BNY MELLON

October 21, 2013

Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, N.W.
Washington, D.C. 20551
Attn: Robert de V. Frierson, Secretary
Docket No. R-1460
RIN 7100-AD99

Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
Attn: Robert E. Feldman
RIN 3064-AE01

Office of the Comptroller of the Currency
250 E. Street, S.W.
Mail Stop 2-3
Washington, D.C. 20219
Attention: Legislative and Regulatory Activities Division
Docket ID OCC-2013-0008
RIN 1557-AD69

Re: *Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and Their Subsidiary Insured Depository Institutions*

Ladies and Gentlemen:

The Bank of New York Mellon Corporation (**"BNY Mellon"**)[1] appreciates the opportunity to provide comments to the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency (collectively the **"Agencies"**), with respect to proposed supplementary leverage ratio enhancements (hereinafter the **"Proposal"**). Our role as a global custodian and a major clearing bank provides us with a unique perspective on how the Proposal may impact financial markets and market participants. As a matter of first principles, BNY Mellon strongly supports the enactment of leverage requirements that function as a "simple non-risk based 'backstop'" to the existing risk-based capital regime, which is the stated purpose of the Basel Committee on Banking Supervision (the **"Basel Committee"**).[2]

We welcome the increased regulatory attention to bank capital and believe efforts to properly align and calibrate risk-based and leverage capital requirements are critical to ensuring

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1 BNY Mellon is a global investments company dedicated to helping its clients manage and service their financial assets throughout the investment lifecycle. BNY Mellon performs investment management and investment services in 35 countries and more than 100 markets. As of September 30, 2013, BNY Mellon had $27.4 trillion in assets under custody and/or administration, and $1.53 trillion in assets under management.

2 *See* ¶ 2 of the June 2013 Basel Consultation entitled *Revised Basel leverage ratio framework and disclosure requirements* (the **"Basel Consultation"**), which states "The Basel III reforms introduced a simple, transparent, non-risk based leverage ratio to act as a credible supplementary measure to the risk-based capital requirements. The leverage ratio is intended to...reinforce the risk-based requirements with a simple, non-risk 'backstop' measure."

financial stability. But appropriately establishing such requirements is not only important for macroprudential policy reasons – real market and competitive consequences will result from the capital reforms ultimately enacted by the Agencies. For this very reason, we believe it is critical that the Agencies consider post-crisis capital reforms in a holistic manner. We are concerned that portions of the Proposal could operate at cross-purposes with other recent macroprudential, capital, and liquidity reforms. Enacting the Proposal without changes would undercut the Basel III Accord both by turning the supplementary leverage ratio (**"SLR"**) into the binding capital constraint for many U.S. banking organizations under normal circumstances, and by discouraging many firms from holding reserves of liquid assets. In short, the Agencies are not simply proposing super-equivalent leverage standards, which would be their prerogative, but are proposing to totally change the fundamental balance present in the existing U.S. regulatory capital framework. This is not only unwise and at odds with both the policy objectives of the Basel Committee and decades of regulatory capital policy, it would also put U.S. firms at a competitive disadvantage with other global banks.

Custody banks[3] gather deposit liabilities incidental to the provision of safekeeping and custody services, generally investing the proceeds of this stable funding in a high volume of low-risk assets such as government securities and central bank placements. This conservative approach not only increases custody bank resiliency, it is also dictated by the business model: custody banks must remain highly liquid and highly creditworthy to serve clients best. BNY Mellon elucidated our primary concerns with a binding leverage requirement in our recent submission to the Basel Committee, filed in response to the Basel Consultation.[4] Those same fundamental perceptions and comments are relevant to the Agencies' release as well.[5]

Avoiding the market-disrupting consequences of applying a binding leverage measure under normal circumstances on low-risk banks will require a holistic reassessment of the proposed SLR buffer. BNY Mellon believes the Agencies should reconsider and revise the Proposal's calibration and denominator components. We recommend two primary adjustments to the denominator upon which the SLR buffer rests:

- The SLR's denominator should exclude central bank deposits.
- The SLR's denominator should also exclude the sorts of high-quality sovereign debt instruments mandated by new liquidity rules.

