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Via Electronic Mail

Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, N.W.
Washington, D.C. 20551
Attention: Ann E. Misback
Docket No. R-1724; RIN 7100-AF95

Re: Amendments to Capital Planning and Stress Testing Requirements for Large Bank Holding Companies, Intermediate Holding Companies and Savings and Loan Holding Companies

Ladies and Gentlemen:

The Goldman Sachs Group, Inc. (“Goldman Sachs” or “we”) appreciates the opportunity to comment on the recent notice of proposed rulemaking (the “Proposal”)¹ issued by the Board of Governors of the Federal Reserve System (the “Federal Reserve”) regarding capital planning. While the Proposal outlines several amendments to the Capital Plan Rule² related to the Tailoring Framework,³ it also solicits comment on all aspects of its capital planning guidance,⁴ since “certain aspects of the guidance have not been updated since the 2007–2008 financial crisis,” and in light of “revisions made to the Board’s regulations in the recent tailoring and stress capital buffer rules and experiences with capital planning during the Coronavirus Disease 2019 event” (“COVID-19”). In particular, the Proposal raises several questions related to how well the guidance reflects good risk management practice, and how the guidance interacts with recently implemented rules.⁵

We agree with the premise of the Proposal and existing capital planning guidance that “a firm’s processes for managing and allocating its capital resources are critical to its financial strength and resiliency, as well as to the stability and effective functioning of the U.S. financial system.”⁶ We are concerned, however, that a number of capital-related rules issued subsequent to the issuance of the existing guidance have created a conflict between this premise and banks’ ability to manage and allocate capital. In our experience, the current design and calibration of certain capital-related rules creates volatility and leads to inefficient capital allocation. The net effect is unintended pro-cyclicality as banks may be reluctant to deploy capital due to regulatory uncertainty. These challenges were especially present at the

¹ See [Federal Register](#), p. 63222 – 63235.

² 12 CFR § 225.8.

³ See [Federal Register](#), p. 59032 – 59123.

⁴ Relevant guidance includes [SR 15-18](#), [SR 15-19](#), [SR 09-4](#), and “[Unsound Banking Practices](#) - Cash Dividends Not Fully Covered by Earnings” (November 14, 1985).

⁵ See for example [Federal Register](#), p. 63227 – 63228, Questions 15-19.

⁶ See [Federal Register](#), p. 63227, and [SR 15-18](#).

peak of pandemic-induced volatility, as banks were required to manage through an actual crisis while anticipating an unknown Stress Capital Buffer (“SCB”).

Capital planning is particularly challenging for banks whose activities primarily support capital markets activities. This is because several of the most volatile and least transparent elements of the capital framework include the Global Market Shock (“GMS”), Largest Counterparty Default (“LCD”) and the Federal Reserve’s single trading revenue model for Pre-Provision Net Revenue (“PPNR”). This penalty on market intermediation is likely to worsen with the implementation of the Basel III Revisions, which tend to increase capital requirements for market and counterparty credit risk. Consistent with remarks made by Vice Chair for Supervision Quarles on the need to address counterproductive swings in bank capital requirements resulting from the current stress testing framework,⁷ bank capital should be stable, and only shift meaningfully if and when the fundamental risk profile of a bank or its exposures and activities change. This allows management and the Board of Directors to set strategic priorities that can be executed in response to changing market dynamics and client needs – consistent with existing SR 15-18 guidance⁸ – rather than requiring them to respond to annual fluctuations in capital requirements driven primarily by opaque supervisory models and single-point supervisory stress test results that lack sufficient transparency.

The remainder of this letter is divided into two sections: the first highlighting challenges to capital planning caused by SCB mechanics, and the second highlighting how rules inhibit banks’ ability to anticipate capital requirements for activities related to capital markets intermediation.

I. Capital Planning Challenges Caused by SCB Mechanics

SCB Volatility Limits the Relevancy of Internal Capital Planning

Volatile regulatory capital requirements that are not transparent or do not provide sufficient lead time for compliance (e.g., a one-quarter time frame for an increase in the SCB) make internal capital planning processes less useful and diminish banks’ ability to manage and allocate capital efficiently. This is particularly the case today because the current capital framework requires banks to hold buffers well in excess of post-stress minimums.⁹ Our suggested adjustments to the capital framework would reduce volatility and improve banks’ ability to anticipate requirements, ultimately improving the efficiency with which they allocate capital across various activities. These recommendations reflect the fact that building capital takes time, and that sudden increases in capital requirements as a result of hypothetical stress outcomes can create market distortions. As a reference, the Countercyclical Capital Buffer (“CCyB”) and Global Systemically Important Banks (“G-SIB”) frameworks, both of which are more transparent than the SCB, allow for more gradual capital increases (one and two years, respectively). Consistent with the stated intention in the SCB final rule to “study potential ways to mitigate unnecessary volatility in requirements”¹⁰

