CSBS SINCE 1902
CONFERENCE OF STATE BANK SUPERVISORS

October 21, 2013

Robert E. Feldmen, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
RIN 3064–AE01

Office of the Comptroller of the Currency
250 E Street, SW, Mail Stop 2-3
Washington DC, 20219
Docket ID OCC–2013–0008

Robert de V. Frierson
Secretary, Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington DC, 20551
Docket No. R–1460

The Conference of State Bank Supervisors (CSBS) appreciates the opportunity to comment on the Federal Deposit Insurance Corporation's (FDIC's), the Board of Governors of the Federal Reserve System's (FRB's), and the Office of the Comptroller of the Currency's (OCC's) (collectively, "the Agencies") joint Notice of Proposed Rulemaking (NPR, proposal, or proposed rule) to strengthen leverage ratio standards for the largest, most interconnected banks, entitled *Regulatory Capital Rules: Regulatory Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and Their Subsidiary Insured Depository Institutions.*

CSBS is generally supportive of a higher quantity and quality of capital in the United States banking system. Given the disproportionate levels of risk large, interconnected US banking organizations pose to the banking system and the wider economy, it is appropriate that the largest global systemically important banking organizations (Global Systemically Important Banks or G-SIBs: those with over $700 billion in consolidated assets or over $10 trillion under custody) should have a strengthened leverage ratio. Advanced Approaches banks (those with over $250 billion in consolidated assets or $10 billion in foreign exposures) should also be subject to the proposed supplemental leverage ratio standards. These institutions should hold a supplementary buffer of capital because of their significant levels of off-balance sheet assets and dependence on methods of funding which proved unreliable during the financial crisis. This proposal will help advance the goal of financial stability.

While this proposal is a positive step in mitigating the significant risks that G-SIBs pose to the economy, it does not fully address the problem of institutions being "too big to fail".

Covered institutions should hold a significantly greater amount of capital to absorb losses during periods of stress and have additional checks on risk-taking. State regulators believe that “too big to fail” institutions continue to pose a threat to the financial system. This proposal may mitigate that problem, but will not solve it.

The Role and Strength of the Leverage Ratio

The Leverage Ratio is an important complement to risk based capital. Each compensates for the flaws of the other and leads to banks being less susceptible to unanticipated market shocks. A leverage ratio framework must be *equal* in importance to a risk based capital framework for this reason. CSBS appreciates the effort of the Agencies to appropriately strengthen the leverage ratio to correspond to enhancements to risk based capital rules in the 2013 revised capital approaches. G-SIBs are particularly susceptible to macro-economic shocks due to their size and interconnectedness. They are connected to the global economy in a way that the vast majority of banks in the United States are not. Additionally, their economic significance and activities make the application of the enhanced supplementary leverage ratio a prudent measure that works to the benefit of financial stability goals.

The Calculation of Exposure: Ensuring a Credible Leverage Ratio and Capital Framework

The credibility of capital was tested in many cases during the last financial crisis. Particularly, collateral which was allowed to reduce exposure often did not serve its risk mitigating purpose or in fact *increased* leverage, and thus risk in many cases. Therefore, CSBS has voiced support for the Basel Committee on Banking Supervision’s (BCBS) Revised Leverage Ratio Framework. This framework accounts for the risk from counterparty exposure and the inherent exposure of a contract to the underlying asset separately in the exposure measure. Importantly, it also bans accounting netting for security financing transactions and would force G-SIBs to gross-up collateral that is provided or received rather than allowing that collateral to reduce exposure. State regulators believe it would be appropriate for the Agencies to apply this leverage framework to the largest banking organizations in the United States.

Fundamentally, CSBS agrees with the separation of counterparty risk from exposure to the underlying asset and the prohibition of accounting netting for securities financing transactions. Ensuring that capital frameworks are credible and accurately capture exposure is essential to their success and to financial stability.

State regulators appreciate the agencies soliciting comment on how the standardized approach can be simplified in the future. We support efforts to simplify capital rules for banks under $10 billion as long as they maintain the credibility of capital.

The BCBS has announced that they will be replacing the Current Exposure Method (CEM) from the current risk-based capital rules with an alternate, simplified method for capturing derivatives exposure. While standardized approach banks generally have far less off-balance sheet activity than advanced approached banks, state regulators would nonetheless like to see consistency in how derivatives are accounted for, regardless of a bank's size. We support the replacement of the CEM with a method that is congruent in principle with the BCBS proposed revisions to the leverage framework, if not as complex. Capital held against off-balance sheet exposures will be more credible and more useful if collateral is *not allowed* to reduce exposures. The replacement cost of that collateral, whether provided or received, should also be included in measurements of off-balance sheet exposures. However, we believe exemptions for simple fixed-floating interest rate swaps are appropriate. These products can often assist in promoting safety and soundness and are genuinely used to *reduce* risk.

Scope of Coverage

The Agencies specifically solicit comment on whether the proposed changes to the supplementary leverage ratio should apply to all advanced approaches institutions. State regulators believe that the strengthened requirements should apply to all advanced approaches Bank Holding Company (BHCs) and their subsidiary Insured Depository Institutions (IDIs). While concerns about adverse impacts on the provision of credit deserve to be assessed and adjusted if appropriate, it is our view that higher quality and quantity of capital serve to strengthen the broader banking system and also increase the confidence of investors in large banks. Additionally, promoting financial stability is now a statutory obligation of regulators. More capital at the largest banks makes the economy more resilient and will help ensure that large banking organizations can still provide the essential functions of maturity transformation and credit intermediation in times of economic crisis.

The Levels of Capital: Ensuring the Bank Holding Company is a Source of Strength

State regulators believe that BHCs should serve as a source of strength for their subsidiary IDIs during times of stress. We appreciate that the Agencies state they will periodically re-visit and assess the levels of proposed capital as well as the scope of application. This is a prudent approach which we support. The proposed levels appear to be a good starting point and will meaningfully increase capital held by covered institutions.

However, state supervisors recognize that BHCs have obligations to support non-bank affiliates as well. In times of stress, these non-bank affiliates can also present a significant strain on the consolidated entity's capital resources. We therefore encourage the Agencies to ensure that all entities within the banking organization are sufficiently capitalized so that the BHC may serve as a genuine source of strength for its insured depository subsidiaries.

Conclusion

We appreciate the efforts of the Agencies to increase the quantity and quality of capital. We are supportive of the efforts to promote financial stability and to mitigate the impact of "too big to fail". State regulators support efforts to integrate lessons learned from the financial crisis into capital rules. Boosting the credibility of capital and ensuring it actually serves the purpose it is intended to serve is one of the most important steps regulators can take to ensure that the sustainability of the financial system is not threatened during periods of rapid de-leveraging and financial crisis.

Best regards,

John W. Ryan

President & CEO

1129 20th Street, N.W. • Ninth Floor • Washington, DC • 20036
www.csbs.org • 202-296-2840 • FAX 202-296-1928