



April 3, 2015

BY ELECTRONIC SUBMISSION

Robert de V. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: *Risk-Based Capital Guidelines: Implementation of Capital Requirements for Global Systemically Important Bank Holding Companies*
Docket No. R-1505, RIN 7100 AE-26

Ladies and Gentlemen:

The Bank of New York Mellon Corporation (“BNY Mellon”) appreciates the opportunity to comment on the notice of proposed rulemaking by the Board of Governors of the Federal Reserve System (“Federal Reserve”), *Risk-Based Capital Guidelines: Implementation of Capital Requirements for Global Systemically Important Bank Holding Companies* (the “Proposal”).¹ The Proposal would implement in the United States a risk-based capital surcharge for global systemically important bank holding companies (“GSIBs”) based on the international standards adopted by the Basel Committee on Banking Supervision (“BCBS Framework”).² The Proposal deviates from the BCBS Framework to reflect the systemic risk implications of an overreliance on certain short-term wholesale funding strategies by some large U.S. bank holding companies.

BNY Mellon is a global custody and trust bank focused on client servicing. We specialize in providing safekeeping, settlement, asset administration, and trust and banking services to institutional customers. BNY Mellon’s deposit levels principally are a by-product of these custodial and cash management services. These deposits have a core component necessary to service customer transactions, and a residual or “excess” component arising out of these same servicing relationships.

Deposit liabilities inherently linked to the provision of operational services form the central part of the custody and trust bank balance sheet and liquidity profile. Because

¹ Risk-Based Capital Guidelines: Implementation of Capital Requirements for Global Systemically Important Bank Holding Companies; Notice of Proposed Rulemaking, 79 Fed. Reg. 75473 (Dec. 18, 2014).

² Basel Committee on Banking Supervision, *Global Systemically Important Banks: Updated Assessment Methodology and the Higher Loss Absorbency Requirement* (July 2013).

customer servicing relationships are crucial to the BNY Mellon business model, BNY Mellon places these customer servicing deposits at central banks or in low-risk, highly liquid assets to make sure that cash is available when customers need it. We believe this low-risk, highly liquid asset mix is the best way to serve our customers and is prudent as a matter of liquidity risk management.

Due to both our distinct business model and general principles of safety and soundness, BNY Mellon supports macroprudential regulations that increase in stringency based on individual risk characteristics. U.S. bank holding companies have different business models and different risk profiles, which contribute to diversification and specialization in the financial services sector for the benefit of customers and shareholders. Different business models, with different funding strategies, present idiosyncratic risks that require nuanced supervision and regulation practices. Regulators should tailor rules and standards to these risks. The GSIB surcharge achieves this objective—in principle—by increasing in stringency based on five systemic risk categories. That said, BNY Mellon is concerned that the Proposal does not fully capture the operational or funding distinctions between the various GSIBs.

In a departure from the BCBS Framework, the Proposal introduces a new short-term wholesale funding (“STWF”) category in a new method 2. We have significant concerns that the proposed treatment of non-operational wholesale deposits in the STWF category under method 2 does not appropriately capture the risks the surcharge purports to address. To the extent the U.S. GSIB surcharge deviates from the BCBS Framework by including a method 2 surcharge with a STWF category, we urge revisions to the treatment of non-operational unsecured wholesale deposits to recognize both the liability (run risk) and asset (fire sale risk) sides of the balance sheet. This approach would be consistent with general principles of liquidity risk management, supervisory expectations, and existing regulations.

In Part I of this letter, we propose two ways to revise the treatment of non-operational unsecured wholesale deposits in the STWF category according to these fundamental principles. Part II covers additional issues, including the exclusion of operational deposits from the STWF measure, replacement of the substitutability category with STWF in method 2, the cap on the substitutability score in method 1, and the exclusion of capital buffers from capital plan and stress test rules.

