BNY MELLON

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June 13, 2014

BY ELECTRONIC SUBMISSION

Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Docket No. R-1487, RIN AE-16

Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
RIN 3064-AE12

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street, SW
Suite 3D-218
Mail Stop 9W-11
Washington, DC 20219
Docket ID OCC-2014-0008

Re: **Regulatory Capital Rules: Regulatory Capital, Proposed Revisions to the Supplementary Leverage Ratio**

Ladies and Gentlemen:

The Bank of New York Mellon Corporation ("**BNY Mellon**") appreciates the opportunity to comment on the proposed rulemaking, *Regulatory Capital Rules: Regulatory Capital, Proposed Revisions to the Supplementary Leverage Ratio* ("**Proposed Rule**"), issued by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation (collectively, "**the Agencies**").[1] The Proposed Rule seeks to implement the Basel III leverage ratio revised by the Basel Committee on Banking Supervision ("**BCBS**") in January 2014, including important revisions to the denominator of the leverage ratio ("**the total leverage exposure**").[2] The Proposed Rule would apply the revised total leverage exposure to the 3 percent supplementary leverage ratio ("**SLR**") and the 5 and 6 percent "enhanced" supplementary leverage ratio ("**eSLR**") applicable

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1 Regulatory Capital Rules: Regulatory Capital, Proposed Revisions to the Supplementary Leverage Ratio, 79 Fed. Reg. 24596 (May 1, 2014).

2 Basel Committee on Banking Supervision, *Basel III Leverage Ratio Framework and Disclosure Requirements* (Jan. 2014) ("**BCBS 2014 Revisions**").

to the eight U.S. global systemically important banks ("**G-SIBs**") and their insured depository institutions (collectively, the "**leverage ratio**").[3]

BNY Mellon supports the adoption of macroprudential regulations that encourage low risk, highly liquid business strategies, stable sources of funding, and prudent capital and liquidity management. We recognize that macroprudential regulations also seek to address size and complexity. To that end, the leverage ratio is "particularly relevant for *large, complex* organizations that are internationally active and often have *substantial off-balance sheet exposures.*"[4] Further, the eSLR is intended to "counterbalance possible *funding cost advantages* that these organizations may enjoy as a result of being perceived as 'too big to fail.'"[5]

While BNY Mellon recognizes and supports these goals, we strongly believe that these regulations should be tailored to the institutions that actually pose these risks. In other words, "enhanced prudential standards must increase in stringency based on the systemic footprint and risk characteristics of *individual companies.*"[6] When viewed individually, the eight U.S. G-SIBs possess different business models and different risk profiles. We believe that these differences contribute to diversification and specialization in the financial services sector, which benefit retail and commercial customers and shareholders.

BNY Mellon does not present the risks that the eSLR is intended to address. We have a relatively simple custody bank business model focused on client servicing rather than asset growth or credit risk assets. We have a high proportion of low risk, highly liquid assets, few off-balance sheet activities, few lending activities, few complex trading activities, and minimal reliance on short-term wholesale funding. We are not one of the banks under examination by the Government Accountability Office for a "too big to fail" funding advantage.[7] And we are not very large or complex despite the G-SIB designation. Instead, BNY Mellon is systemically important because of the services and support we provide to financial markets, not because of our trading, retail, or lending activities. In light of these differences, the Financial Stability Board assigned the lowest G-SIB surcharge of 1.0 percent to BNY Mellon.

Despite BNY Mellon's very different, low risk business model focused on client servicing, it is subject to the same macroprudential regulations as the other G-SIBs—G-SIBs that are much larger, that engage in significant trading activities, that rely on short-term wholesale funding, or that are large lenders to consumers and corporates. Unsurprisingly then, the leverage ratio has an outsized effect on companies such as BNY Mellon with a simple custody bank business

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3 *See* Proposed Rule, 79 Fed. Reg. at 24598.

