FINANCIAL SERVICES ROUNDTABLE

November 20, 2017

Via Electronic Submission

Anne E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, D.C. 20551

Re: Large Financial Institution Rating System; Regulations K and LL; Notice of Proposed Rulemaking (Docket No. R–1569; RIN 7100-AE82)

To Whom It May Concern:

The Financial Services Roundtable[1] (the "FSR") appreciates the opportunity to submit this letter to the Board of Governors of the Federal Reserve System (the "FRB" or the "Board") in connection with the FRB's notice of proposed rulemaking on a new ratings system for large financial institutions (the "LFI Rating System").[2] Overall, the FSR acknowledges the need to vary supervisory expectations based on a banking organization's size and complexity, and supports the FRB's desire to implement a framework for communicating its supervisory expectations consistent with that principle.

In particular, we fully support the FRB's stated objective to "enhance the clarity and consistency of supervisory assessments and communications of supervisory findings and implications" and to "[p]rovide appropriate incentives for LFIs to maintain financial and operational strength and resilience . . . by more clearly defining the supervisory consequences of a given rating."[3] In addition, we also believe that such a system should not be overly prescriptive or formulaic; an appropriately tailored rating system for large financial institutions needs to allow for enough flexibility to reflect the varying business models and risk management infrastructures of all institutions, even for those that are similarly situated.

[1] The Financial Services Roundtable represents the largest integrated financial services companies providing banking, insurance, payment and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. FSR member companies provide fuel for America's economic engine, accounting for $54 trillion in managed assets, $1.1 trillion in revenue, and 2.1 million jobs. Learn more at FSRoundtable.org.

[2] FRB, Large Financial Institution Rating System; Regulations K and LL, 82 Fed. Reg. 158 (Aug. 17, 2017), 39049.

[3] Id. at 39050.

To that effect, we offer the following comments and recommendations. We believe that these recommendations strike an appropriate balance between the desire for clarity and consistency and the need for sufficient flexibility. The outline, attached hereto as Appendix A, describes how our recommendations map to the Board's specific Request for Comments.

I. RECOMMENDATIONS ON SCOPE AND APPLICABILITY

A. The threshold for applicability of the proposed LFI Rating System should be based on risk-based factors rather than asset size, consistent with the U.S. Department of the Treasury's Core Principles Report.

As proposed, bank holding companies would be subject to the LFI Rating System only if they had total consolidated assets of $50 billion or more. This $50 billion threshold is based on the threshold set forth in the Section 165 of the Dodd-Frank Act (the "EPS Threshold"), which imposes on banking organizations above this threshold a set of strenuous regulations promulgated and administered by the FRB. Reliance on asset size as the sole factor in identifying risk is incomplete, overly simplistic and prone to error. Since its adoption, the EPS Threshold has been widely discredited; it is now generally accepted that risk-based criteria provide a far better measure of risk than asset size.[4]

For example, before Governor Tarullo resigned his position at the FRB, he stated that "we have found that the $50 billion in assets threshold established in the Dodd-Frank Act for banks to be "systemically important" and thus subject to a range of stricter regulations, was set too low."[5] Similarly, Governor Powell testified before the Senate Banking Committee that "the Federal Reserve has also supported increases in various statutory thresholds in the Dodd-Frank Act to more narrowly focus financial stability reforms on larger banking firms . . . [we] would support an increase . . . in the $50 billion threshold for enhanced prudential standards under section 165 of the Dodd-Frank Act." Finally, in connection with its report to the President examining the United States' financial regulatory system, the U.S. Department of the Treasury (the "Treasury") recommended that the EPS Threshold be amended "to more appropriately tailor these standards to the risk profile of bank holding companies."[6]

The FSR continues to believe that the EPS Threshold should not be a "bright line" standard, but rather a principles-based framework that takes into account the risk profile of specific banking organizations. At the very least, the LFI Rating System proposal should either be delayed until Congress has had the opportunity to implement a revised EPS Threshold, or the threshold for applicability for the proposed LFI Rating System should be automatically adjusted

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[4] Aite Group, Bank Size vs. Systemic Importance (Oct. 2015), available at http://www.fsroundtable.org/wp-content/uploads/2015/10/Bank-Size-vs-Systemic-Importance_Aite-Group-Study_FINAL_October-19-2015.pdf.