I. Treatment of Non-Operational Unsecured Wholesale Deposits

The Proposal intends for the STWF measure in method 2 to “increase the resiliency of the firm against runs on its short-term wholesale funding and help internalize the cost of using short-term wholesale funding.”³ The social costs of the firm’s distress include (1) “vulnerab[ility] to short-term creditor runs” and (2) the heightened risk that a firm’s “significant stress or failure will give rise to fire sale externalities.”⁴ Requiring firms to internalize these social costs is a sound prudential objective, and BNY Mellon agrees with the

³ Proposal, 79 Fed. Reg. at 75479.

⁴ *Id.*

principle that excessive reliance on certain types of STWF can have systemic effects in certain circumstances. It remains unclear, however, whether a capital surcharge is the appropriate tool to address these risks. The BCBS Framework, for example, intentionally does not address STWF. Other aspects of the regulatory framework, including the Liquidity Coverage Ratio (“LCR”) and the Net Stable Funding Ratio (“NSFR”), are already tailored to address run risk and fire sale risk.

To the extent the U.S. GSIB capital surcharge continues to incorporate a STWF measure, BNY Mellon strongly believes that the surcharge should recognize that sound asset management strategies can mitigate the risk of losing access to replacement funding. The focus in the preamble on run risk *and* fire sale risk is sensible because liquidity risk management requires robust asset *and* liability management strategies. For example, the LCR takes into account both high quality liquid assets (“HQLA”) *and* net cash outflows; the NSFR takes into account both available stable funding *and* required stable funding. The liquidity stress test requirement of the Enhanced Prudential Standards final rule recognizes that an asset may be “used as a cash flow source to offset projected funding needs.”⁵

Just as the STWF category differentiates among the relative run risk of different funding classes, it should also differentiate among the relative fire-sale risk of different asset classes. Such an approach would be consistent with supervisory expectations regarding liquidity risk management, the liquidity provisions of the Enhanced Prudential Standards final rule, the LCR, and the NSFR. It would also better reflect the risk-weighted assets framework that forms the basis of the GSIB surcharge.

The Proposal’s treatment of secured funding transactions does just that, assigning progressively higher weights to transactions secured by less liquid assets. By contrast, the Proposal assigns 0 to 50 percent weights to unsecured wholesale funding from non-financial sector entities, and 25 to 100 percent weights to unsecured wholesale funding from financial sector entities—regardless of the assets available to offset funding needs. This asymmetrical treatment of unsecured wholesale funding only accounts for the risk of losing access to replacement funding during periods of market stress without recognizing the many strategies a banking organization adopts to mitigate this risk. It seems counterintuitive, for example, to assign a lower weight to funding transactions secured by level 2A liquid assets than to unsecured wholesale deposits, the proceeds of which are placed at central banks or invested in other level 1 liquid assets.

The treatment of non-operational wholesale deposits should recognize that banking organizations accept customer deposits for a variety of reasons and place them into a variety of asset classes as a matter of prudent liquidity management. For a custody and trust bank like BNY Mellon, client deposits have a core, stable component and a variable component. Based on historical experience, clients leave a stable amount of deposits with the bank to service day-to-day operational needs—these are generally considered “operational deposits” as defined in the LCR. Clients also leave excess, variable deposits with the bank as a result of these same

⁵ 12 C.F.R. § 252.35(a)(5).

operational servicing relationships—these are generally considered “excess” deposits. These excess deposits may result, for example, from a recently closed deal or a “flight to safety” during market stress. It would be very difficult as a practical and reputational matter to turn away client deposits that arise from these existing operational servicing relationships.

Due to the variable nature of these deposits, custody and trust banks place this cash predominantly at central banks.⁶ This low-risk asset-liability management strategy is distinct to the custody and trust bank business model to account for customer cash flows from operational servicing relationships. We believe that these conservative actions reflect prudent liquidity risk management, are consistent with supervisory expectations, increase safety and soundness, and mitigate the risk of a liquidity crisis or insolvency. We also believe that this low-risk, highly liquid asset mix is the best way to serve our customers. For example, custody and trust banks maintain a high level of central bank deposits in part to avoid payments bottlenecks and mitigate intraday liquidity risk in the payments and settlements systems.