⁷ Vice Chair for Supervision Randal K. Quarles, [Speech](#), *Stress Testing: A Decade of Continuity and Change*, at *Stress Testing: A Discussion and Review*, a research conference sponsored by the Federal Reserve Bank of Boston, Boston, Massachusetts (July 9, 2019): “When I think about volatility in stress testing, I want to distinguish what I consider to be useful variation in the tests, in the form of exploration of salient risks, from what I consider to be less useful variation, in the form of unexpected swings in capital requirements that don’t have any particular relationship to changing risks at individual firms.”

⁸ SR 15-18, p. 4: “A firm’s board of directors is ultimately responsible and accountable for the firm’s capital-related decisions and for capital planning. The firm’s capital planning should be consistent with the strategy and risk appetite set by the board and with the firm’s risk levels, including how risks at the firm may emerge and evolve under stress. The board must annually review and approve the firm’s capital plan.”

⁹ SR 15-18 focuses on a bank’s ability to set appropriate post-stress capital goals, but does not recognize that this exercise is often overshadowed by external buffers that may result in multiples of required capital relative to minimums.

¹⁰ See [Federal Register](#), p. 15581.

and Vice Chair for Supervision Quarles' recent statements,¹¹ the Federal Reserve should consider the following.

Recommendation: Allow banks a one-year period to comply with increased SCBs, with reduced SCBs effective immediately,¹² and

Recommendation: Introduce averaging, for example, over a two- to three-year time frame, of SCB results in order to reduce volatility in overall capital requirements from year to year¹³

The SCB Limits Buffer Usability in Stress

The design and calibration of the SCB also limit banks' ability to use capital buffers, particularly in times of stress and in periods just prior to SCB recalibrations. This runs counter to regulators' recent statements regarding buffer usability,¹⁴ and limits the efficacy of banks' own internal capital management processes. The U.S. differs from most other Basel jurisdictions in that stress loss buffers are used to set capital distribution limits. For example, existing regimes in the E.U. and U.K. (Capital Requirements Directive IV) only impose distribution limits once the required Basel III buffers are breached.¹⁵ The following recommendation would not only reduce some of the adverse effects of U.S. gold-plating as it relates to the use of stress loss results, but would also increase the likelihood of buffer usability in stress.

Recommendation: In times of stress, allow banks' internal capital management and planning processes to govern by eliminating supervisory restrictions on capital distributions when a bank breaches the portion of the SCB above the 2.5% floor¹⁶

II. Capital Planning Challenges Related to Capital Markets Intermediation

The GMS Hinders Banks' Ability to Plan and Allocate Capital

The GMS is based on a single set of stress factors instantaneously applied to a single day's positions, and is the primary driver of year-over-year volatility of Comprehensive Capital Analysis and Review ("CCAR") results, and in turn capital requirements, for banks with large capital markets intermediation operations. This result seems inconsistent with the Federal Reserve's Policy Statement on

¹¹ Vice Chair for Supervision Randal K. Quarles, [Speech](#), *Spontaneity and Order: Transparency, Accountability, and Fairness in Bank Supervision*, American Bar Association Banking Law Committee Meeting 2020 (January 17, 2020): "[W]e continue to look for ways to reduce the volatility of stress-test requirements from year to year. We are considering a number of options, such as averaging outcomes over multiple years or averaging the results of the current year's stress test with the results of one or more previous years. Again, the goal here is not to make the tests less strenuous but to give banks a greater opportunity to plan for them and to meet our expectations ex ante rather than through an ex post remedial process."

¹² Goldman Sachs' Stress Capital Buffer NPR [Comment Letter](#) (June 25, 2018), p. 12.

¹³ Vice Chair for Supervision Randal K. Quarles, [Speech](#), *Stress Testing: A Decade of Continuity and Change*, at *Stress Testing: A Discussion and Review*, a research conference sponsored by the Federal Reserve Bank of Boston, Boston, Massachusetts (July 9, 2019): "In distinguishing useful from less useful volatility, one option to address the year-over-year volatility of the tests would be to average the results of the tests from the previous year or years."

