American Bankers Association
Building Success. Together.

Hugh Carney
Vice President of Capital Policy
202-663-5324
hcarney@aba.com

April 3, 2015

Robert deV. 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

Dear Mr. Frierson;

The American Bankers Association (ABA)[1] appreciates the opportunity to comment on the Federal Reserve Board's (Board) Notice of Proposed Rulemaking (Proposal) on the implementation of a capital surcharge on global systemically important banks (GSIBs). ABA recommends that the Proposal be withdrawn at this time, pending the public presentation of data and other analytical justification sufficient to support the proposal, consistent with the standards of the Administrative Procedure Act. Given the size, scope, and significance of the proposal for the economy and the banking industry that plays a key role in financing economic growth, such a capital surcharge proposal should publicly unite clearly articulated policy objectives with transparent calculations within a reasoned analytical framework. A regulatory decision directly affecting the allocation of tens of billions of dollars and indirectly affecting several times that amount in economic activity for the nation cannot be made in the obscurity that currently shrouds the Proposal. The proposed new capital regime, developed in less than open deliberations by the global experts at the Basel Committee, remains relatively unexposed in its foundations and methodology to public light by the Board, even while the Board proposes to apply substantially heavier requirements on U.S. banks than are being applied internationally.

We view the Proposal as part of a troubling trend of black box or secret law in large bank supervision at a time when transparency of policy and regulatory requirements is needed. For example, under the Proposal, the GSIB capital surcharge is based on a market share test of a bank's systemic importance, yet the key elements of that test remain hidden from view. The Basel Committee relies upon data provided by financial regulators of some 75 banks from around the globe. The Board, in calculating the capital surcharge on U.S. banks, would draw upon this non-transparent information from the Basel Committee. Neither U.S. banks nor the public know who U.S. banks are being compared against, which foreign regulators are providing data, and whether the numbers are accurate and comparable to the information provided by U.S. institutions. Nor is it clear whether U.S. regulators can audit the data provided to the Basel

[1] The American Bankers Association is the voice of the nation's $15 trillion banking industry, which is composed of small, regional, and large banks that together employ more than 2 million people, safeguard $11 trillion in deposits and extend more than $8 trillion in loans.

Committee to ensure (or appropriately discount) its accuracy, even though there have long been serious questions raised about the uneven quality of bank data reported by regulators in China, Europe, and other regulatory homes of competing globally significant institutions. We believe it is bad policy for a U.S. regulator to determine capital requirements for U.S. banks with excessive reliance on foreign regulators' data, particularly when under-reporting in foreign jurisdictions could yield to their banks a competitive advantage.

As an industry we have supported the development of several important reforms in recent years to enhance the resilience of banks and the quality of bank supervision. There is a long litany of new measures that have been applied to the largest U.S. banks, together with new authorities that have been provided to prudential regulators. In light of all of these measures, it is important that new capital regimes, particularly those developed outside of the United States, be given the fullest public exposure to ensure consistency with recent reforms and the needs of the U.S. economy. This desideratum is frustrated when standards, and the data and factual bases behind those standards, are more or less developed in the dark, away from public scrutiny.

The Board should publish any analytical and empirical analyses it uses to arrive at a capital surcharge. Failure to do so impedes the public's ability to assess and provide comment. The Administrative Procedure Act and applicable case law recognize this first principle by requiring that the public be provided the "most critical factual material"[2] used by the agency in developing a rulemaking.[3] The Proposal does not do this.

Thus, we cannot tell from the Proposal whether the stated objectives of the GSIB surcharge—to encourage banks to have the resources and engage in prudent management so as to reduce significantly the likelihood of bank failure while reducing the financial costs and dislocations should a bank failure occur nonetheless—are met. We support those purposes, while noting that the Congress and bank regulators have already imposed a number of major requirements on banks (with additional measures being proposed this year) to achieve them. What is missing is a public statement and explanation by the Board as to how the GSIB surcharge as the Board proposes would meet these goals, and would do so without imposing unnecessary costs that would affect the competitiveness of U.S. banks and their ability to promote economic recovery and growth in the nation.

The Board will receive other comment letters highlighting many technical concerns. We encourage the board to give these comments careful consideration and address them appropriately. We would give particular emphasis to several matters that we encourage the Board to consider.

---

2 See, *Chamber of Commerce of the United States v. SEC*, 443 F.3d 890, 900 (D.C. Cir. 2006); *Appalachian Power Co. v. EPA*, 249 F.3d 1032, 1039 (D.C. Cir. 2001).

3 *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983); *Business Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011).

I. Adoption of the Proposal would be detrimental to U.S. bank customers and the institutions that serve them.

Imposing higher capital requirements on GSIBs is not a cost-free proposition. While we note that some GSIBs may hold enough capital to meet the surcharge amount as proposed, banks generally must manage their regulatory capital levels above set regulatory standards, given the market and regulatory consequences of dropping below the standards. This is particularly the case with GSIBs which will face volatility in their regulatory capital ratios due to the new requirement to recognize unrealized gains and losses in their investment portfolios. As a result, banks with capital that already exceeds any GSIB surcharge will take steps to increase their capital ratios even further, a "regulatory buffer."

A recent IMF staff study has reaffirmed what economists have long understood and that ample experience shows, that one effect of holding excess capital is a very real reduction in credit availability and banking activity.[4] The Proposal also ignores the tangible costs to the economy of requiring U.S. GSIBs to hold disproportionately high levels of capital, such as the resulting impairment in market liquidity. Likewise, the Proposal underestimates and dismisses the potential impact on GSIBs' customers, including the limitation or discontinuation of business activities caused by the interaction of multiple, separate capital regulations—developed globally and with limited recognition of the U.S. economic structure—that can each force banks to hold additional capital against the same business activities. The impact on support for commercial real estate, mortgage markets, and commercial lending more generally are prominent examples.