[3] Throughout this commentary we use the terms "custody" and "custody bank" to reference the full scope of services offered by BNY Mellon, especially our processing, clearance, and safekeeping businesses.
[4] BNY Mellon Comment Letter to the Basel Committee dated September 20, 2013.
[5] As a preliminary matter, we concur with the comments of The Clearing House Association, L.L.C. that the Agencies cannot precisely evaluate the consequences of the Proposal because substantial uncertainty remains regarding changes that are being considered pursuant to the Basel Consultation and otherwise, and the Agencies have not yet provided the details of any global systemically important bank (**"G-SIB"**) capital surcharge that they may adopt as part of the risk-based capital framework. We believe that the Agencies should not proceed with the Proposal until informed decisions have been made on the entire waterfront of related regulatory initiatives. At this time, we feel that it is premature for the Agencies to change the calibration of the SLR until relevant proposals are resolved and their full impact can be considered together. Because the SLR is not currently intended to become effective in the United States until January 1, 2018, there is more than ample time to permit these other initiatives to be completed and any re-calibration of the ratio considered and addressed thereafter.

Further, we are deeply concerned that the Proposal eschews differences among the eight U.S. G-SIBs previously acknowledged by U.S. and global regulators.[6] There is significant diversity amongst the G-SIB cohort, in risk profile, operating structure, and approaches to balance sheet management. A one-size-fits-all approach to any SLR buffer is unduly punitive for banks with significant amounts of highly liquid low-risk assets. We recommend that the Agencies track proposed SLR increases with the 1 to 2.5% risk-based capital surcharges under development for G-SIBs.

We believe these modifications to the Proposal are necessary and consistent with its stated purpose: fashioning a simple and transparent leverage requirement. This commentary is divided into four parts. Part I addresses the tenuous connection between the Agencies' stated macroprudential policy objectives and the proposed application of a uniform buffer requirement for all G-SIBs. Part II explains BNY Mellon's concerns with including central bank deposits in the SLR's denominator. Part III provides our perspectives as a large clearing agent of government securities on systemic risk consequences of including high-quality sovereign instruments in the denominator. Parts II and III include, as appropriate, tailored policy solutions for the Agencies consideration. Last, Part IV addresses our concerns with the requirement to use the average of three, month-end spot measurements to calculate SLR denominator elements.

Part I: The Agencies should consider graduated SLR buffers to account for the highly liquid, low-risk nature of certain G-SIB balance sheets.

It is axiomatic that the eight U.S. G-SIBs do not all pose the same risks to financial stability. The Agencies themselves endorse this proposition in the Proposal by questioning whether they should graduate any SLR buffers ultimately imposed. We believe such graduation is necessary and appropriate.

The Proposal provides significant detail concerning the prudential and regulatory concerns that undergird the belief that an enhanced leverage measure is necessary. Among the factors cited to explain the imposition of the SLR buffers are: size, insufficient capital relevant to pre-crisis levels, preventing G-SIB insolvencies, substantial off-balance sheet exposures, and purported "gaming" of the risk-based capital rules.[7] Considering all of these factors, BNY Mellon is an outlier among the group of banks to which the Agencies intend to apply the SLR buffers. Our firm is half as large as the asset threshold proposed by the Agencies. Likewise, our

[6] For instance, the U.S. banking agencies were highly active in the Basel Committee and Financial Stability Board efforts to craft the capital surcharge structure for G-SIBs, which differentiate enhanced capital requirements between firms according to their idiosyncratic risk profiles. Further, in the United States, the FDIC recognized the different nature of custody banks in its deposit insurance assessment calculation methodology. 12 C.F.R. § 327.5(c).

[7] To further buttress the view that the G-SIB approach to delineating between institutional risk profiles should be imported to the U.S. SLR rules, we would commend to the Agencies' attention the recent announcement by the Basel Committee that the G-SIB surcharge methodology required updating because it was overstating the systemic importance and financial stability risks of banks that are core parts of the financial infrastructure (e.g., BNY Mellon). Going forward, to ensure that banks with significant assets under custody are properly separated from firms with other activities, there will be a cap on the "substitutability" factor used in the G-SIB methodology. These changes are addressed in the Preface of the Basel Committee's Consultative Document, *Global systemically important banks: updated assessment methodology and the higher loss absorbency requirement (July 2013).*

risk of insolvency is both absolutely and relatively low because our operations do not involve material credit or trading risks. Moreover, we have a highly liquid balance sheet that is primarily funded through stable operational deposits.

