

June 25, 2018

Via Electronic Mail

Office of the Comptroller of the Currency
400 7th Street, SW, Suite 3E-218
Mail Stop 9W-11
Washington, DC 20219
Attention: Legislative and Regulatory Activities Division
Docket ID OCC—2018—0002; RIN1557—AE35

Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, N.W.
Washington, D.C. 20551
Attention: Ann E. Misback, Esq., Secretary
Docket No. R —1604; RIN 7100 AF-03

**Re: Regulatory Capital Rules: Regulatory Capital, Enhanced
Supplementary Leverage Ratio Standards for U.S. Global Systemically
Important Bank Holding Companies and Certain of Their Subsidiary
Insured Depository Institutions; Total Loss-Absorbing Capacity
Requirements for U.S. Global Systemically Important Bank Holding
Companies**

Ladies and Gentlemen:

The Goldman Sachs Group, Inc. (“Goldman Sachs” or “we”) appreciates the opportunity to comment on the notice of proposed rulemaking issued by the Office of the Comptroller of the Currency (the “OCC”) and the Board of Governors of the Federal Reserve System (the “Federal Reserve” and, together with the OCC, the “Agencies”) to modify the enhanced supplementary leverage ratio (“eSLR”) requirements for U.S. top-tier bank holding companies (“BHCs”) identified as global systemically important bank holding companies (“G-SIBs”) and certain of their insured depository institution (“IDI”) subsidiaries (“the Proposed Rule”).¹

¹ Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for U.S. Global Systemically Important Bank Holding Companies and Certain of Their Subsidiary Insured Depository Institutions; Total Loss-Absorbing Capacity Requirements for U.S. Global Systemically Important Bank Holding Companies, 83 Fed. Reg. 17317 (Apr. 19, 2018).

I. Introduction

As a fundamental principle, we believe that any banking organization's regulatory capital requirements should reflect primarily the risk profile of the firm's assets and off-balance sheet exposures: the higher the risk, the higher the amount of capital required, and, conversely, the lower the risk, the lower the amount of capital required. That is why we believe that the primary drivers of any firm's regulatory capital requirements should be the risk-based capital requirements reflected in the Agencies' respective capital rules.² The Agencies' Tier 1 Leverage Ratio, Supplementary Leverage Ratio ("SLR") and eSLR requirements are indifferent to the relative risk of those assets and exposures, treating an exposure to U.S. Treasury securities in exactly the same way as an exposure common equity issued by a highly leveraged start-up company. These leverage capital measures act as risk-indifferent limits to the size of a firm's balance sheet and other exposures and, as such, they do not incentivize prudent risk-taking. For this reason, while we believe that leverage capital measures are appropriate and useful as backstops, they should never be a firm's primary regulatory capital constraint.

Consistent with this fundamental principle, we generally support the Agencies' proposed modifications to the eSLR requirements for U.S. G-SIBs. This would further the Agencies' stated goal of returning the SLR to its intended role as a backstop, as a leverage ratio that serves as a binding constraint can "create incentives for firms to reduce participation in or increase costs for low-risk, low return businesses"³ and can thereby create a perverse incentive for firms to engage in riskier activities.⁴ As a result, we welcome the Agencies' proposal, which would reduce the likelihood that the SLR will serve as a G-SIB's binding constraint.

We note, however, that even if the Agencies adopt their proposed changes to the eSLR, the SLR could become binding on the U.S. G-SIBs in the future, particularly under stressed market conditions. In order to ensure that leverage measures remain a backstop to risk based capital requirements, and to avoid the incentives against prudent risk-taking that a binding leverage ratio can create, we encourage the Agencies to consider additional modifications to (1) the calibration of the G-SIB surcharge and (2) the

² See generally 12 C.F.R. pts. 3, 217

³ 83 Fed. Reg. at 17319–20 "Over the past few years, banking organizations have raised concerns that in certain cases, the standards in the eSLR rule have generally become a binding constraint rather than a backstop to the risk-based standards. Thus, the current calibration of the eSLR rule may create incentives for banking organizations bound by the eSLR standards to reduce participation in or increase costs for lower-risk, lower-return businesses, such as secured repo financing, central clearing services for market participants, and taking custody deposits, notwithstanding client demand for those services. Accordingly, in light of the experience gained since the initial adoption of the eSLR standards, and to avoid potential negative outcomes, the Board and the OCC are proposing to recalibrate the standards in the eSLR rule."