Moreover, there is no discussion in the Proposal as to why the requirements for U.S. GSIBs should be significantly higher than for GSIBs in the rest of the world. The competitive effects should be weighed and considered in the context of the lower relative risk posed by U.S. banking organizations to U.S. financial stability than competitors pose in their home jurisdictions. The assets of U.S. banking organizations make up a sharply lower share of the financial markets than do local banks in virtually any other developed country.

II. The Proposal fails to consider broader regulatory reforms.

Since the Basel Committee began discussion of implementing a GSIB capital surcharge in 2011, the United States has pursued significant regulatory reform efforts aimed at making banking organizations' capital adequacy and liquidity risk positions more robust. The Board in its Proposal, however, neither considers the efficacy of those rules nor their cumulative costs for purposes of a GSIB surcharge. Perhaps the clearest example relates to the parallel development of liquidity standards.

The United States is currently in the process of implementing the Liquidity Coverage Ratio (LCR) and will soon be considering regulations to implement the Net Stable Funding Ratio (NSFR), liquidity standards that together constitute the Basel liquidity framework. The intent of the Basel liquidity framework is, among other things, to require individual banking organizations to hold adequate high quality liquid assets (HQLA) against elements of future stress and lengthen

---

[4] IMF working paper titled "The Role of Bank Capital in Bank Holding Companies' Decisions." Available at http://www.imf.org/external/pubs/ft/wp/2015/wp1557.pdf.

the duration of their funding. Yet, under one of the calculations of the Proposal, GSIBs essentially would be required to hold a capital charge against liquidity risk. It is unclear why this extra charge is necessary unless there is an assumption that the various liquidity regimes will be ineffective. In the Proposal, the Board notes that "fire sale risk" is a key concern. However, the Proposal fails to recognize that requiring banks to hold large amounts of HQLA, as the LCR requires, is designed by regulators to mitigate fire sale risk, as by definition these assets are among the most likely to retain their value in a crisis. Nor does the Proposal consider already applicable regulations under Section 165 of the Dodd- Frank Act, which requires robust liquidity risk management and governance.

Given the novelty of the liquidity framework, the Board should fully implement liquidity standards in the United States before requiring an additional capital charge for liquidity risk. If the Board, and the other agencies, has concerns about the effectiveness of liquidity standards they should be noted publicly and addressed as needed through the LCR and soon to be proposed NSFR.

III. The Proposal inexplicably doubles a key surcharge indicator.

The calculation method the Proposal uses to determine the capital surcharge that would apply to take account of short term wholesale funding risk inexplicably simply doubles the systemic importance score. There is no explanation for this choice versus any other choice of multiplier or whether a multiplier is even analytically sound. The Proposal's weightings of funding categories are overly punitive and do not reflect an institution's actual liquidity risk. For example, it fails to consider either an institution's amount of HQLA held to mitigate liquidity risk more broadly, or the fact that an institution already holds 40 to 100 percent of HQLA against non-operational wholesale deposits. Regarding secured funding transactions, the rationale for the calibration of the weighting behind these transactions is unclear, and we do not feel there is enough meaningful information provided to allow adequate public review and more ample comment.

IV. The Proposal does not moderate the effects of foreign exchange rate volatility.

The Proposal uses a common currency aggregate of the largest global banking organizations for calculation of market share (the denominator for each systemic indicator). This makes the systemic importance scores for U.S. GSIBs proportionate to the strength of the U.S. dollar versus other currencies, introducing potentially significant fluctuations in surcharge determinations based entirely on an exogenous factor—exchange rates—that (unless occurring for a sustained period of time or as a result of other major sources of economic and financial dislocation more appropriately dealt with using other policy tools) has limited relationship or relevance to actual systemic importance. Indeed, the consequences of foreign exchange volatility on bank capital standards already are apparent. Analyst reports indicate the recent strengthening of the U.S. dollar alone places at least three of the eight U.S. GSIBs at risk of moving up one surcharge tier, or "bucket," under the Proposal, resulting in a 50 basis point increase in required capital at each of these firms.[5] This result is purely a factor of the Proposal's chosen calculation method and has little relationship to the underlying systemic importance of the affected U.S. GSIBs. This foreign exchange volatility therefore also produces an additional layer of unwarranted uncertainty and impact on the ability of banks to finance the broader economy, compounding the difficulty of capital planning for U.S. GSIBs.

V. **A GSIB capital surcharge should not be included into stress tests.**

The Proposal raises the possibility of incorporating the GSIB surcharge into the Comprehensive Capital Analysis and Review (CCAR) and other Board stress-test regimes. Although few details of how this would be done are included in the Proposal, ABA believes that incorporation of the GSIB buffer into CCAR is inconsistent with the primary objective of CCAR and other stress tests, which is to ensure going-concern viability on a post-stressed basis. Indeed, incorporation of the GSIB buffer as part of the post-stress minimums under CCAR is contrary to the very purpose of a capital buffer, which is to *absorb* losses in stressful periods without reaching to required minimum capital ratios.

ABA appreciates the opportunity to comment on the Proposal. We would be pleased for the opportunity to meet with representatives of the Board to discuss these comments and technical aspects of the Proposal more broadly. If the Board would like additional information regarding these comments, please contact Hugh Carney, at (202) 663-5324 (hcarney@aba.com), or Alison Touhey, at (202) 663-5181 (atouhey@aba.com).

Sincerely,

Hugh C Carney

Hugh Carney
Vice President of Capital Policy

[5] A February 2, 2015, Nomura global markets research report uses a static analysis to demonstrate how each GSIB's systemic importance score would change if the 2013 indicator values were converted into euro using the spot rate as of year-end 2014, assuming all else remains equal.