¹⁴ Joint [Statement](#) on Capital Buffer Usage by the Federal Reserve, Federal Reserve Insurance Corporation, Office of the Comptroller of the Currency (March 17, 2020); and, Federal Reserve [Press Release](#) on Capital Buffers (August 10, 2020): "Capital buffers, such as the SCB and GSIB surcharge, are different than minimum capital requirements for each firm. The Federal Reserve supports banking organizations that choose to use their capital buffers to lend to households and businesses and undertake other supportive actions in a safe and sound manner. When using their buffers, banking organizations may make capital distributions up to prescribed limits, which include automatic limitations in the capital framework, as well as any additional limitations determined by the Board."

¹⁵ Directive 2013/36/EU of the European Parliament and of the Council on Access to the Activity of Credit Institutions and the Prudential Supervision of Credit Institutions and Investment Firms, 2013 O.J. L 176/338, art. 144.

¹⁶ Goldman Sachs' Stress Capital Buffer NPR [Comment Letter](#) (June 25, 2018), p. 13.

the Scenario Design Framework, which describes the GMS as an “add on,”¹⁷ and serves to impede banks’ capital planning beyond a one-year horizon. Based on CCAR 2020 results, the GMS accounts for half of Goldman Sachs’ SCB, and one-quarter of our overall capital requirements. It results in considerable variability for the other domestic G-SIBs as well (see Exhibit 1). The Federal Reserve should consider how to address the magnitude and year-over-year variability of CCAR results, especially in light of the fact that the GMS framework was largely created during the Global Financial Crisis and has not undergone a transparent, holistic assessment, despite substantial subsequent regulation and evolution of market dynamics.

Exhibit 1: GMS Volatility and Contribution to SCB

	GS	MS	JPM	C	BAC	WFC
Average Year-over-Year Change in GMS (2016 – 2020)						
Losses in billions	\$2.2	\$2.1	\$5.9	\$5.7	\$3.7	\$2.6
In SCB terms	0.4%	0.6%	0.4%	0.5%	0.3%	0.2%
Maximum Year-over-Year Change in GMS (2016 – 2020)						
Losses in billions	\$5.1	\$3.5	\$9.0	\$10.0	\$8.4	\$4.5
In SCB terms	0.9%	1.0%	0.6%	0.9%	0.6%	0.4%
The GMS is a primary driver of the SCB requirement (2020)						
SCB with GMS	6.6%	5.7%	3.3%	2.5%	2.5%	2.5%
SCB ex. GMS	3.4%	3.2%	2.5%	2.5%	2.5%	2.5%
Change in SCB	(3.2)%	(2.5)%	(0.8)%	0.0%	0.0%	0.0%

In January 2020, Vice Chair for Supervision Quarles noted the Federal Reserve’s intention to “modify [the] scenario design policy statement to provide greater transparency on the design of the global market shock component....”¹⁸ The need for this increased transparency is even more urgent in light of the current stressed market conditions, and in anticipation of the scenario design process for CCAR 2021. In fact, the COVID-19 experience has underscored the divergence between the impact of the GMS and Goldman Sachs’ actual results (See Exhibit 2). For example, the CCAR 2020 GMS implied an instantaneous loss of \$17.8 billion, including the unexpected default of the bank’s largest trading counterparty. In reality, Goldman Sachs experienced net trading revenue gains of \$2.1 billion in the first quarter of 2020,¹⁹ and further, large volumes of margin calls did not result in losses as modeled by the LCD framework. Although this dynamic also holds true for most peers, the variance in CCAR stress results versus actual stress results is especially acute for banks whose activities primarily support capital markets intermediation. To the extent that the shocks and assumptions under the GMS continue to diverge from historical experience, it remains less credible as a risk management tool and even less useful for capital planning.

¹⁷ See 12 CFR 252, Appendix A, Section 6(b).

¹⁸ Vice Chair for Supervision Randal K. Quarles, Speech, *Spontaneity and Order: Transparency, Accountability, and Fairness in Bank Supervision*, American Bar Association Banking Law Committee Meeting 2020 (Jan. 17, 2020).

¹⁹ While we do not report revenues with the bifurcation of GMS versus PPNR used in CCAR, we estimate the \$2.1 billion net revenues includes \$6.3 billion of activity-driven revenues.

