



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 Clearing House Association L.L.C., the Securities Industry and Financial Markets Association, the Financial Services Roundtable, and the International Swaps and Derivatives Association (together, the “**Associations**”)¹ appreciate the opportunity to comment on the Agencies’ proposal² to revise the enhanced supplementary leverage ratio (“**eSLR**”) requirements applicable to U.S. GSIBs and their subsidiary insured depository institutions (“**IDIs**”) and to make conforming changes to the total loss-absorbing capacity (“**TLAC**”) and eligible long-term debt (“**LTD**”) requirements applicable to U.S. GSIBs.

¹ Descriptions of the Associations are provided in Annex A of this letter.

² 83 Fed. Reg. 17317 (Apr. 19, 2018).

The Associations continue to support leverage requirements as a simple backstop to risk-based capital requirements. However, in light of the significant shortcomings of a leverage ratio measure,³ we continue to believe it is critical that any leverage requirement be set as a backstop, and not as the predominant – or even a primary – capital requirement in ordinary circumstances; the latter would drive misallocation of capital in the economy – as any measure that ignores risk is bound to do if applied as a binding constraint – and discourage low-risk, low-return activities that are critical to the effective functioning of the banking system and financial markets. Accordingly, the Proposal’s modifications to the capital framework would represent a marked improvement toward making leverage requirements a backstop measure, as intended by the Agencies⁴ and the Basel Committee,⁵ and not a binding constraint. Furthermore, in light of the risk-based capital requirements and other aspects of the U.S. capital framework, the proposed changes to the eSLR requirements would not appreciably reduce Tier 1 capital requirements for U.S. GSIBs or affect the overall resilience of the banking sector or financial system.

To further improve the role of leverage requirements in the context of the larger bank capital framework, we provide in this letter a range of suggestions, including changes to the TLAC SLR and LTD SLR requirements, that we believe would enhance the eSLR and related capital frameworks.

I. Executive Summary

- The leverage ratio is a poor indicator of bank condition.
- The Proposal would not meaningfully reduce the aggregate level of Tier 1 capital required to be held by U.S. GSIBs, nor would it undermine in any way the overall resilience of the banking sector or the financial system as a whole.
- The proposed modifications to the eSLR requirements would better align those requirements with their appropriate role as a backstop to risk-based capital requirements and reduce disparities between the U.S. capital framework and international standards. Additional modifications would further improve the role of the eSLR within the U.S. capital framework.

³ See, e.g., Greg Baer, The Clearing House, *The Leverage Ratio: Neither Simple Nor Sensible* (June 26, 2017), available at <https://www.theclearinghouse.org/advocacy/articles/2017/06/26-leverage-ratio>; The Clearing House, *Comment Letter Re: Stress Testing Transparency Proposals* (Docket Nos. OP-1586, OP-1587 and OP-1588) (Jan. 22, 2018), at Annex A 3-5, available at https://www.theclearinghouse.org/-/media/tch/documents/tch-weekly/2018/20180122_tch_comment_letter_re_stress_testing_transparency.pdf.

⁴ See 83 Fed. Reg. 17317, 17319 (“Leverage capital requirements should generally act as a backstop to the risk-based requirements.”); see also Vice Chairman for Supervision Randal K. Quarles, *Liquidity Regulation and the Size of the Fed’s Balance Sheet* (May 4, 2018), at 2 (“The proposed change [to the eSLR] simply restores the original intent of leverage requirements as a backstop measure to risk-based capital requirements.”), available at <https://www.federalreserve.gov/newsevents/speech/files/quarles20180504a.pdf>.

⁵ See Basel Committee, *Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems* (Dec. 2010, rev. June 2011), at 2 and 61, available at <https://www.bis.org/publ/bcbs189.pdf>.

- The Proposal's use of the Federal Reserve's GSIB surcharge rule to determine eSLR requirements increases the importance of a comprehensive reassessment and recalibration of the U.S. GSIB surcharge.
 - The eSLR requirement for subsidiary IDIs of U.S. GSIBs should be implemented as a buffer requirement instead of a requirement for well-capitalized status under the prompt corrective action ("PCA") framework.
 - The Agencies should make changes to the denominators for leverage capital requirements to further improve the regulatory capital framework.
- The Federal Reserve should make further changes to the TLAC SLR and LTD SLR requirements applicable to U.S. GSIBs in addition to modifying these requirements to reflect the recalibration of the eSLR.
- Recalibrating the TLAC SLR buffer from a uniform 2% amount to half of a firm's GSIB surcharge would appropriately reflect the proposed modifications to the eSLR buffer.
 - The Federal Reserve should recalibrate the minimum TLAC SLR requirement from 7.5% to 5.5% to reflect the capital refill framework, or, at a minimum, recalibrate the minimum requirement from 7.5% to 6.75% to eliminate U.S. gold-plating relative to international standards.
 - Any changes to the calibration of the minimum TLAC SLR requirement for U.S. GSIBs should result in corresponding changes to the minimum TLAC SLR requirement for covered IHCs to reflect the appropriate scaling of internal TLAC requirements for covered IHCs.
 - The Federal Reserve should eliminate the separate LTD requirements applicable to U.S. GSIBs and covered IHCs from the TLAC rule, or at least eliminate the LTD SLR requirement. If the Federal Reserve retains the LTD SLR requirement, it should:
 - recalibrate the minimum LTD SLR requirement for U.S. GSIBs from 4.5% of total leverage exposure to 2.5% of total leverage exposure, without incorporating half of a firm's GSIB surcharge in the minimum requirement or requiring it as a buffer; and
 - recalibrate the minimum LTD SLR and LTD Tier 1 leverage ratio requirements for non-resolution covered IHCs to 1.875% and 2.625%, respectively, to reflect the appropriate scaling of internal TLAC requirements for non-resolution covered IHCs.
 - The Proposal's clarification of the formulas used to calculate a firm's TLAC buffer amount(s) would improve the TLAC rule.

II. The leverage ratio is a poor indicator of bank condition.

By design, two banks of the same asset size with the same amount of capital will have the same leverage ratios irrespective of the nature of their assets; but the bank with riskier assets will have a lower risk-based capital ratio. As TCH has previously shown,⁶ risk-based capital ratios are a meaningfully better predictor of bank failure than leverage ratios. TCH's analysis calculates the Basel I Tier 1 risk-based capital ratio and the Tier 1 leverage ratio, at the end of 2006 for more than 8,000 commercial banks that existed at that time, and tests which regulatory capital ratio has a stronger ability to predict the more than 400 failures that occurred between 2007 and 2011.⁷

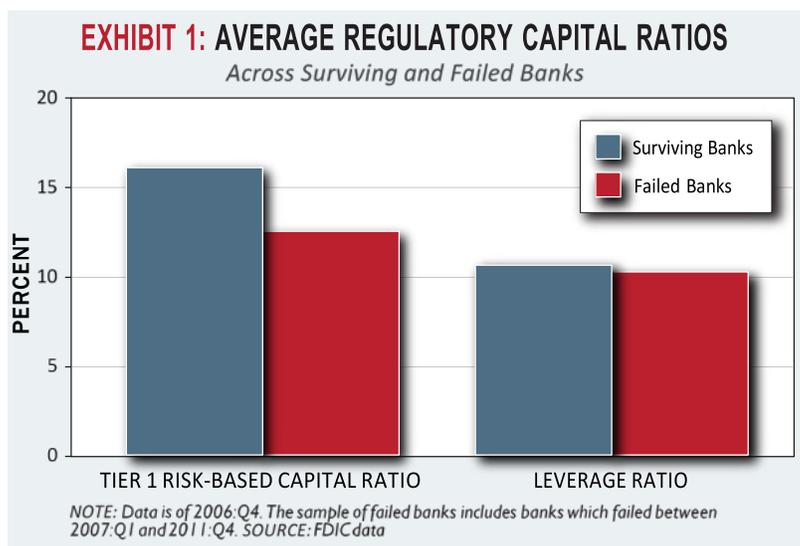


Exhibit 1 compares the average regulatory capital ratios at the end of 2006 of the banks that survived and the banks that failed during the past financial crisis. In 2006, banks that would later survive the crisis reported a Tier 1 capital ratio (which is risk-weighted) that was about 30% higher than the Tier 1 capital ratio of banks that failed. In contrast, the Tier 1 leverage ratio of banks that survived is only slightly higher than the Tier 1 leverage ratio of banks that failed. Thus, the difference between the surviving banks' and the failed banks' risk-based and non-risk-based capital ratios demonstrates that risk-based capital requirements were a clearly superior predictor of bank failure. That superior performance of risk-based capital requirements is

⁶ See Francisco Covas and Bill Nelson, The Clearing House, *Shortcomings of Leverage Ratio Requirements* (August 2016) (“**Shortcomings of Leverage Ratio Requirements**”), available at https://www.theclearinghouse.org/-/media/tch/documents/research/articles/2016/08/20160809_tch_research_note_leverage_ratio.pdf.

