November 18, 2019

Via Electronic Mail

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Re: Tailoring of Supervisory Practices and Expectations for Banking Organizations

Ladies and Gentlemen:

The Bank Policy Institute[1] is writing to urge the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, and Federal Deposit Insurance Corporation (collectively, the "Agencies") to build upon the Agencies' recent final rule to better tailor prudential regulatory standards by revising their supervisory practices and expectations for banking organizations to complement and align with those changes. The Agencies have indicated interest in identifying process improvements to their supervisory frameworks, and we hope that this letter is helpful in identifying and implementing such changes.[2]

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1 The Bank Policy Institute is a nonpartisan public policy, research and advocacy group, representing the nation's leading banks and their customers. Our members include universal banks, regional banks and the major foreign banks doing business in the United States. Collectively, they employ almost 2 million Americans, make nearly half of the nation's small business loans, and are an engine for financial innovation and economic growth.

2 *See, e.g.*, Federal Reserve, Opening Statement by Vice Chair for Supervision Randal K. Quarles (Oct. 10, 2019), https://www.federalreserve.gov/newsevents/pressreleases/quarles-opening-statement-20191010.htm.

As we detailed in our comment letters dated January 22, 2019[3] and June 21, 2019,[4] the Federal Reserve's rule[5] and related interagency rule[6] to tailor enhanced prudential standards and regulatory capital and liquidity requirements for both domestic and foreign banking organizations ("FBOs") represent a positive and significant step toward a regulatory framework for these firms that more appropriately aligns prudential regulatory standards and burdens with the diverse risk profiles, activities, and business models of these firms.

While we recognize that many of these prudential regulatory standards are solely within the purview of the Federal Reserve, and so have addressed those standards in a separate letter, it is equally important that the tailoring of regulatory standards in the Interagency Tailoring Rule is promptly and consistently reflected in the supervisory environment for insured depository institutions, including in:

- The Agencies' supervisory expectations (as opposed to formal regulatory requirements) for different firms, both as articulated publicly (*e.g.*, through interpretive letters and other guidance documents) and nonpublicly;
- The cohort groups of supervised firms into which the Agencies organize their supervision activities and establish peer-level supervisory expectations; and
- The Uniform Financial Institutions Rating System ("UFIRS"), more commonly known as the CAMELS rating system,[7] which forms the basis of supervisory ratings of insured depository institutions, as well as other assessment tools (*e.g.*, horizontal reviews) by which the Agencies assess banks against these expectations.[8]

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3 Bank Policy Institute, *Comment Letter re: Regulatory Tailoring and DFAST Proposals* (Jan. 22, 2019) (the "Domestic Tailoring Comment Letter"), https://bpi.com/wp-content/uploads/2019/01/BPI-Comment-Letter-on-Regulatory-Tailoring-and-DFAST-Proposals-Final.pdf.

4 Bank Policy Institute, American Bankers Association, *Comment Letter re: Proposed Changes to Applicability Thresholds for Regulatory Capital Requirements for Certain U.S. Subsidiaries of Foreign Banking Organizations and Application of Liquidity Requirements to Foreign Banking Organizations, Certain U.S. Depository Institution Holding Companies, and Certain Depository Institution Subsidiaries (Docket ID OCC–2019-0009, RIN 1557-AE63; FRB Docket No. R1628B, RIN 7100-AF21; FDIC RIN 3064-AE96); Prudential Standards for Large Foreign Banking Organizations; Revisions to Proposed Prudential Standards for Large Domestic Bank Holding Companies and Savings and Loan Holding Companies (FRB Docket No. R-1658, RIN 7100-AF45)* (June 21, 2019), https://bpi.com/wp-content/uploads/2019/06/FBO-Tailoring-NPRs-Comment-Letter.pdf (the "FBO Tailoring Comment Letter").

5 Federal Reserve, *Prudential Standards for Large Bank Holding Companies and Savings and Loan Holding Companies*, 84 Fed. Reg. 59032 (Nov. 1, 2019), https://www.govinfo.gov/content/pkg/FR-2019-11-01/pdf/2019-23662.pdf (the "Federal Reserve Tailoring Rule").