⁴ See U.S. Department of the Treasury, *A Financial System That Creates Economic Opportunities: Banks and Credit Unions* (June 2017), at 51, <https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf> "A capital regime that is exclusively dependent upon a leverage ratio, or that makes it a primary binding capital constraint, could have the unintended outcome of encouraging risk-taking by banking organizations.", (hereinafter the "Treasury Banking Report").

total leverage exposure measure of the SLR and eSLR.⁵ Many of the recommendations in this letter are consistent with the U.S. Treasury Department's Report to the President, *A Financial System That Creates Economic Opportunities: Banks and Credit Unions*.⁶

II. Recommended Revisions to the G-SIB Surcharge

We support the Agencies' proposal to replace the current static 2% eSLR buffer requirement for G-SIB BHCs with a tailored buffer requirement equal to 50% of a firm's applicable G-SIB surcharge. This is similar to the approach adopted by the Basel Committee,⁷ although it still results in significantly higher requirements for U.S. banks given the gold-plating that has been incorporated into the Federal Reserve's G-SIB methodology. This approach, however, makes it important to ensure that the G-SIB surcharge itself is calculated and calibrated appropriately, and thus we recommend that the Federal Reserve separately revisit the calibration of the framework that will be incorporated in the eSLR buffer to more accurately reflect the systemic risk of U.S. G-SIBs. This recalibration would ensure that the SLR requirements serve as a backstop rather than a binding constraint and would avoid putting U.S. G-SIBs at a disadvantage relative to their foreign counterparts. For additional detail on the rationale for the recalibration of the G-SIB surcharge and specific recommendations, please see Appendix A of GS' comment letter on Proposed Amendments to the Regulatory Capital, Capital Plan and Stress Test Rules (Docket No. R-1603; RIN 7100-AF2).

A. Recalibrate the G-SIB Surcharge to Account for Improvements Made by U.S. G-SIBs to Reduce Their Systemic Footprint

The Federal Reserve should consider revisiting its calibration of the U.S. G-SIB surcharge framework to account for improvements that each U.S. G-SIB has made since the G-SIB surcharge rule was adopted in August 2015⁸ both to reduce the probability of its failure and to reduce the impact that its failure would have on the U.S. financial system. First, all of the U.S. G-SIBs have significantly improved their resolution plans in recent years, thereby reducing the impact of a potential failure. Each U.S. G-SIB has adopted or announced an intention to adopt a single-point-of-entry strategy for its resolution plan,⁹ under which only the top-tier parent holding company would enter

⁵ The Federal Reserve has separately proposed to amend its regulatory capital rule and Comprehensive Capital Analysis and Review ("CCAR") and stress test rules and establish new stress capital buffer and stress leverage buffer requirements. Amendments to the Regulatory Capital, Capital Plan, and Stress Test Rules, 83 Fed. Reg. 18160 (Apr. 25, 2018). We support the removal of the SLR from any stress leverage buffer that the Federal Reserve adopts.

⁶ See Treasury Banking Report at 14, 16.

⁷ Basel Committee on Banking Supervision, *Basel III: Finalising post-crisis reforms* (Dec. 2017), at 141, <https://www.bis.org/bcbs/publ/d424.pdf>.

⁸ Regulatory Capital Rules: Implementation of Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies, 80 Fed. Reg. 49082 (Aug. 14, 2015).

⁹ See the public sections of the 2017 165(d) resolution plans of Bank of America, Bank of New York Mellon, Citi, Goldman Sachs, JPMorgan, Morgan Stanley and State Street, each indicating an SPOE strategy, available at <https://www.fdic.gov/regulations/reform/resplans/index.html>. See also Wells Fargo & Company (...continued)

bankruptcy proceedings and the key subsidiaries would be recapitalized or provided with additional liquidity, as necessary, and would remain open and operating. Each U.S. G-SIB has also entered into a secured support agreement with contractual triggers based on sophisticated resolution capital execution need (“RCEN”) and resolution capital liquidity need (“RLEN”) modeling, among other features.¹⁰ These triggers ensure that a bankruptcy filing would occur at a time when the U.S. G-SIB still has enough assets and liquidity to meet the projected capital and liquidity needs of material subsidiaries, and the secured support agreement contractually obligates the parent holding company (and intermediate holding company or other funding entity, if applicable) to ensure that key subsidiaries have the appropriate capital and liquidity those entities would need in resolution. Crediting these improvements, the Federal Reserve and the FDIC determined that each resolution plan submitted by a U.S. G-SIB in 2017 was credible.¹¹