⁷ More than two-thirds of bank failures in the sample occurred between 2009 and 2010, and only one bank was closed by the Federal Deposit Insurance Corporation in 2007. Thus there is a sizable time gap between the time period in which the regulatory capital ratios are observed and bank failure occurs, which strengthens the validity of the empirical results as it reduces concerns about endogeneity and reverse causality.

confirmed using statistical analysis. Both the Tier 1 risk-based capital ratio and the Tier 1 leverage ratio predict bank failure.⁸ In each case, a higher regulatory capital ratio reduced the odds of failure; however the Tier 1 risk-based capital ratio has a stronger ability to predict bank failure. For instance, a 1 percentage point increase in the Tier 1 risk-based capital ratio lowered the probability of bank failure by more than 60 basis points, whereas the same increase in the Tier 1 leverage ratio reduced the odds of failure by only approximately 20 basis points.⁹ Lastly, when the Tier 1 risk-based capital ratio and the Tier 1 leverage ratio are both included in the regression, banks with a lower leverage ratio are less likely to fail.¹⁰ While the result seems counterintuitive, it may reflect the fact that if two banks have the same risk-weighted capital ratios, the bank with the lower leverage ratio must have a higher share of low-risk and liquid assets, thereby reducing the magnitude of its losses due to fire sales during a financial crisis. Regardless, the analysis demonstrates that, empirically, the leverage ratio is a poor indicator of bank condition, especially compared to risk-based capital ratios.

III. The Proposal would not meaningfully reduce the aggregate level of Tier 1 capital required to be held by U.S. GSIBs, nor would it undermine in any way the overall resilience of the banking sector or the financial system as a whole.

According to the Agencies, the proposed changes to the eSLR would reduce the required amount of Tier 1 capital for U.S. GSIBs by only approximately \$400 million, which is approximately 0.04% of total U.S. GSIB Tier 1 capital as of the third quarter 2017 (which was, in the aggregate, \$955 billion).¹¹ Therefore, the Proposal would have a de minimis impact on the

⁸ See Shortcomings of Leverage Ratio Requirements, at 7-8.

⁹ The result is particularly striking because, since total assets are greater than risk-weighted assets, a one percentage point increase in the leverage ratio requires that the bank have substantially more additional capital than a one percentage point increase in the risk-based capital ratio.

¹⁰ A similar result was provided in Andrew Haldane in “The Dog and the Frisbee,” August 2012. Haldane nevertheless concluded that the leverage ratio is a better measure than the risk-based capital ratio because simpler measures of bank strength performed better in smaller samples, which according to Haldane proxied for an environment with greater model uncertainty.

¹¹ Indeed, members of the Board of Governors have recently noted the robust capitalization of the banking sector. See Vice Chairman for Supervision Randal K. Quarles, *Statement before the Committee on Financial Services of the U.S. House of Representatives* (Apr. 17, 2018), at 2 (“The largest U.S. banking organizations – those the failure of which would pose the greatest risk to the financial system and that are subject to the Federal Reserve’s stress testing framework – have increased the dollar amount of their loss-absorbing common equity capital by more than \$700 billion since 2009, more than doubling their common equity capital ratios from approximately 5 percent to more than 12 percent.”), available at <https://www.federalreserve.gov/newsevents/testimony/files/quarles20180417a.pdf>; Vice Chairman for Supervision Randal K. Quarles, *Early Observations on Improving the Effectiveness of Post-Crisis Regulation* (Jan. 19, 2018), at 2 (“Core aspects of [the post-financial crisis regulatory reform] project have resulted in critical gains to our financial system: higher and better quality capital, an innovative stress testing regime, new liquidity regulation, and improvements in the resolvability of large firms.”), available at <https://www.federalreserve.gov/newsevents/speech/files/quarles20180119a.pdf>; Governor Lael Brainard, *An Update on the Federal Reserve’s Financial Stability Agenda* (Apr. 3, 2018), at 6 (“The core of the framework is the requirement of a substantial stack of common equity to build resilience against shocks and to provide an incentive for prudent risk management. Regulatory capital ratios for the largest banking firms at the core of the system have about doubled since 2007 and are currently at their highest levels in the post-crisis era. U.S. firms have substantially increased their capital since the first round of stress tests led

aggregate level of Tier 1 capital that U.S. GSIBs must hold and, correspondingly, would not have negative effects on the resilience of the banking sector or the financial system more broadly.¹² Moreover, the reduction of required Tier 1 capital levels does not necessarily result in increased distributions to shareholders or a reduction in actual capital levels. U.S. GSIBs' capital distributions and actual capital levels are determined in light of all applicable capital requirements and constraints, including stress-based capital requirements established through the Federal Reserve's CCAR and DFAST processes.

Although the estimated quantitative impact of the Proposal is very small, we urge the Agencies to promptly finalize the Proposal in order to address the incentives created by the current calibration of the eSLR and mitigate the adverse effects of the current calibration on the capital-allocation decisions of U.S. GSIBs. In this way, the Proposal would promote the efficiency of the U.S. capital framework.¹³

The Agencies estimate that, for the lead subsidiary IDIs of U.S. GSIBs, the Proposal would reduce the amount of required Tier 1 capital by approximately \$121 billion. This figure, however, exaggerates the potential effects of the proposal on the resilience of the banking sector or the financial system as a whole. First, this figure may not even represent an accurate estimate of the impact of the Proposal on those IDIs. The estimate compares the amount of Tier 1 capital required to meet the proposed eSLR well-capitalized requirement to the amount of Tier 1 capital

by the Federal Reserve in 2009.”), *available at* <https://www.federalreserve.gov/newsevents/speech/files/brainard20180403a.pdf>.

¹² The Conference of State Bank Supervisors and the Independent Community Bankers of America have submitted letters to the Agencies, dated April 30, 2018 and May 8, 2018, respectively, requesting the extension of the comment period for the Proposal. Both letters assert that the Proposal would reduce minimum Tier 1 capital requirements for U.S. GSIBs by \$9 billion, citing the impact analysis in the Proposal. That figure does not take into account the capital that U.S. GSIBs must hold to satisfy requirements under the Federal Reserve's capital plan rule and Comprehensive Capital Analysis and Review (“CCAR”) process. *See* 83 Fed. Reg. 17317, 17321 at n. 25 and n. 27. Accordingly, that figure does not accurately reflect the estimated impact of the Proposal. CCAR post-stress capital requirements are frequently firms' binding capital constraints, and the impact analysis taking those requirements into account – the \$400 million reduction in required Tier 1 capital referenced above – presents more meaningful information. Indeed, had capital requirements been calculated under the Federal Reserve's proposals regarding stress buffer requirements and the eSLR using DFAST 2018 results, the proposed stress capital buffers for the eight U.S. GSIBs would have risen 1.1 percentage points and capital requirements would have increased by approximately \$70 billion compared to capital requirements calculated using DFAST 2017 results, which were reflected in the Federal Reserve's estimates of the quantitative impact of the eSLR Proposal. *See* Francisco Covas, William Nelson and Robert Lindgren, The Clearing House, *An Assessment of DFAST 2018 results through the lenses of the SCB and eSLR proposals* (June 22 2018), *available at* <https://www.theclearinghouse.org/research/articles/2018/06/2018-22-06-assessment-dfast>. We note that because CCAR 2018 results have not yet been released, it is not possible to replicate the Federal Reserve's impact analysis comparing the estimated effects of the eSLR Proposal to point-in-time and CCAR post-stress capital requirements using 2018 data.