6 OCC, Federal Reserve, and the FDIC, *Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements*, 84 Fed. Reg. 59230 (Nov. 1, 2019), https://www.govinfo.gov/content/pkg/FR-2019-11-01/pdf/2019-23800.pdf (the "Interagency Tailoring Rule," and together with the Federal Reserve Tailoring Rule, the "Tailoring Rules").

7 Federal Financial Institutions Examination Council, *Uniform Financial Institutions Rating System*, 61 Fed. Reg. 67021 (Dec. 19, 1996), https://www.govinfo.gov/content/pkg/FR-1996-12-19/pdf/96-32174.pdf. *See also* FDIC, FIL-105-96, *Adoption of Revised FFIEC Policy Statement on Uniform Financial Institutions Rating System* (Dec. 26, 1996), https://www.fdic.gov/news/news/financial/1996/fil96105.html; Federal Reserve, Division of Banking Supervision and Regulation, *Uniform Financial Institutions Rating System*, SR 96-38 (SUP) (Dec. 27, 1996), https://www.federalreserve.gov/boarddocs/srletters/1996/sr9638.htm.

8 On October 18, 2019, the Federal Reserve and the FDIC issued a request for information seeking public input regarding how CAMELS ratings are assigned to supervised institutions, and the implications of such ratings in the application and enforcement

Appropriate changes in each of these areas will be essential if regulatory tailoring for banking organizations is to be honored consistently and faithfully in the examination process. Absent such changes, there is significant risk that compliance with standards that are removed from the Agencies' regulations are nonetheless imposed in the examination process through matters requiring attention, horizontal reviews, or rating decisions, with those standards instead cast as "best practices" or "supervisory expectations." Should that occur, the Agencies' supervisory practices would conflict with the underlying policy objectives of the Interagency Tailoring Rule, as well as the Congressional intent of the Economic Growth, Regulatory Relief, and Consumer Protection Act ("EGRRCPA").

These risks can and should be mitigated through a public and explicit commitment by the Agencies to ensure that tailored rules are supported by tailored supervision. To assist the Agencies in implementing these critical changes to their supervisory regimes, this letter provides specific and concrete suggestions for further tailoring of supervisory and examination activities and expectations in a manner consistent with the Interagency Tailoring Rule. These include, importantly, changes to the Agencies' supervision frameworks so that they map to, rather than conflict with, the categories established under the Interagency Tailoring Rule and the specific alignment of CAMELS ratings evaluations with the new contours of prudential standards that the Agencies' regulations do (and do not) apply to different firms. In each case, as described in more detail below, these changes should be effected through notice and comment processes to revise existing guidance or, where appropriate, establish new supervisory standards. In addition to the recommended changes, we believe it also is important that examination and supervisory staff be trained, as appropriate, to ensure appropriate understanding of the revisions to supervisory documents and procedures and to ensure unambiguous differentiation between the supervisory approaches and expectations applicable to firms in different categories.

Part I of this letter provides an executive summary of our comments. Part II presents suggested changes to the Agencies' supervisory processes and cohorts that would align with, and promote consistency in application of, the Interagency Tailoring Rule. Part III sets out our recommendations to ensure that Agency evaluations pursuant to the CAMELS rating system are consistent with the Interagency Tailoring Rule.

I. Executive Summary

- The Agencies should revise the scope and substance of their frameworks for the supervision of large financial institutions, horizontal reviews, and supervisory expectations and guidance to align with the tailoring categorization and differentiation established in the Interagency Tailoring Rule.

- For purposes of evaluating a bank's CAMELS rating, the Agencies should confirm via notice and comment processes that the standard and scope of their supervisory review aligns with the standards included in the Interagency Tailoring Rule.

