

April 3, 2015

The Honorable Thomas Curry
Comptroller of the Currency
Office of the Comptroller of the Currency
400 7th Street, SW
Washington, D.C. 20219

The Honorable Martin J. Gruenberg
Chairman
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429

The Honorable Janet L. Yellen
Chair
Federal Reserve Board
Eccles Board Building
20th and C Street, N.W.
Washington, D.C. 20219

Re: Basel Standardized Proposal and Improvements to U.S. Process for International Standards

Dear Comptroller Curry, Chairman Gruenberg, and Chair Yellen:

On December 22, 2014, the Basel Committee issued two related consultative documents titled “Revisions to the Standardised Approach for credit risk” (Revised Standardized Approach) and “Capital floors: the design of a framework based on standardised approaches.” The former would revise the risk based capital denominator. The latter would establish the Revised Standardized Approaches as a risk-based capital floor for banking organizations globally. At the same time, the U.S. banking agencies (Agencies) issued a press release stating:

These proposed revisions are intended to apply primarily to large, internationally active banking organizations and not community banking organizations. A key objective of the paper is to seek comment on preliminary alternatives to internal models and external credit ratings for calculating risk-weighted assets.

This signal from the Agencies regarding the scope of applicability in the United States of the Basel Committee’s *ongoing* work on capital rules served to lessen the worries of many banks with regard to being affected by yet another series of major changes to capital rules while the

most recent reforms are still being implemented. The American Bankers Association (ABA)¹ continues to believe, however, that the development of international standards for regulatory capital rules would be better crafted and better matched to the U.S. economy and the financial sector that supports it if the process for developing international standards were more robust and transparent, particularly with regard to early engagement with the public and with the Congress.² We believe advance and substantive engagement with the public and the Congress would inform the Agencies' understanding of the impact on the U.S. economy as a whole, as well as how specific sectors and participants in the economy might be affected by the particular concepts and objectives of the proposals under consideration. Specifically, ABA recommends the following:

- Prior to the initiation of international discussions at either the Financial Stability Board (FSB) or the Bank for International Settlements (BIS, or Basel), the Agencies would issue a detailed Advance Notice of Proposed Rulemaking (ANPR) that clearly presents to the public the purpose of the discussions (including the problems to be addressed), the scope and objectives of any U.S. participation in discussions (including possible proposals to be considered) an initial estimate of the U.S. sectors and institutions that might be affected, and other relevant information connected with the discussions.
- As part of the ANPR stage, the Agencies conduct an empirical study of the impact on the U.S. banking system, bank customers, and the economy in general resulting from the adoption of the range of options to be considered in the international discussions and publish the results for public review and comment.
- Concurrent with the ANPR the Agencies brief the relevant Congressional committees of jurisdiction on the planned discussions.

The potential adoption by the Agencies' of the latest proposed capital standards has raised the prospect of larger banking organizations, notably banking organizations subject to the Advanced Approaches regulatory capital standard,³ having two risk-based capital floors. Wholesale adoption of the Revised Standardized Approach as a second floor, as proposed, would create significant implementation and compliance burdens, while also further complicating the already highly complex process of managing to different capital ratios. This is unlikely to be of use to the investor community and provide little added value to safety and soundness and systemic stability. As a result, ABA opposes adoption of the proposed Revised Standardized Approach and the establishment of another risk-based capital floor.

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.

² Although this letter specifically focuses on the process for developing international capital standards, the same suggested improvements are applicable to other global standard setting initiatives (e.g. liquidity, interest rate risk).

³ The Advanced Approaches capital rules are mandatory for banking organizations with \$250 billion or more in assets or \$10 billion or more in foreign exposure.

The Banking Agencies Should Adopt Procedures for Greater Public and Congressional Involvement in Setting International Standards

In response to the implementation of the Basel III standards in the United States, many smaller banking organizations were surprised and frustrated by the manner of the United States' participation in the Basel Committee's deliberations. These reactions stem from the fact that even though the Basel standards were held out to be designed and intended for large, internationally active banks, U.S. regulators have increasingly applied them beyond that scope. In the wake of the widespread public criticism of the Basel capital proposals, ABA has encouraged the Agencies to adopt a better public process (see above) that brings greater transparency to U.S. participation in the development of international regulatory standards, increasing the possibility for national consensus on standards that reach across the whole economy.⁴

We recognize that the Basel Committee does issue proposals for comment. Often, these come relatively late in the process, after the basic framework has been substantially developed, options have been narrowed, and a strong degree of international commitment to a new regulatory regime has been reached by the regulatory participants. Moreover, because the rules are ostensibly intended to harmonize regulation for institutions that compete at the *global level*, the vast majority of U.S. banks, and the American public, are generally unaware of the committee's proposals and do not monitor or participate in the international comment process. Neither does it appear that Congress is brought actively into the process before the U.S. regulators take up implementation of the international agreement.

No wonder, then, that the final international Basel III capital standards raised a storm of controversy in the U.S. They were formed with no participation from Congress, very little exposure to comment from much of the U.S. banking industry, and virtually no input from bank customers who would be significantly affected by higher costs for and reduced access to banking products and services.

The Agencies' press release on December 22, 2014, should be credited as an important step in recognizing the value of greater transparency. At a relatively early stage of discussion, it identified a standard that is actively being considered by the Agencies and in general terms provided the scope of potential application in the United States.

While a significant improvement, the press release was vague, and many questions still remain. ABA has been approached by mid-size, regional, and Advanced Approaches opt-in banks⁵ with questions about the potential scope of application in the United States. Moreover, larger banks are struggling with how the Revised Standardized Approach could apply while maintaining the generally applicable standardized approach for all banks, as required by the Collins Amendment

⁴ ABA letter comment dated November 12, 2013, in response to FDIC Basel III Interim Final Rule. Available at: <http://www.aba.com/Advocacy/commentletters/Documents/11-12-13CommentLettertoFDICreBaselIII.pdf>.