¹³ *See* Vice Chairman for Supervision Randal K. Quarles, *Early Observations on Improving the Effectiveness of Post-Crisis Regulation* (Jan. 19, 2018), at 2 (“[Efficiency] can mean addressing unintended adverse consequences to the industry and the broader public from a regulation or eliminating perverse incentives created by a regulation.”), *available at* <https://www.federalreserve.gov/newsevents/speech/files/quarles20180119a.pdf>.

required to meet the current 6% requirement, as well as the Tier 1 risk-based capital ratio and applicable capital conservation buffer.¹⁴ Notably, it does not consider the amount of Tier 1 capital required to satisfy requirements based on the Tier 1 leverage ratio, in particular the 5% requirement for well-capitalized status, which the Proposal would not change.

Second, reduced capital requirements at the subsidiary level potentially provide U.S. GSIBs greater flexibility to allocate capital among their subsidiaries. But such lower requirements do not allow U.S. GSIBs to distribute more capital to their shareholders. Capital requirements at the U.S. GSIB level – including stress-based requirements established through the Federal Reserve’s CCAR and DFAST processes – and not the requirements that apply to their subsidiaries, ultimately determine the capital distribution capacity of U.S. GSIBs. As described above, the Proposal is estimated to result in a de minimis reduction in their Tier 1 capital requirements for U.S. GSIBs.¹⁵

Third, as for U.S. GSIBs, the reduction of required Tier 1 capital levels does not necessarily result in increased distributions by subsidiary IDIs. Subsidiary IDIs’ capital distributions are determined in light of all applicable capital requirements and constraints, including Tier 1 leverage ratio requirements and projected capital needs in stressed conditions, which the impact analysis did not address. Further, any distributions by subsidiary IDIs are subject to supervisory oversight and quantitative limitations. Under the National Bank Act and the Federal Reserve’s regulations, absent supervisory approval, a national bank or state member bank may not declare dividends in any year that are greater than that year’s net income plus the prior two years’ retained net income.¹⁶ The Proposal would not result in an unregulated distribution of capital by subsidiary IDIs of U.S. GSIBs.

Finally, as the Agencies recognize in the Proposal, the current eSLR requirements tend to be more binding for subsidiary IDIs than their U.S. GSIB parents because, among other reasons, the subsidiary-level requirements are calibrated 100 basis points higher.¹⁷ The Proposal would recalibrate the eSLR requirements for subsidiary IDIs so they would be quantitatively the same as those for their U.S. GSIB parents. Accordingly, the estimated impact at the subsidiary-level reflects the extent of the miscalibration of the current eSLR requirement for well-capitalized status.

¹⁴ 83 Fed. Reg. 17317, 17321-22 at n. 29.

¹⁵ See Vice Chairman for Supervision Randal K. Quarles, *Liquidity Regulation and the Size of the Fed’s Balance Sheet* (May 4, 2018), at n. 2 (“Required capital at the bank subsidiaries of these firms would be reduced by larger amounts – and would only allow the firm to move that capital to different subsidiaries within the firm – but, more importantly, the overall capital regime prevents this capital from being distributed out of the banking organization as a whole except in this de minimis amount. Thus, the overall organization retains the same capital levels without the structure of capital regulation creating an incentive to add risk to the system.”), available at <https://www.federalreserve.gov/newsevents/speech/files/quarles20180504a.pdf>.

¹⁶ See 12 U.S.C. § 60(b); 12 C.F.R. § 208.5(c). Similar requirements exist under state banking laws for state-chartered banks. See, e.g., New York Banking Law § 112(2).

¹⁷ See 83 Fed. Reg. 17317, 17321.

IV. The proposed modifications to the eSLR requirements would better align those requirements with their appropriate role as a backstop to risk-based capital requirements and reduce disparities between the U.S. capital framework and international standards.

A. Calibration of eSLR requirements for U.S. GSIBs and their subsidiary IDIs.

1. The Proposal would promote the role of leverage requirements as a backstop to risk-based capital requirements and not as a binding capital requirement in the ordinary course.

A leverage ratio measures the capital adequacy of a banking organization by dividing its capital by its total assets (and, in the case of the SLR and the eSLR, certain off-balance-sheet exposures) without taking into account the risk of any particular asset or exposure. A leverage ratio thus requires the same amount of capital to be held against every similarly sized asset or exposure irrespective of risk, making low-risk, low-return assets and exposures less attractive and more costly compared to higher-risk, higher-return assets and exposures. By requiring a banking organization to hold capital based on the size but not risk of its assets and exposures, a leverage requirement provides incentives for banking organizations to decrease their activities involving low-risk, low-return assets and exposures, including activities that are vital to the proper functioning of the banking system and financial markets, such as the provision of custody, treasury and clearing services. These incentives are particularly strong where, as is frequently the case with the eSLR currently,¹⁸ a leverage ratio is a banking organization's binding capital constraint, but we describe below how even non-binding leverage requirements can affect a banking organization's capital allocation decisions.

Improperly calibrated leverage requirements also run counter to other regulatory requirements intended to improve the resilience of banking organizations and reduce systemic risk. U.S. GSIBs must hold substantial amounts of central bank reserves and U.S. Treasury securities, among other low-risk, low-return assets, in order to comply with liquidity regulations (such as the liquidity coverage ratio) and satisfy resolution planning requirements (such as those relating to resolution liquidity adequacy and positioning (“**RLAP**”) and resolution liquidity execution need (“**RLEN**”) methodologies). As noted above, leverage requirements create disincentives for banking organizations to hold those assets, as compared to higher-risk, high-yielding assets, with the strength of those disincentives increasing significantly where leverage requirements are a binding capital constraint. Accordingly, in light of the current calibration of the eSLR, U.S. GSIBs are subject to inconsistent regulatory regimes that simultaneously mandate holding low-risk, low-return assets and strongly discourage them from holding the very same assets. Such inconsistencies result in an inefficient regulatory framework that has adverse effects on lending, market activity and economic growth.¹⁹

¹⁸ *Id.*

¹⁹ *C.f.* Vice Chairman for Supervision Randal K. Quarles, *Early Observations on Improving the Effectiveness of Post-Crisis Regulation* (Jan. 19, 2018), at 2 (describing efficiency of regulation as referring to “the degree to which the net cost of regulation – whether in reduced economic growth or in increased frictions

Further, the miscalibration of leverage requirements frustrates the longstanding policy goal – reflected in the 2009 G20 derivatives reform agenda²⁰ and the Dodd-Frank Act²¹ – to increase the central clearing of derivatives in order to reduce interconnectedness and complexity in the derivatives markets. Leverage requirements and, in particular, the eSLR, discourage U.S. GSIBs from providing clearing services. Although risk-based capital requirements allow banking organizations to reduce the exposure amount of centrally cleared derivatives by initial margin posted by their clients, the eSLR ignores any such posted margin. As a result, the eSLR exaggerates the exposure amount of these derivatives and effectively requires U.S. GSIBs to hold un-economic amounts of capital when providing clearing services to clients. Indeed, this issue has been recognized and addressed in other jurisdictions. For example, the European Commission has stated that “[a] leverage ratio should . . . not undermine the provision of central clearing services by institutions to clients” and, accordingly, proposed to exclude initial margin that institutions receive from their clients for cleared derivatives from the leverage ratio denominator “in order not to dis-incentivise client clearing.”²² The proposed recalibration of the eSLR would address these adverse effects by reducing the extent to which leverage requirements function as a binding capital constraint instead of as a backstop to risk-based capital requirements by generally lowering eSLR requirements. Below we provide a range of suggestions to further improve the role of the eSLR within the U.S. capital framework.

2. The Proposal’s use of the Federal Reserve’s GSIB surcharge rule to determine eSLR requirements increases the importance of a comprehensive reassessment and recalibration of the U.S. GSIB surcharge.

As we have previously described,²³ we have significant concerns regarding the conceptual foundation, methodology and calibration of the Federal Reserve’s GSIB surcharge

in the financial system – is outweighed by the benefits of the regulation.”), *available at* <https://www.federalreserve.gov/newsevents/speech/files/quarles20180119a.pdf>.

²⁰ See G20, Leaders Statement – the Pittsburgh Summit – September 24-25, 2009 (Sept. 2009), at 9, available at http://www.fsb.org/wp-content/uploads/g20_leaders_declaration_pittsburgh_2009.pdf; see also Financial Stability Board, *Review of OTC derivative market reforms – Effectiveness and broader effects of the reforms* (June 29, 2017), at 7, available at <http://www.fsb.org/wp-content/uploads/P290617-1.pdf>.

