AMERICANS
FOR FINANCIAL REFORM
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Americans for Financial Reform
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June 13, 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 Thomas J. Curry
Comptroller
Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219

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

RE: Regulatory Capital Rules: Regulatory Capital, Proposed Revisions to the Supplementary Leverage Ratio (Docket No. R-1487; Docket ID OCC-2014-0008; RIN 3064-AD 12)

To Whom it May Concern:

Americans for Financial Reform ("AFR") appreciates this opportunity to comment on the above-referenced notice of proposed rulemaking (the "Proposed Rule") by the Federal Deposit Insurance Corporation, the Federal Reserve Board, and the Office of the Comptroller of the Currency (the "Agencies"). AFR is a coalition of over 200 national, state, and local groups who have come together to advocate for reform of the financial industry. Members of AFR include consumer, civil rights, investor, retiree, community, labor, faith based, and business groups.

AFR strongly supported the Agencies move to impose a 5 percent Supplementary Leverage Ratio for the largest U.S. bank holding companies (6 percent for large depository banks). However, the effectiveness of the headline leverage ratio will be crucially dependent on the

exposures to which the leverage ratio is applied. In this Proposed Rule the Agencies specify the application of the leverage ratio to several areas, including exposures for credit derivatives, certain repurchase agreement ('repo') and securities lending transactions, and certain off balance sheet transactions. Combined, the Agencies estimate that these changes along with others in the rule would on net increase total leverage exposure and therefore required capital at the eight banks subject to the supplementary leverage ratio by 8.5 percent (CFR 24604).

AFR supports the strengthening of the exposure definition for credit derivatives and the restrictions put on the ability to net repo transactions. Below, we offer more specific comment.

Credit Derivatives

As the Agencies point out (CFR 24600), selling credit protection through a derivative is functionally identical to providing a guarantee. Yet under the 2013 capital rule, credit derivatives exposure would be capitalized based on counterparty credit risk (e.g. the risk of loss of the counterparty's future premium payments) rather than on the amount of credit risk guaranteed.[1] The use of similar exposure rules for leverage capital would lead to leverage capital charges for credit protection sold through derivatives that were significantly lower than leverage capital charges for credit guarantees. This would undercapitalize credit derivatives exposures and also create incentives for banks to shift from guarantees to credit derivatives where possible.

The Agencies' decision to include the entire notional principal amount of sold credit exposure (i.e. the full amount guaranteed) in the leverage denominator is therefore entirely appropriate and a valuable improvement in the exposure rules for credit derivatives. AFR supports this change.

AFR also supports the requirement that any hedge (purchased credit protection) that is counted as reducing the exposure of sold credit protection must refer to the identical legal entities, have the identical level of subordination and protection to the credit protection, and have a maturity at least as great as the sold credit protection. A partial or imperfect hedge of a credit derivative can easily mask a proprietary basis trade. The ability under previous capital rules to substantially reduce risk weighted assets by using imperfect credit derivatives hedges (i.e. hedges that were correlated but not identical to the derivative being hedged) appears to have been a significant motivation driving the size of 'London Whale' trades.[2] Thus, any requirement that falls short of an exact hedge could drive significant capital arbitrage.

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[1] AFR made a similar point in our comments on the proposed Basel capital rules – See p. 14 in the AFR October 22, 2012 on the proposed implementation of Basel rules, available at http://ourfinancialsecurity.org/2012/10/comment-letter-on-basel-iii-regulatory-capital-rules/.

[2] See Watt, Michael, "JP Morgan and the CRM: How Basel 2.5 Beached the London Whale", Risk Magazine, October 5, 2012.

Repo And Securities Lending Transactions

The Proposed Rule includes a detailed discussion of the circumstances under which banks may net or offset repo and securities lending transactions for leverage purposes. We cannot comment on all the complexities raised by these issues at this time. However, we would note concerns arising from the credit exposure of the bank to a securities lending counterparty which may rehypothecate or reinvest money or securities owed to the bank, creating a situation in which potentially offsetting exposures could not actually be returned. Such reinvestment of cash collateral for securities was a significant contributor to losses at AIG that had to be reimbursed through a taxpayer bailout.

We would also note that particularly in securities-for-securities repo transactions (and potentially also for cash repo transactions, depending on the collateralization arrangements), the bank is exposed to market risk related to the value of the securities. This kind of market risk is likely to be particularly salient for 'collateral transformation' transactions where high-quality collateral is exchanged for lower quality securities. It is important that any such market risk that is not fully captured in bank margin arrangements be reflected in any offsetting or netting procedure.

The specific requirements that the Agencies propose as a pre-requisite for offsetting securities lending transactions will be helpful in addressing these and other general risk issues in securities lending. AFR strongly supports these pre-requisite requirements, including the matching of final settlement dates, the requirement that offsetting transactions be settled on a net basis through the same settlement system, and the requirement that such a settlement system be supported by cash or intra-day credit facilities designed to ensure net cash settlement.