⁵ All banking organizations may elect to use the Advanced Approaches regulatory capital standard. From the press release it is unclear if banks that have opted to use the Advanced Approaches would be considered internationally active.

to the Dodd-Frank Act. Because of this uncertainty, efforts to provide comments to the Basel Committee are constrained.

As U.S. regulators prepare to discuss developing standards in Basel, they should have a much clearer understanding of to whom and how the standard could apply domestically, and that understanding should be shared with affected banks and their customers. Use of the ANPR process would alert the Congress and the public that the Basel Committee is considering standards that could apply to a significant portion of the banking industry and to banking customers, offering Congress and the public the critical opportunity to raise important issues publicly with both the Agencies and the Basel Committee before nation-to-nation negotiations harden.

Improving the process by issuing an ANPR is not without precedent. In 2003, during the development of the Basel II standards, the Agencies issued an ANPR that clearly outlined scope, potential regulatory requirements, and asked for comments so the Agencies could “seek appropriate modifications” at the international level. As a result of the Basel II ANPR, every bank knew whether the Basel process would affect them and with that information could decide whether to participate in the comment process. It also led to the development of a more tailored approach for the United States, with a menu of options better adapted to the variety in size, complexity, and business models of U.S. banks.

In addition, the Agencies should conduct empirical studies of the impact on the U.S. banking system, bank customers, and the economy that would result from the adoption of proposed international standards to be considered. While the Basel QIS process is informative, that process is limited to a few banking organizations and does not take into account U.S. specific laws that might alter how a standard is implemented. In order to support U.S. rulemaking efforts, the empirical study should be conducted during the ANPR phase of a rulemaking with the result made publically available. Public availability of the study would notify the public of the analyses underlying key elements of the Agencies’ determinations as is required under the Administrative Procedure Act.⁶

The ANPR process, as well as the related study, would enhance the likelihood that the Agencies were fully informed as they negotiated with the Basel Committee and/or the Financial Stability Board. Moreover, it would allow banks and the public to identify and comment on banking policy objectives and standards at a stage of the process where appropriate adjustments to the needs of the U.S. economy can be most easily made.

U.S. Regulators Should not Consider Wholesale Adoption of the Revised Standardized Approaches

To comment on the most immediate set of international discussions, we believe that the Agencies should not consider the adoption of the Revised Standardized Approach as a second risk-based capital floor, because it would create costly and redundant systems with no additional

⁶ The Administrative Procedure Act requires the Agencies to “offer the rational connection between facts and judgment.” *Motor Vehicle Mfrs. Ass’n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, at 31 (1983).

safety and soundness benefit for U.S. banks or the financial system. The press release issued by the Agencies has raised the possibility of U.S. Advanced Approaches banking organizations being subject to *two* risk-based capital floors simultaneously. The first, which is applied as a result of provisions contained in the Dodd-Frank Act, has the current U.S. standardized approach acting as a floor to the Advanced Approaches risk-based capital standard. The second could potentially be the Basel Committee's Revised Standardized Approach.⁷ In total, this would mean Advanced Approaches banking organizations in the United States could be forced to report and disclose as many as nine risk-based capital ratios, with several that produce disparate and inconsistent results.

The additional ratios would require banks to create redundant and costly systems for compliance while effectively covering the same risks as existing ratios. Adoption of a second risk-based capital floor would make internal capital management and allocation, along with the management of business activities, increasingly complex, detracting from rather than enhancing prudential management of the bank. Furthermore, it is doubtful that the investor community would find an additional capital floor to be a useful metric for risk, and indeed there is the very real prospect of substantial confusion and misapplication, undermining the effectiveness of market discipline.

Adoption of a second risk-based capital floor based on the Revised Standardized Approach is unnecessary considering the current Dodd-Frank Act risk-based capital floor, leverage rules, and capital planning and supervisory stress testing requirements. We also note that adoption is unnecessary from a Basel perspective, because paragraph 26 of the Basel Committee's floor proposal permits significant and appropriate national discretion. It is our belief that the United States would still be Basel compliant were the Agencies not to adopt the Revised Standardized Approach as a second floor.

In light of the discretion afforded individual jurisdictions, the Agencies can and should consider the additional costs of a second risk-based capital floor together with the insignificant additional safety and soundness benefit over the current U.S. regulatory capital framework and not consider wholesale adoption of the Revised Standardized Approach. As the Agencies identify elements of the U.S. regulatory capital framework that could be improved, we encourage them to propose for comment those deficiencies and possible carefully targeted remedies.⁸

ABA appreciates the opportunity to comment on the Basel proposals in particular and how to improve the public consultation process more generally. We would be pleased for the opportunity to meet with representatives of the agencies to discuss these comments and the topics of the Standardized Approach and the Capital Floors Proposal more broadly.

⁷ The Agencies' press release indicated that the Revised Standardized Approach is not being considered for community banks. As a result, there is confusion about whether larger banking organizations would still be subject to the current, generally applicable, standardized approach if the Revised Standardized Approach is adopted domestically.

⁸ A discussion of the merits of individual methodologies in the Revised Standardized Approach is contained in a letter submitted to the Basel Committee by The Clearing House.

If the Agencies would like additional information regarding these comments, please contact Hugh Carney, at (202) 663-5324 (hcarney@aba.com).

Sincerely,

A handwritten signature in black ink that reads "Hugh C. Carney". The signature is fluid and cursive, with the first name "Hugh" being the most prominent.

Hugh C. Carney
Vice President, Capital Policy