BNY Mellon's business model also does not raise the same concerns associated with model imperfections. We are not completely unsympathetic to the concerns that have been raised regarding certain modeling techniques. But, unlike many global banking organizations, we do not engage in complex trading activities, nor do we have large capital markets operations. Due to our unique business model, the risk-based capital requirements *are* a simple and transparent metric by which to judge our capital adequacy. Likewise, BNY Mellon has significantly increased our levels of high-quality tier 1 common equity since the financial crisis. Further, the Basel III capital reforms recently put in place by the Agencies require that capital to be a higher quality than that which we previously held (e.g., it is substantially more loss absorbent because of the various capital instruments phased-out). Beyond our significantly stronger capital position, we do not have the credit and trading risks that other G-SIBs have and we engage in limited activities that give rise to off-balance sheet risk.

For these reasons, we believe it is inappropriate to apply a rigid SLR buffer framework to all of the U.S. G-SIBs. A more sensible course would be to follow the lead of the Financial Stability Board and Basel Committee and apply graduated capital surcharges that account for the low-risk nature of certain firms. We recommend that the Agencies establish leverage ratios, inclusive of buffers, of between 4 and 5.5%, as outlined in Question 5 of the Proposal.[8]

Part II: The inclusion of central bank deposits in the SLR's denominator may impact the operations of low-risk banks and increase, rather than reduce, systemic risk.

The Proposal's formulation of the SLR is predicated upon a denominator broader than the traditional total assets base. According to the Agencies, the SLR must account for certain portions of risky off-balance sheet exposures that "generally applicable" leverage standards do not capture. Accordingly, the approach to the SLR's denominator construction combines both leverage principles and principles traditionally embodied in the risk-based regime.

The Agencies note that this blended leverage construct is necessary to address the idiosyncratic risks of large, complex banks arising out of substantial off-balance sheet exposures. While we are supportive of regulatory efforts to bring more transparency to opaque and potentially risky activity, this approach presumes that all G-SIBs have similar risk profiles. They do not. If correctly capturing an institution's risk-profile and risk of failure means that the exposure measure should include off-balance sheet exposures that contain credit risks, then it should also logically exclude on-balance sheet exposures that do not have credit risk. As noted above, BNY Mellon believes the Agencies should exclude central bank deposits and Level 1 high-quality liquid assets (**"HQLAs"**), as defined in the Basel III Accord's Liquidity Coverage Ratio (the **"LCR"**)[9], from the SLR.

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8 78 Fed. Reg. 51108.

9 *See* ¶ 24 of Basel Consultation entitled, *Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools* (January 2013) (hereinafter referred to as the **"Basel LCR Framework"**).

A. Liabilities-driven business models result in substantial central bank deposits.

BNY Mellon is a safe place for customers to deposit money because of our unique operations and risk-profile. Our business model diverges from most other U.S. G-SIBs, because it is liabilities-driven; in other words, our balance sheet expands not through asset growth or trading activity, but rather through the organic development of operational client relationships that, over time, translate into increased volumes of highly stable deposits. We do not leverage our balance sheet or generate illiquid, risky assets and then attempt to derive funding strategies to support those holdings. Instead, we typically see steady flows of operational deposits coming onto our balance sheet. These flows are directly linked to the processing services we provide. Our customers maintain cash balances with BNY Mellon to facilitate their ongoing operational activities (e.g., payment and settlement processing). Because of our processing businesses, we concentrate on deploying cash we receive into a high volume of low-risk, highly liquid assets that meet our clients' operational needs and risk appetites. It is the common practice of custodians to place cash arriving through deposit inflows from customers at central banks, or to otherwise invest these funds in very low-risk assets.

The client base we serve, and the operating businesses in which we specialize, drive our approach to asset-liability management and result in sizeable holdings of highly liquid assets. Unsurprisingly, the percentage of our risk-weighted assets to total assets is proportionally lower than that of other large banks. As of September 30, 2013, risk-weighted assets represented 31% of BNY Mellon's total assets.[10] The composition of the left side of our balance sheet is also unique – again due to our custody operations. Central bank deposits and high-quality government securities account for 42% of our total assets.[11] Current publicly available data indicate that custody banks hold, as a percentage of total assets, approximately three times more central bank deposits and high-quality government securities than the major U.S. trading and universal banks.[12] The liquidity, safety, and certainty of central bank deposits are a key cornerstone of this low-risk, highly liquid strategy.