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action processes, including the consistency of how CAMELS ratings are assigned. The RFI specifically sought comment on to what "extent do the agencies apply the CAMELS rating system in a manner that is sufficiently flexible to reflect differences between financial institutions such as size, business models, risks, and internal and external operating environments, as well as overall technological developments and emerging risks" and steps the agencies should take "to promote the consistent application of the CAMELS framework in the supervisory process." Federal Reserve, FDIC, *Request for Information on Application of the Uniform Financial Institutions Rating System*, 84 Fed. Reg. 58383 (Oct. 31, 2019), https://www.govinfo.gov/content/pkg/FR-2019-10-31/pdf/2019-23739.pdf. As described throughout this letter, aligning CAMELS to the categories established in the Interagency Tailoring Rule would help account for the differences in size and risk profile between firms, and promote consistency in the supervisory process.

- The Agencies' evaluations of a bank's Capital Adequacy component of the CAMELS rating system should be consistent with the capital regulatory requirements that apply to that bank and specifically, should reflect the less stringent standards that apply to Category III and IV banks.

- The Agencies' evaluations of a bank's Liquidity component of the CAMELS rating system should be consistent with the liquidity regulatory requirements that apply to that bank and specifically, should reflect the less stringent quantitative liquidity standards applicable to Category III and IV banks.

II. The Agencies should revise the scope and substance of their frameworks for the supervision of large financial institutions, horizontal reviews, and supervisory expectations and guidance to align with the tailoring categorization and differentiation established in the Interagency Tailoring Rule.

The Interagency Tailoring Rule establishes, for purposes of a wide range of prudential requirements, an approach to categorizing firms that is very likely to be inconsistent with the current cohorts the Agencies use to organize their supervisory activities and expectations, including horizontal reviews. Absent alignment, current supervisory processes and cohorts raise the significant risk that supervisory expectations will, in practice, reflect an alternative view of the differing risk profiles of firms that, in many cases, has never been subject to notice and comment and directly conflicts with the Interagency Tailoring Rule's carefully considered risk-based categories.

For example, the OCC generally provides for a set of supervisory standards and examination processes for midsize, large, or international banking organizations in its Large Bank Supervision handbook,[9] whereas it has a separate booklet for Community Bank Supervision (generally banks with assets of $10 billion or less).[10] Moreover, OCC interpretive guidance generally differentiates between guidance applicable to "large banks" and "community banks." However, the "large bank" group comprises banks of varying sizes and risk profiles, and it is unclear how that group does or does not align to the categories established in the Interagency Tailoring Rule. The other Agencies have similar cohorts or ways of differentiating groups of firms as part of their supervisory processes.

Accordingly, we recommend the Agencies review their supervisory processes and cohorts, including supervisory guidance or examination-related documents that may have differentiated among banks of various sizes, in order to identify and revise those documents to reflect the categories in the Interagency Tailoring Rule through a notice and comment process. This would, among other things, provide more transparency into the process by which the Agencies conduct horizontal reviews among peer groups and organize firms to separate supervisory activities and expectations.

III. For purposes of evaluating a bank's CAMELS rating, the Agencies should confirm via notice and comment processes that the standard and scope of their supervisory review aligns with the standards included in the Interagency Tailoring Rule.

The Interagency Tailoring Rule left unsaid whether examiners will evaluate and assign ratings to banks on the basis of revised regulatory requirements or if instead banks will nonetheless be assessed against, or held to,

9 *See* OCC, Comptroller's Handbook, Examination Process, Large Bank Supervision, V. 1.1 (Sept. 2019), https://www.occ.gov/publications-and-resources/publications/comptrollers-handbook/files/large-bank-supervision/pub-ch-large-bank-supervision.pdf.

10 *See* OCC, Comptroller's Handbook, Examination Process, Community Bank Supervision, V. 1.1 (Sept. 2019), https://www.occ.gov/publications-and-resources/publications/comptrollers-handbook/files/community-bank-supervision/pub-ch-community-bank-supervision.pdf.

requirements that the Interagency Tailoring Rule ultimately eliminated or modified for institutions in certain categories. As noted above, the Federal Reserve and FDIC have released a request for information regarding the CAMELS rating system which suggests that revisions to CAMELS may be considered. BPI intends to submit a response to the CAMELS request for information, but offers here the following recommendations to specifically address needed alignment of CAMELS and the Interagency Tailoring Rule. The Agencies should take this opportunity, working through the Federal Financial Institutions Examination Council, to revise the CAMELS rating system to more appropriately reflect its original intent to evaluate an institution's "financial condition and operations."[11]

Regardless, it is crucial that the Agencies expressly confirm, via notice and comment revisions to UFIRS, that their supervisory expectations for purposes of evaluating the six component categories of the CAMELS rating system will align and be consistent with standards included in the Interagency Tailoring Rule. In particular, the Agencies' evaluation of a bank's Capital Adequacy and Liquidity components of the CAMELS rating system should be consistent with corresponding changes to capital and liquidity rules based on the new categories in the Interagency Tailoring Rule.