²¹ See, e.g., Commodity Futures Trading Commission, *Clearing Requirement Determination Under Section 2(h) of the CEA*, 77 Fed. Reg. 74284, 74285 (Dec. 12, 2012) (quoting S. Rep. 111-176), at 32 (Apr. 30, 2010) and Letter from Senators Christopher Dodd and Blanche Lincoln to Congressmen Barney Frank and Collin Peterson (June 30, 2010).

²² European Commission, *Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements and amending Regulation (EU) No 648/2012*, COM (2016) 850 final (Nov. 23, 2016) (“**European Commission November 2016 Proposal**”), at 18 and 26, *available at* <https://ec.europa.eu/transparency/regdoc/rep/1/2016/EN/COM-2016-850-F1-EN-MAIN.PDF>.

²³ See The Clearing House, *Submission to the U.S. Treasury Department: Aligning the U.S. Bank Regulatory Framework with the Core Principles of Financial Regulation* (May 2, 2017), at 15-17, available at https://www.theclearinghouse.org/~media/TCH/Documents/TCH%20WEEKLY/2017/20170502_TCH_Su

rule relating to both the Method 1 and Method 2 calculations. Although we recognize that revisions to the Federal Reserve's GSIB surcharge rule are beyond the scope of the Proposal, we believe that the Proposal cannot be assessed completely without considering whether the Federal Reserve's GSIB surcharge rule itself is properly calibrated and based on an appropriate methodology and coherent conceptual foundation. Accordingly, we urge the Federal Reserve to undertake a comprehensive reassessment and recalibration of its GSIB surcharge rule.

We also address our concerns and recommendations regarding the Federal Reserve's GSIB rule in our comment letter on the Federal Reserve's recent proposal regarding stress buffer requirements²⁴ in light of that proposal's approach to integrating the U.S. GSIB surcharge and stress-based capital requirements. The concerns and recommendations presented in that comment letter generally apply to this Proposal as well, with one key difference. In our comment letter on the stress buffer requirements, we recommend that the Federal Reserve use the time before the stress buffer requirements first become applicable to undertake a comprehensive reassessment, redesign and recalibration of its GSIB surcharge rule; with respect to this eSLR Proposal, we recommend that the Federal Reserve finalize and implement the Proposal as soon as possible, and not delay implementation until the reassessment, redesign and recalibration of the GSIB surcharge rule are completed. These differences are due to the divergent effects of the two proposals on the capital framework. The proposed integration of the U.S. GSIB surcharge and stress buffer requirements would have a material effect on the calibration and coherence of capital requirements. In contrast, this eSLR Proposal would improve the capital framework by promoting the role of leverage requirements as a backstop measure.

B. The eSLR requirement for subsidiary IDIs of U.S. GSIBs should be implemented as a buffer requirement instead of a requirement for well-capitalized status under the PCA framework.

The Agencies sought comment on whether "it would be more appropriate to apply the eSLR standard to a covered IDI as a capital buffer requirement, rather than as part of the PCA 'well capitalized' threshold."²⁵ We believe that a buffer requirement would be more appropriate because it would promote simplicity of the U.S. capital framework by harmonizing and aligning the mechanics of eSLR requirements at both the U.S. GSIB and subsidiary IDI levels. Further, a

[bmission to UST re Core Principles Study.pdf](#); The Clearing House, SIFMA, FSR, *Comment Letter re: Notice of Proposed Rulemaking; Comment Request: Risk-Based Guidelines – Implementation of Capital Requirements for Globally Systemically Important Bank Holding Companies* (79 Fed. Reg. 75,473, December 18, 2014) (Apr. 2, 2015), available at <https://www.theclearinghouse.org/-/media/files/association%20related%20documents/20150402%20tch%20comment%20letter%20on%20gsib%20surcharge.pdf?la=en>; see also The Clearing House, *Comment Letter re: Consultative Document – Global systemically important banks – revised assessment framework* (March 2017) (June 27, 2017), available at https://www.theclearinghouse.org/-/media/tch/documents/tch%20weekly/2017/20170627_tch_comments_to_bcbs_gsib_revised_assessment_framework.pdf.

²⁴ Federal Reserve, *Amendments to the Regulatory Capital, Capital Plan and Stress Test Rules* 83 Fed. Reg. 18160 (Apr. 25, 2018).

²⁵ *Id.*

payout restriction, such as a buffer requirement, is a type of ‘early warning’ indicator that should apply before the more severe consequences of loss of well-capitalized status under the PCA framework, including potential loss of financial holding company status, loss of eligibility for streamlined application procedures and loss of ability to accept brokered deposits without restrictions. Indeed, in the context of risk-based capital requirements, the Agencies calibrated the capital conservation buffer and risk-based PCA well-capitalized thresholds so that IDIs would be subject to payout restrictions before losing well-capitalized status.²⁶ Applying the eSLR requirements to U.S. GSIBs’ subsidiary IDIs as a buffer requirement would appropriately reflect the relationship between the buffer requirements and the PCA framework.

Further, implementing the eSLR as a buffer requirement instead of as a PCA well-capitalized threshold would not meaningfully weaken the quantity of capital at U.S. GSIBs’ subsidiary IDIs. As a practical matter, U.S. GSIBs will manage subsidiary IDI capital levels to satisfy the subsidiary-level eSLR requirement whether implemented as a buffer requirement or well-capitalized threshold. Accordingly, there would be little, if any, day-to-day practical difference between implementing the eSLR as a buffer or PCA well-capitalized threshold. The differences relate to the consequences in the event of a breach, and a buffer requirement would provide more appropriate consequences. In the case of a breach of a buffer requirement, a subsidiary IDI would be subject to payout limitations, which would trigger changes to capital management actions that would facilitate increases in capital. In the case of a well-capitalized threshold, the subsidiary IDI and its parent U.S. GSIB would face immediate and important changes to their regulatory status that could have significant adverse effects on a U.S. GSIB’s operations and ability to pursue its strategic objectives. Accordingly, a buffer requirement would provide sufficient incentives for subsidiary IDIs to exceed their applicable eSLR requirements in the ordinary course, as well as more appropriate remedial consequences in the event of a breach.

V. The Agencies should make changes to the denominators for leverage capital requirements to further improve the regulatory capital framework.

The Agencies also sought comment on whether they should consider alternative approaches to address the relative bindingness of leverage requirements to risk-based capital requirements. In addition to recalibrating the eSLR requirements, the Agencies should consider modifying the denominators for leverage requirements, including by implementing the U.S. Treasury Department’s recommendations in its June 2017 report regarding the SLR denominator.²⁷ In that report, the U.S. Treasury Department recommended that the total

²⁶ Federal Reserve, OCC, *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-Weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule*, 78 Fed. Reg. 62018, 62036 (Oct. 11, 2013) (“The capital conservation buffer has been designed to give banking organizations the flexibility to use the buffer while still being well capitalized. Banking organizations that maintain their risk-based capital ratios at least 50 basis points above the well capitalized PCA levels will not be subject to any restrictions imposed by the capital conservation buffer, as applicable.”).

²⁷ U.S. Department of the Treasury, *A Financial System That Creates Economic Opportunities, Banks and Credit Unions, Report to President Donald J. Trump, Executive Order 13772 on Core Principles for*

leverage exposure measure (i.e., the SLR denominator) exclude (a) central bank reserves, (b) U.S. Treasury securities and (c) initial margin for centrally cleared derivatives. As we have discussed in prior publications, submissions and comment letters to the Federal Reserve,²⁸ such adjustments to the SLR denominator would mitigate the adverse effects of improperly calibrated leverage requirements, including those described above in Section IV.A.1. We urge the Agencies to implement them.

Adjustments to the SLR denominator are critical for two reasons. First, capital requirements based on the SLR denominator will remain binding constraints. As the Agencies recognize, the eSLR would remain a binding capital constraint in some cases even if revised as proposed.²⁹ Moreover, for some U.S. GSIBs, the current post-stress SLR requirement in CCAR is a binding capital constraint.³⁰ Second, even if the eSLR and other SLR-based requirements ceased to be binding capital constraints, our recommended changes to the denominator would remain important to address the effects of leverage requirements on banking organizations' capital- and asset-allocation decisions. Although the impacts of leverage requirements are most significant at those banking organizations for which the requirements represent a binding capital constraint, all banking organizations are affected by leverage requirements. Such requirements affect how banking organizations allocate capital to their various activities and assess the economic returns of their activities. As a result, so long as banking organizations remain subject to leverage requirements, they will continue to have incentives not to engage in activities that involve low-risk, low-return assets and exposures because of lower returns on attributed capital.