Second, the U.S. G-SIBs must now comply with the final TLAC rule, which establishes minimum requirements for loss-absorbing capacity and, pursuant to the clean holding company requirements, restricts the activities in which the parent holding company can engage and limits the types and quantum of certain liabilities that the parent holding company can incur.¹² Today U.S. G-SIBs collectively have approximately \$2 trillion of total loss-absorbing capacity,¹³ and beginning January 1, 2019 they must comply with the rule’s clean holding company restrictions, which will limit the ability of the parent holding company of a U.S. G-SIB to engage in activities that could precipitate a run or otherwise create contagion in resolution.

Finally, since the G-SIB surcharge was calibrated, U.S. G-SIBs (and other banking organizations) have been required to come into compliance with the fully phased-in U.S. Basel III Liquidity Coverage Ratio rule, which requires U.S. G-SIBs to

(continued....)

Annual Report to Stockholders, Exhibit 13 to Report on Form 10-K (Mar. 1, 2018), <https://www.sec.gov/Archives/edgar/data/72971/000007297118000272/wfc-12312017xex13.htm> (“The strategy described in our most recent resolution plan submission is a multiple point of entry strategy; however, we have made a decision to move to a single point of entry strategy for our next resolution plan submission.”).

¹⁰ See the public sections of the 2017 165(d) resolution plans of the eight U.S. G-SIBs, available at <https://www.fdic.gov/regulations/reform/resplans/index.html>.

¹¹ See Federal Reserve and FDIC, *Agencies announce joint determinations for living wills* (Dec. 19, 2017), <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20171219a.htm>.

¹² Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations, 82 Fed. Reg. 8266 (Jan. 24, 2017).

¹³ See U.S. Department of the Treasury, *Orderly Liquidation Authority and Bankruptcy Reform*, at 16, https://home.treasury.gov/sites/default/files/2018-02/OLA_REPORT.pdf. (“U.S. bank holding companies have greatly enhanced their loss-absorbing capacity in recent years.”)

maintain sufficient high-quality liquid assets to cover expected net cash outflows in a 30-day stress scenario.¹⁴

Taken together, these developments since the G-SIB surcharge was adopted would both reduce the probability and impact of the failure of a G-SIB, supporting an overall lower G-SIB surcharge. Accordingly, we believe the Federal Reserve should revisit the calibration of the G-SIB surcharge to account for these developments.

B. At a Minimum, the eSLR Buffer Should be Based on the Method 1 G-SIB Surcharge

The Proposed Rule would amend the eSLR buffer so that it would equal “50 percent of the G-SIB surcharge calculated in accordance with subpart H of Regulation Q (12 CFR part 217, subpart H) applicable to the global systemically important BHC that controls the [bank].”¹⁵ By referring to subpart H of Regulation Q, the proposed buffer would incorporate both methods of calculating the G-SIB surcharge—Method 1 and Method 2. Under current rules, Method 1 calculates the G-SIB surcharge based on measures of systemic risk that reflect a G-SIB’s size, interconnectedness, substitutability, complexity and cross-jurisdictional activity,¹⁶ which is consistent with the Basel Committee’s G-SIB surcharge calculation methodology.¹⁷ Method 2 eliminates Method 1’s substitutability measure and replaces it with metric for short-term wholesale funding¹⁸ and increases the remaining components by a factor of 2, which results in a higher calibration of the G-SIB surcharge than Method 1.¹⁹ The U.S. G-SIB surcharge rule, by requiring a firm to use the higher of its Method 1 and Method 2 scores, is significantly over-calibrated relative to the Basel Committee’s internationally agreed methodology.²⁰ Because the eSLR would still be based on the current version of the U.S. G-SIB surcharge calculation, the eSLR would itself be over-calibrated relative to the international standard.²¹

At a minimum, therefore, we recommend that the Agencies recalibrate the eSLR buffer requirement so that it is equal to 50% of a firm’s Method 1 G-SIB surcharge,

¹⁴ Liquidity Coverage Ratio: Liquidity Risk Measurement Standards; Final Rule, 79 Fed. Reg. 61440 (Oct. 10, 2014) (requiring compliance with a 100% liquidity coverage ratio by January 1, 2017).