[5] See Daniel Tarullo, Departing Thoughts, Address at The Woodrow Wilson School, Princeton University, Princeton, New Jersey (Apr. 4, 2017), available at https://www.federalreserve.gov/newsevents/speech/tarullo20170404a.htm .

[6] Treasury, A Financial System That Creates Economic Opportunities, Banks and Credit Unions 12 (June 2017).

based on changes made to the EPS Threshold.[7] In this regard, we note that the EPS Threshold not only impacts the applicability of the proposed LFI Rating System, but also impacts many of the supervisory programs under underpinning components of the system. The threshold for applicability should avoid the possibility that a bank holding company would be subject to the proposed LFI Rating System, but would not be subject to one of the supervisory programs that the proposed LFI Rating System uses to evaluate bank holding companies.[8]

B. The scope and expectations for bank holding companies subject to the LFI Rating System should vary by size.

The proposed LFI Rating System currently applies the same standard of review to all bank holding companies above the EPS Threshold. We believe such a "one-size-fits-all" approach would inappropriately hold smaller, less complex banks to the same standards and expectations as complex, multitrillion dollar global banks. Smaller, less complex banks are less interconnected and pose less systematic risk to the financial system than larger, more complex banks. In addition, smaller, less complex banks would have fewer resources to comply with the new LFI Rating System, and any additional regulatory burdens would put them at a competitive disadvantage to their larger, more complex rivals, even though they are of less regulatory concern.

As a result, we believe a proportionate standard of review would be appropriate. In particular, we recommend that the LFI rating system should state explicitly that the standard of review examiners should apply in assessing a firm's practices and condition must be in proportion to the risk profile, size, complexity and other unique characteristics of the firm.

C. The proposed LFI Rating System should be implemented no earlier than January 1, 2019.

Under the current proposal, the FRB would implement the LFI Rating System beginning in 2018. We would recommend that the FRB implement the new ratings system no earlier than 2019. Allowing for a longer implementation period would ensure that FRB examiners have time to be properly trained and will help ensure that the FRB has sufficient time to communicate their expectations under the new system.

We believe any implementation period should be similar to the parallel run system used for bank holding companies implementing the so-called "advanced approaches" to calculate risk-

[7] For example, a bipartisan Senate bill released on November 13, 2017 proposes to raise the EPS threshold from $50 billion to $250 billion. See Senators Announce Agreement on Economic Growth Legislation, available at https://www.banking.senate.gov/public/index.cfm/republican-press-releases?ID=1271F394-4DCD-4917-A8DF-D194A058B68F.

[8] Should the FRB maintain the EPS Threshold, we would recommend removing the provision under which firms would continue to be subject to the LFI Rating System until their total consolidated assets fell below $45 billion. This provision would in effect create a backdoor $45 billion threshold instead of a $50 billion threshold for firms currently subject to the LFI Rating System. We believe that if the FRB wishes to keep the EPS threshold then it should be the same threshold for all bank holding companies.

weighted assets under the FRB's Regulation Q. After a banking organization crosses the advanced approaches thresholds under Regulation Q, it must conduct a parallel run for no less than four calendar quarters before becoming subject to the rule.[9] This parallel run allows bank holding companies to have the time to gain experience with the new methodology for calculating risk-weighted assets, solicit feedback from regulators and identify and fix any issues before full implementation. Similar to the parallel run for "advanced approaches", we believe that bank holding companies that meet the EPS Threshold should have at least a one year parallel run period to test the new LFI Rating System alongside the current system to allow for the FRB to clarify its expectations with respect to the new system and to allow for bank holding companies to identify and address issues in implementing the new system.

D. The FRB should defer the implementation of the LFI Rating System for "large and non-complex" firms until after the implementation of other regulatory reforms, including new risk-based supervisory thresholds.