A. The Agencies' evaluations of a bank's Capital Adequacy component of the CAMELS rating system should be consistent with the capital regulatory requirements that apply to that bank and specifically, should reflect the less stringent standards that apply to Category III and IV banks.

Because the Interagency Tailoring Rule eliminates certain requirements in the capital rules for some banks and reduces them for others, it is essential that evaluation of the Capital Adequacy component of a bank's CAMELS rating does not become a vehicle to reintroduce more stringent expectations in practice.

The CAMELS rating system should be amended to reflect the changes in applicability of certain provisions of the capital rules to banks in the various tailoring categories established in the Interagency Tailoring Rule. Specifically, under the Interagency Tailoring Rule, the capital rules applicable to Category III and Category IV banks are tailored in several important ways, including by (i) permitting banks in both categories to apply the accumulated other comprehensive income filter in calculating regulatory capital and (ii) exempting Category IV banks from the countercyclical capital buffer.[12] This tailoring of regulatory standards should be reflected in the Agencies' evaluation of a bank's Capital Adequacy rating under the CAMELS rating system.

B. The Agencies' evaluations of a bank's Liquidity component of the CAMELS rating system should be consistent with the liquidity regulatory requirements that apply to that bank and specifically, should reflect the less stringent quantitative liquidity standards applicable to Category III and IV banks.

Because the Interagency Tailoring Rule eliminates the Liquidity Coverage Ratio ("LCR") requirements for some banks and reduces them for others,[13] it is essential that evaluation of the Liquidity component of a bank's CAMELS rating does not become a vehicle to reintroduce more stringent expectations in practice.

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11 61 Fed. Reg 67021, 67025.

12 Previously, certain banks in Category IV were subject to the countercyclical capital buffer, but under the Interagency Tailoring Rule, the countercyclical capital buffer does not apply to any Category IV banks.

13 We understand similar changes would be made to the proposed Net Stable Funding Ratio if and when that rule is finalized.

Category IV banks. Under the Interagency Tailoring Rule, Category IV banks with less than $50 billion in weighted short-term wholesale funding are no longer subject to the LCR. Accordingly, the Agencies should confirm they will not use any form of the LCR as a proxy for determining the Liquidity component of such Category IV bank's CAMELS rating. Although Category IV banks, through their holding companies, remain subject to monthly FR 2052a reporting requirements, the Federal Reserve helpfully confirmed in the Federal Reserve Tailoring Rule that it will not use FR 2052a reporting to implicitly bind such Category IV banks to the LCR rule.[14] The OCC and the FDIC should confirm that they will not use the monthly liquidity data they receive from the Federal Reserve to do the same with respect to such Category IV banks.

Under the Interagency Tailoring Rule, Category IV banks with $50 billion or more in weighted short-term wholesale funding are subject to a reduced (70%) monthly LCR. The Agencies should confirm that they will use the reduced LCR for determining the Liquidity component of such Category IV banks' CAMELS rating.

Category III banks. Category III banks with less than $75 billion in weighted short-term wholesale funding ("qualifying Category III banks") are no longer subject to the full LCR, but are subject to a reduced (85%) daily LCR. The Agencies should confirm that they will use the reduced LCR for determining the Liquidity component of such qualifying Category III banks' CAMELS rating.

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The Bank Policy Institute appreciates the opportunity to comment on the Interagency Tailoring Rule. If you have any questions, please contact the undersigned by phone at (202) 589-2424 or by email at dafina.stewart@bpi.com.

Respectfully submitted,

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14 84 Fed. Reg. 59032, 59066.