American Bankers Association
Building Success. Together.

Frank Keating
President and CEO
202-663-5111
fkeating@aba.com

August 11, 2014

The Honorable Janet Yellen, Chair
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

The Honorable Martin J. Gruenberg, Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

The Honorable Thomas Curry
Comptroller of the Currency
Office of the Comptroller of the Currency
400 7th Street, SW
Washington, DC 20219

Dear Chair Yellen, Chairman Gruenberg, and Comptroller Curry:

Liquidity is a key element of safe and sound bank operations, along with adequate capital and strong earnings. Also like capital and earnings, taken alone, liquidity it is not a cure-all.

On behalf of the American Bankers Association's council of mid-size banks, the American Bankers Council,[1] I am writing to you to request a further round of public comment on the Agencies' proposed regulations to implement the Basel Committee on Banking Supervision's (BCBS) international Liquidity Coverage Ratio (LCR). We understand that the central purpose of the BCBS's work is to develop global liquidity standards, notwithstanding the unique characteristics of national jurisdictions. However, given the novelty of the LCR, and its scope of proposed application in the United States (recognizing the degree to which its definitions and biases may come to be applied to all U.S. banks), we believe the Agencies need to take the time to consider the LCR's impact on not only the institutions envisioned in the negotiations in Basel, but also on the broader banking industry and U.S. financial markets.

While there are unquestionably some basic principles of liquidity that apply to banks universally, an institution's liquidity position is inherently affected by local laws, traditions, financial structure and environment, and other conditions particular to one nation or jurisdiction. With liquidity standards, we are asking, in effect: what causes investors and counterparties to panic? Given the complexity of this proposed rule and the impact it will have on the U.S. banking industry and U.S. financial markets—directly and indirectly—it is important that the Agencies be deliberate in crafting the LCR rules so that they are properly targeted to what can and should be done in the United States, avoiding disruptive and unintended consequences.

We support strong and effective liquidity regulation. It is precisely for that reason that we believe that the Agencies need to be sure that the standards meet the realities of U.S. banks and the financial markets. A bad fit could in fact undermine liquidity and the resilience of our system. Where necessary, and based upon a fulsome public comment period, the Agencies should recalibrate and refine the Proposal prior to finalizing the regulation and applying it to the banking industry.

[1] The ABC is a council within ABA, comprised of the leadership of banks generally within the $10 billion to $100 billion asset range.

As indicated by over 100 comment letters submitted in response to the initial Proposal, there are significant issues that need to be further considered before the rule will be ready to fit the unique characteristics of U.S. banks and markets. The comment letters provide details on how the Proposal would adversely impact banks and their customers. We note that the problems with the LCR Proposal were articulated not just by banking organizations, but also by members of Congress, financial market participants, and bank customers.[2]

One of the key concerns that need further consideration is the Proposal's excessive limitation on the types of assets that qualify as High Quality Liquid Assets (HQLA), allowing little more than government instruments, with a straitened allowance for other securities such as GSE securities and certain investment grade corporate debt. We believe that the Proposal's definition of HQLA fails to recognize the strength of U.S. financial markets and the actual quality of assets available for liquidity purposes. In doing so, it creates an operationally narrow supply of HQLA that encourages aggressive acquisition of HQLA in good times and by institutions with the greatest market clout. Perhaps even more worrisome, the constrained supply of HQLA could precipitate panicked acquisition of HQLA and crisis conditions in times of financial stress, when demand would likely rise sharply and supply disappear. Moreover, in prosperous times, favoring concentration of bank investment in the proposed narrow range of HQLA instruments will almost certainly decrease liquidity in asset markets disfavored by the rule, such as those for municipal securities and corporate debt, among others.

Given that the required amount of HQLA to which a bank must have access is determined by the degree to which funding is assumed to leave the bank in a period of idiosyncratic or systemic stress, it is important that the regulation's assumed outflows and attendant run-off rates be reflective of actual U.S. experience rather than global averages or compromises developed in international negotiations. In order to ensure that the LCR is properly calibrated, the banking agencies need to study past behavior of bank counterparties and set run-off rates based on empirical U.S. data so that the LCR reflects both a bank's true liquidity position and the U.S. historical behavior of various funding mechanisms during times of stress. Moreover, while a stated aim of the LCR is the repricing of liquidity, the market impact of this repricing of financial instruments on banks beyond the explicit scope of the Proposal and other market participants needs to be addressed.

It is not clear that the Agencies have performed analysis outside of gathering data from a handful of internationally active banks as part of the quantitative impact study by BCBS. While these data help inform BCBS policy decisions regarding the world's largest, internationally active banking organizations, they are insufficient to understand the consequences of U.S. implementation, particularly given the Agencies' proposed intention to apply the new standards directly to many domestic banks and the likelihood that principles in the Proposal will come to be applied to U.S. banks generally.

There is time for a more robust consideration. We note that the European Union (EU) recently postponed implementation of the LCR in recognition of the significant potential it has to harm European economies. The EU is taking time to consult with affected parties and further study the impact of the LCR on key financial markets before issuing a final rule. We strongly urge the U.S. Agencies to be equally sensitive to the problems of applying the global standard to U.S. banks and the material adverse impact it could have in the U.S. if finalized as proposed. For these reasons, we request that you submit the Proposal for further public comment and agency review.

Sincerely,

Frank Keating

[2] For example see: Congress of the United States, Representatives Jeff Denham, Juan Vargas, Gary Miller, Brad Sherman, Devin Nunes, Grace Napolitano, Ken Calvert, Tony Cardenas, and Gloria Negrete McLeod US Chamber of Commerce Center for Capital Markets Competitiveness, A joint comment letter submitted by a group of non- financial companies and The National Association of State Treasurers