4 Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and Their Subsidiary Insured Depository Institutions, 79 Fed. Reg. 24528, 24530 (May 1, 2014) ("**eSLR Final Rule**") (emphasis added).

5 *Id.* at 24529 (emphasis added).

6 *Id.* (emphasis added).

7 Government Accountability Office, *Government Support for Bank Holding Companies, Statutory Changes to Limit Future Support Are Not Yet Fully Implemented* (Nov. 2013).

model. As a result, the leverage ratio may unduly impact prudent capital deployment under normal, business-as-usual conditions for a low-risk bank such as BNY Mellon. In addition, the leverage ratio could distort risk-taking incentives as it relates to the asset classes in which the deposits are invested. The proposed U.S. Liquidity Coverage Ratio ("**LCR**")[8] could place further pressure on the leverage ratio constraint because it does not accurately capture stable sources of funding and could require additional holdings of high quality liquid assets ("**HQLA**").

As a result of these proposed regulations, BNY Mellon and other custody banks are likely to consider changes to products, services, and asset and liability management strategies, including an incremental focus on additional credit risk assets to manage the leverage ratio as currently calibrated. In effect, the combination of the leverage ratio and the LCR may cause BNY Mellon to look more like the other G-SIBs, leading to greater homogeneity in the banking system. Further revisions to the total leverage exposure, such as limiting the amount of central bank deposits, could mitigate the need for these changes.

We recognize that we have made similar arguments to the Agencies in the past, and we truly appreciate the careful consideration the Agencies gave to custody bank concerns in the eSLR consultation.[9] We note that the Agencies "believe that using daily average balance sheet assets" will address these concerns.[10] We respectfully submit that daily averaging only reduces unusual volatility, but it does not address the fundamental, structural, business-as-usual issues that the leverage ratio poses for BNY Mellon.

We therefore urge the Agencies to limit the amount of central bank deposits included in the total leverage exposure for BNY Mellon to account for these unique circumstances. We believe that these changes would better implement the leverage ratio as a complementary measure that "preserve[s] the historical relationship" between the leverage ratio and risk-based capital.[11] Further, this approach would better capture the actual risks and activities of a low risk custody bank, just as the BCBS 2014 Revisions sought to better capture the actual risks and activities of a large universal or trading bank.

This letter contains three parts. Part I provides an overview of the BNY Mellon balance sheet and BNY Mellon's focus on client servicing relationships. Part II explains how the Proposed Rule will affect the BNY Mellon business model. Finally, Part III offers ways to limit the amount of central bank deposits included in total leverage exposure to mitigate the undesirable effects of the leverage ratio as a capital constraint while maintaining a simple leverage measure.

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8 Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring; Proposed Rule, 78 Fed. Reg. 71818 (Nov. 29, 2013) ("**U.S. LCR Proposed Rule**").

9 *See* eSLR Final Rule, 79 Fed. Reg. at 24534-35.

10 *Id.* at 24535.

11 *Id.* at 24533.

I. BNY Mellon Overview

BNY Mellon is distinct among the G-SIBs because of our smaller size, business model, and a low risk, highly liquid asset mix. First, BNY Mellon is much smaller in size than the six largest U.S. G-SIBs. BNY Mellon held approximately $355 billion in total consolidated assets as of the first quarter of 2014.[12] The six largest G-SIBs ranged from $831 billion to $2.4 trillion in total consolidated assets.[13] The only other U.S. G-SIB with a similar size to BNY Mellon is State Street Corporation, another custody bank.[14] Thus, BNY Mellon has been designated a G-SIB *not* because of our size—which is significantly smaller than the non-custodial G-SIBs—but because of our role as a global custodian and the support it provides to the financial system.

