the laudable policy goals of tailoring requirements to risk profile and promoting competitive equality among similarly situated U.S. and foreign firms.

As initially conceived, the cross-jurisdictional activity component of the G-SIB score methodology was intended to reflect the view that banking organizations with a large global presence are generally more difficult and costly to resolve than purely domestic institutions – with a particular focus on, *e.g.*, deposits and balances placed with other banking organizations.[5] While non-U.S. deposits may potentially complicate a cross-border resolution scenario, ordinary course payables are generally short-term in nature, disaggregated exposures that are reasonably simple to identify, and addressable through the ordinary processes that would be available to creditors in a resolution scenario.

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5 *See, e.g.*, 80 Fed. Reg. 49082, 49097 (Aug. 14, 2015); *accord* FRB Proposal at 61414.

Accordingly, we recommend that the Agencies revise the calculation of cross-jurisdictional activity in the Proposed Rules to exclude operating payables, such as merchant payables, arising in the ordinary course of business. Excluding such payables would avoid a disproportionate and unintended impact on American Express, without compromising the general policy objectives of including cross-jurisdictional activity as a factor.

In furtherance of the tailoring goals of "simplicity, transparency, and efficiency," we recommend that the Federal Reserve refine the reporting of cross-jurisdictional liabilities in the "cross-jurisdictional activity" section of the Federal Reserve's form FR Y-15. Specifically, we recommend that Schedule E of the current form FR Y-15 expand line item 4 of the schedule – "total cross-jurisdictional liabilities" – to separately identify the following components: (i) deposits; (ii) trading liabilities; (iii) borrowings (including short-term borrowings, long-term debt, Federal funds purchased, and repurchase agreements); (iv) accounts payable; and (v) other liabilities. Enhancing the granularity of this reporting item on the form FR Y-15 would provide additional insight to the Federal Reserve and market participants regarding the composition of firms' cross-jurisdictional liabilities, without materially increasing the burden of filing the FR Y-15 report.

We would then recommend, for the foregoing reasons, that item (iv) above – accounts payable – be excluded from the calculation of cross-jurisdictional activity for purposes of the Proposed Rules. Based upon our analysis of publicly available information, excluding this line item from the calculation of cross-jurisdictional activity would correct that disproportionate impact for American Express without fundamentally altering the general segmentation achieved in the Proposed Rules.

Thus, we believe that expanding the granularity of the reporting and excluding this line item in a transparent way would achieve a more appropriate and competitively equitable tailoring, while maintaining the overall transparency of the approach of the Proposed Rules.

c. Category IV Firms should not be Required to File the Form 2052a

The Federal Reserve's form FR 2052a – "Complex Institution Liquidity Monitoring Report," collects quantitative information on selected assets, liabilities, funding activities, and contingent liabilities and uses the information to monitor an organization's overall liquidity profile. Notably, Appendix VI to FR 2052a is intended to assist firms subject to the Liquidity Coverage Ratio ("LCR") rule in mapping the provisions of the LCR rule to the unique data identifiers reported on FR 2052a. Under the Proposed Rules, Category IV firms would no longer be subject to either the "full" or "modified" versions of the LCR rule. However, the preamble to the Proposed Rules notes that Category IV firms would remain subject to monthly, "tailored" 2052a reporting requirements.

In light of the close relationship between the FR 2052a and the LCR rule, a requirement for Category IV firms to file FR 2052a could effectively necessitate each Category IV firm to maintain a "pseudo LCR" for the sole purpose of fulfilling the reporting requirements, which would be inconsistent with both tailoring generally and the specific relief provided. Accordingly, the Federal Reserve should eliminate FR 2052a reporting requirements for Category IV firms.

To the extent it is determined that liquidity reporting remains appropriate for Category IV firms, the Federal Reserve's former reporting form FR 2052b Liquidity Monitoring Report could form the basis for any future reporting. Although it is currently inactive, the form FR 2052b is an existing reporting form that appears to have been tailored to capture and provide a basis for the Federal Reserve to monitor the liquidity profiles of less complex banking organizations. Accordingly, relying upon the FR 2052b (or a modified form based thereon) to gather liquidity information from Category IV firms should more appropriately align the value of the information collected with the burden of producing that information.[6]

d. Category III Firms should be Subject to LCR Requirements based upon the Current Modified LCR Rule

The Agencies should rely upon the current modified LCR rule as the basis for LCR requirements for all Category III firms. Category III firms should not be subject to the "full" LCR nor a "lite" version of the full LCR that includes the maturity mismatch add-on factor.

