American Bankers Association
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Rob Nichols
President and CEO
202-663-7512
rnichols@aba.com

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

The Honorable Janet L. Yellen
Chair
Board of Governors of the Federal Reserve System
Eccles Board Building
20th and C Street, N.W.
Washington, DC 20219

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

Dear Comptroller Curry, Chairman Gruenberg, and Chair Yellen:

Re: Possible Changes to the U.S. Capital Framework

The American Bankers Association[1] (ABA) believes that this is an appropriate time for the banking agencies and other policymakers to consider the effectiveness of the numerous prudential standards implemented in recent years, with a view toward how they can be improved. There is little debate about the importance and purpose of these reforms. The question, now that we have some track record with these reforms individually and in their combination, is whether they are achieving their purposes, and, in particular, whether in doing so are there aspects that are unintentionally limiting economic growth. The persistence of extremely accommodative monetary policies among the developed nations to stimulate anemic growth shows that this is not a minor or academic question.

We also believe that this is an inquiry that should be conducted carefully and dispassionately, so that the improvements in prudential supervision are preserved and strengthened while strengthening economic performance. We consider the recent review of stress test programs as a good example of the exercise we are recommending.

We would turn your attention at this time to another structural element in several prudential regulations. This was a device that is admittedly arbitrary but which was adopted as an early and rudimentary approach to introduce some tailoring into prudential regulations, a welcome recognition that a one-size-fits-all approach does not work well with risk management. What we refer to are the several places where supervisory differences are based upon the sole factor of asset thresholds. Reflection and experience tell us that asset size has a poor correlation with prudential risk.

[1] The American Bankers Association is the voice of the nation's $16 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $12 trillion in deposits and extend more than $8 trillion in loans.

Specifically, in view of proposed reforms to the stress test programs, we believe the Agencies should review and revise the use of thresholds for mandatory application of certain regulatory requirements that are solely based on whether a banking organization has $250 billion or more in total consolidated assets or $10 billion or more in on-balance sheet foreign exposure. We believe an appropriate alternative approach would be to replace the thresholds with a more risk-sensitive, dynamic measure that would better align regulatory requirements with risk.

On September 21, 2016, ABA submitted a comment letter requesting that the Agencies issue an Advance Notice of Proposed Rulemaking (ANPR) setting forth comprehensively and in detail the goals and concerns driving the cluster of proposed modifications to the Standardized Approach and Advanced Approaches for measuring regulatory capital that are being contemplated at the international level. Such an ANPR would provide an appropriate opportunity to re-evaluate the use of such thresholds and adjust or replace them for purposes of applying regulatory capital standards. Similarly, we encourage the banking agencies to a re-evaluate other static size-based thresholds that are applied in other contexts,[2] including the recent Comprehensive Capital Analysis and Review (CCAR) proposals.

1. The Thresholds are Static and Outdated

The Basel Committee on Banking Supervision develops supervisory standards and guidelines for "internationally active" banking organizations.[3] The Agencies participate in the development of those international standards, which have no legal force in the United States until regulations to implement the standards are adopted through the U.S. rulemaking process. It remains with the Agencies, therefore, to determine the appropriate scope of institutions for the application of the standards developed for "internationally active" banking organizations.

The thresholds, which are unique to the United States, were originally established by the Agencies in 2003. They were designed to identify those banking organizations to which the Advanced Approaches capital standards would apply on a mandatory basis.[4] At that time, the Federal Reserve made clear that the implementation in the United States of standards for internationally active banking organizations was intended to reach only the "largest, most complex banks," i.e., those that were the "most complex banking institutions" and were truly "internationally active."[5] Today, however, the thresholds inadvertently capture many banking organizations that do not have significant international operations, or, in some cases do not operate internationally at all, regardless of whether the application of these rules is warranted

[2] The thresholds are currently used in a variety of contexts, including the Advanced Approaches Risk-Based Capital Rules; the Supplemental Leverage Ratio; the requirement under the Basel III rules to take into account accumulated other comprehensive income and application of the countercyclical capital buffer; the Liquidity Coverage Ratio; the Interagency Guidance on Funds Transfer Pricing Related to Funding and Contingent Liquidity Risks; the Federal Reserve's re-proposal of rules to implement the single-counterparty concentration limit under section 165(e) of the Dodd-Frank Wall Street Reform and Consumer Protection Act; and, heightened supervisory requirements for capital planning and stress testing.
[3] *See History of the Basel Committee*, http://www.bis.org/bcbs/history.htm (Oct. 1, 2015).
[4] *Risk-Based Capital Guidelines; Implementation of New Basel Capital Accord*, 68 Fed. Reg. 45,900 (Aug. 4, 2003).
[5] *Testimony of Testimony of Vice Chairman Roger W. Ferguson, Jr.*, *Basel II*, Before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, June 18, 2003, available at http://www.federalreserve.gov/boarddocs/testimony/2003/20030618/default.htm; *see also* Federal Reserve, *Capital Standards for Banks: The Evolving Basel Accord*, 89 Fed. Res. Bull. 395 (Sept. 2003).

due to these banking organizations' business models and risk profiles. Beyond the simple asset threshold measures, other indicators of risk carry no weight.