¹⁵ 83 Fed. Reg. at 17325 (proposed rule text).

¹⁶ 12 C.F.R. § 217.404.

¹⁷ See Basel Committee on Banking Supervision, *The G-SIB assessment methodology – score calculation* (Nov. 2014), at 2, <https://www.bis.org/bcbs/publ/d296.pdf>.

¹⁸ 12 C.F.R. § 217.405.

¹⁹ Treasury Banking Report at 143 (describing Method 2 as “generally calibrated to result in a higher capital requirement”).

²⁰ 12 C.F.R. § 217.403(a).

²¹ Treasury Banking Report at 42 (“The U.S. G-SIB surcharge was calibrated to be roughly double the international standard. . .”).

rather than 50% of the higher of a firm's Method 1 and Method 2 G-SIB surcharge. This change is necessary to ensure that the SLR serves as a backstop to risk-based capital requirements rather than a binding constraint and to eliminate U.S. overcalibration that places U.S. G-SIBs at a competitive disadvantage relative to their foreign peers.

III. Recommended Revisions to the SLR Denominator

A. Provide For Additional Deductions from the Total Leverage Exposure Denominator

In revising SLR and eSLR requirements, we commend the Agencies for seeking to ensure that leverage requirements continue to serve as a backstop rather than a binding constraint. But a lower requirement alone will not permanently address the misaligned incentives created by the leverage metrics, particularly during times of stressed market conditions. Accordingly, we recommend that the Agencies revise the total leverage exposure measure—which is the denominator of the SLR requirement and the eSLR buffer requirement—to allow firms to deduct from total leverage exposure (1) cash deposited at central banks, (2) U.S. Treasury securities, and (3) initial margin for centrally cleared derivatives. We also believe it is prudent to improve hedge recognition for sold credit derivatives in alignment with the broader regulatory capital framework.

As the Agencies themselves have recognized, the current calibration of the eSLR may discourage firms from participating in lower-risk, customer-driven activities such as secured repo financing, central clearing services for market participants, and accepting custody-related deposits.²² Removing riskless assets such as cash deposited at central banks and U.S. Treasury securities would have a positive influence on the ability of firms to intermediate, which would only be enhanced with a further exclusion for financing activity on U.S. Treasury securities.

Similarly, other customer-driven activities involving the provision of liquidity to U.S. capital markets, such as underwriting and market-making, may similarly be adversely affected if the eSLR ever risks becoming a binding capital constraint. This is especially true if that risk is likely to materialize in stressed conditions.

In a period of stressed market conditions, U.S. G-SIBs may experience increases in their balance sheets from such customer-driven activities, because market participants place their cash with institutions they perceive as safe. Because these deposits are likely to be temporary, firms would either reinvest the client deposits in cash equivalents such as U.S. Treasuries or hold them at a central bank such as the Federal Reserve. Firms would not need to hold capital against these additional assets for purposes of the risk-based capital requirements, as these assets would be risk-weighted at zero. Because the SLR does not reflect any risk-weighting, however, a firm would be required to hold additional capital against these assets to the same extent as if the firm had invested in a very risky asset, such as a highly leveraged securitization exposure. As a result, in a time of stressed market conditions, the eSLR or SLR could become the binding constraint on a firm that experiences an expansion of its balance sheet due solely to the flight to quality that typically accompanies a time of stress, effectively

²² 83 Fed. Reg. at 17319–20.

punishing that firm for being perceived by the market as safe. The Agencies should avoid this result by allowing firms to deduct from total leverage exposure riskless assets such as cash deposited at central banks and U.S. Treasury securities.