Certain components of the proposed LFI Rating System depend on regulations and supervisory guidance that have yet to be finalized. We would recommend that the FRB defer implementing the LFI Rating System for large, "non-complex" bank holding companies[10] until the following regulations have been implemented and personnel have had a chance to review those regulations.

First, we would recommend that the FRB delay finalizing the proposed LFI Rating System until key regulatory personnel have been confirmed and have had a chance to weigh in on the proposal. There are currently key senior level positions at the FRB that are unfilled or have yet to be confirmed by the Senate. For example, the FRB Vice Chairman for Supervision, who is charged with leading a unified approach to bank holding company regulation, has only been recently confirmed by the Senate. Providing key personnel with the opportunity to review the LFI Rating System and the related proposals would help ensure a smooth transition to a new LFI Rating System. Furthermore, allowing key personnel to settle in would ensure that the new system is consistent with the overall policy goals of the FRB.

Second, implementation of the proposed LFI Rating System should be delayed until the FRB's proposed board effectiveness guidance[11] and the to-be-published guidance addressing management expectations for core business lines and independent risk management and controls have been finalized. These proposals are currently key elements of the Governance and Control component of the proposed LFI Rating System. Finalizing the LFI Rating System before these other proposals have been finalized would be premature. Banking organizations should have the

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[9] 12 C.F.R. § 217.121(c).

[10] We suggest that the FRB use the definition of "large non-complex" banking institutions in SR Letter 15-19 (December 18, 2015) to define the initial scope of applicability for the LFI Rating System.

[11] FRB, Large Financial Institution Rating System; Regulations K and LL, 82 Fed. Reg. 15 (Aug. 17, 2017), 39049, 39053-39056.

opportunity to internalize the guidance, develop frameworks for implementation, identify potential gaps and address any issues that may arise.

Third, implementation of the LFI Rating System should be delayed until the major regulatory reforms contemplated by the Treasury's Core Principles Report have been implemented. As discussed above, we think that the idea of an asset-based EPS Threshold is fundamentally flawed. The LFI Rating System creates a two-tiered rating scale based on the current EPS Threshold, applying one set of rigorous standards to bank holding companies that meet this threshold, and applying another set of standards to smaller bank holding companies that fall under the threshold. Establishing a two-tier rating scale based on such a flawed threshold would be even more inappropriate. The Core Principles Report contemplates revisions to the EPS Thresholds that would address these issues. Before differentiated supervisory rating standards for "large" versus "small" bank holding companies are implemented, the thresholds used to define those categories should be carefully calibrated and the standards must be appropriately tailored to account for the very wide range of risk and complexity within the proposed "large" group. Furthermore, to the extent that Congress makes further changes to the EPS Threshold, we would expect the FRB to amend the scope of applicability for the proposed LFI Rating System accordingly.

E. The FRB should propose a ratings system for insurers through a separate rulemaking process.

The proposed LFI Rating System would apply only to non-insurance, non-commercial savings and loan holding companies ("<u>SLHCs</u>").[12] The proposed LFI Rating System therefore would not apply to SLHCs or nonbank systemically important financial institutions ("<u>SIFIs</u>") that engage in significant insurance or commercial activities. The FSR supports this exclusion. We believe that a rating system designed for bank holding companies and for the business of banking would be wholly inappropriate for SLHCs and SIFIs engaged primarily in insurance or commercial activities. If the FRB decides to implement a rating system analogous to the proposed LFI Rating System for such companies, we would encourage the system to be carefully tailored for the business in which such companies engage. For example, a rating system that would apply to insurance SLHCs and SIFIs must be appropriately tailored to the business of insurance.

II. Recommendations for LFI Rating Components

A. The proposed LFI Rating System should include a standalone composite rating, which should be used as the sole basis for determining "well-managed" status.

