CSBS Comment Letter on Fed & OCC Regulatory Capital Rules

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Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
0th Street and Constitution Avenue, NW
Washington, DC 20551

Docket No. R-1604; RIN 7100 AF-03

Office of the Comptroller of the Currency
Legislative and Regulatory Activities Division
400 7th Street, SW, Suite 3E-218
Washington, DC 20219
Docket ID OCC-2018-0002

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.

Dear Sir or Madam,

The Conference of State Bank Supervisors (“CSBS”)[1] appreciates the opportunity to comment on the Notice of Proposed Rulemaking issued by the Federal Reserve Board (the “Board”) and the Office of Comptroller of the Currency (the “OCC”) (collectively, the “Agencies”) titled “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” (the “proposed rule”).[2]

In recalibrating the enhanced supplementary leverage ratio (the “eSLR”) standards for the most systemically important banking organizations in the country, the agencies acknowledge that if the proposed rule were to be adopted, minimum Tier 1 capital requirements would be reduced by $9 billion for global systemically important bank holding companies ("G-SIB BHCs") and by $122 billion for their insured depository institution subsidiaries ("G-SIB IDIs"), which represents 1 percent and 17 percent of the amount of Tier 1 capital held by G-SIB BHCs and IDIs as of the third quarter of 2017, respectively.

To put this in context, the Federal Deposit Insurance Fund had a balance of only $93 billion as of the end of 2017.

In light of the significant implications for financial stability and the resiliency of the U.S. banking industry, state bank regulators believe it is important that agreement across all of the federal banking agencies should be reached before any proposed revisions to the eSLR are issued or adopted. Agreement of all federal banking agencies as to the appropriate manner for recalibrating the eSLR will help ensure that any proposed revisions do not erode the benefits to financial stability from post-crisis reforms and create undue risks for the Deposit Insurance Fund.

The stated intention of recalibrating the eSLR standards is to ensure that the eSLR serves as a backstop to risk-based capital requirements rather than the binding constraint. The agencies indicate that the current eSLR standards function as the binding constraint for the majority of G-SIB BHCs and IDIs.[3] The proposed rule states that the eSLR functioning as a binding constraint can create perverse incentives for firms to reduce participation in or increase costs for low-risk, low-return businesses. However, if the eSLR results in G-SIBs acquiring higher-risk assets, then, assuming risk-based capital standards are appropriately calibrated, this riskier asset base should attract higher risk weights until the risk-based capital requirements become the binding constraint. State regulators do not support the proposed reduction of leverage capital requirements for all U.S. G-SIBs. However, we do support recalibrating the SLR for those G-SIBs with predominantly custodial business models.

State regulators are concerned that the proposed rule, in significantly reducing capital requirements for the G-SIBs, could have negative consequences for non-G-SIBs, including community banks, by providing the large, deposit-taking G-SIBs with significantly greater flexibility in deposit pricing. Given the significant deposit market share of most of the U.S. G-SIBs, the increased deposit pricing flexibility could intensify deposit competition and result in heightened liquidity risks and funding stress for the rest of the banking industry. State regulators believe the agencies have a responsibility to analyze and discuss the potential indirect impact on non-G-SIB institutions (including community banks) from reducing the eSLR capital requirements for G-SIBs.

Lastly, the proposed rule requests comment on whether it would be more appropriate to apply the eSLR standard as a capital buffer requirement rather than as part of the PCA "well capitalized" threshold. State regulators support the PCA framework as an important supervisory and regulatory tool that is critical for ensuring the continued safety and soundness of banks. Thus, given the different purposes for which the PCA framework and capital buffers are designed and calibrated,[4] state regulators believe that the proposed eSLR standard should remain part of the PCA "well capitalized" threshold rather than be applied as a capital buffer requirement.

CSBS appreciates the opportunity to comment on the proposed rule and encourages the agencies to thoroughly assess the direct and indirect consequences of recalibrating the eSLR in light of the significance of the proposed rule to financial stability and the resiliency of the U.S. banking system.

Sincerely,

John Ryan
President & CEO

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[1] *CSBS is the nationwide organization of state banking and financial regulators from all 50 states, American Samoa, the District of Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands. CSBS supports the state banking agencies by serving as a forum for policy and supervisory process development, by facilitating regulatory coordination on a state-to-state and state-to-federal basis, and by facilitating state implementation of policy through training, educational programs, and exam resource development.*

[2] *See 83 Fed. Reg. 17317 (Apr. 19, 2018).*

[3] *The agencies estimate that the current eSLR standard is more binding than risk-based capital requirements for four of the eight U.S. G-SIB BHCs and for all eight of the lead G-SIB IDIs. However, while the agencies' estimation compares the current 6 percent well-capitalized eSLR standard with the minimum tier 1 risk-based capital ratio plus applicable capital buffer and surcharge, the proposal did not incorporate the countercyclical capital buffer into this analysis. Although the countercyclical capital buffer is currently set at zero percent, it will presumably be deployed to its fullest extent at some point prior to the next downturn. If the countercyclical capital buffer had been deployed at its maximum of 2.5 percent as of the third quarter of 2017, then CSBS estimates that the current eSLR*

standard would not be more binding than risk-based capital requirements for any G-SIB BHCs, and for only five of the eight lead G-SIB IDIs.

[4] *While the PCA framework is intended to ensure that problems at banks are addressed promptly and at the least cost to the Deposit Insurance Fund, capital buffer requirements are designed to incentivize banking organizations to hold sufficient capital to reduce the risk that capital levels would fall below their minimum requirements during times of economic and financial stress.*

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