The Proposal does not recognize these low-risk asset-liability management strategies. It only provides high weights for the run risk of unsecured wholesale funding categories and no corresponding credit for the low-risk asset strategies adopted to manage this risk. BNY Mellon proposes two ways to remedy this asymmetry.

First, the STWF surcharge should exclude non-operational unsecured wholesale deposits, where the amount of the exclusion is no greater than the amount of level 1 liquid assets held by the banking organization.⁷ This cap on the excluded amount would ensure that the risk of losing access to replacement funding during periods of market stress can be met only with the most liquid and readily marketable assets to minimize fire sale risk and would appropriately recognize the low-risk asset management strategies taken by a bank to mitigate this risk.

Alternatively, the STWF surcharge should at least exclude excess deposits that arise from operational servicing relationships.⁸ Excess deposits that arise from operational servicing relationships would be defined as deposits that meet the definition of “operational deposit” in the LCR except for the criteria in 12 C.F.R. § 249.4(b)(5) and (7) regarding excess funds.⁹ This restrictive definition would ensure that this exclusion only applies to those deposits

⁶ Historical experience shows a close correlation between the custody banks’ client deposits and central bank placements.

⁷ The STWF methodology should continue to exclude all operational deposits without limit as in the Proposal and as discussed in section II.A.

⁸ Likewise, the STWF methodology should continue to exclude all operational deposits without limit as in the Proposal and as discussed in section II.A.

⁹ Section 249.4(b)(5) provides that the Federal Reserve Board-regulated institution must demonstrate that the deposit is empirically linked to the operational services and that it has a methodology that takes into account the volatility of the average balance for identifying any excess amount, which must be excluded from the operational deposit amount. Section 249.4(b)(7) provides that the deposits must not be for arrangements in which the Federal Reserve Board-regulated institution (as correspondent) holds deposits owned by another depository institution bank (as respondent) and the respondent temporarily places excess funds in an overnight deposit with the Federal Reserve Board-regulated institution.

that are necessary for the bank to provide operational services pursuant to a legally binding written agreement subject to stringent termination provisions, that are held in specifically designated operational accounts for the primary purpose of obtaining operational services, that do not provide an economic incentive for the customer to maintain excess funds, and that are not provided in connection with prime brokerage services or services to a non-regulated fund. The excluded amount of excess deposits arising from operational servicing relationships should not be greater than the amount of level 1 liquid assets held by the banking organization, again to ensure that the risk of losing access to replacement funding can be met with only the most liquid and readily marketable assets to minimize fire sale risk.

These exclusions capped by the amount of level 1 liquid assets—whether for all non-operational unsecured wholesale deposits or just those excess deposits that arise from operational servicing relationships—would better recognize a firm’s liquidity risk management strategies and funding profile. They also would be tailored to the distinct custody bank business model where deposit liabilities are the by-product of client servicing relationships and placed at central banks and in low-risk, highly liquid assets.

II. Additional Comments

BNY Mellon supports the Proposal’s exclusion of operational deposits from the STWF measure, replacement of the substitutability category with STWF in method 2, cap on the substitutability score in method 1, and exclusion of capital buffers from the capital plan and stress test rules.

A. *Exclude Operational Deposits from the STWF Measure in Method 2*

To the extent the U.S. GSIB capital surcharge incorporates a STWF measure, BNY Mellon strongly supports the Proposal’s exclusion of operational deposits from the STWF calculation. As the Federal Reserve, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, and BCBS have recognized, operational deposits are a stable source of funding without the heightened risk of other types of wholesale funding. These deposits “present less liquidity risk during a stress period” because they “are tied to the provision of specific services to the customer.”¹⁰ Although operational deposits do present some funding risks, the preamble to the Proposal recognizes that these liquidity risks “are more appropriately considered under the liquidity regulatory framework” than through the GSIB capital surcharge.¹¹ The LCR and NSFR expressly address the liquidity risks of operational deposits, and liquidity stress testing addresses the risks of wholesale deposits more broadly.