Under the proposed LFI Rating System, the FRB would not assign a standalone composite rating. The FRB stated that assigning a standalone composite rating is not necessary because the three proposed LFI component ratings are designed to clearly communicate

[12] Id. at 39049.

supervisory assessments and associated consequences for each area. One of the consequences of the lack of a standalone composite rating under the proposed LFI Rating System is that a Deficient-1 or lower rating under any of the three proposed component ratings would result in the loss of "well-managed" status. This consequence is extraordinarily punitive and could have wide-ranging implications for the affected bank holding company. A Deficient-1 rating could seriously curtail the ability of a bank holding company to acquire or expand its business which could negatively impact consumers, as well as the safety and soundness of the bank.

As a general matter, the FSR supports a holistic ratings system that allows for flexibility and allows institutions to remediate issues identified by regulators before concrete regulatory sanctions are imposed. A small number of MRAs or other deficiencies in one component does not necessarily mean that an institution is not well-managed, and should not result in the severe penalties associated with loss of "well-managed" status for what is overall a well-run company. In that regard, we note that horizontal exams for the Capital Planning and Positions or Liquidity Risk Management component ratings are exclusively process-oriented and leave an enormous amount of discretion to individual examiners. As discussed below, an overreliance on horizontal examinations could result in inconsistent application of Deficient-1 or lower ratings across organizations.

We recommend that the FRB adopt a standalone composite rating similar to what is currently in effect for the RFI/C(D) system. Such a standalone composite rating should not default to the lowest component rating and should instead be based on the average of the three component ratings. A standalone composite rating would reduce the risk of the loss of "well-managed" status when it is not warranted by ensuring that "well-managed" designations are based on a more complete assessment of a firm's performance and practices rather than perceived deficiencies in a specific, narrow category, particularly for those categories that rely on horizontal examinations. Consequently, loss of "well-managed" status should be tied to this standalone composite rating, rather than each of the proposed component ratings.

B. Each of the three proposed LFI component ratings should include subcomponents that correspond to the factors that the FRB has listed it will use in evaluating each component.

Although the FRB explicitly lists the factors that it would consider in evaluating each of the LFI component ratings, the proposed LFI Rating System does not include any subcomponent ratings. We recommend that the FRB add additional subcomponent ratings to each of the three LFI component ratings similar to those which are currently in effect for the RFI/C(D) rating system. Subcomponents corresponding to the factors that the FRB has already listed would help to ensure that ratings can be consistently applied across institutions and exam groups without reducing flexibility.

In particular, subcomponent ratings would allow FRB exam staff to communicate findings in specific areas in a way that is more consistent and transparent, and which would allow bank holding companies to more easily identify, communicate, and correct deficiencies across the organization. Should bank holding companies find that their assigned rating was unwarranted, subcomponents also could provide additional details that bank holding companies could use as a basis for discussion with examiners.

Despite the virtues of subcomponent ratings, we would not support a formulaic approach to subcomponent ratings where a component rating would be a mathematical function of the subcomponent ratings. Explicitly tying subcomponent ratings via a formula would be overly prescriptive, and could contribute to a "one-world" view of risk management that could perversely increase the overall risk to the financial system by creating a herd mentality where some risks are uniformly overlooked by every bank holding company.

C. The FRB should not add additional components to the rating system beyond the three currently proposed.

We do not support additional components beyond the three currently proposed. In particular, we do not support a separate resolution planning component. The failure to cure deficiencies on resubmission of a resolution plan will already potentially result in more stringent capital, leverage or liquidity requirements or restrictions on the growth, activities or operations of a bank holding company.[13] Adding a resolution planning component to the proposed LFI Rating System would be duplicative, given the severe penalties associated with deficiencies under the FRB's resolution plan rule. Furthermore, the addition of such a component would be directly contrary to the recommendations in the Core Principles Report to limit scope of resolution plan requirements, particularly for smaller, less complex firms.

D. The FRB should clarify that "passing" CCAR should create the presumption of a "Satisfactory" rating under the Capital Planning and Positions component and should clarify how the component would incorporate SR 15-18/15-19.