In addition, to support market liquidity and to encourage continued credit intermediation, including during times of stressed market conditions, the Agencies should allow firms to deduct from total leverage exposure initial margin for centrally cleared derivatives and sold credit derivatives. Firms are currently required to hold capital against initial margin for centrally cleared derivatives for purposes of compliance with the SLR. This treatment penalizes firms for providing clients with access to central clearing and for holding very low-risk assets as initial margin. U.S. Commodity Futures Trading Commission (“CFTC”) Chairman J. Christopher Giancarlo has criticized this treatment as reflecting a “flawed understanding” of central counterparty (“CCP”) clearing given that swaps clearing “was adopted . . . to move customer margin off the balance sheets of bank [futures commission merchants (“FCMs”)] and into CCPs” but the rules “apply[.] a capital charge against that customer margin,” thereby “treat[ing] FCMs as having retained the exposure.”²³ Accordingly, firms should be permitted to deduct such initial margin from their total leverage exposure. By the CFTC’s estimates, such a deduction would reduce the capital costs associated with clearing activities by up to 70 percent, while reducing overall capital levels by only one percent.²⁴

Similarly, the Agencies should permit partial hedge recognition for sold credit derivatives by allowing firms to net against purchased credit derivatives even when there is some maturity mismatch. The Agencies’ current capital rules require that the full notional of sold credit derivatives be included within the SLR’s total leverage exposure measure; they recognize netting of sold credit derivatives against purchased credit derivatives, but only if the purchased credit derivative has a remaining maturity that is equal to or greater than the sold credit derivative.²⁵ For example, if Goldman Sachs sold protection with a remaining maturity of five years and purchased protection with a remaining maturity of four years and 364 days, it would receive no recognition for the hedge. This treatment is misaligned with the risk associated with sold credit derivatives and discourages firms from market making, potentially reducing the liquidity of the U.S. capital markets, and from providing a critical credit intermediation function. The Agencies should correct this issue by allowing firms to net purchased credit derivatives against sold credit derivatives to the full extent of their maturity overlap. For example, a sold credit protection with a remaining maturity of 2 years and purchased credit protection with a remaining maturity 1.5 years should be offset by 75% since the purchased protection will provide protection for 75% of the remaining duration of the sold protection. This is largely consistent with the risk-based credit risk mitigation framework. Alternatively, the Agencies could grant full hedge recognition for purchased credit protection with a tenor that is sufficiently long-term (e.g., one year, which would match

²³ Remarks of Acting Chairman J. Christopher Giancarlo before International Swaps and Derivatives Association 32nd Annual Meeting, Lisbon, Portugal, *Changing Swaps Trading Liquidity, Market Fragmentation and Regulatory Comity in Post-Reform Global Swaps Markets* (May 10, 2017), <https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-22>.

²⁴ *Id.*

²⁵ 12 C.F.R. §§ 3.10(4)(ii)(D)(2), 217.10(c)(4)(ii)(D)(2).

the maturity requirement for a short position that is eligible to be netted against a long position for purposes of calculating the size of a firm's investment in an unconsolidated financial institution or in own capital instruments,²⁶ or two years, which would nearly align with the nine-quarter planning horizon used for Comprehensive Capital Analysis and Review ("CCAR").²⁷

B. Consider the Basel III Framework

We recommend that the deductions proposed above be incorporated immediately in the final eSLR rule. We also suggest that the rationale behind these deductions be considered more generally as the Agencies implement the final revised Basel III framework, which could result in changes that would have the effect of further increasing the total leverage exposure measure. We will not comment on those specifics in this letter, but urge the Agencies to consider further adjustments to the SLR denominator as they implement the rest of Basel III to avoid a further increase in the total leverage exposure measure. Any such further increase risks the SLR being a binding constraint instead of a backstop.

C. Apply Deductions to Tier 1 Leverage Ratio

To the extent that the deductions identified above relate not only to off-balance sheet assets but also to on-balance sheet assets, the Agencies should similarly consider permitting those deductions to be made from the denominator of the Tier 1 leverage ratio. Doing so would prevent the ratio from becoming a binding constraint on firms in general and during times of stressed market conditions in particular.

V. Conclusion

We appreciate your consideration of our comments and suggestions on the Proposed Rule. We would be pleased to provide any additional information or to discuss any of our comments and suggestions with the Agencies in more detail.

Sincerely,



Brian Lee

Chief Accounting Officer

²⁶ See 12 C.F.R. §§ 3.22(h)(3)(i), 217.22(h)(3)(i).

²⁷ See 12 C.F.R. § 225.8(d)(12).