Questions 8 and 9 in the Proposed Rule ask about the potential operational implications and costs of developing such settlement systems. We do not believe any additional costs, if they exist, involved in implementing these systems would be a valid reason for failing to require them as a pre-requisite for granting the capital benefits of netting. Given that severe flaws in repo settlement systems were a major contributor to liquidity failures during the financial crisis, and in the case of tri-party repo have been an area of emphasis for regulators and bank working groups for years, it would be deeply problematic if a claimed inability to implement improved settlement systems was accepted as an excuse for lenient capital treatment of securities lending exposures.

Regarding the operational implications of these Proposed Rules, we would also note that when the Agencies state that netting will be permitted in security-for-security lending 'unless and until the securities lender sells or re-hypothecates the security' (CFR 24602), this requirement concerning re-hypothecation must also be supported by adequate information systems so that both the lending parties and the regulators understand if a security has been re-hypothecated. Since it would clearly be inappropriate to permit netting in a case where a security had been re-

hypothecated or sold, such netting should not be allowed in cases where the treatment of the security is not fully transparent to all parties.

Finally, AFR also supports the treatment of securities lending indemnifications as credit guarantees, since they clearly do represent such a guarantee.

Other Types of Off Balance Sheet Exposures

Undercapitalized off balance sheet exposures were clearly a major contributor to the financial crisis. In 2008 banks were forced to recognize implicit guarantees (as well as explicit liquidity commitments) to securitization conduits and bring these commitments on to their balance sheets.[3] The capital treatment of off balance sheet exposures is thus an important area for the reform of capital rules. Sharp divergences between on balance sheet and off balance sheet treatments of exposures are likely to trigger efforts to arbitrage leverage requirements by achieving off balance sheet accounting treatment.

This Proposed Rule does create such divergences. It follows the Basel 2014 leverage ratio standards in weighting many off balance sheet exposures at less than 100 percent. The exact weights vary depending on the length of the commitment and whether it is unconditionally cancelable by the bank, and vary from 10 percent to 100 percent.

AFR agrees that some off balance sheet commitments can reflect a lower risk to the bank than on balance sheet exposures. There may therefore be an argument for a lower capital charge in particular cases. However, we remain concerned about possibilities for arbitraging off balance sheet treatment of exposures. We would caution the Agencies against an excessive reliance on accounting rules alone, particularly in cases where implicit or reputational factors may require a bank to execute on a nominally off balance sheet commitments, and also in cases where important bank customers are likely to need to draw on off balance sheet facilities during times of financial stress.

Agencies should also be careful to ensure adequate capital is held against securitization commitments where banks hold an ongoing interest in securitized assets but claim off balance sheet treatment due to granting control rights to outsiders. The formal control rights set up in an initial agreement may not reflect risk exposures or even the actual control of key decisions in a stressed or abnormal financial situation. In this respect, it is useful that the 2014 BCBS revisions put 50 to 100 percent weightings on off balance sheet securitization exposures. The Agencies should adopt these high weightings.

[3] Acharya, Viral V. and Schnabl, Philipp and Suarez, Gustavo, "Securitization Without Risk Transfer", CEPR Discussion Paper No. DP8769, January 2012. Available at SSRN: http://ssrn.com/abstract=1988700

Finally, we would also note that the disclosures required in this Proposed Rule do not appear to provide a meaningful breakout of types of off balance sheet exposures beyond derivatives and repo categories. Lines 17 and 18 of the disclosure document (CFR 24605) simply provide a total of 'other off balance sheet exposures'. Agencies should consider a more detailed breakout of these exposures.

Thank you for the opportunity to comment on these Proposed Rules. Should you have any questions, please contact Marcus Stanley, AFR's Policy Director, at marcus@ourfinancialsecurity.org or (202) 466-3672.

Following are the partners of Americans for Financial Reform.

All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.

- AARP
- A New Way Forward
- AFL-CIO
- AFSCME
- Alliance For Justice
- American Income Life Insurance
- American Sustainable Business Council
- Americans for Democratic Action, Inc
- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Center for Effective Government
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Green America
- Greenlining Institute
- Good Business International

- HNMA Funding Company
- Home Actions
- Housing Counseling Services
- Home Defender's League
- Information Press
- Institute for Agriculture and Trade Policy
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America
- Lawyers' Committee for Civil Rights Under Law
- Main Street Alliance
- Move On
- NAACP
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Council of Women's Organizations
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Resource Center
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United
- National People's Action
- National Urban League
- Next Step
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO National Network
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer's for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club

- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS
- U.S. Public Interest Research Group
- UNITE HERE
- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now
- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

List of State and Local Partners

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)
- Cooperative Fund of New England, Wilmington NC

- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- New Economy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- New Yorkers for Responsible Lending

- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY
- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG

Small Businesses

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Environmental Planning
- Hayden & Craig, PLLC
- Mid City Animal Hospital, Pheonix AZ
- UNET