Although the U.S. Treasury Department's recommendations and our prior discussions focused on the denominator for the SLR, any adjustments made to the SLR denominator should also be made to the Tier 1 leverage ratio denominator because the same policy considerations apply in the context of the Tier 1 leverage ratio as for the eSLR and SLR.³¹ We would welcome the opportunity to work with the Agencies to recalibrate the denominators for all leverage requirements in order to promote their role as a backstop measure and mitigate their adverse effects on activities involving low-risk, low-return assets and exposures.

Regulating the United States Financial System (June 2017), available at <https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf>.

²⁸ See note 3; see also The Clearing House, *Submission to the U.S. Treasury Department: Aligning the U.S. Bank Regulatory Framework with the Core Principles of Financial Regulation* (May 2, 2017), at 13-15, available at https://www.theclearinghouse.org/~media/TCH/Documents/TCH%20WEEKLY/2017/20170502_TCH_Submission_to_UST_re_Core_Principles_Study.pdf.

²⁹ 83 Fed. Reg. 17317, 17321.

³⁰ We note that the Federal Reserve's recent proposal to create stress buffer requirements and make other changes to CCAR and the supervisory stress tests could affect the degree to which the SLR is a binding capital constraint, but that the proposal did not quantify its estimated impact on SLR-based capital requirements. See Federal Reserve, *Amendments to the Regulatory Capital, Capital Plan and Stress Test Rules* 83 Fed. Reg. 18160 (Apr. 25, 2018).

³¹ Indeed, the Federal Reserve's recent proposal to introduce a stress leverage buffer for the Tier 1 leverage ratio may increase the relative stringency of the Tier 1 leverage ratio, as well as the likelihood of the Tier 1 leverage ratio being a binding capital constraint. See *id.*

VI. The Federal Reserve should make further changes to the TLAC SLR and LTD SLR requirements applicable to U.S. GSIBs in addition to modifying these requirements to reflect the recalibration of the eSLR.

A. Recalibrating the TLAC SLR buffer from a uniform 2% amount of total leverage exposure to half of a firm’s GSIB surcharge would appropriately align the eSLR buffer and the TLAC SLR buffer.

The TLAC SLR buffer was originally calibrated at 2% to align with the current leverage buffer applicable under the eSLR.³² The Proposal would appropriately keep the TLAC SLR buffer aligned with the eSLR buffer. Such alignment would further the coherence and consistency of the U.S. capital framework and TLAC rule, as well as the Agencies’ objective of calibrating the leverage-based requirements as a backstop to risk-based capital requirements instead of as a binding constraint.

B. The Federal Reserve should recalibrate the minimum TLAC SLR requirement from 7.5% to 5.5% to reflect the capital refill framework, or, at a minimum, recalibrate the minimum requirement from 7.5% to 6.75% to eliminate U.S. gold-plating relative to international standards.

The Federal Reserve has not directly proposed recalibrating the minimum TLAC SLR requirement, but Question 9 of the preamble to the Proposal invites comment on the recalibration of that requirement. Specifically, it asks “[w]hat, if any, modifications to the 7.5 percent requirement would be appropriate to address the changes proposed . . . or to address other changes in circumstances since the TLAC rule was finalized . . . ?”³³

We believe that the current minimum TLAC SLR requirement of 7.5% is too high and should be recalibrated for several reasons. First, changed circumstances since the TLAC rule was finalized support a lower calibration. The U.S. GSIBs have entered into secured support agreements with contractual triggers based on conservative RCEN / RLEN projections.³⁴ These triggers are calibrated so that a bankruptcy filing of the top-tier parent BHC of a U.S. GSIB would occur at a time when the U.S. GSIB still has enough assets to meet the projected capital needs of its material subsidiaries. Accordingly, the current minimum TLAC SLR requirement is calibrated substantially higher than necessary for a U.S. GSIB to have enough gone concern loss-absorbing capacity (“GLAC”) at the parent’s point of non-viability for its material subsidiaries to be recapitalized under any reasonably conceivable severely adverse scenario. Second, the

³² See 83 Fed. Reg. 17317, 17322 (“The adoption of [the TLAC SLR] buffer was designed to parallel the leverage buffer applicable to these firms under the eSLR rule and applies on top of the minimum TLAC leverage requirement.”).

³³ *Id.*

³⁴ RCEN stands for resolution capital execution need and is an estimate of the capital needs of each U.S. GSIB’s material subsidiaries, including its material non-U.S. subsidiaries (both pre- and post-bankruptcy), during the entire stabilization and resolution period in an SPOE resolution. RLEN is an estimate of the liquidity needs of each U.S. GSIB’s material subsidiaries, including its material non-U.S. subsidiaries (both pre- and post-bankruptcy), during the entire stabilization and resolution period in an SPOE resolution.

Federal Reserve should recalibrate the minimum TLAC SLR requirement so that it serves as a backstop to the minimum risk-based TLAC requirement rather than a binding constraint. As the preamble to the Proposal notes, “[l]everage capital requirements should generally act as a backstop to the risk-based requirements. If a leverage ratio is calibrated at a level that makes it generally a binding constraint through the economic and credit cycle, it can create incentives for firms to reduce participation in or increase costs for low-risk, low-return businesses.”³⁵ The current calibration of the minimum TLAC SLR requirement is higher than appropriate to act as a backstop and increases the risk that it will instead act as a binding constraint.

Accordingly, the Federal Reserve should recalibrate the minimum TLAC SLR requirement to 5.5%, which equals twice the normal minimum SLR requirement of 3%, minus a 0.5% allowance for balance sheet depletion. Under this approach, U.S. GSIBs would have enough GLAC at the top-tier parent’s point of failure for its material subsidiaries to be recapitalized. Further, this approach is consistent with the capital refill framework, which Question 9 of the preamble to the Proposal suggests as a potential basis for modifications to the minimum TLAC SLR requirement³⁶ and which we agree should be applied in setting the minimum TLAC SLR requirement.

Under the capital refill framework, TLAC SLR requirements would be calibrated at a level intended to result in each U.S. GSIB (i.e., covered BHC) having a minimum amount of TLAC such that, “if the covered BHC’s going-concern capital is depleted and the covered BHC fails and enters resolution,” its remaining GLAC will be “sufficient to absorb losses and fully recapitalize the covered BHC by replenishing its going-concern capital.”³⁷ By incorporating an allowance for balance-sheet depletion, a TLAC SLR requirement that is calibrated based on the capital refill framework would take into account that “the losses that the covered BHC incurs leading to its failure will deplete its risk-weighted assets as well as its capital. Accordingly, the pre-failure losses would result in a smaller balance sheet for the covered BHC at the point of failure, meaning that a smaller dollar amount of capital would be required to restore the covered BHC’s pre-stress capital level.”³⁸ Based on this capital refill framework, the minimum TLAC SLR requirement for U.S. GSIBs should be recalibrated to 5.5% of total leverage exposure. A minimum TLAC SLR requirement of 5.5% of total leverage exposure would appropriately reflect an allowance for balance sheet depletion and would result in a U.S. GSIB having enough TLAC to be recapitalized at Basel III minimum SLR levels even if it ran out of all of its going-concern capital (i.e., to satisfy the capital refill goal). Because it is not necessary for a U.S.

³⁵ 83 Fed. Reg. 17317, 17319.

³⁶ *Id.* at 17323.

³⁷ Federal Reserve, *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, 8274 (Jan. 24, 2017).

³⁸ Federal Reserve, *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; Regulatory Capital Deduction for Investments in Certain Unsecured Debt of Systemically Important U.S. Bank Holding Companies*, 80 Fed. Reg. 74926, 74932 (Nov. 30, 2015).

GSIB to be in full compliance with buffer requirements (as opposed to minimum requirements) immediately following resolution, the eSLR buffer should be reflected only in the separate TLAC SLR buffer requirement, and not incorporated within the minimum TLAC SLR requirement.