This unintended consequence has occurred because the thresholds, besides being simple, are static, neither allowing for the diversity of business models nor recognizing actual risk profiles and changing risk conditions. A recognized management and supervisory challenge from this sole reliance on asset size is that banking organizations that cross the threshold face significant cliff affects that do not reflect the actual risk profile of an institution. In today's market, the thresholds are a clumsy way of measuring important risk concepts such as international activity. Nonetheless, the Agencies continue to use the thresholds as the cutline for implementing a broad variety of regulatory requirements. Moreover, the Agencies have indicated that they expect to continue to use the thresholds when adopting future Basel standards.[6]

We believe that it is time to reevaluate the purpose and use of the thresholds and consider whether they should be revised in a manner that ensures more appropriate tailoring of regulatory requirements based on banking organizations' business models and actual risk profile. Notably, revisiting and revising the thresholds would be consistent with recent Congressional direction included in the report of the House Committee on Appropriation's report accompanying the 2016 Financial Services and General Government Appropriations bill, which was incorporated into the 2016 Consolidated Appropriations Act enacted in December 2015:

> *Basel Standards.*—The Committee is concerned that the U.S. prudential regulators have inappropriately applied several standards developed by the Basel Committee on Bank[ing] Supervision (Basel), which are explicitly designed for only the most internationally active, globally systemic, and highly complex banking organizations to less complex organizations, like regional banking organizations, which have only limited foreign exposure and do not pose a threat to the U.S. or global financial system. The Committee encourages Treasury and other prudential regulators to reexamine the impact of certain liquidity and capital standards as they apply to U.S. regional banks and other less complex organizations.[7]

2. More Sophisticated Methods Exist to Tailor Regulatory Requirements

Turning our focus to the consideration of how to identify "internationally active banks," we can identify the value of a more multifactor, risk-based approach in tailoring prudential regulations. The international regulatory community and the Agencies have developed more risk-specific and sensitive, dynamic tools that we believe have significant merit to consider using to tailor regulatory requirements better, based on the actual risk profile of banking organizations. The

[6] *See* Banking Agencies' Statement Regarding the Basel Committee's Second Consultative Paper, "Revisions to the Standardized Approach for Credit Risk", http://www.federalreserve.gov/newsevents/press/bcreg/20151210b.htm (Federal Reserve); http://www.occ.treas.gov/news-issuances/news-releases/2015/nr-ia-2015-158.html (OCC); https://www.fdic.gov/news/news/press/2015/pr15096.html (FDIC) (each stating, "These proposed revisions would apply primarily to large, internationally active banking organizations and not to community banking organizations.")
[7] H.R. Rep. No. 114-194 (2015), at 10.

Agencies participated in the international development of the systemic indicator approach,[8] which the Federal Reserve has implemented in the United States for identifying G-SIBs.[9]

The systemic indicator approach takes into account not only size, but also interconnectedness, substitutability, complexity, and cross-jurisdictional activity. Moreover, the systemic indicator approach is dynamic, because the attributes that it takes into consideration, and the denominators that are used to evaluate those attributes, are updated periodically.[10] The systemic indicator approach offers powerful insights into complexity, international activities, and the actual risk profile of a banking organization. It can identify “internationally active” banking organizations better than do the rudimentary asset and on-balance sheet foreign exposure-based measures incorporated into the thresholds.

The systemic indicators make it clear that the banking organizations captured by the thresholds as “internationally active” are not all the same. Some of the captured institutions engage in large trading activities, have substantial cross jurisdictional activities, and large derivative portfolios. However, others engage predominately in domestic lending and deposit-gathering. In light of the many differences between institutions captured by the thresholds, we believe that a more dynamic and risk-sensitive approach is necessary to determine the scope of implementation for heightened regulatory requirements in the United States. This reexamination is all the more timely and urgent given the expected future use of the thresholds in implementing changes to international standards and the recent CCAR proposal.

Thank you very much for considering these issues. If the Agencies would like additional information regarding these comments, please contact Hugh Carney, at 202-663-5324 or hcarney@aba.com.

Sincerely,

Rob Nichols
President & CEO

[8] Basel Committee, *Global systemically important banks: updated assessment methodology and the higher loss absorbency requirement* (July 2013).
[9] *See Regulatory Capital Rules: Implementation of Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Final Rule*, 80 Fed. Reg. 49,802 (Aug. 14, 2015).
[10] The Federal Reserve’s FR Y-15 Banking Organization Systemic Risk Report, which collects data comprising the five components underlying the systemic indicator approach (size, interconnectedness, substitutability, complexity, and cross-jurisdictional activity), is submitted by bank holding companies with total consolidated assets of $50 billion or more on a quarterly basis. The aggregate systemic indicators used as the denominators to calculate a banking organization’s systemic indicator score are updated on an annual basis.