The Capital Planning and Positions component rating would be significantly based on the findings of the Comprehensive Capital Analysis and Review ("CCAR"). On February 3, 2017, the FRB amended its capital plan rule to remove the qualitative assessment of CCAR for certain large and noncomplex firms in order to reduce significant burdens on those firms.[14] As a result, CCAR for large and complex firms would include both quantitative and qualitative assessments, while CCAR for large and noncomplex firms would focus on the quantitative assessments. Qualitative assessments for large and noncomplex firms would be subject to regular supervisory assessments.

For large and complex firms, we recommend that passing CCAR, which consists of both quantitative and qualitative assessments, should result in the presumption of a Satisfactory rating under the Capital Planning and Positions component. A "Satisfactory Watch" rating would be

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[13] 12 C.F.R. § 243.6(a).

[14] FRB, Amendment to the Capital Plan and Stress Test Rules; Regulations Y and YY, 82 Fed. Reg. 22 (Feb. 3, 2017), 9308.

appropriate only for large and complex firms that pass CCAR if the FRB identifies significant deficiencies in the firm's capital planning process as outlined in SR 15-18 that would not otherwise cause the FRB to object to the firm's capital plan.

Similarly, for large and noncomplex firms, passing CCAR, which would mean passing a quantitative assessment, should result in a presumption of a Satisfactory rating, subject to additional qualitative assessment based on horizontal review and the guidelines set forth in SR 15-19.

E. The FRB should clarify that passing a CLAR exam should be sufficient to achieve a "Satisfactory" rating under the Liquidity Risk Management and Positions component.

We recommend the FRB clarify that passing CLAR should be sufficient to achieve a Satisfactory rating under the Liquidity Risk Management and Positions component. Currently, financial firms that are deemed to pose elevated risk to the U.S. financial system by the Large Institution Supervision Coordinating Committee ("LISCC Firms") are subject to the Comprehensive Liquidity Assessment and Review (CLAR). CLAR is an annual horizontal exam used to assess the adequacy of an LISCC Firm's liquidity positions. CLAR both qualitatively examines the firm's liquidity and risk management controls and quantitatively measures the firm's liquidity metrics. Like the liquidity rating component, CLAR relies in large part on stress testing to measure the ability of liquidity positions to cover a range of scenarios.

As described above, both CLAR and the liquidity rating component have the same objective, to ensure that a firm's liquidity positions are sufficient to cover a range of conditions, and both largely use the same tools and metrics to make such a determination. We believe that going through both processes would be an unnecessary duplication of regulatory efforts. Allowing an association between CLAR and the liquidity rating component enables the Board and covered institutions to build on current processes and shared expectations, while saving valuable time and resources.

F. The FRB should clarify that any deficiencies identified in the qualitative part of the Capital Planning and Positions component will not result in the loss of a "well-managed" rating.

As described above, the FRB removed qualitative assessment of CCAR for certain large and noncomplex firms. The FSR is concerned that the Capital Planning and Positions component could reinstate a similar qualitative assessment through the LFI Rating System if is administered in the same way that the CCAR qualitative assessment was. Such a result would negate these recent efforts by the FRB to tailor capital planning expectations for large and noncomplex firms. In particular, the penalties that could result from a Deficient-1 rating could be just as severe, if not more so, than the penalties imposed for an objection to a firm's capital plan on qualitative grounds (e.g., restrictions on capital distributions).

Contrary to the FRB's stated goal to reduce the burden for large and noncomplex firms, bank holding companies would be incentivized to simply reallocate resource from CCAR to the qualitative aspects of the Capital Planning and Positions component. The FRB should clarify its qualitative expectations under the Capital Planning and Positions component and make clear that the component was not intended to revive the qualitative assessment of CCAR for large and noncomplex firms.

G. The FRB should not rely exclusively on the proposed board effectiveness guidance to evaluate the effectiveness of a bank holding company's board of directors.