Exhibit 2: GMS vs. Industry Performance

	GS	MS	JPM	C	BAC	WFC
GMS losses diverge materially from industry performance in the COVID-19 crisis						
CCAR GMS (instantaneous)	\$(17.8)	\$(9.5)	\$(21.8)	\$(5.7)	\$(10.5)	\$(8.7)
1Q20 Y9C Actual Trading Revenue	\$2.1	\$2.5	\$(3.5)	\$1.8	\$4.4	\$0.1
\$ Difference	\$(19.9)	\$(12.0)	\$(18.3)	\$(7.5)	\$(14.9)	\$(8.8)

Recommendation: As summarized in the appendix, the Federal Reserve should reconsider the design, calibration and assumptions underlying the GMS and LCD, consistent with a number of Goldman Sachs and industry letters to the Federal Reserve in recent years²⁰

PPNR Models for Non-Interest Income and Expenses Further Complicates Capital Planning and Allocation

The issues discussed above regarding the GMS are further exacerbated by the Federal Reserve's PPNR models, which among other things, duplicate mark-to-market trading losses in both the GMS and the nine-quarter macroeconomic path. While the Federal Reserve uses 15 models to assess net interest income, it uses only one to assess trading revenue. This one model is insufficiently precise and results in a projection of reduced revenue during heightened periods of volatility. This reduction in revenues is inconsistent with Goldman Sachs' own modeled results as well as broader historic experience, particularly the first half of 2020. The divergence between a bank's models and PPNR discounts its own capital adequacy assessment and reduces its ability to engage in effective capital planning.

It appears that the Federal Reserve's models demonstrate negative correlation between trading revenue and volatility because mark-to-market losses are commingled with activity-based revenue. While the Federal Reserve recognizes this issue and uses median regression to reduce the impact of extreme movements, analysis suggests that this adjustment is not a sufficient mitigant. Consistent with SR 15-18 guidance that a bank "should generally include all available data in its analysis, unless the bank no longer engages in a line of business or its activities have changed such that the bank is no longer exposed to a particular risk",²¹ the Federal Reserve should consider other data sources at its disposal, such as Volcker Metric 4 – Comprehensive Profit and Loss Attribution, to avoid the underestimation of trading revenue. Similarly, the Federal Reserve should consider excluding data from 2008 such as mortgage and structured credit losses to reflect the reduction in risk from these activities.

In addition, intermediation-related expenses comprise a large share of non-compensation, non-interest expense for most capital markets banks. It appears that the Federal Reserve includes these expenses in its non-interest expense model, which projects expenses for the industry using macroeconomic variables such as GDP growth. While this approach may be suitable for traditional lending activity, it does not appropriately reflect the nature and variability of intermediation expenses. Further, for most banks that engage in market intermediation, when topline revenue underperforms, other non-interest expense – such as brokerage, clearing, exchange and distribution expenses – is consistently lower. In contrast, the Federal Reserve appears to keep these other expenses relatively flat with revenues.

²⁰ Goldman Sachs' Stress Capital Buffer NPR Comment Letter (June 25, 2018); The Securities Industry and Financial Markets Association ("SIFMA") *Global Market Shock and Large Counterparty Default Study* (September 3, 2019); SIFMA Comment on Capital Planning and Stress Testing Requirements NPR (November 20, 2020).

²¹ See SR 15-18, p. 20.

The following recommendations would align capital planning with likely outcomes, and restore a more realistic relationship between volatility and intermediation revenue and expense.

Recommendation: The Federal Reserve should avoid the underestimation of intermediation revenue during periods of higher volatility by using a combination of existing Volcker Metric 4 – Comprehensive Profit and Loss Attribution data,²² de-weighting 2008 losses,²³ and excluding mortgage and structured credit losses from the 2008 period, reflecting changes in the marketplace since the financial crisis²⁴

Recommendation: The Federal Reserve should link intermediation-related expenses to revenues rather than holding expenses flat. At minimum, if the Federal Reserve does not adopt the recommendation to reduce the underestimation of intermediation revenue, to be consistent, it should project correspondingly lower intermediation-related expenses²⁵

III. Conclusion

A key design feature of the post-crisis capital framework is to ensure that management retains the ability to plan and allocate capital within limits and guidelines, especially through stressed conditions. However, a lack of visibility into how to capitalize for various exposures and activities in the near term, particularly those related to market intermediation, confounds banks' ability to comply with the Federal Reserve's capital planning guidance in SR 15-18. This is especially concerning from a public policy perspective as it can result in foregone credit extension and intermediation in businesses where returns cannot justify the associated volatility in capital requirements. Further, banks find it difficult to price risk when the marginal and total cost of capital for various exposures and activities is unknown and can vary materially year over year. The net effect of this dynamic is that critical capital market functions migrate to the non-bank financial intermediation sector, which is largely outside of the Federal Reserve's supervisory and regulatory purview.²⁶ For these reasons, we urge the Federal Reserve to consider the recommendations contained in this letter in order to restore a more reasonable balance between banks' ability to comply with both regulatory capital requirements and capital planning guidance.