Although a minimum TLAC SLR requirement of 5.5% would be less than the FSB's recommended minimum of 6.75%, it would be justified for at least two reasons. First, the U.S. GSIBs have all entered into secured support agreements and adopted RCEN / RLEN triggers since the FSB established its international recommendation. These developments address the concern that a U.S. GSIB's top-tier parent would not make a voluntary bankruptcy filing or be placed into an FDIC receivership under Title II of the Dodd-Frank Act before it ran out of its going-concern capital. Rather, in light of these developments, a U.S. GSIB would be resolved at a time when it still has enough readily available prepositioned and contributable assets and HQLAs to satisfy the capital and liquidity needs of its material subsidiaries throughout the U.S. GSIB's stabilization and resolution periods. In contrast, the FSB international recommendation assumes that GSIBs will have run out of all their going-concern capital by the time they reach the point of non-viability and are placed into a special resolution proceeding or make a voluntary bankruptcy filing. Second, the Federal Reserve's proposed TLAC SLR buffer of half of a U.S. GSIB's surcharge should generally be sufficient to narrow or close the gap between 5.5% and 6.75%.

At the very least, if the Federal Reserve does not recalibrate the minimum TLAC SLR requirement to 5.5% consistent with the capital refill framework, it should recalibrate the minimum TLAC SLR requirement to 6.75% to "better align with . . . foreign or international standards or expectations."³⁹ The Financial Stability Board's TLAC Term Sheet ("**FSB Term Sheet**") provides for a minimum TLAC leverage ratio requirement of 6.75%.⁴⁰ The current U.S. minimum TLAC SLR requirement of 7.5% is therefore gold-plated relative to the international standards established in the FSB Term Sheet. If the Federal Reserve declines to apply the capital refill framework in recalibrating the minimum TLAC SLR requirement, then at a minimum it should align the minimum TLAC SLR requirement with the 6.75% international standard established in the FSB Term Sheet. If the Federal Reserve takes this approach, the proposed eSLR buffer of half of a firm's GSIB surcharge should be reflected only in the separate TLAC SLR buffer requirement, consistent with the FSB Term Sheet.⁴¹

C. Any changes to the calibration of the minimum TLAC SLR requirement for U.S. GSIBs should result in corresponding changes to the minimum TLAC SLR requirement for covered IHCs to reflect the appropriate scaling of internal TLAC requirements for covered IHCs.

³⁹ 83 Fed. Reg. 17317, 17322-23 (Question 9 of the preamble to the Proposal).

⁴⁰ Financial Stability Board, *Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution: Total Loss-absorbing Capacity (TLAC) Term Sheet* (Nov. 9, 2015), at 10.

⁴¹ The FSB Term Sheet "does not limit authorities' powers to . . . put in place buffers in addition to" the TLAC SLR minimum. FSB Term Sheet at 10.

As described in Section VI.B above, the minimum external TLAC SLR requirement for U.S. GSIBs should be recalibrated to reflect the capital refill framework, or, at a minimum, to align with the FSB Term Sheet. Corresponding changes should be made to the minimum internal TLAC SLR requirements applicable to non-resolution covered IHCs that reflect the appropriate scaling of internal TLAC requirements relative to external TLAC requirements. Currently, non-resolution covered IHCs are subject to a minimum internal TLAC SLR requirement of 6% (i.e., 90% of the current 6.75% minimum TLAC SLR requirement for resolution covered IHCs).⁴² The Federal Reserve should recalibrate the minimum internal TLAC SLR requirement for non-resolution covered IHCs to 75% of any recalibrated minimum TLAC SLR requirement for U.S. GSIBs, i.e., at the low end of the 75% to 90% scaling range set out in the FSB Term Sheet.⁴³ Moreover, if the Federal Reserve reduces the minimum external TLAC SLR for U.S. GSIBs to a level below 6.75%, it should reduce the minimum TLAC SLR requirement for resolution covered IHCs to the same level.

A gold-plated internal TLAC requirement for non-resolution covered IHCs of foreign GSIBs (i.e., a requirement above 75% of the lower of the minimum TLAC SLR requirement for U.S. GSIBs and resolution covered IHCs) is unnecessary to protect U.S. interests. The Federal Reserve has the power in appropriate cases to require non-resolution covered IHCs to file for bankruptcy based on RCEN / RLEN triggers in their Title I resolution plans at a time when they still have enough assets and HQLAs to meet the projected capital and liquidity needs of their material U.S. subsidiaries during a resolution of the U.S. IHC, regardless of whether their minimum internal TLAC requirement is calibrated at 75% or 90% of the minimum TLAC requirements of U.S. GSIBs or resolution covered IHCs.⁴⁴ Gold plating of minimum internal TLAC requirements for non-resolution covered IHCs also raises the likelihood of U.S. GSIBs facing similarly gold-plated minimum internal TLAC requirements abroad for their non-U.S. material entities and subgroups.⁴⁵ If one or more other host authorities follow the Federal Reserve's example and calibrate internal TLAC requirements for non-U.S. material entities and subgroups at the high end of the 75% to 90% range in the FSB Term Sheet, a collective action

⁴² 12 C.F.R. § 252.165(b)(2).

⁴³ FSB Term Sheet at 19.

⁴⁴ See FDIC and Federal Reserve, *Guidance for 2018 §165(d) Annual Resolution Plan Submissions By Foreign-based Covered Companies that Submitted Resolution Plans in July 2015* (Mar. 24, 2017), available at <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20170324a21.pdf> (requiring the covered IHCs of Barclays, Credit Suisse, Deutsche Bank and UBS to consider entering into secured support agreements and adopting RCEN / RLEN triggers for their U.S. operations).

⁴⁵ Federal Reserve Vice Chairman for Supervision Randal K. Quarles recently acknowledged this dynamic and called on the Federal Reserve to consider reducing its internal TLAC calibration for covered IHCs so that it is no longer at the high end of the 75% to 90% range. Vice Chairman for Supervision Randal K. Quarles, *Trust Everyone--But Brand Your Cattle: Finding the Right Balance in Cross-Border Resolution* (May 16, 2018), at 9 ("I believe we should consider whether the internal TLAC calibration for IHCs could be adjusted to reflect the practice of other regulators without adversely affecting resolvability and U.S. financial stability. The current calibration is at the top end of the scale set forth by the FSB, and willingness by the United States to reconsider its calibration may prompt other jurisdictions to do the same, which could better the prospects of successful resolution for both foreign G-SIBs operating in the United States, and for U.S. G-SIBs operating abroad."), available at <https://www.federalreserve.gov/newsevents/speech/files/quarles20180516a.pdf>.

problem that we have described elsewhere⁴⁶ will give all host authorities a powerful incentive to calibrate internal TLAC requirements at the high end of the FSB's 75% to 90% range, resulting in excessive pre-positioning of assets in their countries (i.e., ex-ante ring fencing) that are likely to be trapped in their countries during any resolution (i.e., ex-post ring fencing), a new impediment to the resolvability of a U.S. GSIB.⁴⁷

Question 9 of the preamble to the Proposal specifically requests comment on whether the minimum TLAC SLR requirement should be modified to "address new foreign or international standards related to total loss absorbing capacity or capital."⁴⁸ Since the final TLAC rule was adopted, the Bank of England and the Hong Kong Monetary Authority have established 75% as the starting point for the calibration of their minimum internal MREL/TLAC requirements.⁴⁹ The Federal Reserve should follow these positive examples and likewise recalibrate the internal TLAC SLR requirement for non-resolution covered IHCs at 75% of the minimum requirement for U.S. GSIBs and resolution covered IHCs of foreign GSIBs, which should be calibrated to be the same.

Accordingly, if the Federal Reserve recalibrates the minimum TLAC SLR requirement for U.S. GSIBs to 5.5%, then it should recalibrate the minimum TLAC SLR requirement for non-resolution covered IHCs to 4.125% (which would be 75% of the U.S. GSIB requirement) and that for resolution covered IHCs to be the same as that for U.S. GSIBs. The table below illustrates our proposed recalibration of the minimum TLAC SLR requirements.

⁴⁶ See, e.g., Section I.B of our February 17, 2017 comment letter to the FSB on its proposed guiding principles on internal TLAC, available at https://www.theclearinghouse.org/~media/TCH/Documents/TCH%20WEEKLY/2017/20170217_Joint_Comment_Letter_re_FSB_Internal_TLAC.pdf; Section I.A of our January 2, 2018 comment letter to the Bank of England on its proposed approach to setting a minimum requirement for own funds and eligible liabilities within groups, available at https://www.theclearinghouse.org/~media/new/tch/documents/advocacy/20180102_tch-sifma_comment_letter_on_bank_of_england_internal_mrel_consultation_paper.pdf. See also Davis Polk FinRegReform, *FSB Finalizes Guiding Principles on Internal TLAC* (July 10, 2017), available at <https://www.finregreform.com/single-post/2017/07/10/fsb-finalizes-guiding-principles-on-internal-tlac/>.