A key component of the Governance and Controls rating is an evaluation of the bank holding company's board of directors. The proposed board effectiveness guidance states that the five attributes described therein "would provide the framework with which the Federal Reserve proposes to assess a firm's board of directors under the proposed LFI rating system."[15] We believe the FRB should not rely exclusively on the proposed board effectiveness guidance to evaluate a bank holding company's board of directors. In our concurrent comment letter concerning the board effectiveness guidance, we underscored the need for proportionality and clarity in the guidance. This will ensure that governance principles are applied by examiners appropriately and consistently, allowing boards to have the flexibility and resources to carry out their responsibilities.[16] Relying exclusively on the proposed board effectiveness guidance to evaluate governance would exacerbate the issues described above, by attaching additional consequences to a potential evaluation.

These additional consequences further justify the "cottage industry" that would likely arise to ensure director effectiveness compliance. The current proposal would incentivize a prescriptive, check-the-box system of governance as boards would avoid adopting unique or innovative approaches out of fear of scrutiny and the severe consequences of a less than Satisfactory rating. This would undercut the purpose of the board effectiveness guidance, which is to reduce regulatory burdens and allow boards to increase their focus on their core responsibilities. Even if board effectiveness reviews are to become a regular exam focus, we would recommend that the reviews should remain part of the FRB's review of other substantive areas rather than as a stand-alone board effectiveness exam, in order to avoid duplication.

H. Horizontal reviews should not be the primary way in which the FRB evaluates the Capital Planning and Positions and Liquidity Risk Management components.

Under the current proposal, the Capital Planning and Positions and Liquidity Risk Management components rely heavily on horizontal reviews. These reviews often ignore specific business models, risk profiles and other differentiating characteristics of particular

[15] FRB, Proposed Guidance on Supervisory Expectation for Board of Directors, 82 Fed. Reg. 152 (Aug. 9, 2017), 37,219, 37,220.

[16] Comment letter from Financial Services Roundtable to the Board of Governors of the Federal Reserve System on the Board Effectiveness Guidance Proposal (November 15, 2017).

companies and give too much discretion to examiners. We recommend that instead of using horizontal reviews to form the basis for each firm's component ratings, the FRB should use the results of those reviews to clarify their expectations from firms in the form of SR letters or FAQs, in each case subject to the customary notice and comment procedures.

Using horizontal reviews as a basis to provide additional guidance to firms, rather than as a means to penalize individual firms for perceived deficiencies, would provide firms and FRB examiners with a less combative forum to address the differences between firms, and would ensure orderly and thoughtful consideration of industry views at a senior level within the FRB.

I. The LFI rating should be based in part on the subsidiary bank rating.

The FRB should consider basing a portion of the rating of the bank holding company on the subsidiary bank rating if the bank holding company primarily consists of the subsidiary bank. Furthermore, the greater the percentage that a bank holding company's assets consist of the bank's assets, the more heavily-weighted the bank's CAMELS rating should be in its LFI Rating(s). Presumably, the safety and soundness of a bank holding company would be directly tied to the safety and soundness of its bank subsidiary. Banks are already subject to the CAMELS rating system which includes an assessment of the bank's capital adequacy, management capability and liquidity.[17] Incorporating the CAMELS rating system, where appropriate, into the LFI Rating System would prevent unnecessary regulatory duplication and allow firms to conserve resource by building from existing processes.

III. RECOMMENDATIONS FOR LFI RATING SCALE

Currently, the FRB proposal has provided very little guidance on the Board's expectations for each rating. We would recommend that the FRB more clearly articulate its expectations for each rating to help ensure that examiners apply the ratings system in a consistent manner and provide firms with clarity with regard to their regulatory expectations. At the very least, the FRB should clarify the correspondence between ratings under the old system and ratings under the new LFI Rating System.

A. Clarify circumstances under which an MRA or MRIA would trigger a downgrade from the Satisfactory rating.

Under the current "Satisfactory" definition, any supervisory issues would trigger a less than satisfactory rating if a firm is not "effectively mitigating the issues or the Federal Reserve has deemed the issues are unlikely to present a threat to the firm's ability to maintain safe and sound operations."[18] By comparison, the FRB's proposal for communicating supervisory findings defines an MRA as an issue that must be addressed to ensure the firm operates in a safe

[17] FDIC, Uniform Financial Institution Rating System, 62 Fed. Reg. 3 (Jan. 6, 1997), 752.