BNY Mellon's role as a global custodian is precisely what drives our low risk, highly liquid balance sheet. As of the first quarter of 2014, nearly 75 percent of our liabilities consisted of client deposits.[15] Only about 7 percent of our liabilities consisted of repurchase agreements and customer and broker-dealer payables.[16]

BNY Mellon's deposit levels are a by-product of the custodial and cash management services that BNY Mellon provides to institutional clients. The Basel Committee recognizes, for example, that institutional customers "need[] to place, or leave, deposits with a bank in order to facilitate their access and ability to use payment and settlement systems and otherwise make payments."[17] Because these client servicing relationships are crucial to the BNY Mellon business model, BNY Mellon invests these deposits in low risk, highly liquid assets to make sure that cash is available when our clients need it. Thus, as of the first quarter of 2014, nearly one-quarter of our assets were deposits at central banks, and nearly one-half of our assets were deposits at

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12 *See* The Bank of New York Mellon Corporation Form 10-Q for the Quarterly Period Ended March 31, 2014, at 11.

13 *See* Bank of America Corporation Form 10-Q for the Quarterly Period Ended March 31, 2014, at 11; Citigroup, Inc. Form 10-Q for the Quarterly Period Ended March 31, 2014, at 29; The Goldman Sachs Group, Inc. Form 10-Q for the Quarterly Period Ended March 31, 2014, at 4; JP Morgan Chase & Co. Form 10-Q for the Quarterly Period Ended March 31, 2014, at 12; Morgan Stanley Form 10-Q for the Quarterly Period Ended March 31, 2014, at 1; Wells Fargo and Company Form 10-Q for the Quarterly Period Ended March 31, 2014, at 6.

14 *See* State Street Corporation Form 10-Q for the Quarterly Period Ended March 31, 2014, at 24.

15 *See* The Bank of New York Mellon Corporation Form 10-Q for the Quarterly Period Ended March 31, 2014, at 11.

16 *See id.*

17 *See* Basel Committee on Banking Supervision, *Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools* ¶ 93 (Jan. 2013); *see also* U.S. LCR Proposed Rule, 78 Fed. Reg. at 71841 ("Some covered companies provide services, such as those related to clearing, custody, and cash management services, that require their customers to maintain certain deposit balances with them.").

banks or U.S. government and agency securities.[18] We believe that this low risk asset mix is the best way to serve our clients.

For example, BNY Mellon's subsidiary, Pershing LLC, provides operational services to retail investment advisors ("**RIAs**"), which are generally small investment advisory firms that serve sophisticated, high net-worth clients. As part of its suite of services, BNY Mellon offers RIAs deposit accounts for their clients to manage daily activities, such as investing and bill payments. These RIA client deposits are liabilities on BNY Mellon's balance sheet, which we then place at central banks or in other low risk, liquid assets.

This low risk, highly liquid business model also is prudent as a matter of liquidity risk management. For example, BNY Mellon maintains a considerable cash surplus to avoid payments bottlenecks and manage intraday liquidity in the payments systems. In addition, BNY Mellon receives significant deposit inflows during periods of stress as clients deposit cash at banks in the "flight to safety." BNY Mellon places these deposit inflows in central banks to mitigate liquidity risk, recognizing that these are often "surge" or "excess" deposits that may quickly run off once the market stabilizes.[19]

Due to this low risk, highly liquid balance sheet, BNY Mellon consistently has among the highest risk-based capital ratios of the U.S. G-SIBs. As of the first quarter of 2014, BNY Mellon's estimated fully phased-in Basel III common equity tier 1 capital ratio was 11.1 percent under the Standardized Approach and 10.7 percent under the Advanced Approach.[20] BNY Mellon's high risk-based capital ratios are not due to the complex internal models that the leverage ratio is intended to guard against.[21] Rather, BNY Mellon's high risk-based capital ratios are purely because of our simple, low risk asset mix. As of the first quarter of 2014, BNY Mellon held approximately one-half of our assets in central bank deposits, deposits with other banks, and U.S. government and agency obligations—assets with little model risk.[22] And as of the first quarter of 2014, trading securities accounted for only one percent of assets.[23]

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18 *See* The Bank of New York Mellon Corporation Form 10-Q for the Quarterly Period Ended March 31, 2014, at 11.