When the Federal Reserve adopted its LCR rule, it included a modified, less stringent version to apply to certain BHCs that would not otherwise be subject to the "full" LCR requirements.[7] Rather than introduce a new type of LCR requirement as contemplated by the Proposed Rules, the Agencies should use the existing modified LCR to develop the less stringent LCR requirement for all Category III firms. Application of the full LCR – if retained for any firms – should be limited to the firms identified as G-SIBs, consistent with the intention of applying the full LCR to the largest and most complex institutions with the most significant liquidity risk profiles.

In particular, the modified LCR does not include the maturity mismatch add-on factor. The maturity mismatch add-on factor represents a material deviation from the Basel Committee standards. Although we generally believe that the maturity mismatch add-on factor should be eliminated for all U.S. firms subject to the LCR because of the potential implications for global competitiveness, we certainly would not support the introduction of a new LCR requirement for Category III firms that includes the add-on factor. Applying the maturity mismatch add-on factor to smaller regional banks is inappropriate and could create a highly uneven playing field for banks with vastly different business models. For example, based on publicly available data as of June 30, 2018, the size of this add-on factor as a portion of net cash outflow ranges from 1.5% to 92% for U.S. non-GSIBs.[8]

In addition, Category III firms should be allowed to calculate LCR on a monthly basis, instead of the daily calculation requirements in the current proposals. A monthly calculation

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6 To the extent that the Federal Reserve's reporting forms, including the form FR Y-15, rely on data currently reported on the form 2052a, we recommend that the instructions to those reporting forms be revised such that the FR 2052a not be the exclusive source of that data.

7 12 C.F.R. Part 249, Subpart G.

8 American Express calculation based upon banking organizations' public disclosures as required by the LCR rule (12 C.F.R. Part 249, Subpart J), as of June 30, 2018.

would align with the FR 2052a reporting requirements for firms in such category, and reflects the less complex nature of these firms relative to the G-SIBs.

e. The Definition of Weighted Short-Term Wholesale Funding should be Revised to Reflect Original Maturity rather than Remaining Maturity

As currently defined, weighted short-term wholesale funding ("STWF") generally includes all unsecured wholesale funding with a *remaining* maturity of one year or less, regardless of original maturity. We believe that the definition should be revised to focus on original maturity.

Generally, the aggregate remaining maturity of funding instruments provides a snapshot of the potential funding need for a given firm. This funding need is managed by liquidity regulations including liquidity stress testing and, where applicable, the LCR and – if finalized in the United States – the Net Stable Funding Ratio ("NSFR"). On the other hand, the definition of STWF appears to have been intended to address the particular risk associated with an over-reliance on short-term funding such as "unsecured commercial paper, asset-backed commercial paper, wholesale certificates of deposits, and securities financing transactions," and the associated risk of funding long-term assets using short-term instruments.[9] In this context, only a measurement based on original maturity would provide an accurate measure of a firm's reliance on short-term funding. The focus on STWF was also intended to incentivize firms to reduce their reliance on short-term funding in favor of more stable sources. However, by focusing the definition of STWF on remaining maturity, the current definition of STWF inappropriately captures long-term debt that is approaching maturity, notwithstanding the significant proven differences in the risk profile of long-term and short-term sources of funding.

Short-term funding presents a particular risk in significant part as a result of the potential for near-term volatility in that market. Funding through long-term debt instruments reduces that volatility considerably. Although long-term debt that is approaching maturity may need to rely on a willing market to be rolled-over, the term of the debt and management of long-term debt as a funding source has a much longer window of preparation and evaluation than that utilized for short-term funding. This deliberative planning process for long-term debt is also utilized in connection with the replacement of long-term funding as it winds down. In addition, the liquidity risk associated with funding using long-term debt is already adequately addressed through existing liquidity stress testing regulations and practices. Thus, bundling long-term debt with short-term debt in order to disincentivize the latter is not necessary from a risk perspective and presents a distorted picture of a firm's funding profile. From a policy perspective, defining STWF based upon remaining maturity fails to act as an incentive to firms to reduce their reliance on true short-term funding, because it treats all unsecured wholesale funding the same as it approaches maturity.