[18] FRB, Large Financial Institution Rating System; Regulations K and LL, 82 Fed. Reg. 158 (Aug. 17, 2017), 39049, 39049.

and sound manner.[19] If the two proposals are adopted as proposed, the presence of an MRA could therefore be interpreted to mean that the firm cannot be rated "Satisfactory" unless it is "effectively mitigating the issues." It is not clear what criteria examiners would use to assess whether a firm is "effectively mitigating" a newly issued MRA where remediation may not yet have begun.

Furthermore, the proposed LFI Rating System does not clarify the level of materiality that would result in the Board deeming that specific issues are likely to present a threat to a firm's safety and soundness. For example, issues relating to the capital and liquidity position of a firm clearly present safety and soundness concerns. On the other hand, limited compliance issues could result in an MRA, but one that would not necessarily be material to the firm as a whole. The FRB should clarify that limited-scope compliance issues do not give rise to safety and soundness concerns which in turn could give rise to a downgrade; remediation of such issues is better addressed through separate proceedings.

B. The "Satisfactory Watch" rating should be a permanent category.

Under the proposed LFI Rating System, the "Satisfactory Watch" rating is intended to provide firms with a set time period to correct any outstanding safety and soundness issues before the firm is downgraded to a Deficient-1 rating. The FRB anticipates that this timeframe would be temporary and generally would not be expected to last longer than 18 months.[20] We do not support such a time limit. Many MRAs and MRIAs simply cannot be resolved within 18 months especially when verifying the sustainability of a corrective action. Sometimes it will take an entire annual cycle (for example, DFAST) to verify sustainability, and then the examiners will need to test the sustainability of the corrective action after that annual cycle has passed. Failure to remediate an MRA or MRIA does not necessarily indicate lack of urgency on the part of a bank holding company, and does not necessarily reflect the severity of the underlying issue. The length of time to resolve an MRA or MRIA oftentimes is not within a firm's control.

This problem is further exacerbated by the fact that the FRB states that the Satisfactory Watch rating is intended for issues that can be resolved "in a timely manner in the normal course of business,"[21] which would not seem to apply to most MRAs or MRIAs. Resolution of many MRAs or MRIAs generally require substantial infrastructure investment and changes in processes and controls that are significant for the relevant business area or function. By design, such changes would not be "normal course" actions. We propose that the Satisfactory Watch rating instead be a permanent rating category that signals that the company faces moderate but

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[19] FRB, Proposed Guidance on Supervisory Expectation for Board of Directors, 82 Fed. Reg. 152 (Aug. 9, 2017), 37,226.

[20] FRB, Large Financial Institution Rating System; Regulations K and LL, 82 Fed. Reg. 158 (Aug. 17, 2017), 39049, 39051.

[21] Id. at 39059.

manageable issues. So long as reasonable progress is made in addressing those issues, the FRB should not presume that a downgrade to Deficient-1 would follow.

C. The "Satisfactory Watch" Rating should be used infrequently.

We would recommend that the final rule state that the Satisfactory Watch rating should be applied infrequently or should explicitly state that any issues raised by a Satisfactory Watch rating should be resolved in proportion to its severity. In practice, the severe consequences of a Deficient-1 rating would cause a firm to fix any issues raised by a Satisfactory Watch at all costs in order to avoid a downgrade. The rating would thus be similar to an informal enforcement action, and if applied frequently would divert resources from other, potentially more productive uses, in order to fix a specific issue.

D. The Implications of the "Deficient-1" rating should be clarified.

Under the current proposal, a "Deficient-1" rating "would often be an indication that the firm should be subject to either an informal or formal enforcement action, and may also result in the designation of the firm as being in 'troubled condition'."[22] It is not clear under what circumstances a Deficient-1 rating would result in "troubled condition" status or a formal enforcement action. We propose that the FRB clarify that the Deficient-1 rating is the equivalent of the "3" rating in the current RFI/C(D) system. This would make clear that absent unusual circumstances, the Deficient-1 rating would not trigger "troubled condition" status and would ensure that examiners apply penalties under the LFI Rating System in a consistent manner.