19 For example, the Dow Jones Industrial Average decreased by approximately 31 percent in the second half of 2008. During this same period, BNY Mellon's average deposits increased by approximately 25 percent. This deposit surge caused BNY Mellon's U.S. tier 1 leverage ratio to decrease by 90 basis points, or approximately 14 percent, at year-end 2008.

20 *See* The Bank of New York Mellon Corporation Form 10-Q for the Quarterly Period Ended March 31, 2014, at 2, 55.

21 *See, e.g.*, Basel Committee on Banking Supervision, *Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems* ¶ 16 (June 2011).

22 *See* The Bank of New York Mellon Corporation Form 10-Q for the Quarterly Period Ended March 31, 2014, at 11.

23 *See id.*

BNY Mellon's risk-based capital ratios remain resilient after stress testing. In the 2014 Comprehensive Capital Analysis and Review ("**CCAR**"), for example, BNY Mellon had the highest projected minimum tier 1 common ratio of 12.7 percent over the nine-quarter planning horizon in the severely adverse scenario.[24] BNY Mellon also had the highest projected minimum tier 1 common ratio of 13.5 percent over the nine-quarters in the adverse scenario.[25] BNY Mellon's actual tier 1 common ratio during the CCAR review also was among the highest at 14.1 percent.[26] Finally, BNY Mellon maintained a resilient U.S. tier 1 leverage ratio of 5.3 percent in the severely adverse and adverse scenarios, and an actual U.S. tier 1 leverage ratio of 5.6 percent.[27]

II. Potential Impact of the Leverage Ratio

The high calibration of the eSLR with the proposed total leverage exposure may well become a capital constraint for low risk banks. There are basically two ways to manage the proposed leverage ratio requirements: decrease total leverage exposure or increase tier 1 capital. Agency memoranda indicate that covered organizations subject to the leverage ratio "could take systemic risk-reducing actions without much economic cost to mitigate the impact of a stricter definition of total leverage exposure, including (i) reducing the net notional amount of sold credit protection by matching maturity more closely with purchased credit protection and (ii) further compressing their over-the counter derivative trades."[28]

While BNY Mellon can and is taking steps to effectively manage our capital position to comply with the leverage ratio, we respectfully submit that such changes are not as simple as better hedging written credit derivatives or compressing derivative trades. Unlike many of the other U.S. G-SIBs, BNY Mellon does not have a large portfolio of derivatives. We also do not have a large portfolio of principal securities financing transactions. Thus, to reduce total leverage exposure, we would be required to reduce assets or off-balance sheet exposures, such as commitments. The primary way to do this would be to reduce client deposits and the corresponding investments in low risk, highly liquid assets. But it would be very difficult for BNY Mellon to discourage client deposits when the very purpose of the bank is to provide custody and cash management services that require customer deposits. In practice, discouraging deposits is complex and may require us to actually close client accounts. Such actions could affect client relationships, including on-boarding new clients that increase our balance sheet usage and place additional pressure on the leverage ratio constraint.

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[24] *See* Board of Governors of the Federal Reserve System, *Comprehensive Capital Analysis and Review 2014: Assessment Framework and Results* 11, table 4 (March 2014).

[25] *Id.* at 12, table 5.

[26] *See id.* at 13, table 6.A & 15, table 7.A.

[27] *See id.*

[28] Memorandum from Staff to the Board of Governors re: Final Rule on Enhanced Supplementary Leverage Ratio (SLR) standards; Proposed Rule on the SLR; and Proposed Rule on the Definition of Eligible Guarantee in the Advanced Approaches Risk-Based Capital Rule, 11 (Apr. 4, 2014) ("**FRB Staff Memo**").

BNY Mellon and other banks also have received significant inflows of client deposits during times of financial stress, including the financial crisis in 2008 and the U.S. debt ceiling crisis in 2011. These deposit inflows reflect existing clients' "flight to cash" due to circumstances outside our control, and *not* BNY Mellon's efforts to expand our client base or increase economic exposure. It is particularly difficult to discourage client deposits during these times of stress because clients rely on their bank, BNY Mellon, as the one safe place to keep cash.