Accordingly, we believe that the definition of STWF should be revised to include only unsecured wholesale funding with an *original* maturity of one year or less.

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9 *See, e.g.*, 79 Fed. Reg. 75473, 75474 (Dec. 18, 2014).

II. Alternative Tailoring Methodology

a. The G-SIB Method 1 Score provides a Reasonable Alternative to the Dollar-Thresholds Approach in the Proposed Rules

Assuming a reasonable threshold level is selected, the G-SIB method 1 score would provide a reasonable alternative to the dollar-based thresholds set out in the Proposed Rules.

The Basel Committee on Banking Supervision (the "Basel Committee") and the Federal Reserve developed the method 1 score methodology to be a more comprehensive measure of the size, complexity, and overall systemic risk of individual banks.[10] This approach generally has two advantages over fixed dollar-based thresholds. First, it evaluates systemic importance across a comprehensive set of attributes – asset size, interconnectedness, substitutability, complexity, and cross-jurisdictional activity. Second, the data used to evaluate systemic importance are updated periodically to reflect changes over time.[11]

The inclusive and dynamic nature of the method 1 score method make it a reasonable alternative to dollar-based thresholds, and preferable to fixed dollar-based thresholds. As applied to tailor application of capital and liquidity requirements and prudential standards, we believe it would be appropriate for the line between Category IV and Category III to be set initially at a method 1 score of 35, and the line between Category III and Category II to be set initially at 55. Such a segmentation would generally retain the categories as set forth in the Proposed Rules, and would be dynamic enough to adjust over time based upon the underlying component factors.

b. The G-SIB Method 2 Score Methodology is Significantly Miscalibrated when Applied to Non-GSIBs

American Express opposes use of the G-SIB method 2 score for tailoring and supervisory segmentation. Unlike the method 1 score, the method 2 methodology represents a material deviation from the Basel Committee standards. Further, in practice, applying the method 2 scoring methodology to non-GSIBs results in the significant overrepresentation of short-term wholesale funding component in the overall score.

The method 2 scoring methodology is a U.S.-specific, Federal Reserve creation intended to be used by firms already identified as G-SIBs to calculate the G-SIB surcharge that will apply. In developing the method 2 scoring methodology, the Federal Reserve incorporated the use of a "fixed conversion factor." The fixed conversion factor was selected when the general G-SIB surcharge methodology was developed based upon data specific to the 8 U.S. bank holding companies identified at the time as G-SIBs. The fixed conversion factor was reverse engineered

10 *See* Basel Committee, *Global systemically important banks: updated assessment methodology and the higher loss absorbency requirement* (July 2013); *Regulatory Capital Rules: Implementation of Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Final Rule*, 80 Fed. Reg. 49,802 (Aug. 14, 2015); 12 C.F.R. § 217.400 *et seq.*

11 The Federal Reserve's FR Y-15 Banking Organization Systemic Risk Report, which collects data comprising the five components underlying the systemic indicator approach, is submitted by BHCs with total consolidated assets of $50 billion or more on a quarterly basis. The aggregate systemic indicators used as the denominators to calculate a banking organization's systemic indicator score are updated on an annual basis.

using this G-SIB-specific data in order "to weight the short-term wholesale funding amount such that the short-term wholesale funding score accounts for approximately 20 percent of the method 2 score."[12] Thus, the method 2 methodology used G-SIB data to target a weighting so that each of the 5 components of the method 2 score represented approximately 20 percent of the total score.

Applying the method 2 score methodology to non-GSIBs creates a much different result. Based upon internal calculations using public data, we estimate that the STWF component of the method 2 scores of non-GSIBs represents on average approximately <u>66 percent</u> of the total method 2 score. This extremely disproportionate result reflects that the method 2 methodology would not be appropriate to export outside of its use in the G-SIB surcharge methodology, and certainly would not be the right basis upon which to segment the industry for tailoring purposes.

III. Conclusion

We greatly appreciate the work of the Agencies in developing the Proposed Rules and appreciate opportunity to comment. We respectfully submit that the Agencies should take the discrete steps outlined above to further refine the tailoring set out in the Proposed Rules to ensure that the final rules are more risk-sensitive while still meeting the goals of promoting safety and soundness and enhancing financial stability.

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12 79 Fed. Reg. at 75489; *see also*, 80 Fed. Reg. at 49100.

Thank you for considering our comment letter. We appreciate the opportunity to share our views with the Agencies 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,

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