Finally, we believe it is critical for the Agencies to consider the direct interplay between monetary policy and the presence of significant central bank deposit holdings. Often times, excess reserves at central banks are a function of a central bank's monetary policy. BNY Mellon is concerned that forcing firms to manage to a binding leverage constraint that necessitates holding capital against central bank deposits is unduly punitive given that such holdings are shaped by monetary policy decisions.

B. Including central bank deposits in the SLR's denominator could impede the ability of liquid, low-risk banking organizations to accept deposits during periods of systemic stress.

Banking organizations constrained by the SLR are likely to consider remediation strategies that reduce holdings of highly liquid and low-risk assets because such assets tend to be less productive than higher-risk assets. Given the Proposal's deep concerns for financial stability and avoiding large bank insolvencies, it is important for the Agencies to clarify what it

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10 BNY Mellon's FR Y-9C Report (September 30, 2013).
11 *Id*; BNY Mellon 10-Q filing (September 30, 2013).
12 Data compiled from Call Reports and FR Y-9C filings.

means to have an SLR that is "complementary." If the Agencies calibrate the SLR without any denominator adjustments, its application to low-risk firms will undermine ongoing regulatory work to enhance financial stability and may reduce the ability of custody banks to accept deposits during periods of market stress.

BNY Mellon is a safe and secure place for customers to deposit their money during periods of market stress. Indeed, recent historical data demonstrate the significant deposit inflows we receive during episodes of market uncertainty. For example, during the second half of 2008, the Dow Jones Industrial Average decreased by approximately 31%. During this same period, our average deposits increased by approximately 25% (or approximately $29 billion). The impact of this deposit increase resulted in a reduction of our traditional (balance-sheet asset based) leverage ratio by 90 basis points, or approximately 14%, at December 31, 2008. This was not merely a crisis-era phenomenon, during this month's debt ceiling debates in the United States, BNY Mellon experienced significant cash inflows. As these liabilities come onto our balance sheet, we need to deploy them into corresponding assets. We typically place inflows during periods of stress at central banks. This paradigm may be untenable in an environment where an unduly punitive SLR serves as the binding constraint under normal circumstances.

Improperly crafted capital standards could disrupt that natural flow of funds to banks or divert funds to the less-regulated shadow banking system. Such results would be in tension with the Agencies' stated policy objectives. We strongly believe the Agencies should address this by excluding from the SLR's denominator deposits maintained at central banks.

BNY Mellon also believes that the Proposal does not sufficiently recognize the dynamic yet foreseeable impacts of the Basel Committee's proposed treatment of repo transactions and securities finance transactions.[13] Broad movements by global regulators – including the U.S. banking regulators – to increase the costs associated with repo market activity may drive a disproportionate amount of cash onto custodian balance sheets in the form of deposits. Such treatment of repo and other securities finance transactions could also limit the liquidity of low-risk, investible assets on the short-end of the yield curve, which could result in market participants holding excess cash and looking for a safe bank with which to place it. This is a further reason for the Agencies to exclude from the SLR's denominator deposits maintained at central banks.

Part III: Including high-quality government securities in the SLR's denominator works at cross-purposes with broader policy efforts.

From a risk-perspective – and from a macroprudential policy perspective – BNY Mellon believes that high-quality sovereign debt should be treated the same as central bank deposits. Such an approach would be consistent with other macroprudential reform measures that compel the use of high-quality sovereign instruments as risk mitigants, including those pertaining to liquidity risk and as collateral for OTC derivative transactions. Regulators should consider capital and liquidity regulation in tandem. We believe that it is impossible to both ensure sufficient loss absorbency at global banking organizations and avoid liquidity risks absent

[13] BNY Mellon believes the proposed enhancements to the U.S. SLR must be considered in the context of the denominator revision work underway at the Basel Committee. As fn. 18 of the Proposal notes, the Agencies will consider the migration of those denominator changes when they are finalized. 78 Fed. Reg. 51105.

cogent and clear links between all components of the Basel III Accord. This is especially true when one considers the premium that forthcoming quantitative liquidity requirements will place on low and no risk assets. Calibrating the SLR to place undue capital charges on low-risk assets mandated by the Basel III liquidity rules will be counterproductive and discourage prudent liquidity risk management.