Another way to manage the impact of the leverage ratio is to shift to higher-yield assets. However, this strategy would increase risk and likely increase volatility in tier 1 capital due to the changes to accumulated other comprehensive income in the final Basel III Capital Rules.[29]

The Agencies also state that the leverage ratio is less likely to be the capital constraint if the Federal Reserve were to subject covered banking organizations to an additional risk-based capital surcharge based on short-term wholesale funding levels.[30] Although this statement might apply for other G-SIBs that have a higher percentage of short-term wholesale funding, it should not apply to BNY Mellon because we have minimal reliance on short-term wholesale funding.

As a result, BNY Mellon is contemplating the strategic consequences of the leverage ratio, including its interaction with other regulatory requirements. For example, the proposed U.S. LCR captures only a limited range of operational deposits that are "truly operational in nature."[31] In addition, the proposed U.S. LCR assumes that non-maturity deposits run off on the first day of the 30-day stress period.[32] This assumption, combined with the "peak day" approach,[33] assumes a net cash outflow that significantly overstates actual, observed cash outflows during stressed scenarios.[34] If adopted as proposed, BNY Mellon may be required to reduce client deposits or increase the stock of HQLA on our balance sheet. It would be very difficult for BNY Mellon to discourage client deposits for the reasons discussed above. And re-allocating limited balance sheet resources to increase the stock of HQLA would place additional pressure on the leverage ratio constraint.

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29 *See* 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. 62018, 62176 (§ __.22(b)(1)).

30 *See* FRB Staff Memo, at 11.

31 U.S. LCR Proposed Rule, 78 Fed. Reg. at 71841. *See also* Letter from Scott Freidenrich, Executive Vice President and Treasurer of BNY Mellon, to the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency re: Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring; Proposed Rule, 5-12 (Jan. 31, 2014) ("**BNY Mellon U.S. LCR Comment Letter**").

32 *See* U.S. LCR Proposed Rule, 78 Fed. Reg. at 71834.

33 *See id.* at 71833.

34 *See* BNY Mellon U.S. LCR Comment Letter, at 4-5.

III. Recommended Adjustments to the Total Leverage Exposure

The leverage ratio with the proposed total leverage exposure could very well reverse the historical relationship between the risk-based capital requirements and the leverage ratio by making the leverage ratio the day-to-day constraint for low risk banking organizations. This is especially the case for custody banks, like BNY Mellon, that have a high proportion of low risk, highly liquid assets, few off-balance sheet activities, few complex trading activities, and minimal reliance on short-term wholesale funding.

Limiting the amount of central bank deposits included in the total leverage exposure would avoid this reversal and the resulting consequences described in section II. We recognize that limiting the amount of central bank deposits could conflict with the design of the leverage ratio as a simple measure that does not distinguish among asset types and is not risk-sensitive. However, we respectfully note that the proposed total leverage exposure is no longer a simple balance sheet measure—it now includes revised treatments for derivatives, written credit derivatives, securities financing transactions, and off-balance sheet commitments to better reflect the actual exposures and activities of universal and trading banks.

Limiting central bank deposits similarly would better reflect the actual exposures and activities of a low risk, custody bank like BNY Mellon. This could be accomplished through a full exclusion for central bank deposits from the total leverage exposure or a cap on the amount of central bank deposits included in the total leverage exposure. We also respectfully recommend that the Agencies preserve flexibility to grant regulatory forbearance for the leverage ratio requirement during periods of financial stress.