¹⁰ Liquidity Coverage Ratio: Liquidity Risk Measurement Standards; Final Rule, 79 Fed. Reg. 61440, 61497 (Oct. 10, 2014).

¹¹ Proposal, 79 Fed. Reg. at 75487.

B. Replace Substitutability with STWF in Method 2

To the extent the U.S. GSIB surcharge incorporates a STWF category, BNY Mellon agrees that STWF should replace the substitutability category.¹² The purpose of the GSIB surcharge is to reduce a GSIB's probability of failure or default.¹³ As the Federal Reserve recognized in the preamble to the Proposal, substitutability may be relevant to systemic importance but not to susceptibility to failure.¹⁴

C. Cap Substitutability Score in Method 1

BNY Mellon supports the cap on the substitutability score in method 1, consistent with the BCBS Framework. As the BCBS and Federal Reserve recognized, the cap on the substitutability category is necessary to avoid a greater-than-intended impact on a bank holding company's systemic importance score.¹⁵ This treatment is especially appropriate because substitutability has little impact on a GSIB's susceptibility to failure, which is the stated objective of the surcharge.¹⁶

D. Exclude the GSIB Surcharge from Capital Plan and Stress Test Rules

BNY Mellon does not support the inclusion of the proposed GSIB surcharge, or any other capital surcharges or buffers, as a required component of the capital plan or stress test rules.¹⁷ Regulatory capital surcharges and buffers are just that—cushions above and beyond minimum capital requirements to allow banking organizations to use the buffers in times of stress. In creating the concept of a capital buffer, the BCBS emphasized that “the regulatory minimum requirement is the amount of capital needed for a bank to be regarded as a viable going concern by creditors and counterparties, while a buffer can be seen as an amount sufficient for the bank to withstand a significant downturn period and still remain above minimum regulatory levels.”¹⁸ Likewise, in implementing the capital conservation buffer in the United States, the Federal Reserve emphasized that the buffer “has been designed to give banking organizations the flexibility to use the buffer while still being well-capitalized.”¹⁹ The Proposal “augments” the capital conservation buffer with the GSIB surcharge but does not change this basic principle.

¹² *See id.*

¹³ BCBS Framework, at 3; Proposal, 79 Fed. Reg. at 75475.

¹⁴ Proposal, 79 Fed. Reg. at 75479.

¹⁵ *Id.* at 75485.

¹⁶ *Id.* at 75479.

¹⁷ 12 C.F.R. § 225.8; 12 C.F.R. part 252.

¹⁸ Basel Committee on Banking Supervision, *Calibrating Regulatory Minimum Capital Requirements and Capital Buffers: A Top-Down Approach* (Oct. 2010).

¹⁹ 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, 62036 (Oct. 11, 2013).

Incorporating a surcharge or buffer into the capital plan or stress test rules would fundamentally alter the basic concept that buffers can and should be used during times of stress. To the extent that the Federal Reserve seeks to incorporate certain liquidity risk management practices into stress test frameworks, BNY Mellon notes that these practices are already tested or could be tested through the liquidity provisions of the Enhanced Prudential Standards final rule and other supervisory reviews.²⁰

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BNY Mellon appreciates this opportunity to comment on the Federal Reserve's notice of proposed rulemaking to implement the GSIB capital surcharge in the United States. We would be pleased to work further with agency staff to better calibrate the STWF measure, or to provide any other information. Should you have any questions, please contact Eli Peterson, Managing Director, at (202) 624-7925 or eli.peterson@bnymellon.com.

Sincerely,

A handwritten signature in black ink, appearing to read "Eli Peterson". The signature is written in a cursive style with a large initial "E".

Executive Vice President and Treasurer

²⁰ 12 C.F.R. §§ 252.34 & 252.35.