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Wayne A. Abernathy
Executive Vice President
Financial Institutions Policy
and Regulatory Affairs
202-663-5222
wabernathy@aba.com

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The Honorable Joseph Otting
Comptroller of the Currency
Office of the Comptroller of the Currency
400 7th Street, S.W.
Washington, D.C. 20219

The Honorable Jelena McWilliams
Chairman
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

The Honorable Randal K. Quarles
Vice Chairman for Supervision
Board of Governors of the Federal Reserve System
Eccles Board Building
20th and C Street, N.W.
Washington, D.C. 20219

Re: An Activity Based Approach to the LCR and NSFR and Technical Corrections to the LCR

Dear Comptroller Otting, Chairman McWilliams, and Vice Chairman Quarles:

The American Bankers Association (ABA)[1] has submitted a number of materials to the U.S. Congress, Department of the Treasury, and banking agencies discussing the U.S. implementation of the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR). Together, these metrics comprise the Basel III liquidity framework. Through our communications we have consistently supported the principle of adequate and ready sources of liquidity, recommending various changes intended to ensure that the U.S. liquidity standards are consistent with U.S. conditions and reflect the characteristics of the U.S. banking system and financial markets. We continue to urge the agencies to work toward liquidity standards that reflect the depth and breadth of liquidity in U.S. markets and that avoid the dangers of fomenting scarcity of liquid instruments in times of economic stress.

[1] *The American Bankers Association is the voice of the nation's $17 trillion banking industry, which is composed of small, regional, and large banks that together employ more than 2 million people, safeguard $13 trillion in deposits, and extend nearly $10 trillion in loans.*

ABA and its members understand and acknowledge the importance of robust liquidity risk measurement, monitoring, and management in making both individual banks and the U.S. financial system more resilient.

The recent enactment of S.2155, which, among other things, directs the agencies to adjust the LCR, provides an excellent opportunity for the Agencies to revisit and implement necessary improvements to the LCR to ensure that it is customized to meet actual *systemic* liquidity concerns and that its application is tailored to account for the differing liquidity risk profiles of covered organizations.

We recommend that the agencies make use of the rulemaking process to evaluate the LCR rule's calibrations holistically and include such a question inviting public comment. The information collected under the question would provide valuable insight into what aspects of the LCR achieve the policy goals and what aspects are in need of adjustment. We also recommend that the agencies use this rulemaking process to invite public comment as to whether the related NSFR proposal at this point offers anything new and valuable with regard to bank supervision and management of systemic risk that is not adequately addressed by the LCR and other prudential standards already implemented in the U.S.

We have expressed elsewhere[2] our belief that the NSFR addresses issues that have already been addressed in the United States in a variety of other ways. Any consideration of implementation of the NSFR regulations should fully recognize the degree to which the systemic risks that the NSFR is intended to mitigate have already been mitigated by other prudential measures.

Asset Size Thresholds Should not Be the Sole Criterion in Application of Liquidity Standards

Of major importance to any regulatory framework is ensuring that requirements are properly calibrated, targeting the variety of risks that the framework intends to mitigate. In that regard, we continue to be troubled by the prominence given to the sole criterion of asset size of an institution in the application of liquidity standards.

The LCR and proposed NSFR rules rely solely on asset thresholds for identifying the banking organizations subject to the rules. As is increasingly clear, this scope of application is not a good fit, focusing on only one factor, which in practice is an inadequate indicator of liquidity risk. This unbalanced view of liquidity risk creates unnecessary burdens and costs with little added value to overall management of systemic risk. Instead of using arbitrary asset thresholds to identify the banking organizations covered by the rules, we urge the banking agencies to take a more risk-based approach to the U.S. liquidity framework.

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[2] American Bankers Association, *Liquidity*, white paper submitted to the Department of the Treasury, March 2017, https://www.aba.com/Advocacy/LetterstoCongress/Documents/LiquidityReport-ABA-March2017.pdf. Also see, ABA comment letter on proposed NSFR regulations, https://www.aba.com/Advocacy/LetterstoCongress/Documents/LiquidityReport-ABA-March2017.pdf.

Technical Changes Are Needed Prior to Finalization of the Basel Liquidity Framework in the U.S.

Essential to a robust liquidity framework are well-structured, well-calibrated requirements that accurately reflect and mitigate systemic liquidity risks. That means that the liquidity framework, in addition to being activity based in scope, should also mirror the experience of U.S. banking organizations and the depth and composition U.S. financial markets. The Basel III liquidity framework does not meet this bar in its current iteration.

We supported earlier steps by the Federal Reserve to broaden the recognition of financial instruments that can help meet liquidity demand,[3] and we encourage the agencies to continue to evaluate the liquidity value of assets outside of those originally deemed as High Quality Liquid Assets (HQLA). We remind the agencies that liquidity is not a static condition, and that the current static nature of HQLA designation under the LCR ignores the much greater breadth and depth of liquidity in the U.S. economy while creating the very real risk of HQLA scarcity in times of stress by excessively narrow reliance on sovereign instruments. Congress recently supported the concept of a broader pool of HQLA, through enactment of legislation to include some municipal securities in the LCR's definition of High Quality Liquid Assets (HQLA). That is a good step in the direction of ensuring adequate supplies of HQLA in good times and in times of financial trouble.

In addition to creating a broader and more dynamic pool of HQLA, we maintain that it is in need of several structural corrections, both to avoid exacerbating scarcity of HQLA in times of stress and to relieve its negative pressure on a diverse funding mix, including certain deposits.[4] With respect to the NSFR, we continue to believe that the NSFR is superfluous given the plethora of U.S. regulations aimed at mitigating liquidity risk in general and lengthening banks' structural funding specifically. Additionally, as ABA has noted, the NSFR is fundamentally flawed in that it confuses available liquidity in short-term stress with long-term funding needs. Moreover, certain definitions and treatments, such as those for operational deposits, are inexplicably inconsistent with the LCR.

Before the Agencies even consider implementation of the NSFR in the U.S., they should address existing problems in the LCR regulations (upon which much of the NSFR rules rest), including the inadequate tailoring of the LCR's application. Otherwise, the flaws of the LCR will be exacerbated by the layering on of the NSFR, which uses and thereby reinforces key LCR definitions, certain of which are misapplied in the U.S. After that, we recommend that the regulators carefully examine what the NSFR seeks to achieve that is not already addressed in existing rules and supervision in the U.S. Such an exercise could also form the basis for a review of the overall NSFR standards by the Basel Committee or the Financial Stability Board.

[3] Federal Register 30383 Vol. 80, No. 102 (May 2015) ABA Comment letter on the Treatment of U.S. Municipal Securities as High Quality Liquid Assets HQLA, https://www.aba.com/Advocacy/commentletters/Documents/LCR%20Muni%20Final.pdf.

[4] Unintended consequences, including discouraging bank deposit taking and potential risks of too narrow a definition of HQLA, are described in greater detail in the comment letter by ABA on the Liquidity Coverage Ratio, https://www.aba.com/Advocacy/commentletters/Documents/13114-ABA-LCR.pdf. See also the ABA March 2017 Liquidity white paper submitted to the Department of the Treasury, cited above.

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Thank you for considering the comments and recommendations set forth in this letter. If you have any questions or need further information, please do not hesitate to contact the undersigned or Alison Touhey, atouhey@aba.com; 202-663-5182.

Sincerely,

Wayne A. Abernathy
Executive Vice President
Financial Institutions Policy
and Regulatory Affairs