We also propose that the FRB clarify that a Deficient-1 rating provides the FRB sufficient flexibility to approve expansionary activities where appropriate. The current proposal states that a firm with a Deficient-1 rating would require the FRB's approval to engage in new or expansionary activities which would be granted based on a number of factors, such as whether the firm is making meaningful progress fixing the issues that led to the downgrade or whether the new activity would distract the board from fixing current issues.[23] We would recommend that limits on expansionary activities associated with Deficient-1 status should not extend to purely internal or de novo expansions, even where such internal growth may require prior approval from the FRB. Such expansions would be highly unlikely to exacerbate any issues raised by the Deficient-1 rating, and would ensure that the approval of any restricted expansion activities is consistently granted or rejected.

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Thank you for your consideration, and we look forward to working with the FRB to improve upon the proposed LFI Rating System. If it would be helpful to discuss the FSR's

[22] Id. at 39052.

[23] Id. at 39052.

specific comments or general views on this issue, please contact me via telephone at (202) 589-2424 or email at Richard.Foster@FSRoundtable.org.

Sincerely yours,

Rich Foster

Richard Foster
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Financial Services Roundtable

<u>Appendix A</u>
Responses to Specific FRB Questions

I. RESPONSES TO SPECIFIC FRB QUESTIONS

A. Are there specific considerations beyond those outlined in this proposal that should be considered in the Federal Reserve's assessment of whether an LFI has sufficient financial and operational strength and resilience to maintain safe and sound operations?

The FRB should consider tying, in part, the rating in the LFI Rating System to the rating of its bank subsidiary as discussed in Section II.D, the CLAR exam to the liquidity rating component as discussed in Section I.E and CCAR to the Capital Planning and Positions component rating as discussed in Section II.I.

B. Does the proposal clearly describe the firms that would be subject to the LFI Rating System, and those firms that would continue to be subject to the RFI rating system?

Please refer to our comments in Section I.A and Section I.B of this letter where we discuss revising the EPS Threshold to make it more risk-sensitive as contemplated by the Core Principles.

C. Does the proposal clearly describe the supervisory expectations for senior management in the evaluation of a firm's governance and controls under the proposed LFI Rating System?

Please refer to our comments in Section I.D and Section II.G of this letter. The lack of clear supervisory expectation only underscores the need to delay imposing a new rating system until the guidance concerning supervisory expectations is in place.

D. Does the proposal clearly describe how and under what circumstances a "Satisfactory Watch" rating would or would not be assigned? Does that rating provide appropriate messaging and incentives to firms to correct identified deficiencies?

Please refer to our comments in Section III.B. and Section III.C of this letter, where we propose to clarify that the "Satisfactory Watch" rating will be assigned infrequently and that the rating should be permanent.

E. Should the LFI rating system be revised at a future date to assess the sufficiency of a firm's resolution planning efforts undertaken to reduce the impact on the financial system in the event of the firm's failure? If yes, what should the Federal Reserve specifically consider in conducting that assessment?

Please see comments in Section II.C where we argue that resolution planning should not be included as a component.

F. Are there options that should be considered to enhance the transparency of LFI ratings in order to incent more timely and comprehensive remediation of supervisory deficiencies or issues?

Please refer to our comments in Sections II.A where we propose a standalone composite rating, Section II.B where we propose subcomponents and Section III where we propose to clarify the "Satisfactory," "Satisfactory Watch" and "Deficient-1" ratings.

G. What specific issues should the Federal Reserve consider when using the LFI Rating System to inform future revisions to other supervisory rating systems used to assess the U.S. operations of foreign banking organizations?

We believe our recommendation to make asset-based thresholds risk-sensitive, as described in Section I.A and Section I.B, would be applicable to any supervisory rating system.