⁴⁷ Such behavior can already be observed. For example, the European Commission has proposed to calibrate minimum internal MREL (TLAC) requirements for material subsidiaries of non-EU GSIBs at 90% of the external MREL (TLAC) requirements for EU GSIBs. See European Commission November 2016 Proposal.

⁴⁸ 83 Fed. Reg. 17317, 17322.

⁴⁹ Bank of England, *Consultation on a proposed updated Statement of Policy: Internal MREL — the Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL) within groups, and further issues* (Oct. 2017), at 15, available at <https://www.bankofengland.co.uk/~media/boe/files/financial-stability/resolution/internal-mrel-consultation-october-2017.pdf?la=en&hash=33594C3FB3C7F1D129033AFE4E3A2BF20A4F9AA8>; Hong Kong Monetary Authority, *Consultation Paper: An Effective Resolution Regime for Financial Institutions in Hong Kong: Financial Institutions (Resolution) Ordinance (Chapter 628); Rules on Loss-Absorbing Capacity Requirements for Authorized Institutions* (Jan. 2018), at 42, available at http://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/resolution/LAC_CP_ENG.pdf.

Minimum TLAC SLR requirement	Final TLAC Rule	Recalibration
U.S. GSIBs	7.5%	5.5%
Non-resolution covered IHCs	6%	4.125%
Resolution covered IHCs	6.75%	5.5%

If the Federal Reserve agrees to recalibrate the TLAC SLR requirements, it should likewise recalibrate the minimum TLAC Tier 1 leverage ratio requirements for resolution and non-resolution covered IHCs to be consistent with the leverage ratio's role as a backstop to risk-based capital requirements. Specifically, as we recommended in our foreign GSIB comment letter on the TLAC proposal,⁵⁰ the Federal Reserve should recalibrate the minimum TLAC Tier 1 leverage ratio requirement for resolution covered IHCs from 9% to 7.5%, which equals twice the normal U.S. Tier 1 leverage ratio requirement of 4% minus a balance sheet depletion allowance of 0.5%. The Federal Reserve should also recalibrate the minimum TLAC Tier 1 leverage ratio requirement for non-resolution covered IHCs from 8% to 5.625%, which equals 75% of 7.5% – our proposed recalibrated minimum requirement for resolution covered IHCs.

Finally, as we also recommended in our foreign GSIB comment letter,⁵¹ the Federal Reserve should eliminate the TLAC Tier 1 leverage ratio for covered IHCs that are subject to the SLR, as having two leverage-based TLAC requirements is a duplicative backstop. Conversely, covered IHCs that are not subject to the SLR should only be required to comply with the TLAC risk-based and Tier 1 leverage ratios, and not with the TLAC SLR requirements.⁵²

- D. The Federal Reserve should eliminate the separate LTD requirements applicable to U.S. GSIBs and covered IHCs from the TLAC rule, or at least eliminate the LTD SLR requirement. If the Federal Reserve retains the LTD SLR requirement, it should (1) recalibrate the minimum LTD SLR requirement for U.S. GSIBs from 4.5% of total leverage exposure to 2.5% of total leverage exposure, without incorporating half of a firm's GSIB surcharge in the minimum requirement or requiring it as a buffer and (2) recalibrate the minimum LTD SLR and LTD Tier 1 leverage ratio requirements for non-resolution covered IHCs to 1.875% and 2.625% respectively to reflect the appropriate scaling of internal TLAC requirements for non-resolution covered IHCs.**

The Federal Reserve should take a fresh look at the TLAC rule's separate LTD requirements for U.S. GSIBs and covered IHCs and eliminate them entirely, including the

⁵⁰ The Clearing House Association, Securities Industry and Financial Markets Association, the American Bankers Association, the Financial Services Roundtable and the Financial Services Forum, *Re: Comment Letter on the Notice of Proposed Rulemaking on Internal TLAC, Long-Term Debt, Clean Holding Company and Other Requirements Applicable to the U.S. IHCs of Foreign G-SIBs* (Feb. 19, 2016), at 9-10, 12-13, available at <https://www.theclearinghouse.org/advocacy/articles/2016/02/~media/d5889d6659814d1aaac3b72a84840ac8.ashx>.

⁵¹ *Id.* at 10.

⁵² *Id.* at 10-11.

minimum LTD SLR requirement.⁵³ The development of secured support agreements and RCEN / RLEN triggers since the Federal Reserve's TLAC rule was finalized has made it clear that a U.S. GSIB's or a covered IHC's actual capacity to absorb its standalone losses and those of its material subsidiaries depends solely on the value of its standalone assets at the time of its failure, and not on whether the claims against it are in the nature of debt or equity or on the amount of any LTD claims against it. The amount and priority of LTD and other debt claims against the U.S. GSIB or covered IHC merely determine how its standalone losses and those of its material subsidiaries pushed up to it will be distributed among investors with debt or equity claims against it. Therefore, whether a U.S. GSIB or covered IHC's TLAC includes a minimum amount of LTD or consists entirely of equity is irrelevant to the U.S. GSIB or covered IHC's actual gone-concern loss-absorbing capacity.

In addition, as we argued in our U.S. GSIB and foreign GSIB comment letters on the TLAC proposal,⁵⁴ the separate LTD requirements are unnecessary to develop a framework in which U.S. GSIBs and covered IHCs have enough TLAC at the point of failure to be recapitalized at Basel III levels. This is even more true today than it was when we submitted those letters in February 2016, since the subsequently developed RCEN / RLEN triggers would result in a U.S. GSIB filing for bankruptcy long before balance-sheet insolvency, and at a time when the U.S. GSIB would still have sufficient assets and corresponding remaining GLAC – whether in the form of equity or debt – to recapitalize all of the U.S. GSIB's material subsidiaries. Likewise, the Federal Reserve has the power in appropriate cases to require a covered IHC to file for bankruptcy based on RCEN / RLEN triggers in its Title I resolution plan at a time when it still has enough assets and HQLAs to meet the projected capital and liquidity needs of its material U.S. subsidiaries during a resolution of the covered IHC.⁵⁵ As a result, the

⁵³ This recommendation is consistent with Federal Reserve Vice Chairman for Supervision Randal K. Quarles' recent statement that the Federal Reserve should "look closely" at the possibility of "streamlin[ing] the elements of our resolution loss absorbency regime, which include both TLAC and long-term debt requirements." Vice Chairman for Supervision Randal K. Quarles, *Trust Everyone--But Brand Your Cattle: Finding the Right Balance in Cross-Border Resolution* (May 16, 2018), at 9, available at <https://www.federalreserve.gov/newsevents/speech/files/quarles20180516a.pdf>.

⁵⁴ The Clearing House Association, Securities Industry and Financial Markets Association, the American Bankers Association, the Financial Services Roundtable and the Financial Services Forum, *Re: Comment Letter on the Notice of Proposed Rulemaking on External TLAC, Long-Term Debt, Clean Holding Company and Other Requirements Applicable to U.S. G-SIBs* (Feb. 19, 2016), at 9–10, available at <https://www.theclearinghouse.org/advocacy/articles/2016/02/~media/6dfcfa9098f34b8180555412f3f39ed2.ashx>; The Clearing House Association, Securities Industry and Financial Markets Association, the American Bankers Association, the Financial Services Roundtable and the Financial Services Forum, *Re: Comment Letter on the Notice of Proposed Rulemaking on Internal TLAC, Long-Term Debt, Clean Holding Company and Other Requirements Applicable to the U.S. IHCs of Foreign G-SIBs* (Feb. 19, 2016), at 6–7, 12–13, available at <https://www.theclearinghouse.org/advocacy/articles/2016/02/~media/d5889d6659814d1aaac3b72a84840ac8.ashx>.