In many respects the SLR is fundamentally at odds with the important liquidity reform work the Agencies are undertaking. In the foreseeable, ordinary course instances where the SLR is a firm's binding constraint, it will penalize the holding of HQLAs of the type required by the LCR. Such treatment will discourage banking organizations from holding such instruments in quantities above imposed minimums. Once again, this result would not only undercut the Agencies' other macroprudential work, it would inject liquidity risk back into the financial system. We strongly urge the Agencies to consider excluding from the SLR's denominator all Level 1 HQLAs.

Excluding HQLAs from the SLR's denominator is consistent with the framework's stated objectives. Just as cash deposits increase in banks during crises, investors engage in system-wide "flight to quality" by investing in low-risk Level 1 HQLA rather than in riskier assets during periods of stress. These "flight to quality" assets remain liquid even in times of stress, and like cash, simply do not generate any meaningful or measurable risk of loss.

To the extent that the Agencies feel it necessary to cabin any HQLA-related denominator adjustment more precisely, we offer the following three suggestions:

- It would be sensible for the Agencies to limit the application of any Level 1 HQLA exclusion involving government securities to only those deemed so safe that the Organization for Economic Co-operation and Development excludes them from its country risk classification system.
- The Agencies could formally link capital and liquidity regulation by providing an SLR denominator adjustment for Level 1 HQLAs limited to the amount of Level 1 HQLAs necessary for the firm to obtain an LCR of 100%.
- The Agencies might adopt a graduated approach, under which Level 1 assets are included in the SLR denominator according to their individual liquidity risk characteristics. For example, cash would receive a liquidity weight of zero percent, and sovereign bonds would receive a low-but-not-zero liquidity weight. The calibration could correspond to the HQLA haircuts used in the LCR.[14]

Part IV: Where available, the Agencies should permit the use of daily or other more frequent information to calculate the SLR's constituent inputs.

The Proposal is silent as to the calculation methodology for many of the SLR's critical inputs. We want to reiterate the views we expressed to the Basel Committee regarding the use of daily data for calculating the balance sheet components of the SLR. As the Agencies finalize the U.S. SLR rules, we request that they permit the use of daily or other more frequent information and not rigidly rely on three end-of-month spot measurements for quarterly calculations.

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14 *See* Basel LCR Framework, at ¶¶ 49, 52, 54.

While month-end averages produce more accurate and relevant results than one quarter-end measurement, they are inferior to daily or other more frequent averages. In many jurisdictions, including the United States, a number of the components of the SLR's denominator are available on a daily basis (e.g., the balance sheet elements). Indeed, the existing U.S. leverage ratio can be calculated using daily averages. Prohibiting the use of daily averages could allow firms to manipulate end-of-month data inputs and overstate the impacts of common month-end balance sheet management activity.

Permitting the use of the most accurate – and continuously available – data is critical for custody banks. Many of BNY Mellon's customers, particularly mutual funds, money market funds, and other banking organizations, process payments, and otherwise engage in periodic yet non-standard activities at the end of each month that cause cash to flow onto the balance sheet. Mandating the use of three spot-measurement dates will result in inaccurate results by forcing custody banks to use peak total asset figures that provide an inaccurate picture of more normalized asset holdings.

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BNY Mellon appreciates the opportunity to comment on the Agencies' critical work to strengthen leverage requirements. We respectfully request that the Agencies consider our recommended adjustments to the SLR framework to better align it with the risk-based capital reforms and enhanced liquidity requirements of the Basel III Accord. BNY Mellon believes our policy proposals are particularly useful to ensuring the SLR appropriately captures the balance sheet composition and operational nuances of custody banks.

We would be happy to provide any further information regarding any of the comments contained in this commentary. Should you have any questions, please contact our Global Treasurer, Scott Freidenrich (scott.freidenrich@bnymellon.com or 212-804-2006) or our Global Chief Regulatory Counsel, Heather Koenig (heather.koenig@bnymellon.com or 212-635-7399).

Regards,

Gerald Hassell
Chairman and Chief Executive Officer