A. Exclusion for Central Bank Deposits

An exclusion for all central bank deposits would, of course, be the simplest solution. We appreciate the Agencies' concern that "excluding specific categories of assets from the supplementary leverage ratio denominator would in effect allow banking organizations to finance these assets exclusively with debt, potentially resulting in a significant increase in a banking organizations' ability to deploy financial leverage."[35] We respectfully submit, however, that a U.S. banking organization would not be able to finance such assets entirely with debt because of the longstanding 4 percent U.S. tier 1 leverage ratio. Moreover, central bank deposits do not generate the risk of loss that capital is intended to offset, as regulators have long recognized with the zero percent risk-weight for central bank deposits in the risk-based capital context.

B. Cap on Central Bank Deposits

Absent a full exclusion for central bank deposits, we recommend capping the amount of central bank deposits included in the total leverage exposure at a percentage of total consolidated assets, such as 10-15 percent. Central bank deposits over the cap would be

[35] eSLR Final Rule, 79 Fed. Reg. at 24536.

excluded from the total leverage exposure. We believe that such a cap is a simple, effective way to avoid penalizing a bank that holds a high proportion of central bank deposits to prudently cover client deposits. This cap is intended to strike a balance between the need for simplicity and the need to avoid incentives that could shift a low risk, client service-oriented bank like BNY Mellon to a different business model mix.

A conservative cap, such as 10-15 percent, would ensure that a bank holds capital against all or a large portion of its central bank deposits for purposes of the leverage ratio. This cap would prevent a bank from "financ[ing] these assets exclusively with debt,"[36] even absent the 4 percent U.S. tier 1 leverage ratio.

A cap also would alleviate the leverage ratio constraint during times of financial stress when clients suddenly increase deposits at banks in a "flight to safety." BNY Mellon has experienced such deposit spikes before, and we recognize that such deposits are "excess balances" that can rapidly flow in and out of client accounts. Thus, BNY Mellon places these excess balances in central bank deposits as part of a prudent liquidity risk management strategy. Without a cap on central bank deposits, BNY Mellon could be compelled to turn away client deposits or raise capital in a period of stress.

C. Regulatory Flexibility for Temporary Surges in Deposits

In order to more generally address these very real "flight to safety" concerns, we request that the Agencies include in the final rule a formal process through which banks could seek regulatory forbearance during periods of financial stress. The leverage ratio rule should allow the Agencies to exempt an institution from the negative regulatory consequences of a temporary failure to meet leverage ratio requirements due to a sudden surge in cash deposits during periods of financial stress. Such regulatory flexibility would allow banks to meet client demand for safekeeping and promote the stability of financial markets during periods of stress, all without increasing the bank's own economic exposure.

This regulatory flexibility would be consistent with the Agencies' position on the LCR. As the Agencies recognized in that context, "it may be necessary for a banking organization to fall below the requirement during a period of liquidity stress."[37] Supervisory actions to address any shortfall "should not discourage or deter a banking organization from using its HQLA when necessary to meet unforeseen liquidity needs arising from financial stress that exceeds normal business fluctuations."[38] Flexibility is needed because "there are a wide variety of potential liquidity stresses that a covered company may experience (both idiosyncratic and market-wide), and . . . it is difficult to foresee the different circumstances that may precipitate or accompany such stress scenarios."[39] Likewise, here, regulatory flexibility is needed in the leverage ratio

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36 *Id.*

37 U.S. LCR Proposed Rule, 78 Fed. Reg. at 71845.

38 *Id.*

39 *Id.*

context so as not to penalize banks that temporarily hold a high proportion of low risk assets due to idiosyncratic or market-wide stress scenarios.

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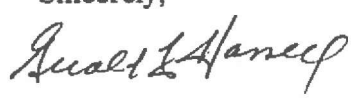
BNY Mellon appreciates this opportunity to comment on the Agencies' proposal to revise the total leverage exposure of the leverage ratio. We would be pleased to work further with the Agencies to develop alternative or additional proposals to limit the amount of central bank deposits included in the total leverage exposure, or to provide any other additional information. Should you have any questions, please contact Scott Freidenrich, Executive Vice President and Treasurer, at (212) 815-4008 or scott.freidenrich@bnymellon.com.

Sincerely,