⁵⁵ See FDIC and Federal Reserve, *Guidance for 2018 §165(d) Annual Resolution Plan Submissions By Foreign-based Covered Companies that Submitted Resolution Plans in July 2015* (Mar. 24, 2017), available at <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20170324a21.pdf> (requiring the covered IHCs of Barclays, Credit Suisse, Deutsche Bank and UBS to consider entering into secured support agreements and adopting RCEN / RLEN triggers for their U.S. operations).

principal justification for the separate LTD requirement – for the firm to have sufficient remaining GLAC after balance-sheet insolvency⁵⁶ – is no longer relevant.⁵⁷

If the Federal Reserve declines to eliminate the separate LTD requirements altogether, it should at least eliminate the minimum LTD SLR requirement applicable to U.S. GSIBs and covered IHCs and the minimum LTD Tier 1 leverage ratio requirement applicable to covered IHCs, since in light of the TLAC leverage-based requirements they effectively function as a double backstop. As discussed above, leverage-based requirements are intended to serve as a backstop to risk-based capital requirements. The Federal Reserve has likewise described the TLAC rule's LTD requirements as serving a backstop function. In defending its inclusion of a separate LTD requirement in the final TLAC rule, the Federal Reserve described the separate LTD requirement as “help[ing] to ensure that a covered firm would have a known and observable quantity of loss-absorbing capacity in excess of its going-concern equity capital,” and thereby “enhanc[ing] the prospects for the successful resolution of a failed GSIB . . . as compared with an approach that relied solely on a minimum TLAC requirement.”⁵⁸ Eliminating the LTD SLR requirement and the LTD Tier 1 leverage ratio requirement – which, in light of the existence of the TLAC SLR and TLAC Tier 1 leverage ratio requirements effectively function as a double backstop – would eliminate the possibility that these leverage-based requirements could function as a binding constraint on firms, would simplify the TLAC rule and would reduce the number of capital requirements to which a firm must manage without affecting the firm's actual GLAC or resolvability.

If the Federal Reserve declines to eliminate the minimum LTD SLR requirement, it should at least recalibrate the minimum LTD SLR requirement for U.S. GSIBs to 2.5% of total leverage exposure – thereby eliminating the eSLR buffer from the minimum requirement and not requiring it as a buffer – to better reflect that the minimum LTD SLR requirement effectively functions as a double backstop. The current 4.5% minimum LTD SLR requirement was originally calibrated based on the capital refill framework by starting with the amount required to satisfy the normal minimum SLR requirement of 3%, adding the eSLR buffer of 2%, and then subtracting a 0.5% balance sheet depletion allowance.⁵⁹ The Proposal would recalibrate the minimum LTD SLR requirement to the sum of 2.5% plus half of a firm's GSIB surcharge, which is the normal minimum SLR requirement of 3% minus a balance sheet depletion allowance of 0.5%, plus the proposed eSLR buffer of half of a firm's GSIB surcharge. This change would simply keep the existing calibration aligned with the modified eSLR buffer. The Federal

⁵⁶ Federal Reserve, *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. at 8274.

⁵⁷ At a minimum, the Federal Reserve should eliminate the 50% haircut that applies to the amount of unpaid principal of LTD due to be paid in one to two years for purposes of satisfying the minimum LTD requirements of the TLAC rule. 12 C.F.R. § 252.62(b)(1)(ii). The haircut further gold plates the minimum LTD requirements relative to the international standard, which provides merely for an expectation that at least 33% of a GSIB's minimum TLAC be comprised of LTD without any haircutting of debt maturing between one and two years. FSB Term Sheet at 12.

⁵⁸ 82 Fed. Reg. at 8274.

⁵⁹ *Id.* at 8275.

Reserve should instead recalibrate the minimum LTD SLR requirement for U.S. GSIBs to a flat 2.5% of total leverage exposure, which is consistent with the capital refill framework approach of subtracting a 0.5% balance sheet depletion allowance from the normal SLR minimum requirement of 3%. It is unnecessary for the Federal Reserve to require firms to hold an additional amount of LTD equal to half of the firm’s GSIB surcharge as a buffer on top of the minimum LTD SLR requirement. Instead, such a buffer should only be incorporated within the TLAC SLR requirements in the manner described above.

If the Federal Reserve nonetheless decides to incorporate the modified eSLR buffer within the LTD SLR requirement for U.S. GSIBs, it should do so as a separate LTD SLR buffer requirement rather than as part of the minimum LTD SLR requirement. This change would better align the overall LTD SLR requirement with the overall TLAC SLR requirement and is consistent with our comments in Section VI.B above explaining why the eSLR buffer should be reflected only in the separate TLAC SLR buffer requirement and not incorporated within the minimum TLAC SLR requirement.

The Federal Reserve should also recalibrate the minimum LTD SLR requirement for non-resolution covered IHCs to 1.875%, which is 75% of 2.5%, our proposed recalibrated minimum LTD SLR requirement for U.S. GSIBs. Finally, the Federal Reserve should recalibrate the minimum LTD Tier 1 leverage ratio requirement for non-resolution covered IHCs from 3.5% to 2.625%, which equals 75% of 3.5%, the minimum requirement applicable to resolution covered IHCs.

The tables below illustrate our proposed recalibration of the minimum LTD SLR and LTD Tier 1 leverage ratio requirements, if the Federal Reserve declines to eliminate those requirements.

Minimum LTD SLR requirement	Final TLAC Rule	Recalibration
U.S. GSIBs	4.5%	2.5%
Non-resolution covered IHCs	2.5%	1.875%
Resolution covered IHCs	2.5%	2.5%

Minimum LTD Tier 1 leverage ratio requirement	Final TLAC Rule	Recalibration
U.S. GSIBs	N/A	N/A
Non-resolution covered IHCs	3.5%	2.625%
Resolution covered IHCs	3.5%	3.5%

E. The Proposal’s clarification of the formulas used to calculate a firm’s TLAC buffer amount(s) would improve the TLAC rule.

Under the current TLAC rule, 50% of the amount of LTD maturing in one to two years (the “**50% amount**”) is excluded from a firm’s LTD amount in determining compliance with the

minimum LTD requirements.⁶⁰ The 50% amount, however, is not excluded from a firm's TLAC amount in determining compliance with the minimum TLAC requirements. The TLAC rule achieves this by defining a firm's TLAC amount to include the LTD amount plus the 50% amount.⁶¹ The final TLAC rule, however, did not explicitly add back the 50% amount into the three TLAC buffer amounts used in determining a firm's compliance with the TLAC buffer requirements (i.e., for the TLAC risk-weighted and SLR buffers for U.S. GSIBs and the TLAC risk-weighted buffer for covered IHCs).⁶² By explicitly adding back the 50% amount in each of the three TLAC buffer amounts, the Proposal appropriately clarifies that there is no discrepancy between the amounts used to determine compliance with the minimum TLAC requirements (which already explicitly add back the 50% amount) and the TLAC buffer amounts.

* * * * *

The Associations appreciate the opportunity to comment on the Proposal. If you have any questions, please contact the undersigned by phone at (212) 613-9883 or by email at david.wagner@theclearinghouse.org.

Respectfully submitted,



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⁶⁰ 12 C.F.R. §§ 252.62(b)(1)(ii), 252.162(b)(1)(ii).

⁶¹ 12 C.F.R. §§ 252.63(b)(3), 252.165(c)(1)(iii), 262.165(c)(2)(iii).

⁶² 12 C.F.R. §§ 252.63(c)(3), 252.63(c)(5)(iii), 262.165(d)(3).



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cc: Michael Gibson
Mark Van Der Weide
(Board of Governors of the Federal Reserve System)

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(Office of the Comptroller of the Currency)

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ANNEX A

The Clearing House. The Clearing House is a banking association and payments company that is owned by the largest commercial banks and dates back to 1853. The Clearing House Association L.L.C is a nonpartisan organization that engages in research, analysis, advocacy and litigation focused on financial regulation that supports a safe, sound and competitive banking system. Its affiliate, The Clearing House Payments Company L.L.C., owns and operates core payments system infrastructure in the United States and is currently working to modernize that infrastructure by launching a new, ubiquitous, real-time payment system. The Payments Company is the only private-sector ACH and wire operator in the United States, clearing and settling nearly \$2 trillion in U.S. dollar payments each day, representing half of all commercial ACH and wire volume.

Securities Industry and Financial Markets Association. The Securities Industry and Financial Markets Association (“**SIFMA**”) is the voice of the U.S. securities industry. It represents the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over \$2.5 trillion for businesses and municipalities in the U.S., serving clients with over \$18.5 trillion in assets and managing more than \$67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit <http://www.sifma.org>.

The Financial Services Roundtable. The Financial Services Roundtable represents the largest banking and payment companies financing the American economy. Member companies participate through the Chief Executive Officer (CEO) and other senior executives nominated by the CEO.

The International Swaps and Derivatives Association. Since 1985, the International Swaps and Derivatives Association (“**ISDA**”) has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 850 Member institutions from 66 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on ISDA’s website: www.isda.org.