Sincerely,



Sheara Fredman
Chief Accounting Officer

²² Federal Reserve [Letter](#) to Goldman Sachs in response to our request for reconsideration of the Stress Capital Buffer requirement (September 4, 2020), p. 6.

²³ We understand the FRB attempts to adjust for 2008 losses using a median regression, but because the model does not consider outliers, the weight of 2008 losses persists.

²⁴ SIFMA Comment Letter on Capital Planning and Stress Testing Requirements NPR (November 20, 2020), p. 4-5.

²⁵ Federal Reserve Letter to Goldman Sachs in response to our request for reconsideration of the Stress Capital Buffer requirement (September 4, 2020), p. 7 and 9; SIFMA Comment Letter on Capital Planning and Stress Testing Requirements NPR (November 20, 2020), p. 5.

²⁶ Financial Stability Board's [Global Monitoring Report on Non-Bank Financial Intermediation 2019](#) (January 19, 2020).

Appendix: Detailed Recommendations for the GMS and LCD

Issue	Recommendations
<ul style="list-style-type: none"> The calibration of shocks within the GMS diverge from realistic losses, and are overdue for review²⁷ Shocks are extremely unlikely to occur simultaneously²⁸ 	<ul style="list-style-type: none"> Subject the GMS to holistic recalibration with a notice and comment period considering: <ul style="list-style-type: none"> Overall level of assumed losses and the rate at which they occur Correlation of shocks across asset classes Coherence of the GMS with the macroeconomic path
<ul style="list-style-type: none"> The impact of the GMS is highly dependent on banks' positions on a random date²⁹ 	<ul style="list-style-type: none"> Average multiple years' GMS scenarios with varying macro shocks to capture a broader range of outcomes
<ul style="list-style-type: none"> The GMS is assumed to occur instantaneously, with no recognition of hedging or risk mitigating actions a bank would realistically take, particularly for the most liquid positions³⁰ The LCD does not allow for the suite of risk mitigating actions that reduce the impact of a large counterparty's deteriorating financial position and has proven effective³¹ 	<ul style="list-style-type: none"> The GMS should allow for hedging of highly liquid assets in stress The GMS should also allow for reduction of expenses associated with the instantaneous reduction in asset values The LCD should be revised to realistically reflect market dynamics, including distinguishing between margined and un-margined exposures, allowing banks to reflect their rights to collateral
<ul style="list-style-type: none"> The impact of the GMS on less liquid products, when combined with capital held against risk-weighted assets ("RWA") under the Capital Rule, can have implied losses that vastly exceed exposure^{32, 33} 	<ul style="list-style-type: none"> Cap losses across the GMS component and RWA at the maximum loss on each exposure

²⁷ Goldman Sachs' Stress Capital Buffer NPR Comment Letter (June 25, 2018), p. 24-27; SIFMA *Global Market Shock and Large Counterparty Default Study* (September 3, 2019), p. 19; SIFMA Comment on Capital Planning and Stress Testing Requirements NPR (November 20, 2020), p. 6-7.

²⁸ SIFMA *Global Market Shock and Large Counterparty Default Study* (September 3, 2019), p. 21; SIFMA Comment on Capital Planning and Stress Testing Requirements NPR (November 20, 2020), p. 8.

²⁹ SIFMA Comment on Capital Planning and Stress Testing Requirements NPR (November 20, 2020), p. 13.

³⁰ Goldman Sachs' Stress Capital Buffer NPR Comment Letter (June 25, 2018), p. 8; SIFMA *Global Market Shock and Large Counterparty Default Study* (September 3, 2019), p. 34; SIFMA Comment on Capital Planning and Stress Testing Requirements NPR (November 20, 2020), p. 7.

³¹ Goldman Sachs' Stress Capital Buffer NPR Comment Letter (June 25, 2018), p. 9; SIFMA *Global Market Shock and Large Counterparty Default Study* (September 3, 2019), p. 43.

³² Goldman Sachs' Stress Capital Buffer NPR Comment Letter (June 25, 2018), p. 8; SIFMA *Global Market Shock and Large Counterparty Default Study* (September 3, 2019), p. 54.

³³ For example, securitized products have implied losses close to twice the exposure amount after aggregating GMS losses and RWA.